COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200729036

APR 25 2007

U.I.L. 402.00-00
U.I.L. 415.00-00

SE:T:EP:RA:T:2

Attn:

Legend:

State B =

System A =

Board M =

Group B Members =

Statute T =

Statute W =

Statute U =

System B =

Plan X =

Plan Y =

Plan Z =

Rule N =

Dear :

This letter is in response to a ruling request dated January 9, 2006, as supplemented by correspondence dated September 22, 2006, December 21, 2006, and February 7, 2007, submitted on your behalf by your authorized

representative concerning the effect of certain legislation upon Plan X. In your letter dated September 22, 2006, you withdrew your ruling request number four pertaining to the qualified status of Plan X.

The following facts and representations have been submitted on your behalf:

System A is a body corporate and an instrumentality of State B. System A is administered by Board M, a governmental instrumentality of State B, which is composed of thirteen members. Plan X is a defined benefit program that is also administered by System A. The plan document that relates to Plan X is statutorily promulgated by the State B legislature and is the relevant sections of Statute T and Statute W. You represent that Plan X meets the requirements for qualification under Code section 401(a) and qualifies as a governmental plan within the meaning of Code section 414(d).

Plan X received its most recent favorable determination letter on June 8, 2000. Since that time, Plan X has been amended to include amendments to the benefits and contributions structures.

Plan X was established for the benefit of Group B Members who are employed by State B. Membership is mandatory for all Group B Members of the State B Supreme Court, Court of Criminal Appeals, Workers' Compensation Court, Court of Appeals and District Courts and the Administrative Director of the Courts, as enumerated in section 11.0l of Statute T. Group B Members are eligible immediately upon election or appointment and membership is a condition of service on the bench. Plan X is a contributory plan and the member contributions assumed and paid by a Group B Member are treated as employer pick-up contributions under Code section 414(h)(2).

Prior to September 1, 2005, an unmarried Group B Member contributed five percent of his or monthly salary to Plan X. A married Group B Member contributed eight percent of his or her monthly salary, with an additional three percent over the normal contribution to fund survivor benefits ("Survivor Contribution"). Within thirty (30) days of becoming a Group B Member or becoming married, each married Group B Member must file a written statement to bring the Group B Member's spouse under the survivor benefit provisions. Effective July 1, 1999, each married Group B Member who had not so previously elected was brought within the survivor benefit provisions. The provisions for survivor benefits may be waived with the written consent of the spouse within the specified time and such waiver is irrevocable.

Effective September 1, 2005, every Group B Member contributes eight percent of his or her monthly salary to Plan X regardless of marital status.

Pursuant to the provisions of Code section 414(h)(2), Group B Members' contributions with respect to compensation earned after December 31, 1999, are treated as picked-up, pre-tax contributions, not includible in the Group B Member's investment in the contract. Plan X has treated Group B Member contributions with respect to compensation earned prior to January 1, 2000, as post-tax contributions, includible in the Group B Member's investment in the contract.

Effective after January 1, 2001, State B contributed an amount equal to two percent of the monthly gross salary (not in excess of the allowable annual compensation) of each Group B Member to Plan X. Effective July 1, 2005, the percentage began increasing according to a schedule, beginning with three percent in 2005 and continuing to increase at intervals until June 30, 2018. July 1, 2018 and thereafter the rate will be 22.0 percent. Regardless of the specified employer contribution rate, Plan X is not permitted to have a funded ratio below one hundred percent. Board M is authorized to adjust the contribution rate as necessary to maintain the funded ratio. Board M reports its decision regarding the contribution rate annually to the Governor of State B, the Chef Justice of the Supreme Court of State B, the Legislative Service Bureau, the Speaker of the House of State B and the President Pro Tempore of the Senate of State B.

Eligibility for a normal retirement benefit occurs upon reaching eight years of service and age sixty-five, or ten years of service and age sixty, or a combination of years of service and age which total at least eighty with a minimum of eight years of service.

The normal monthly retirement benefit for Group B Members retiring after June 30, 2004, is the product of four percent of average monthly salary based on the thirty-six highest months of active service multiplied by years of credited service. A Group B Member's retirement benefit may not exceed one hundred percent of average monthly salary based on the thirty-six highest months of active service. After August 31, 2005, the normal retirement benefit is reduced by any survivor option elected by the Group B Member.

Prior to the enactment of Statute U, section 1103A of Plan X provided that a married Group B Member was required to bring his or her spouse under the provisions of Plan X within thirty days of the act establishing the survivor provisions, becoming a member of Plan X, or the date of marriage. Effective July 1, 1999, subsequent legislation provided that all spouses who had not been previously brought within the provisions of Plan X were included and every married Group B Member was required to pay the additional three percent Survivor Contribution. However, a spouse could waive survivor benefits in writing within thirty days of July 1, 1999, if those benefits had not previously been waived, or the date of marriage. Such waiver was irrevocable.

The standard survivor waiver was equivalent to fifty percent of the benefits the deceased retiree was receiving immediately prior to death, or fifty percent of the amount the deceased Group B Member would have been entitled to receive on the date of death (determined without regard to whether the Group B Member had satisfied the minimum retirement age at the time of death), plus any additional amounts due pursuant to section 1103A of Plan X. In order for a surviving spouse to receive benefits, the deceased Group B Member must have had at least eight years of service and have made all required contributions. In addition, the surviving spouse must have been married to the Group B Member ninety days prior to the employee's termination of employment and must have been so married to the member continuously for at least three years immediately before the member's death.

Section 1103A of Plan X provided for additional benefits to surviving spouses based upon the number of years during which the Group B Member had been making the Survivor Contribution. The additional benefit resulted in a benefit to the surviving spouse of (i) fifty-five (rather than 50%) if the member made the Survivor Contribution at least one month but less than ten years, (ii) sixty percent if the member made the Survivor Contribution at least ten years but less than twenty years, and (iii) sixty-five percent if the member made the Survivor Contribution for twenty years or longer. In order to be eligible for these additional benefits, the member must have retired or died on or after July 1, 1999, the member must have paid the Survivor Contribution prior to July 1, 1999, the Survivor Contribution must have not been refunded, the surviving spouse must have been continuously married to the member, and the member must have paid the Survivor Contribution until the time of his or her retirement or death.

Survivor benefits are payable pursuant to section 1102A(B) of Plan X, if the surviving spouse is age sixty or older. If the surviving spouse is not yet sixty, survivor benefits are payable based upon the calculation set for in section 1102(A)(B) of Plan X upon the earliest to occur of the following: (i) attainment of age sixty (60); (ii) disability of the surviving spouse; (iii) the deceased member served for at least ten years and the Workers' Compensation Court determined that the death arose out of and in the course of employment; or (iv) the deceased member would have met the requirements for retirement.

Subsequent to Statute U, for Group B Members who are married on September 1, 2005, and who are still making the Survivor Contribution, survivor benefits are paid to the surviving spouse if he or she is married to the member at least ninety days prior to the termination of the member's employment and was married to the member continuously for at least three years immediately preceding his or her death. These surviving spouse benefits are paid in the amount of fifty percent of the benefits the deceased retiree was receiving immediately prior to death, or fifty percent of the amount the deceased member would have been entitled to receive on the date of death determined without regard to whether the

member had satisfied the minimum retirement age at the time of death. In lieu, of these benefits the member may elect at retirement Option A or Option B, as described below.

Survivor benefits are payable pursuant to section 1102A(B) of Plan X, if the surviving spouse is sixty or older. If the surviving spouse is not yet sixty, survivor benefits are payable based upon the calculation set for in section 1102A(B) of Plan X, upon the earliest to occur of the following: (i) attainment of age sixty; (ii) disability of the surviving spouse; the deceased Group B Employee served for at least ten years and the Workers' Compensation Court determined that the death arose out of and in the course of employment; or (iv) the deceased member would have met the requirements for retirement.

Group B Members who are married on September 1, 2005, but who are not paying the additional three percent Survivor Contribution are only eligible for survivor benefits pursuant to the options provided by Statute U.

