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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEC 19 2014

Uniform Issue List: 420-00:00

T:EP: RA:T2

Legend:

Company A =

Plan A =

Plan B =

Dear :

This letter is in response to your request dated December 31, 2013, submitted on your behalf by your authorized representative, in which you request a private letter ruling that payments of lump sums to retired participants (Covered Individuals) under either Plan A or Plan B (the "Pension Plans") who have already commenced annuity payments or the otherwise settling of retired participants' pension liability through a section 414(l) of the Internal Revenue Code (the "Code") transfer will not result in the exclusion of such participants from the class of individuals with respect to whom "qualified transfers," "qualified future transfers" and "collectively bargained transfers" can be made to fund post-retirement health and insurance benefits under section 420 of the Code.

Company A sponsors Plan A and Plan B, two tax-qualified defined benefit pension plans under section 401(a) of the Code which are the subject of this ruling request. Each of the Pension Plans has a favorable determination letter.

Plan A provides that Qualified Transfers (defined under section 420(b)(1) of the Code, as set forth under the Applicable Law section) of excess pension assets (generally in excess of 120% or 125% of the plan's benefits liabilities, depending on the type of transfer) may be made to an account meeting the requirements of section 401(h). Plan B provides that Qualified Transfers, as well as Qualified Future Transfers and Collectively Bargained Transfers (both defined under section 420(f)(2), as set forth under the Applicable Law section) may be made pursuant to section 420 of the Code.¹

Company A intends to amend the Pension Plans to make available, during a limited window period, to certain participants who are currently receiving benefits, an opportunity to select a lump sum distribution in lieu of their remaining annuity payments.

Both Plan A and Plan B have provisions which are represented to meet the requirements of section 401(h) of the Code and which are used to fund post-retirement health benefit plans. Plan B also has provisions for a Life Insurance Fund used to fund post-retirement life insurance benefits.² Plan A and Plan B provide that health care funds shall be credited with company contributions designated for that purpose, as well as transfers of excess assets under the plans, to the extent and as defined and permitted by section 420 of the Code. Under Plan B, the Life Insurance Fund shall be credited with transfers of excess assets under the plan, to the extent and as defined and permitted by section 420 of the Code.

Plan A and Plan B currently provide for section 420 transfers to fund and pay post-retirement health and life insurance benefits, as applicable, for participants who are retired and currently receiving pension benefits.

Based on the facts and representations stated above, Company A requests a ruling that the payment of lump sums, or the otherwise settling of the pension liability to Covered Individuals who elected to receive their remaining annuity payments in the form of lump sum distributions, or whose remaining annuity payments have been otherwise settled, such as through purchase of an irrevocable annuity contract, or a section 414(l) of the Code transfer, will not result in the exclusion of such participants from the class of individuals to whom transfers can be made under section 420 to fund post-retirement health and life insurance benefits.

APPLICABLE LAW

Section 401(h) of the Code provides in applicable part, "[u]nder regulations prescribed by the Secretary, and subject to the provisions of section 420, a pension or annuity plan may provide for payment of benefits for sickness, accident, hospitalization, and medical expenses of retired employees, their spouses and dependents[.]"

¹ The Company may amend Plan A to allow for Qualified Future Transfers.

² The Company may amend Plan A to provide for a Life Insurance Fund.

Treas. Reg. § 1.401-14(b)(1) provides:

Under section 401(h), a qualified pension or annuity plan may provide for the payment of medical benefits described in section 401(h) only for retired employees, their spouses, or their dependents. To be "retired" for purposes of eligibility to receive medical benefits described in section 401(h), an employee must be eligible to receive retirement benefits provided under the pension plan or else be retired by an employer providing such medical benefits by reason of permanent disability. For purposes of the preceding sentence, an employee is not considered to be eligible to receive retirement benefits provided under the plan if he is still employed by the employer and a separation from employment is a condition to receive the retirement benefits.

Section 420(a) of the Code provides, generally, that if there is a qualified transfer of any excess pension assets of a defined benefit plan to a health benefits account, established and maintained under section 401(h), or to an applicable life insurance account within the meaning of section 420(e)(4) of the Code, no amount shall be includable in the gross income of the employer maintaining the plan solely by reason of such transfer and the transfer shall not be treated as an employer reversion for purposes of section 4980 or as a prohibited transaction for purposes of section 4975.

Section 420(b)(1) of the Code provides, generally, that Qualified Transfer means a transfer of excess pension assets of a defined benefit plan to a health benefits account, or an applicable life insurance account, which is part of such plan, and which does not contravene any other provision of the law and with respect to which certain use, vesting and minimum cost requirements under section 420(c) are met.

Section 420(b)(3) provides, "The amount of excess pension assets which may be transferred to an account in a qualified transfer shall not exceed the amount which is reasonably estimated to be the amount the employer maintaining the plan will pay (whether directly or through reimbursement) out of such account during the taxable year of transfer for qualified current retiree liabilities."

Section 420(e)(1)(A) of the Code provides that

"qualified current retiree liabilities" means, with respect to any taxable year, the aggregate amounts (including administrative expenses) which would have been allowable as a deduction to the employer for such taxable year with respect to applicable health benefits and applicable life insurance benefits provided during such taxable year if—

- (i) such benefits were provided directly by the employer, and
- (ii) the employer used the cash receipts and disbursements method of accounting.

Section 420(e)(1)(C) of the Code defines "applicable health benefits" as health benefits or coverage which are provided to (i) retired employees who, immediately before the qualified transfer, are entitled to receive such benefits by reason of retirement and who are entitled to pension benefits under the plan, and (ii) their spouses and dependents.

Section 420(e)(1)(D) of the Code defines "applicable life insurance benefits," in relevant part, as group-term life insurance coverage provided to retired employees who, immediately before the qualified transfer, are entitled to receive such coverage by reason of retirement and who are entitled to pension benefits under the plan, subject to certain requirements.

Section 420(e)(1)(E) of the Code states that key employees under section 416(i)(1) are excluded in computing qualified current retiree liabilities.

Section 420(f) of the Code, which was added to section 420 in 2006, provides special rules for Qualified Future Transfers and Collectively Bargained Transfers. Qualified Future Transfers and Collectively Bargained Transfers mean transfers which meet all the requirements for a Qualified Transfer with certain exceptions:

(a) In determining excess pension assets, the excess shall be determined by reference to 120% of the Plan's benefits liabilities. Also there is a requirement to maintain a funded status for the Plan within the parameters set out in section 420(f)(B)(ii) of the Code.

(b) Under section 420(f)(2)(C)(i) of the Code, the amount of excess pension assets which may be transferred in the case of a Qualified Future Transfer is generally limited to the sum of (1) if the transfer period includes the taxable year of the transfer, the amount determined under section 420(b)(3) for such taxable year, plus (2) in the case of all other taxable years in the transfer period, the sum of the qualified current retiree liabilities which the plan reasonably estimates, in accordance with guidance issued by the secretary, will be incurred for each of such years.

Section 420(f)(2)(C)(ii) provides that the amount of excess pension assets which may be transferred in a Collectively Bargained Transfer is generally limited to the amount which is reasonably estimated to be the amount the employer will pay out of the account during the collectively bargained cost maintenance period for "collectively bargained retiree liabilities."

(c) The minimum cost requirements of section 420(c)(3) of the Code must be modified as provided under section 420(f)(2)(D).

(d) In the case of a Collectively Bargained Transfer it is a transfer which—

- (i) is made in accordance with a collective bargaining agreement,
- (ii) before the transfer, the employer designates, in a written notice delivered to each employee organization that is a party to the collective bargaining agreement, as a collectively bargained transfer in accordance with this section, and
- (iii) involves a defined benefit plan maintained by an employer which in its taxable year ending in 2005, provided health benefits or coverage to retirees and their spouses and dependents under all of the health benefit plans maintained by the employer, but only if the aggregate cost...of such benefits or coverage which would have been allowable as a deduction to the employer [in the circumstances described] is at least 5 percent of the gross receipts of the employer.

Section 420(f)(6)(B) of the Code defines "collectively bargained retiree liabilities" as the present value, as of the beginning of a taxable year and determined in accordance with the applicable collective bargaining agreement, of all collectively bargained health benefits and collectively bargained life insurance benefits (including administrative expenses) for such taxable years during the collectively bargained cost maintenance period [as defined in section 420(f)(6)(A)], excluding benefits for key employees under section 416(i)(1).

Section 420(f)(6)(C) of the Code defines, in applicable part, "collectively bargained health benefits" as health benefits or coverage—

- (i) which are provided to retired employees who, immediately before the collectively bargained transfer, are entitled to receive such benefits by reason of retirement and who are entitled to pension benefits under the plan, and their spouses and dependents, and,
- (ii) if specified by the provisions of the collectively bargained agreement governing the collectively bargained transfer, which will be provided at retirement to employees who are not retired employees at the time of the transfer and who are entitled to receive such benefits and who are entitled to pension benefits under the plan and their spouses and dependents.

Section 420(f)(6)(D) of the Code defines "collectively bargained life insurance benefits" as (1) applicable life insurance benefits which are provided to retired employees who, immediately before the transfer, are entitled to receive such benefits by reason of retirement, and (2) if specified by the provisions of the collectively bargained agreement governing the transfer, applicable life insurance benefits which will be provided at retirement to employees who are not retired employees at the time of transfer.

ANALYSIS

The issue in this ruling request is whether individuals who have elected to receive lump sum distributions in lieu of their remaining annuity payments, or whose remaining annuity payments are otherwise settled, are members of the class of individuals with respect to whom Qualified Transfers, Qualified Future Transfers, and Collectively Bargained Transfers may be made and for whom applicable health benefits under section 420(e)(1)(C) of the Code, applicable life insurance benefits under section 420(e)(1)(D), collectively bargained health benefits under section 420(f)(6)(C) and collectively bargained life insurance benefits under section 420(f)(6)(D) may be paid from the Pension Plans' section 401(h) accounts and retiree life insurance accounts, as applicable.

Under 420(e)(1)(C) of the Code (relating to a Qualified Transfer) the class of individuals eligible for health benefits are those "retired employees who, immediately before the qualified transfer, are entitled to receive such [health] benefits and who are entitled to pension benefits under the plan." Section 420(e)(1)(D) defines eligibility for applicable life insurance benefits in almost identical terms. Individuals eligible are those "who immediately before the qualified transfer, are entitled to receive such coverage by reason of retirement and who are entitled to pension benefits under the plan..." Similar language is also used in section 420(f)(6)(C), (relating to collectively bargained health benefits), and section 420(f)(6)(D), (relating to collectively bargained life insurance benefits).

It is clear from sections 420(e)(1)(C), 420(e)(1)(D), 420(f)(6)(C) and 420(f)(6)(D) that a qualifying retiree with respect to whom a Qualified Transfer, Qualified Future Transfer or Collectively Bargained Transfer may be made must be an individual who is retired and who, immediately before the transfer, was entitled to receive health or life insurance benefits by reason of retirement. What is less clear is whether such an individual must be entitled to receive pension benefits under the plan immediately before the transfer, or whether it is sufficient that the retiree was entitled to pension benefits at retirement, *i.e.*, whether the provisions also cover retirees whose pension benefits have already been completely paid out in a lump sum prior to transfer or whose remaining annuity payments have been otherwise settled.

Section 420(e)(1)(C) of the Code defines the applicable health benefits that may be funded through a Qualified Transfer to section 401(h) account. Section 420(e)(1)(C) provides further that health benefits may be provided to retired employees who, immediately before the qualified transfer, are entitled to receive such benefits upon retirement and who are entitled to pension benefits under the plan and their spouses and dependents.

Treas. Reg. § 1.401-14(b)(1) explains that for an employee to be "retired" for purposes of eligibility to receive medical benefits described in section 401(h) of the Code he or she must be separated from service. The focus of the regulation is on retirement. Active participants are not eligible for medical benefits under section 401(h).

There is no indication that the manner in which pension benefits are paid out is relevant for purposes of determining eligibility for benefits under section 401(h). Thus, any employee who has received a distribution, is receiving a distribution or who has retired and is entitled to receive a future distribution is a member of the class which is entitled to pension benefits under the plan, and as such, amounts can be set aside in a 401(h) account for them. Distributions to these members include, but are not limited to, a monthly annuity, a term certain form of payment or a prior lump sum distribution. This class also includes those individuals who are spouses or dependents of these employees.

As long as an individual has earned pension benefits under the plan and retired, his or her retiree health benefits can be funded through a section 401(h) account, even if the pension benefit has been paid out through a lump sum or otherwise settled prior to payments being made under the section 401(h) account. The same principle applies to retiree life insurance benefits.

RULING

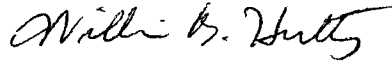
Therefore, in this circumstance, Covered Individuals who elect to receive a lump sum distribution in lieu of their current annuity or whose remaining annuity payments are otherwise settled, in the manner previously described, and their spouses and dependents, are members of the class of participants with respect to whom Qualified Transfers, Qualified Future Transfers and Collectively Bargained Transfers may be made under section 420 of the Code and with respect to whom transferred assets (and any income allocable thereto) may be paid from a section 401(h) account or an applicable life insurance account.

Except as specifically ruled above, no opinion is expressed as to the federal tax consequences of the transaction above under any other provision of the Code. No opinion is expressed regarding the qualification of the Pension Plans.

This letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

If you wish to inquire about this ruling please contact ***** . Please address all correspondence to SE:T:EP:RA:T2.

Sincerely,



William B. Hulteng, Manager
Employee Plans Technical

Enclosures:
Deleted copy of letter ruling
Notice of Intention to Disclose

cc: