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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

SEP 3 0 2004

SE:T:EP:RA:T:A1

In Re:

Plan =

Taxpayer =

Section C of the Plan =

Dear

This is in response to the request for rulings with regard to the limitations on benefits under section 415 of the Internal Revenue Code ("Code").

The Plan is a defined benefit plan and is intended to be a qualified plan under section 401 of the Code. The Plan is a governmental plan within the meaning of section 414(d) of the Code.

Benefits under the Plan are determined based on service and compensation. The Plan also provides, under Section C of the Plan, for cost of living adjustments, for all retired participants, of three percent, compounded annually, commencing on the first day of the January following the third anniversary of the retirement of the participant.

You have requested the following rulings:

(1) That the maximum benefit payable under section 415 of the Code payable at retirement is not reduced to reflect the value of the cost of living adjustment provided for under Section C of the Plan and that a retired participant may automatically receive an enhanced benefit reflecting the cost of living adjustment provided for under Section C of the Plan as long as the benefit for the calendar year does not exceed the maximum benefit for the calendar year section 415, computed without regard to the cost of living adjustment or, in the alternative,

(2) that the maximum benefit payable under section 415 of the Code payable at retirement is not reduced to reflect the value of the cost of living adjustment provided for under Section C of the Plan until the cost of living adjustment provided for under Section C of the Plan begins to take effect on the January 1 following the third anniversary of the participant's retirement date, or, in the alternative,

(3) that the maximum benefit payable under section 415 of the Code payable at retirement is reduced to reflect the value of the cost of living adjustment provided for under Section C of the Plan even though the adjustment does not begin until the January 1 following the third anniversary of the participant's retirement date.

(4) That the Plan is not required to recoup payments, if any, that have been made to a retired participant prior to this ruling request in excess of the amount payable under section 415(d) of the Code, by suspending or reducing the retirement benefit paid to the participant in the future.

Law

Section 401(a)(16) of the Code provides that a trust shall not constitute a qualified trust under that section if the plan of which such trust is a part provides for benefits or contributions which exceed the limitations of section 415.

Section 415(b)(1) of the Code provides that the benefits with respect to a participant exceed the limitations of that subsection if, when expressed as an annual benefit (within the meaning of paragraph (2), such annual benefit is greater than the lesser of (A) $160,000 or (B) 100 percent of the participant's average compensation for his high 3 years.

Section 415(b)(2)(A) of the Code provides, in general, that for purposes of paragraph (1), the term "annual benefit" means a benefit payable annually in the form of a straight life annuity (with no ancillary benefits) under a plan in which employees do not contribute and under which no rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) are made.

Section 415(b)(2)(B) of the Code provides that if the benefit under the plan is payable in any form other than the form described in subparagraph (A), or if employees contribute to the plan or make rollovers contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)), the determinations as to whether the limitation described in paragraph (1) has been satisfied shall be made, in accordance with regulations prescribed by the Secretary, by adjusting such benefit so that it is equivalent to the benefit described in subparagraph (A). For purposes of that subparagraph (B), any ancillary benefit which is not directly related to retirement income benefits shall not be taken into account; and that portion of any joint and survivor annuity which constitutes a qualified joint and survivor annuity (as defined in section 417) shall not be taken into account.

Section 415(d)(1) of the Code provides that the Secretary shall adjust annually

(A) the $160,000 amount in subsection (b)(1)(A),

(B) in the case of a participant who separated from service, the amount taken into account under subsection (b)(1)(B), and

(C) the $40,000 amount in subsection (c)(1)(A),

for increases in the cost-of-living in accordance with regulations prescribed by the Secretary.

Section 1.415-3(c)(1)(i) of the regulations provides that where a defined benefit plan provides a retirement benefit in any form other than a straight life annuity, the plan benefit is adjusted to a straight life annuity beginning at the same age which is the actuarial equivalent of such benefit in accordance with rules determined by the Commissioner.

Section 1.415-3(c)(2)(iii) of the regulations provides that for purposes of the adjustment described in section 1.415-3(c)(1) of the regulations, the value of benefits provided by the plan which reflect post-retirement cost of living increases to the extent that such increases are in accordance with section 415(d) and section 1.415-5 are not taken into account.

Section 1.415-5(a)(1) of the regulations, which were issued in 1980 and have not yet been modified for subsequent changes in law, provides that under section 415(d)(1)(A), the dollar limitation under section 415(d)(1)(A) applicable to defined benefit plans for limitation years to which section 415 applies is adjusted annually to take into account increases in the cost of living. The adjustment of the dollar limitation is made by multiplying an annual adjustment factor by $75,000 (the statutory dollar limit in 1980 before adjustment for the cost of living). For purposes of that paragraph the annual adjustment is to be determined by the Commissioner.

Section 1.415-5(a)(2) of the regulations provides that the adjusted dollar limitation applicable to defined benefit plans is effective as of January 1 of each calendar year and applies with respect to limitation years ending with or within that calendar year.

Section 1.415-5(c)(1) of the regulations provides that a defined benefit plan may include a provision for an annual automatic cost-of-living adjustment of the dollar limitation described in section 415(b)(1)(A) in accordance with section 1.415-5(a)(2) of the regulations. However, the provision may only provide for scheduled annual increases in the dollar limitation which become effective no sooner than the date determined in accordance with section 1.415-5(a)(2) of the regulations.

Analysis

Section 415(b)(1)(A) of the Code provides for a dollar limitation, expressed in the form of an annual benefit, with respect to the benefit of a participant in a defined benefit plan. Section 415(b)(2) of the Code provides that, for purpose of the limitations of section 415(b)(1), benefits must be in the form of a straight life annuity. Section 415(b)(2) further provides that if benefits are not in the form of a straight life annuity such benefits must be adjusted so that they are in the form of a straight life annuity. Generally, an annuity that provides for an increasing benefit would require an adjustment. However, if the increase in benefit is merely because of a dollar limitation increase then the annuity form is still considered straight life.

Section C of the Plan provides, for all retired participants, for three percent benefit increases commencing with the first day of January next following the third anniversary date of retirement. Under the terms of the Plan there are no restrictions or conditions on the three percent increase. Accordingly, the cost of living adjustments provided under Section C of the Plan are a part of the form of retirement benefit provided under the Plan.

Section 1.415-5(c)(1) of the regulations provides that a defined benefit plan may include a provision for an annual automatic cost-of-living adjustment of the dollar limitation described in section 415(b)(1)(A) of the Code in accordance with section 1.415-5(a)(2) of the regulations.

In the instant case, Section C of the Plan differs from the provision described in section 1.415-5(c)(1) of the regulations in that Section C of the Plan provides for benefit increases for all participants of the plan whereas the provision in section 1.415-5(c)(1) provides for increases merely for those participants whose benefits are limited by the provisions of section 415 of the Code. Therefore, the provisions of Section C of the Plan must be taken into account when determining the straight life annuity actuarial equivalents of participants' benefits for purposes of section 1.415-3(c)(1) of the regulations. Consequently, the maximum benefit under section 415 payable at retirement must be reduced to reflect the value of the cost of living adjustment provided for under Section C of the Plan.

Section 401(a)(16) of the Code provides that a trust shall not constitute a qualified trust if the plan of which such trust is a part provides for benefits that exceed the limitations of section 415 of the Code. Accordingly, payments, if any, by the Plan in excess of the limitations of section 415 would cause the Plan to fail to satisfy the requirements of section 401(a)(16). Therefore, the Plan must correct for any payments in excess of the amounts payable under section 415 if it is to continue to be a qualified plan. See Revenue Procedure 2003-44, 2003-1 C.B. 1051.

Conclusions

(1) The maximum benefit payable under section 415 of the Code payable at retirement must be determined taking into account the value of the cost of living adjustment provided for under Section C of the Plan.

(2) A retired participant may not automatically receive an enhanced benefit reflecting the cost of living adjustment provided for under Section C of the Plan merely because the benefit in the calendar year of enhancement does not exceed the maximum benefit for that calendar year under section 415, computed without regard to the cost of living adjustment.

(3) The maximum benefit payable under section 415 of the Code payable at retirement must be reduced at retirement to reflect the value of the cost of living adjustment provided for under Section C of the Plan even though the cost of living adjustment provided for under Section C of the Plan begins to take effect on the January 1 following the third anniversary of the participant's retirement date.

(4) The Plan must correct for payments, if any, in excess of the amounts payable under section 415 of the Code if it is to continue to be a qualified plan.

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

We are furnishing a copy of this letter to the enrolled actuary for the plan in accordance with a power of attorney (Form 2848) on file. A copy of this letter is also being sent to the Manager, Employee Plans Classification in

If you have any questions concerning this matter, please contact
(not a toll free number).

Sincerely,

James E. Holland, Jr., Manager
Employee Plans Technical