TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200231018

MAY - 7 2002

Uniform Issue List: 403.00-00

Attention:

Legend:

System A: =

Council B =

Board C =

State M =

Plan X =

Dear

This is in response to your letter dated January 21, 2001 in which you requested rulings concerning the taxability of contributions made under a plan described in section 403(b) of the Internal Revenue Code. Letters dated February 26, 2002, March 18, 2002, and April 11, 2002, supplemented the request.

System A is responsible for administering defined contribution retirement plans sponsored by the State M and its political subdivisions. Responsibility for administering these retirement plans has been delegated to the System A by Council B and Board C. Council B is a statutory body responsible for the establishment of qualified retirement plans enacted by the State M Legislature. Board C is a statutory body responsible for the establishment of nonqualified plans, such as Section 457 plans. System A is an instrumentality of State M.

A number of public technical schools ("Technical Schools") in State M currently sponsor individual tax deferred annuity plans in accordance with the requirements of section 403(b) of the Code. Each of these presently existing 403(b) arrangements has been separately established by the relevant school and is, at present, independently maintained by that school. Each of the technical schools limits participation in its respective 403(b) plan to individuals who are employees of the sponsoring school. Because each of these schools are subagencies of the State M, participation in each plan is open only to individuals described in section 403(b)(1)(A)(ii), and therefore, each arrangement separately satisfies the requirements of section 403(b)(1)(A)

System A , as an instrumentality of the State M, has the authority to administer State M sponsored defined contribution retirement plans.

To achieve consistency, economies of scale and greater efficiency, State M, through the System A proposes to adopt and sponsor Plan X, a section 403(b) tax deferred annuity plan for the employees of the various State M technical schools that currently maintain individual section 403(b) plans. Plan X is intended to meet the requirements of section 403(b)(1) of the Code. Plan X will be funded with group, fixed and/or variable annuity contracts issued by registered insurance companies and through custodial accounts that hold investments in compliance with the requirements of Section 403(b)(7).

Each individual technical school that currently maintains a separate 403(b) arrangement, as well as other educational institutions in the state whose employees are described in section 403(b)(1)(A)(ii), may elect to become a participating employer under the Plan X. Under section 4.1 of Plan X, all individuals employed by any such participating employer at the time it elects to be a participating employer will become eligible to participate in Plan X immediately. Individuals hired by such a participating employer after it elects to become a participating employer will become eligible to participate immediately as of their date of hire. Such eligible employees will be permitted to make salary reduction contributions to Plan X in any whole or half dollar amount up to the limits imposed under sections 415, and 402(g). Compensation is limited by section 415 annually.

An eligible employee may contribute to Plan X, in cash as a rollover contribution, a prior distribution from a plans described in sections 403(b), 457(b), and 408(a) of the Code, or a plan qualified under section 401(a) of the Code,. Section 5.4 of Plan X provides that a distributee receiving an eligible rollover distribution under Plan X may elect to have the distribution rolled over in a direct rollover to an eligible retirement plan.

To commence participation in Plan X upon adoption by an eligible employer, an eligible employee must submit a salary reduction agreement to such employer requesting that the participant's salary be reduced by a specific amount and that such amount be contributed to Plan X. The participant's employer will then withhold that amount specified and remit same to System A for investment under Plan X.

Pursuant to section 5.1, salary reduction contributions under Plan X will be fully vested and nonforfeitable at all times.

Under section 6.1 of Plan X, a distribution of a participant's account balance may not be made before the earliest of the participants (1) death; (2) termination of service; (3) attainment of age 59 ½ ; or (4) financial hardship.

Under section 4.8 of Plan X, the maximum annual additions to a participant's account during any plan year plan shall not exceed the lesser of (1) 100 percent of his includable compensation as defined under section 415 for such year, or (2) $40,000, as adjusted periodically by the Secretary of Treasury for cost-of-living changes. Finally, section 4.8 of Plan X provides that the annual deferral contributions of a participant may not exceed the limit in effect under Section 402(g) for that plan year.

Article 6 of Plan X provides that all distributions will be determined and made in accordance with the Income Tax Regulations under Section 401(a)(9), including the minimum distribution incidental benefit requirement of Section 1.401(a)(9)-2 of the regulations. The entire interest of a participant will be distributed to him or her in full or at least commence no later than the April 1st following the later of the calendar year in which the participant retires or attains age 70-l/2.

Section 8.1 of Plan X also provides that benefits thereunder shall not be subject to alienation, encumbrance, the claims of creditors or legal process. No person will have the power to transfer, assign, alienate or in any way encumber a participant's benefits.

Based on the foregoing, you request a ruling that Plan X satisfies the requirements of the Internal Revenue Code as applicable to a section 403(b) program and amounts contributed on behalf of employees of State M subagences who sponsor Plan X (other than employee after-tax contributions) shall be excluded from the employees' gross income in the year of contribution to the extent such amounts do not exceed the applicable limits described in the Code.

Section 403(b)(1) of the Code as amended by the Economic Growth and Tax Relief and Reconciliation Act of 2001 ("EGTRRA"), and applicable for years beginning after December 31, 2001, 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, 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, the contract 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.

Section 403(b)(10) 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 that the required beginning date for commencement of benefits is April 1 of the calendar year following the later of the calendar year in which the employee attains age 70 ½, or the calendar year in which the employee retires. Section 401(a)(9) specifies required minimum distribution rules for the payment of benefits from qualified plans.

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 ½ , has a severance from employment, 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 401(g) of the Code requires that the contract be nontransferable.

Section 403(b)(1)(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, of an employer maintaining such plan, 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)(1) 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 $11,000. Such amount is increased by an amount equal to $1,000 for each year through 2006.

Section 402(g)(7) of the Code provides that, in the case of a qualified employee of a qualified organization, with respect to employer contributions used 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 of 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(b) or 415(c) limitations.

In this case, you represent that System A, administers defined contribution plans sponsored by State M and its political subdivisions. Plan X is administered by System A. Plan X will be adopted by certain employers in State M that are educational institutions as defined in section 170(b)(1)(A) of the Code. All 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. The restrictions of transferability of annuity contracts are present in Plan X as required by section 401(g) of the Code.

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 ½ , severance from employment, death, disability, or hardship. In addition, Plan X satisfies the section 403(b)(10) requirements and limits contributions in accordance with sections 402(g) and 415 of the Code. Also, the salary reduction agreement which each eligible employee of Employer A who becomes a participant in Plan X may elect to enter into meets all of the applicable requirements of the Code and regulations.

Accordingly, we conclude with respect to your ruling request that Plan X satisfies the requirements of the Internal Revenue Code as applicable to a section 403(b) program and amounts contributed on behalf of employees of State M subagences who sponsor Plan X (other than employee after-tax contributions) shall be excluded from the employees' gross income in the year of contribution to the extent such amounts do not exceed the applicable limits described in the Code.

This ruling is contingent upon the adoption of the amendments to Plan X, as stipulated in your correspondence dated February 26, 2002, and March 18, 2002 and will have no effect unless such proposed amendments are adopted.

These two rulings have been separated from another ruling you asked regarding the investment of funds of Plan X. That ruling will be addressed in a separate response.

This ruling does not extend to any operational violations of section 403(b) of the Code by Plan X, now or in the future.

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

Any questions concerning this ruling should be addressed to ********** (ID **-*******) at (***) ***-**** (not a toll free number).

Pursuant to a power of attorney on file in this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Frances V. Sloan

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

Enclosures:
Notice 437
Deleted copy of ruling letter

CC: