



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200550042

U.I.L. 415.00-00

SEP 20 2005

SE: T: EP: RA: T2

Attn: *****

Legend:

- System A = *****
- State B = *****
- Plan X = *****
- Plan Y = *****
- Plan Z = *****
- Regulations R = *****

Dear *****:

This is in response to a request for a private letter ruling dated May 23, 2003, and supplemented by correspondence dated April 7, 2004, May 14, 2004, October 8, 2004, and July 26, 2005, which was submitted on your behalf by your authorized representative concerning the tax treatment of certain contributions under section 415(n) of the Internal Revenue Code (the "Code").

In support of your request, the following facts and representations have been submitted:

System A was established to administer Plan X, Plan Y, and Plan Z. Plan X covers employees of participating departments of State B. Plan Y covers all full-time officers of State B's police force. Plan Z covers employees of counties, school boards, and units of local government in State B. The plan documents that relate to Plan X, Plan Y and Plan Z are the relevant sections of the State B Revised Statutes and the relevant sections of the State B Administrative Regulations (Regulations R). Plan X, Plan Y, and Plan Z are defined benefit plans that you represent meet the requirements for qualification under Code section 401(a) and qualify as governmental plans within the meaning of Code section 414(d).

System A is governed by a Board of Trustees, comprised of nine members who are the Secretary of the State B Governor's Personnel Cabinet, members or retirees of the respective plans who are elected by the membership and appointees of the Governor of State B. The day to day administration of System A is carried out by a staff under the supervision of an Executive Director.

Participating employers' contributions to Plan X, Plan Y and Plan Z are actuarially determined. Members of Plan X are required to contribute five percent of their creditable compensation to the plan. Members of Plan Y are required to contribute eight percent of their creditable compensation to the plan. Members of Plan Z are required to contribute five percent of their creditable compensation to the plan. In addition, members in Plan X and Plan Z who are employed in hazardous duty positions are required to contribute eight percent of their creditable compensation to those plans. Employers who participate in Plan X, Plan Y and Plan Z are required to treat employee contributions made to those plans as being picked up under Code section 414(h)(2).

The Plan X defined benefit formula is based on three different criteria: (i) the member's final compensation; (ii) years of service credit, and (iii) a statutory multiplier. Section 61.595 of Plan X contains the provisions for determining a member's service retirement allowance and the basic formula for calculating annual benefits of members in non-hazardous positions. Members of Plan X who serve in hazardous positions are paid a benefit as calculated under section 16.576 of Plan Y.

Plan Y bases its defined benefit calculation on three different criteria: (i) the member's final compensation, (ii) years of service credit, and (iii) a statutory multiplier. The years of service credit used in determining the member's benefit is the sum of the member's current service (service after July 1, 1958) and prior service (service before July 1, 1958). Section 16.576(3) of Plan Y provides that the basic formula for calculating annual benefits for Plan Y members who retire after August 1, 1990 is 2.5 percent of final compensation for each year of service credit.

Plan Z bases its defined benefit calculation on three different criteria: (i) the member's final compensation, (ii) years of service credit, and (iii) a statutory multiplier. Benefit calculations for members of Plan Z who serve in non-hazardous positions are determined under section 61.595 of Plan X. Benefit calculations for members of Plan Z who serve in hazardous positions are calculated under section 16.576 of Plan Y.

Section 61.552(25) of Plan X provides, in pertinent part, that any employee participating in one of the retirement systems administered by System A prior to July 15, 2002, who has accrued at least forty-eight months of service if age sixty-five or at least sixty (60) months of service if under age sixty-five (65) in the systems administered by System A and who has a total service in all State B-administered retirement systems of at least one hundred eighty (180) months of service credit may purchase a combined maximum total of five (5) years of retirement service credit which is not otherwise purchasable under any of the provisions of Plan X, Plan Y and Plan Z. This service is referred to as "other service". In a letter dated July 26, 2005, System A proposed to revise the circumstances under which "other service" may be purchased under Plan X. System will consider a purchase of other service to be permissive service credit only if a member linked the purchase to a period of employment that was not previously credited as service under System A.

Section 61.552(25) of Plan X further provides that the purchase price for the retirement service credit shall be calculated and paid for as a delayed contribution payment and the payment shall not be picked up by the employer. The employee's payment shall be paid into the individual member's contribution account in the appropriate retirement system and shall be considered accumulated contributions of the member. Payment by the member may be by lump sum or by increments. The service purchased under this subsection shall not be used in determining a retirement allowance until the member has accrued at least two hundred forty (240) months of service, excluding service purchased under this subsection. If the member does not accrue at least two hundred forty (240) months of service, excluding service purchased under this subsection, upon retirement, death, or written request following termination, the payment, plus interest, shall be refunded to the member.

Section 61.545 of Plan X contains the rules for service credit determination for the purchase of service credit for fractional year's service. Section 61.545(2), as it specifically pertains to this ruling, provides that employees participating in one of the State B-administered retirement systems who are or have been employed by a school board participating in Plan Z, a State B-operated school, or a State B institution of higher education which participates in Plan X, and who work and receive credit for less than twelve (12) months each year, may purchase the additional months of service credit needed to total one (1) year of service credit, except the amount purchased shall not exceed three (3) months. The employee may purchase the service credit by paying the retirement system a delayed

contribution payment. Employees who have service credit prior to July 1, 1992, or their employers, the State B-operated school, the State B institution of higher education, or the school board may purchase service credit on behalf of the employee for previous years by paying the retirement system the delayed contribution payment. This service is referred to as "summer months service".

Section 61.545(2) further provides that the cost of service under this subsection may be paid by both the employer and employee. The employer shall pay fifty percent of the cost and the employee shall pay fifty percent of the cost. The payment by the employer shall not be deposited to the member's account. Service credit shall not be credited to the member's account until both the employer's and employee's payment is received by the retirement system. The member is only eligible to purchase the additional months under this section to total one (1) year.

Section 61.5525(1) of Plan X provides that effective July 1, 2001, purchase of service under Plan X, Plan Y and Plan Z, except as provided in (2), shall be determined by multiplying the higher of the employee's current rate of pay, final rate of pay, or final compensation as of the end of the month in which the purchase is made times the actuarial factors times the number of years of service being purchased. Section (2) provides that section (1) does not apply to Section 51.552(1) and (23), or section 61.592(3)(c) of Plan X.

(In 2003, the Board of Trustees of System A adopted section 1:150 of Regulations R. Section 1:150 provides, in part, that the Board of Trustees of System A has the authority to promulgate all administrative regulations necessary or proper to carry out the provisions of Plan X, Plan Y and Plan Z. Section 61.552(16) of Plan X provides that an employee participating in one of the retirement systems administered by System A may purchase service credit under any of the provisions of Plan X, Plan Y or Plan Z. Section 61.552(28) of Plan X gives the Board of Trustees of System A the authority to establish a program to provide for the purchase of service credit under Plan X, Plan Y and Plan Z pursuant to the pick up provisions of Code section 414(h)(2). Section 1:150 of Regulations R authorizes the pick up of contributions to purchase service credit in Plan X, Plan Y and Plan Z by payroll deducted installments.)

Based upon the aforementioned facts and representations, you request the following rulings:

1. That service credit available for purchase, as described in section 61.552(25) ("other service") and section 61.545(2) ("summer months service") of Plan X is permissive service credit as defined in Code section 415(n)(3)(A). In a letter dated July 26, 2005, you revised the first part of this ruling request with respect to "other service" to read that "other service" is permissive service credit under Code section 415(n)(3)(A) when the "other service" corresponds to a period of

employment (either public or private sector) not previously credited under Plan X.

2. That, assuming the service credit available for purchase described in Ruling Request Number one is permissive service credit as defined in Code section 415(n)(3)(A), such permissive service credit is subject to the limits under section 415(n).
3. That, assuming the service credit available for purchase in Ruling Request Number one is permissive service credit as defined in Code section 415(n)(3)(A), such service credit may be purchased by a member with amounts transferred through a direct trustee-to-trustee transfer from a Code section 403(b) annuity or an eligible governmental Code section 457(b) deferred compensation plan and will not be includible in gross income under sections 403(b)(13) and 457(e)(17).

Code section 415(b) provides the limitation on annual benefits for defined benefit plans. Section 415(b)(2) provides, in general, that a participant's benefit, expressed as an annual benefit, cannot exceed the lesser of (A) \$160,000, or (B) 100 percent of the participant's average compensation for his or her high 3 years.

The 100 percent of compensation limit under section 415(b)(2) does not apply to governmental plans.

Code section 415(c) provides the limitations on annual additions for defined contribution plans. Section 415(c)(1) provides, in general, that contributions and other annual additions for a participant may not exceed the lesser of (A) \$40,000, or (B) 100 percent of the participant's compensation.

Code section 415(n) provides special rules relating to the purchase of permissive service credit.

Code section 415(n)(1) provides that if the employee makes 1 or more contributions to a defined benefit governmental plan (within the meaning of section 414(d)) to purchase permissive service credit under such plan, then the requirements of this section shall be treated as met only if—

- (A) the requirements of such subsection (b) are met, determined by treating the accrued benefit derived from all such contributions as an annual benefit for the purposes of subsection (b), or
- (B) the requirements of subsection (c) are met, determined by treating all such contributions as annual additions for the purposes of subsection (c).

Code section 415(n)(3)(A) provides that the term "permissive service credit" means service credit—

- (i) recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,
- (ii) which such participant has not received under such governmental plan, and
- (iii) which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.

Code section 415(n)(3)(B) provides the limitation of nonqualified service. Section 415(n)(3)(B) provides that a plan shall fail to meet the requirements of this section if--

- (i) more than 5 years of permissive service credit attributable to nonqualified service are taken into account for purposes of this subsection, or
- (ii) any permissive service credit attributable to nonqualified service is taken into account under this subsection before the employee has at least 5 years of participation in the plan.

Code section 415(n)(3)(C) generally defines the term "nonqualified service" as service other than (i) service as an employee of the federal government, any state or political subdivision or agency or instrumentality thereof; (ii) service as an employee of certain educational organizations who are described in section 170(b)(1)(A)(ii) of the Code; (iii) service as an employee of an association of employees who are described in (i), or (iv) military service. Section 415(n)(3)(C) further provides that in the case of such service previously described in (i), (ii), and (iii), such service will be nonqualified service if recognition of such service would cause a participant to receive a retirement benefit for the same service under more than one plan.

With respect to your first ruling, permissive service credit relates to an actual period of service or period of employment for which the employee has not yet been credited with performing service for an employer under the terms and provisions of a plan, and for which the employee would be credited with performing under the terms and provisions of a plan once payment is made. In this case, System A proposes to link "other service" that is purchasable under section 61.552(25) of Plan X to a period of employment (public or private sector) for which the member has not previously received credit under the terms of System A. The member has not received credit with performing service for the employer for these periods of prior employment but would be credited with performing service once payment is made. The additional service that is purchasable under this section of Plan X is recognizable by Plan X for purposes of

calculating a member's benefit as one of the criteria used to calculate the retirement allowance under the plan is the member's years of service. Since the "other service" relates to an actual period of employment for which the member has not received credit under the terms and provisions of the plan and such additional service can only be purchased by a member making an additional voluntary contribution to Plan X, we conclude that the "other service" that is purchasable under section 61.552(25) (as revised by System A in its letter dated July 26, 2005) is permissive service credit under section 415(n)(3)(A) of the Code.

With respect to the "summer months service" in your first ruling request, section 61.545(2) of Plan X allows members who are or have been employed by a school board that participates in Plan Z, a State B-operated school, or a State B institution of higher education and who work and receive credit for less than twelve (12) months of service during a year to purchase up to an additional three (3) months of service that would be needed to total one (1) year of service. Plan Z defines school term or year to mean the twelve (12) month period from July 1 through the following June 30. The summer months service covers a period, up to three (3) months, and is included in or relates to an actual period of service (school year or term) that consists of twelve (12) months during which the member performs or performs service for the employer. The member has not been credited with performing service for the employer during the summer months but would be credited with performing service for the employer for those months once payment is made. The additional service that is purchasable under this section of Plan X is recognizable by the plan for purposes of calculating a member's benefit as one of the criteria used to calculate the retirement allowance under the plan is the member's years of service. A member can only purchase the amount of service needed to total one (1) year of service. The member has not received credit for the additional months of service that is purchasable under this section since the eligibility to purchase such additional months is available only to employees who work and receive credit for less than twelve (12) months of service during a year.

Under section 61.545(2) of Plan X, the cost associated with purchasing service credit under this section may be paid by both the employer and the member. The part of this section that is pertinent to this ruling is the cost of the service credit that is paid by the member who makes an additional voluntary contribution to purchase the additional months of service. Therefore, with respect to the "summer months service", we conclude that the summer months service that is purchasable under section 61.545(2) of Plan X by a member who makes an additional voluntary contribution to Plan X to purchase such service, is permissive service credit within the meaning of Code section 415(n)(3)(A).

Further, with respect to ruling request number two as it relates to the purchase of service credit under section 61.552(25) of Plan X ("other service") and section 61.545(2) of Plan X ("summer months service"), since we have concluded that such service is permissive service credit within the meaning of Code section

415(n)(3)(A), we also conclude that such permissive service credit is subject to the limits of Code section 415(n).

Your third ruling request involves purchasing service credit with amounts transferred through a direct trustee-to-trustee transfer from a Code section 403(b) arrangement or an eligible governmental plan as described in Code section 457(b). Section 61.552(17) of Plan X provides, in pertinent part, that any member participating in one of the retirement systems administered by System A may purchase service credit under any of the provisions of Plan X, Plan Y or Plan Z by transferring funds through a direct trustee-to-trustee transfer, or through a direct rollover as contemplated by Code section 401(a)(31). Service credit may also be purchased by a rollover of funds pursuant to sections 402(c) and 408(d)(3) of the Code. You state that funds transferred through a direct trustee-to-trustee transfer include Code section 403(b) amounts and Code section 457(b) amounts.

Code section 403(b)(13) provides, in general, that no amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan if such transfer is for the purchase of permissive service credit as defined in section 415(n)(3)(A). Section 457(e)(17) provides, in general, that no amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan if such transfer is for the purchase of permissive service credit as defined in section 415(n)(3)(A).

Since we have concluded that the "other service" and "summer months service" that is purchased with additional voluntary member contributions under sections 61.552(25) and 61.545(2) of Plan X is permissive service credit within the meaning of Code section 415(n)(3)(A), we conclude, with respect to ruling request number three, that amounts transferred from a Code section 403(b) arrangement or an eligible governmental Code section 457(b) deferred compensation plan through a direct trustee-to-trustee transfer will not be includible in a member's gross income under Code section 403(b)(13) or Code section 457(e)(17) to the extent that such transferred amounts are used to pay the member cost associated with purchasing the service credit under section 61.552(25) and section 61.545(2) of Plan X. This conclusion is based on the assumption that the trustee-to-trustee transfer of the Code section 403(b) amounts and the direct trustee-to-trustee transfer of amounts from the eligible governmental Code section 457(b) deferred compensation plan to Plan X, Plan Y or Plan Z meet the requirements of Revenue Ruling 67-213, 1967-2 C.B. 149 and Code section 403(b)(13) and Code section 457(e)(17).

These rulings are based on the assumption that Plan X, Plan Y and Plan Z meet the requirements for qualification under Code section 401(a) and qualify as governmental plans as defined in Code section 414(d). Further, these rulings apply to members of Plan Y and Plan Z to the extent that such plans and members are subject to the same limitations and requirements as described in section 61.552(25) and section 61.545(2) of Plan X. No opinion is expressed as to whether the transfer of assets as contemplated in ruling request number three

meets the requirements of Revenue Ruling 67-213. No opinion is expressed as to the validity of the pick up arrangement of Plan X, Plan Y and Plan Y with respect to the pick up of mandatory employee contributions or with respect to the pick up of employee contributions to purchase service credit as discussed in this ruling.

This ruling is only directed to the taxpayer who requested it. Code section 6110(k)(3) 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 (Form 2848) on file in this office.

Should you have any questions about this ruling, please contact
*****SE:T:EP:RA:T2.

Sincerely yours,

Joyce E. Floyd

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:

- Deleted copy of this letter
- Notice of Intention to Disclose