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

200245060

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Index No.: 403.02-00

AUG 13 2002

T:EP:RA:T4

Legend:

Company A.....

Custodian B.....

Plan X.....

Dear :

This is in response to a letter dated November 1, 2001, submitted by your authorized representative on your behalf requesting rulings relating to section 403(b), 415, and 72 of the Internal Revenue Code (the "Code"). Letters dated November 27, 2001, December 12, 2002, December 28, 2002, March 21, 2002, May 16, 2002, June 26, 2002, July 2, 2002, and August 5, 2002, supplemented this request. You submitted the following facts and representations in connection with your request.

Company A is an organization described in Code section 501(c)(3) and exempt from tax under section 501(a). Company A established a 403(b) plan ("Plan X") for its employees effective July 1, 1991. Plan X is funded through custodial accounts investing in regulated company stock with Custodian B. Company A directly transfers the contributions to Custodian B, a bank, for investment in regulated investment company stock. Section 9 of the Agreement provides that if Plan X and the Agreement are in conflict, the provisions of Plan X shall control to the extent that Plan X's provisions are consistent with section 403(b)(7).

Plan X is funded through elective deferrals; matching contributions; and non-elective, non-matching contributions. Plan X also accepts rollover contributions. Under section 4.01 of Plan X and proposed amendments to the plan ("Proposed Amendments"), each eligible employee may make elective deferrals through salary reduction within the limits of Code section 415 and 402(g). The elections are only effective with respect to compensation that is not currently available to the employee as of the date of the elections. Under the Proposed Amendments, annual additions under the plan may not exceed the lesser of (1) $40,000, as adjusted for cost of living changes, or (2) 100

percent of compensation. Effective January 1, 2002, "compensation" for purposes of applying the limit under section 415 is defined as "includible compensation" under section 403(b)(3). Under the Proposed Amendments to section 4.11 of Plan X, effective January 1, 2002, the exclusion allowance does not apply to limit contributions to Plan X.

Pursuant to the Proposed Amendments, distributions from Plan X may be made on attainment of age 59 and 1/2, severance from employment, disability, death, or with respect to salary reduction contributions, financial hardship.

Pursuant to section 12 of the Proposed Amendments, section 6.06.2 of Plan X provides that minimum distributions will be made from Plan X in accordance with Code section 401(a)(9) and underlying regulations.

Section 6.06.4(d) of Plan X, as proposed to be amended, provides that the required beginning date for distributions under Plan X is the April 1 of the calendar year immediately following the later of the calendar year in which the participant retires or attains age 70 and ½. With respect to account balances that accrued before 1987 and have been separately accounted for, the required beginning date is the later of the date described above or the date the participant attains age 75.

Section 4.08 of Plan X, as amended by Section 3 of an amendment adopted on December 20, 2001 (the "Amendment"), provides for the right of a participant to elect a direct rollover of an eligible rollover distribution. An eligible rollover distribution is defined generally as any distribution from Plan X other than one that is a series of substantially equal periodic payments made for the life or life expectancy or joint lives or joint life expectancies of the distributee and the designated beneficiary, or for a specified period of ten years of more.

Based on the above facts and representations, you request the following rulings that:

(1) Plan X satisfies the requirements of Code sections 403(b) and 403(b)(7);

(2) to the extent the contributions described above made by Company A to Plan X do not exceed the limit under section 415, the contributions are excluded from the participant's gross income; and

(3) the distributions from Plan X will be taxed under section 72.

Code section 403(b)(1) provides in pertinent part that if an annuity contract is purchased (1) for an employee by an employer which is exempt from tax under section 501(a) as an organization described in section 501(c)(3); (2) the annuity contract is not subject to section 403(a); (3) the employee's rights under the contract are nonforfeitable except for failure to pay future premiums; (4) except in the case of a contract purchased by a church, such contract meets the nondiscrimination requirements of paragraph (12);

and (5) in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of section 401(a)(30); then the amounts contributed by the employer will be excludable from the gross income of the employee for the taxable year to the extent the amounts do not exceed section 415.

Code section 403(b)(1) further provides that the amount actually distributed under the annuity contract to a distributee is taxable to the distributee in the year of distribution under section 72.

Code section 403(b)(7) provides that amounts paid by an employer described in section 403(b)(1) to a custodial account shall be treated as amounts contributed to an annuity contract for an employee if the amounts are invested in regulated investment company stock held in the custodial account and under the custodial account, amounts may not be paid to any distributee before the employee dies, attains age 59 1/2, has a severance from employment, becomes disabled (within the meaning of section 72(m)(7)), or in the case of contributions made pursuant to a salary reduction agreement (as provided under section 3121(a)(1)(D)), encounters financial hardship.

Code section 401(a)(30) generally provides that a trust is not qualified under section 401(a) unless it limits elective deferrals to the amount of the limitation in effect under section 402(g)(1).

Code section 402(g)(1) generally provides that the elective deferrals of any individual for taxable year 2002 shall be included in the individual's gross income to the extent the amount of such deferrals exceeds $11,000. This amount is increased by $1,000 for each year through 2006.

Code section 402(g)(7) provides for a special "catch-up" election for employees who have 15 years of service with a qualified organization. The amount of the catch up is equal to the least of (1) $3,000, (2) $15,000 reduced by amounts not included in gross income for prior taxable years by reason of this paragraph, or (3) the excess of $5,000 multiplied by the number of years of service of the employee with the qualified organization over the elective deferrals made by the organization on behalf of the employee for prior taxable years.

Code section 414(u) provides in pertinent part that if any contribution is made by an employer or an employee under an individual account plan, and such contribution is required by reason of the employee's rights under chapter 43 of title 38 of the United States Code, resulting from qualified military service, then the contribution is not subject to any otherwise applicable limitation under sections 403(b), 415, 402(g) and 403(b).

Code section 415(c)(1) limits annual additions to a participant's account to the lesser of $40,000, or 100 percent of the participant's compensation.

Code section 415(c)(3)(E) provides that in the case of an annuity contract under section

403(b), the term "participant's compensation" means the participant's includible compensation as determined under section 403(b)(3).

Code section 403(b)(3) generally defines "includible compensation" to mean the amount of compensation received from the employer that is includible in gross income for the most recent one-year period of service.

Code section 403(b)(10) provides that requirements similar to the requirements under section 401(a)(9) and incidental death benefit requirements of section 401(a) with respect to benefits accruing after December 31, 1986, apply to annuity contracts under section 403(b). This section further provides that the requirements of section 401(a)(31), regarding direct rollovers, are applicable to 403(b) plans.

Code section 401(a)(9) 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 and 1/2, or the calendar year in which the employee retires. This section further imposes other requirements with respect to distributions from qualified plans.

In this case, Company A is an employer described in Code section 501(c)(3) and exempt from tax under section 501(a). The contributions under Plan X are made on behalf of Company A's employees to custodial accounts investing in regulated investment stock. Section 4.02 of Plan X requires that elective deferrals be limited to the dollar limitation of section 402(g), and the amount of all contributions made on behalf of a participant under Plan X are limited by section 415(c)(1) pursuant to section 4.05 of the plan. As provided by section 4.08 of Plan X, a participant has the right to elect a direct rollover with respect to eligible rollover distributions. Pursuant to the Proposed Amendments, amounts under Plan X may not be distributed prior to the time an employer attains age 59 ½, severs employment, becomes disabled, dies, or in the case of salary reduction contributions, encounters financial hardship. Plan X also imposes the minimum distribution requirements of section 401(a)(9).

Accordingly, we conclude that (1) Plan X satisfies the requirements of sections 403(b)(1) and 403(b)(7); (2) contributions under the plan will be excludable from the employee's gross income to the extent the contributions do not exceed the limit of section 415(c)(1) provided the contributions which are elective deferrals also satisfy section 402(g); and (3) amounts distributed from Plan X are taxable under section 72.

This ruling is contingent on the timely adoption of the Proposed Amendments, and will have no effect unless the Proposed Amendments are adopted. This ruling does not extend to any operational violations of Code section 403(b), now or in the future, and it does not address whether Plan X satisfies the nondiscrimination requirements of section 403(b)(12).

Pursuant to a power of attorney on file with this office, a copy of this letter is being sent

to your authorized representative. This ruling is directed only to the taxpayer who requested it. Code section 6110(k)(3) provides that this ruling may not be used or cited by others as precedent. Any questions regarding this ruling should be addressed to

Sincerely yours,

(Signed)

Andrew E. Zuckerman, Manager
Employee Plans Technical Group 1

Enclosures:
Notice 437
Deleted copy of letter

cc: