

**Internal Revenue Service**

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Washington, DC 20224

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Refer Reply To:

**CC:TE/GE:EOEG:ET1-PLR-128049-00**

Date:

**June 8, 2001**

X =

Y =

Dear X:

This is in reply to your request for a ruling concerning the treatment of your retirement plan under section 1402(a)(10) of the Internal Revenue Code (Code).

X is a professional limited liability company engaged in the professional practice of law. X is classified as a partnership for federal income tax purposes. The members of X are treated as partners for federal income tax purposes, and are hereafter referred to as partners. X files income tax returns based upon a calendar year taxable year.

X maintains a retirement benefit program for the partners that provides for payments directly from X to a retired partner. The program is set forth in the operating agreement governing the operations of X.

Retirement under the plan is mandatory as of the January 1 of the year following the year in which the partner attains age 65. A partner may elect to retire any time after attaining age 55. Retirement payments under the plan commence within 90 days of the date of retirement. Upon retirement, the retired partner relinquishes his or her interest in X, and is entitled to receive in full satisfaction and discharge of that interest the following: (1) the retirement payments under the retirement program; (2) the balance of his or her capital account as of the December 31 preceding the date of retirement; and (3) all other benefits payable to the partner under X's benefit plans. The entire amount of the capital account balance is to be paid by the end of the calendar year in which the retirement payments commence.

A retired partner is entitled to a retirement payment equal to the sum of the average of the partner's three highest distributions for any previous calendar year. This amount is paid out, without interest, in a series of monthly payments for a period of not less than sixty months and not more than one hundred and twenty months. The period of payment is determined by X. After this series of monthly payments is completed, and provided that the retired partner is still living, the retired partner is entitled to payments

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of \$100 per month for the rest of the retired partner's life.

Section 1401 of the Code imposes a tax on the self-employment income of every individual. Section 1402(b) defines "self-employment income" as the "net earnings from self-employment" derived by the individual, subject to certain conditions and limitations.

Section 1402(a) of the Code, in defining the term "net earnings from self-employment," specifically excludes retirement payments to a partner if the requirements in section 1402(a)(10) and the regulations thereunder are met.

Section 1402(a)(10) of the Code and section 1.1402(a)-17 of the Income Tax Regulations provide that such retirement payments are excluded from "net earnings from self-employment" if:

- (1) the payments are made on a periodic basis by a partnership pursuant to a written plan that provides for payments on account of retirement to partners generally or to a class or classes of partners to continue at least until the partner's death. To qualify as payments on account of retirement, the payments must constitute bona fide retirement income. Generally, retirement benefits are measured by, and based on, such factors as years of service and compensation received;
- (2) the retired partner to whom the payments are made rendered no service with respect to any trade or business carried on by the partnership (or its successors) during the taxable year of the partnership (or its successors), which ends within or with the taxable year of the partner and in which the payment was received;
- (3) no obligation exists (as of the close of the partnership year referred to in (2) above) from the other partners to the retired partner except with respect to retirement payments under the plan or rights such as benefits payable on account of sickness, accident, hospitalization, medical expenses, or death; and
- (4) the retired partner's share of the capital of the partnership has been paid to him in full before the close of the partnership's taxable year referred to in (2) above.

On the basis of the facts presented, X's retirement program would be considered a bona fide retirement plan, within the meaning of section 1402(a)(10) of the Code and the accompanying regulations. The program provides for retirement payments upon the retirement of the partner after attaining a specified age, and provides for payments based on the partner's historical distributions. Although the payments by X are likely to be reduced after the initial sixty to one hundred twenty monthly payments, the monthly payments will never fall below \$100 per month and will continue until the retired partner's death. The facts also show that the retired partner will withdraw his entire capital account by the end of the taxable year of X in which the payments commence,

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and that after that time period neither X nor the other partners will have any obligations to the retired partner other than the retirement payments and payments provided in X's benefit plans.

Therefore, retirement payments made by X under the plan to a retired partner of X will be excluded from "net earnings from self-employment" by section 1402(a)(10) of the Code (1) if the retired partner renders no service during the taxable year of X which ends within or with the taxable year of the partner and in which the payment is received, (2) if at the close of that taxable year of X, no obligation exists from the partners to the retired partner except with respect to retirement payments under the plan or rights such as benefits payable on account of sickness, accident, hospitalization, medical expenses, or death; and (3) if at the close of that taxable year of X, the retired partner's share of the capital of X has been paid to him in full.

No opinion is expressed as to the treatment of the payments to the retired partners under Subtitle A, Chapter 1, Subchapter K of the Code. Furthermore, no opinion is expressed as to the treatment of the payments under another other provision of Subtitle A, Chapter 2 of the Code except for section 1402(a)(10) of the Code. And furthermore, no opinion is expressed as to the treatment of the payments made in accordance with the provisions of the plan prior to the adoption of the amendments to the plan dated Y.

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

Sincerely,  
Michael A. Swim  
Chief, Employment Tax Branch  
Office of the Division Counsel /  
Associate Chief Counsel  
(Tax Exempt and Government Entities)

cc: