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

200252094

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Index No. 4980.00-00

T:EP:RA:T2

SEP 26 2002

Attn: P

LEGEND:

Company M =

Plan X =

Plan Y =

Dear

This letter is in response to ruling requests submitted on your behalf by your authorized representative in a letter dated ., and modified by correspondence dated . concerning the proper treatment of a potential reversion under section 4980(a) of the Internal Revenue Code (the "Code").

In support of your ruling request your authorized representative has presented the following facts:

On , Company M (with its affiliates) filed voluntary petitions with the Bankruptcy Court for reorganization relief under Chapter 11 of the United States Code. Company M (with its affiliates) continued operating their businesses as debtors in possession and planned to file a plan for reorganization after the 2001 Christmas selling season. However, as a result of the state of the economy and the retail environment, Company M (with its affiliates), with the support of the creditors committee appointed pursuant to Chapter 11, decided to wind down its business.

Company M maintains Plan X, a defined benefit plan, qualified under section 401(a) of the Code. On November 14, 2000, the Board of Directors of Company M, based on a determination that any retirement benefits to be provided by Company M upon its emergence from bankruptcy would be provided under a defined contribution plan, such as Plan Y, adopted resolutions to terminate Plan X. Such termination was made subject to the approval of the Bankruptcy Court and conditioned upon a determination that Plan X would be sufficient for benefit liabilities as of the termination date. The officers of Company M were further authorized by these resolutions to take any action that they deemed necessary or appropriate to make a direct transfer of all or any portion of the maximum amount that Company M could receive as a reversion upon the termination of Plan X to Plan Y as a qualified replacement plan within the meaning of section 4980(d)(2) of the Code.

On , the Bankruptcy Court issued an order authorizing Company M to take all steps necessary or appropriate to effectuate the termination of Plan X and to implement the procedures for distribution thereunder, including the taking of any reversion of any surplus assets or the transfer of such surplus assets to a defined contribution plan for its employees. In connection with the termination, Plan X was amended to permit the payment of lump sum distributions of all accrued benefits upon plan termination and to comply with all applicable laws and regulations effective upon termination. Company M filed a request with the Internal Revenue Service for a determination letter with respect to the effect of the termination of Plan X on its qualification and filed a Standard Termination Notice with the Pension Benefit Guaranty Corporation (the "PBGC").

The trustee of Plan X pursuant to the direction of the plan administrator has purchased annuities or paid lump sum benefits to all participants in Plan X, other than participants who the plan administrator was unable to locate after a diligent search, the value of whose benefits was paid to the PBGC as required by section 4041.29 of the PBGC Regulations. Before taking a reversion of the excess assets under Plan X, Company M proposes to transfer to Plan Y between 25 percent and 100 percent of the maximum amount that it could receive as an employer reversion.

Plan Y is a defined contribution plan qualified within the meaning of section 401(a) of the Code and includes a qualified cash or deferred arrangement described in section 401(k) of the Code and a provision for matching contributions

tested for nondiscrimination purposes under section 401(m) of the Code.

All employees of Company M were eligible to participate in Plan Y upon attainment of age 21 and completion of one year of service. Of the participants with accrued benefits under Plan X who remained as employees of Company M as of (the termination date of Plan X) of such participants were participants in Plan Y on that date. As a result of Company M's decision to liquidate its business, Company M proposes to amend Plan Y to provide for the receipt and immediate allocation of excess assets in the form of a direct transfer from the terminating Plan X provided (i) such transfer is made to Plan Y before any employer reversion from the terminating Plan X and (ii) the amount of such transfer is no less than 25 percent of the maximum amount Company M could receive as an employer reversion from the termination plan with regard to section 4980(d) of the Code.

The proposed amendment to Plan Y provides for the entire amount of the transfer to be allocated as of , to a qualified replacement plan account of each participant (including individuals not making salary deferral contributions pursuant to section 401(k) of the Code) who is an employee on such date and who has at least $200.00 in compensation received during the period beginning on and ending on . Such allocation is to be based on the relative compensation during 2001 of each eligible participant with a minimum allocation to each eligible participant of $200.00. The transferred assets allocable to each eligible participant will be invested in the same manner as such participant's other accounts, provided that, in the absence of a participant election and pending any such participant election, the assets will be invested in the money market fund designated by the Investment Committee responsible for directing assets or choosing investment alternatives under Plan Y.

Company M received a favorable determination letter dated , covering all amendments to Plan Y, including the proposed amendment described above.

Based on the foregoing facts and representations, you have requested the following rulings:

(1) If at least 25 percent of the potential reversion is transferred from Plan X to Plan Y in the manner described, the potential reversion that is so transferred will be included in the gross income of

Company M for federal income tax purposes only to the extent that it exceeds 25 percent of the potential reversion.

(2) A federal income tax deduction will be allowable under Code section 404, with respect to the transfer from Plan X to Plan Y in the manner described only for the portion of the potential reversion in excess of 25 percent.

(3) If at least 25 percent of the potential reversion is transferred from Plan X to Plan Y in the manner described, the portion of such transfer in excess of 25 percent of the potential reversion will be treated as an employer reversion under Code section 4980 and be subject to excise tax pursuant to Code section 4980 at the rate of 20 percent.

Notice 88-58, 1988-1 C.B. 546 provides in part, that for federal income tax purposes, a transfer of excess assets from a defined benefit plan to a defined contribution plan of the same employer constitutes a reversion of the assets to the employer followed by a contribution to the defined contribution plan. Thus, a reversion of excess assets from a defined benefit plan, whether received by the employer or transferred to a defined contribution plan, is included in the gross income of the employer under section 61 of the Code.

Section 4980(a) of the Code provides for a 20 percent excise tax on the amount of any reversion from a qualified plan. Section 4980(d), as added by the Omnibus Budget Reconciliation Act of 1990, P.L. 101-508, provides in general, that the excise tax under section 4980(a) shall be increased to 50 percent with respect to any employer reversion from a qualified plan unless the employer establishes or maintains a qualified replacement plan, or the plan provides for benefit increases which take effect immediately on the termination date. Section 4980(d) generally applies to reversions occurring after September 30, 1990.

Section 4980(c)(2) of the Code defines "employer reversion" as the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan.

Section 4980(d)(2) of the Code generally provides the requirements for a plan to be considered a "qualified replacement plan." The plan must be established or maintained

by the employer in connection with a qualified plan termination and at least 95 percent of the active participants in the terminated plan who remain as employees of the employer after the termination are active employees in the replacement plan. Additionally, a direct transfer must be made from the terminated plan to the replacement plan before any "employer reversion," and the transfer must be in an amount equal to 25 percent of the maximum amount the employer could receive as an "employer reversion."

Section 4980(d)(2)(C)(1) of the Code provides that, if the replacement plan is a defined contribution plan, the amount transferred to the replacement plan must be: (i) allocated under the plan to the accounts of participants in the plan year in which the transfer occurs; or (ii) credited to a suspense account and allocated from such account to accounts of participants no less rapidly than ratably over the seven plan year period beginning with the year of the transfer. Section 4980(d)(4)(B) of the Code provides, in part, that the allocation of any amount (or income allocable thereto) to any account under section 4980(d)(2)(C) shall be treated as an annual addition for purposes of section 415.

Only an amount equal to exactly 25 percent of the excess would meet the assets transfer requirement stated in section 4980(d)(2)(B) of the Code and could be transferred to Plan Y under the terms of section 4980. In other words, only an amount equal to exactly 25 percent of the excess amount would not be subject to the excise tax under section 4980. The remaining 75 percent of the excess would be subject to an excise tax equal to 20 percent as provided in section 4980(d). Any excess amounts over the 25 percent would not meet the assets transfer requirements of section 4980, but can be regarded as a contribution to the plan that is subject, for example, to the requirements of section 404 and section 415.

Your authorized representative asserts that at least 95 percent of the active participants in Plan X, who remain employees of Company M after the termination of Plan X, will be eligible to receive an allocation of excess assets in Plan Y. Furthermore, at least 25 percent of the potential reversion will be directly transferred to Plan Y. These representations indicate that, with respect to Plan Y, the requirements of section 4980(d)(2) will be met and Plan Y constitutes a qualified replacement plan, provided an amount equal to 25 percent of the excess amounts is transferred to Plan Y.

Section 4980(d)(2)(B)(iii) of the Code provides that in the case of any amount transferred under section 4980(d)(2)(B) to a qualified replacement plan, such amount (I) shall not be includible in the gross income of the employer, (II) no deduction shall be allowable with respect to such transfer, and (III) such transfer shall not be treated as an employer reversion for purposes of section 4980.

The Service has concluded that only an amount equal to exactly 25 percent of the excess amount would meet the asset transfer requirements stated in section 4980(d)(2)(B) of the Code ("the 25 Percent Transferred Amount"). Thus, the provisions of section 4980(d)(2)(B)(iii)(I), (II) and (III) would apply only to the 25 Percent Transferred Amount.

Accordingly, we conclude with respect to your first ruling request that only the 25 Percent Transferred Amount that is transferred from Plan X to Plan Y will not be included in the gross income of Company M. The assets in excess of the 25 Percent Transferred Amount would be included in the gross income of Company M for federal income tax purposes.

With respect to your second ruling request, we conclude that no deduction will be allowed for the 25 Percent Transferred Amount that is transferred from Plan X to Plan Y. However, any surplus amounts transferred from Plan X to Plan Y in excess of the 25 Percent Transferred Amount are considered to be contributions to Plan Y that are subject to the deductibility rules of section 404 of the Code.

Finally, with respect to your third ruling request, we conclude that only the 25 Percent Transferred Amount transferred from Plan X to Plan Y will not be treated as an employer reversion and will not be subject to an excise tax under section 4980(a) of the Code. The remaining 75 percent of the assets will be treated as an employer reversion, and pursuant to section 4980(a), an excise tax of 20 percent will be imposed on such amount regardless of whether such amount reverts to the employer or is transferred from Plan X to Plan Y.

This letter is directed only to the taxpayer who requested it. Section 6100(k)(3) of the Code provides that it may not be used or cited as precedent.

This ruling is based on the assumption that Plan X and Plan Y are qualified under section 401(a) of the Code at all times relevant to this transaction.

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

If you have any questions concerning this ruling, Please contact , T:EP:RA:T2, at

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of ruling letter
Notice of Intention to Disclose

cc: