200020062

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

UIL: 501.00-00
408.00-00

Contact Person:

Telephone Number:

In Reference to:

Date: T:EP:RA:T3

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Legend:
Employer M =
Plan X =
Custodian C =

Dear

This letter is in response to a request for a ruling dated October 23, 1997, as supplemented by correspondence dated September 15, 1998, December 17, 1998, August 2, 1999, October 4, 1999, and December 28, 1999 which was submitted on your behalf by your authorized representative, concerning an arrangement described under section 403(b)(7) of the Internal Revenue Code.

The following facts and representations have been submitted on your behalf:

Employer M is an organization described in section 501(c)(3) of the Code. Employer M established Plan X, a section 403(b)(7) custodial account plan for the benefit of its eligible employees, effective May 1, 1997. Contributions to Plan X are paid to Custodian C pursuant to an agreement between Employer M and Custodian C. Amounts will be held by Custodian C and will be invested at all times in a custodial account. Funds in the custodial account will be invested in regulated investment company stock. Custodian C qualifies as a bank as defined in section 408(n) of the Code.

Plan X provides for Salary Deferral Contributions, which are salary reduction pre-tax contributions, Matching Contributions, Employer Basic Contributions and Rollover Contributions.

Under Sections 3.01(a) and 3.02 of Plan X, each eligible employee of Employer M may make Salary Deferral Contributions up to a maximum determined by the Plan X Administrator but not to exceed the maximum dollar limitation contained in section 402(g) of the Code. As allowed by this provision, the Plan X Administrator has established a 20 percent limit and the Plan X

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Administrator assists the participants by providing annual contribution limit projections. Section 3.01(a) requires that Salary Deferral Contributions only be made from compensation that is not currently available to the participant until after the agreement is effective. Sections 4.04 and 4.05 of Plan X further limit Salary Deferral Contributions and Matching Contributions to the exclusion allowance limitation under section 403(b) of the Code and the limitations under section 415 of the Code.

Under Section 3.01(a) of Plan X, a participant may elect to discontinue making salary deferral contributions at any time. Also, under Section 3.01(a), a participant may elect to change his contribution rate or resume contributions as to compensation received after the first day of the next quarter. That section allows the Plan X Administrator to establish time periods for submitting contribution rate elections so that the Plan X Administrator may ensure that the elections apply only to amounts not currently available.

Under Section 3.01(b) and Section 4.01(b) of Plan X, Employer M may make Matching Contributions to the accounts of employees who have five years of vesting service equal to at least 50 percent of the "matchable salary deferrals." Employer M may designate the level of deferrals that will be matched for a year.

Under Section 3.01(c) and Section 4.01(c) Employer M will make an Employer Basic Contribution equal to three percent of compensation of participants who are employed during the year. Employer M's Basic Contribution is accounted for in three parts where:

Part I is for participants with five years of vesting service, is generally fully vested at all times and will be treated as a qualified nonelective contribution.

Part II is for participants with less than five years of participation and is subject to a vesting schedule.

Part III is for all participants and will be treated as a qualified nonelective contribution.

Under Section 2.01(b) and Section 1.14 of the Plan, all employees are eligible to make Salary Deferral Contributions except leased employees, collective bargaining employees and nonresident aliens with no earned income from U.S. sources.

Under Sections 2.01(a) and (b) of the Plan, the employees who are eligible to make Salary Deferral Contributions will be eligible to participate for purposes of receiving Employer Basic Contributions and Matching Contributions on the entry date on or after the later of attainment of age 21, the date the employee is credited with one year of service and the date of adoption by Employer M. Entry dates are January 1, April 1, July 1, and October 1.

Under Section 2.01(c) of Plan X, certain employees who elect to remain under Employer M's defined benefit plan will not be eligible to receive Employer Basic Contributions or Matching Contributions under Plan X, but they will be eligible to make Salary Deferral Contributions

Section 1.25 of Plan X defines normal retirement date for participants of Employer M to mean their 65th birthday. Sections 7.01, 7.02, 7.03 and 8.01 of Plan X provide, in accordance with section 403(b) of the Code, that a participant's account becomes payable when the participant retires, separates from service, dies or becomes disabled. Article 5 only permits the in-service withdrawal of Salary Deferral Contributions upon financial hardship. Section 1.09 defines "Custodial Account" as the sum of the amounts held on behalf of a participant by Custodian C.

Section 3.01 of Plan X provides that Salary Deferral Contributions under Plan X will be remitted to Custodian C as soon as practicable after the date they are withheld from a participant's compensation.

Sections 10.01 and 10.02 of Plan X provide that the assets of Plan X will be held by Custodian C and invested in mutual funds based on the investment elections of the participants.

Section 6.03 of Plan X provides that, notwithstanding any other provision, distributions to a participant will commence no later than the April 1 of the calendar year following the calendar year in which occurs the later of (1) the participant's retirement, or (ii) the participant's attainment of age 70 1/2, in accordance with section 401(a)(9) of the Code.

Section 6.01 of Plan X provides that benefits are payable in the form of a lump sum in the absence of an election of an optional form of payment. Optional forms of payment include payments over a period certain in monthly, quarterly, semi-annual, or annual cash installments or a combination of lump sum payments. Section 6.03 provides that any method of payment under Plan X will be made in accordance with sections 401(a)(9) and 401(a)(14) of the Code including the minimum distribution incidental benefit requirements.

Section 6.06 of Plan X provides that a distributee may elect to have any portion of an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee.

Section 6.06 of Plan X defines an "eligible rollover distribution" as any distribution of all or any portion of the balance to the credit of the distributee, except that it does not include any distribution that is one of a series of substantially equal periodic payments made over the life (or life expectancy) of the distributee or the joint lives (or joint life expectancies) of the distributee and his designated beneficiary, or over a specified period of ten years or more. The term also does not include minimum distributions under section 401(a)(9) of the Code.

Section 6.06 of Plan X defines an "eligible retirement plan" as generally meaning an individual retirement account described in section 408(a) of the Code or an arrangement described in section 403(b) of the Code that accepts the distributee's eligible rollover distribution.

Section 8.01 provides that a participant will always be fully vested in his salary deferral account and rollover account.

Based on the aforementioned facts and representations, a ruling is requested (i) that Plan X, including the three part Employer Basic Contribution feature, satisfies the requirements of sections 403(b), 403(b)(7) and 401(f) of the Code; and (ii) to the extent of the exclusion allowance described in section 403(b)(2) of the Code and the limitations imposed by section 415 of the Code, amounts contributed by Employer M on behalf of a participant under Plan X, pursuant to a salary reduction agreement, or as Matching Contributions, shall be excluded from the participant's gross income.

Section 403(b)(1) of the Code provides that amounts contributed by an employer to purchase an annuity contract for an employee are excludable from the gross income of the employee in the year contributed to the extent of the applicable "exclusion allowance", provided (1) the employee performs services for an employer which is exempt from tax under section 501(a) of the Code as an organization described in section 501(c)(3), or the employee performs services for an educational institution (as defined in section 170(b)(1)(A)(ii) of the Code) which is a state, a political subdivision of a state, or an agency or instrumentality of any one or more of the foregoing; (2) the annuity contract is not subject to section 403(a) of the Code; (3) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums; (4) such contract is purchased under a plan which meets the nondiscrimination requirements of paragraph (12), except in the case of a contract purchased by a church; and, (5) in the case of a contract purchased under a plan which provides a salary reduction agreement , Plan X meets the requirements of section 401(a)(30).

Section 403(b) (1) of the Code provides further that the employee shall include in his gross income the amounts actually distributed under such contract in the year distributed as provided in section 72 of the Code. In addition, except as provided in section 403(b)(7)(B), a custodial account described in section 403 (b) (7) is treated as an annuity contract for all purposes of the Code.

Section 403(b)(7) of the Code provides that the amounts paid by a qualifying employer to a custodial account which satisfies the requirements of section 401(f) (2) shall be treated as amounts contributed by the employer for an annuity contract for his employee if the amounts are to be invested in regulated investment company stock to be held in that custodial account, and under the custodial account no such amounts may be paid or made available to any distributee before the employee dies, attains age 59 1/2, separates from service, becomes disabled (within the meaning of section 72(m)(7)), or, in the case of contributions made pursuant to a salary reduction agreement, encounters financial hardship.

Section 403(b)(7)(B) of the Code states that a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as an organization described in section 401(a) solely for purposes of subchapter F and subtitle F with respect to amounts received by it (and income from investment thereof)

Section 401(f)(2) of the Code provides that a custodial account shall be treated as a qualified trust under section 401 if the assets thereof are held by a bank (as defined in section 408(n)), or another person who demonstrates to the satisfaction of the Secretary that the manner in which he will hold the assets will be consistent with the requirements of section 401.

Section 403(b)(l0) of the Code requires that arrangements pursuant to section 403(b) of the Code must satisfy requirements similar to the requirements of section 401(a)(9) and similar to the incidental death benefit requirements of section 401(a) with respect to benefits accruing after December 31, 1986, in taxable years ending after such date. In addition, this section requires that, for distributions made after December 31, 1992, the requirements of section 401(a) (31) regarding direct rollovers are met.

Section 401(a) (9) of the Code, generally, provides for a mandatory benefit commencement date (A) no later than the April 1st following the calendar year in which the participant attains age 70 1/2, if he or she attains age 70 1/2 before January 1, 1997; and (B) no later than the April 1st following the later of the calendar year in which the participant retires or attains age 70 1/2, if he or she attains age 70 1/2 after December 31, 1996.

Section 403(b) (11) of the Code provides, generally, that section 403(b) annuity contract distributions attributable to contributions made pursuant to a salary reduction agreement (within the meaning of section 402(g)(3)(C)) may be paid only when the employee attains age 59 1/2, separates from service, dies, becomes disabled (within the meaning of section 72(m)(7)), or in the case of hardship. Such contract may not provide for the distribution of any income attributable to such contributions in the case of hardship.

Section 403(b)(l)(E) of the Code provides that in the case of a contract purchased under a plan which provides a salary reduction agreement, the contract must meet the requirements of section 401(a)(30). Section 401(a)(30) requires a section 403(b) arrangement which provides for elective deferrals to limit such deferrals under the arrangement, in combination with any other qualified plans or arrangements providing for elective deferrals, to the limitation in effect under section 402(g) (1) for taxable years beginning in such calendar year.

Section 402(g)(l) of the Code provides, generally, that the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals exceeds $7,000.

Section 402(g)(4) of the Code provides that the limitation under paragraph (1) shall be increased (but not to an amount in excess of $9,500) by the amount of any employer contributions for the taxable year used to purchase an annuity contract under section 403(b) under a salary reduction agreement.

Section 402(g) (8) of the Code provides that in the case of a qualified employee of a qualified organization, with respect to employer contributions to purchase an annuity contract under

section 403(b) under a salary reduction agreement, the limitation of section 402(g)(1), as modified by section 402(g)(4), for any taxable year shall be increased by whichever of the following is the least: (i) $3,000, (ii) $15,000 reduced by amounts not included in gross income for prior taxable years by reason of this paragraph, or (iii) the excess of $5,000 multiplied by the number or years of service of the employee with the qualified organization over the employer contributions described in paragraph (3) made by the organization on behalf of such employee for prior taxable years (determined in the manner prescribed by the Secretary). A "qualified organization" for these purposes means any educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches and includes any organization described in section 414(e)(3)(B)(ii), and a "qualified employee" means any employee who has completed 15 years of service with the qualified organization.

Section 415 (a) (2) of the Code provides, in relevant part, that an annuity contract described in section 403(b) shall not be considered described in section 403(b), unless it satisfies the section 415 limitations. In the case of an annuity contract described in section 403(b), the preceding sentence applies only to the portion of the annuity contract exceeding the section 415 limitations and the amount of the contribution for such portion shall reduce the exclusion allowance as provided in section 403(b)(2).

In this case, you represent that Employer M, an employer described in section 501(c)(3) of the Code, has established Plan X as its section 403(b) program for its employees. A participant's salary reduction contributions and the earnings thereon are fully vested and nonforfeitable at all times. Plan X does not meet the requirements of a section 403(a) annuity contract.

Plan X satisfies the limits, under section 403(b)(11) of the Code, that amounts attributable to elective deferrals shall not be distributable earlier than upon the attainment of age 59 1/2, separation from service, death, disability, or hardship. In addition, Plan X satisfies the section 403(b)(10) requirements and limits contributions in accordance with sections 403(b)(2) and 415 of the Code and satisfies the requirements of section 403(b) (7) of the Code.

Accordingly, based on the foregoing law and facts, we conclude with respect to ruling request one that Plan X, including the three part Employer Basic Contribution feature, satisfies the requirements of sections 403(b), 403(b)(7) and 401(f) of the Code; and with respect to ruling request two, that to the extent of the exclusion allowance described in section 403(b)(2) of the Code and the limitations imposed by section 415 of the Code, amounts contributed by Employer M on behalf of a participant under Plan X, pursuant to a salary reduction agreement, or as Matching Contributions, shall be excluded from the participant's gross income.

This ruling is limited to the form of Plan X excluding any form defects which may violate nondiscrimination requirements of section 403(b) (12) of the Code. This ruling does not extend to any operational violations of section 403(b) by Plan X, now or in the future.

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This ruling 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 by others as precedent.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

/s/ Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3
Tax Exempt and Government
Entities Division

Enclosures:
Deleted Copy of this Letter
Notice of Intention to Disclose