The survivor options available to Group B Members who join Plan X on or after September 1, 2005, are as follows:

> Option A - The retiree receives a reduced benefit during his or her lifetime. After the retiree's death, the surviving joint annuitant receives one-half of the amount paid the retiree for the survivor's lifetime. If the named joint annuitant dies after retirement but before the retiree's death, the retiree will return to the benefit he or she would have received had he or she not elected Option A.
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> Option B - The retiree receives a reduced benefit during his or her lifetime. After the retiree's death, the surviving joint annuitant receives the same amount paid the retiree for the survivor's lifetime. If the named joint annuitant dies after retirement but before the retiree's death, the retiree will return to the benefit he or she would have received had he or she not elected Option B.

The election of Option A or Option B must be made prior to the Group B Member's retirement date or prior to receipt of a benefit after termination of service with a vested benefit. A specific person must be designated as the joint annuitant at the time of election of Option A or Option B. The retirement benefits of a married Group B Member will be paid pursuant to Option A unless the member's spouse consents to payment of benefits under Option B or section 1104 of Plan X.

At the time of retirement, single members who have never made the additional three percent Survivor Contribution will receive an unreduced retirement benefit

or may elect to receive a reduced benefit with a survivor option under Option A or Option B.

Group B Members who are single on September 1, 2005, and who made the additional three percent Survivor Contribution prior to that date are the subject of this ruling request. Plan X has never permitted an unmarried Group B Member to make the additional three percent Survivor Contribution. However, prior to Statute U, some Group B Members who are currently single may have made the Survivor Contributions while previously married. These divorced or widowed Group B Members, therefore, have Survivor Contributions to their credit but no longer have a spouse to whom the survivor benefits based on such contributions could be paid.

In its 2005 session, the State B legislature adopted Statute U, which contains revisions to various contribution and benefit features and systems within Plan X. Statute U was State B's effort to improve benefits within Plan X for Group B Members. You represent that Statute U was enacted to standardize contribution rates for Plan X, requiring all Group B Members to contribute 8 percent of their compensation to Plan X regardless of their marital status. Statute U also revised the Plan X benefit structure in order to offer survivor options for all Group B Members, regardless of marital status and provided an opportunity for those Group B Members who made Survivor Contributions in the past but are no longer married to transfer these contributions to Plan Y. You represent that this ensures that these Group B Members, although no longer married, still have an opportunity to receive a direct benefit as a result of the Survivor Contributions.

Historically, Group B Members who were married paid an additional three percent Survivor Contribution in order to fund surviving spouse benefits. Effective September 1, 2005, Statute U revised the employee contribution system to establish a single contribution rate for all members, regardless of marital status. The eight percent contribution rate is equivalent to the increased rate previously paid by married Group B Members. In addition, the benefits available were revised to provide for survivor benefit options for all members, regardless of marital status.

Statute U provides, in part, that Group B Members who are single as of September 1, 2005 and who made the additional three percent Survivor Contributions at any time prior to that date may apply to receive a refund of such contributions, or a transfer of the additional contributions and receive an unreduced retirement benefit from Plan X. The application must be filed by December 1, 2005, and serves as an irrevocable waiver of any of the survivor benefits otherwise available under law. A Group B Member who does not apply for a refund or transfer may elect a survivor option under Option A or Option B of Plan X upon retirement.

In a letter dated February 7, 2007, you clarified that Board M has interpreted the language of Statute U to only permit a transfer of the Survivor Contribution. Rules N, which was approved by Board M on October 3, 2005, contains to procedures and rules under which Board M intends to implement the provisions of Statute U. You represent that Board M has interpreted the provisions of Statute U to only provide for a transfer of the Survivor Contribution and not for a refund of such. Therefore, Group B Members who previously made the Survivor Contributions to Plan X will only be permitted to transfer such contributions to Plan Y pursuant to Statute U and will not be able to obtain a refund of any of the Survivor Contributions made to Plan X.

An unmarried Group B Member who has previously made the Survivor Contributions receives a normal retirement benefit calculated according to the usual benefit formula in Plan X. After Statute U, an unmarried Group B Member who previously made Survivor Contributions has an opportunity to transfer those contributions to Plan Y. The transfer will have no impact on the Group B Member's benefit under Plan X, as the Survivor Contributions have never been used to determine the benefit of a member who is unmarried at retirement. However, the transfer will permit the Group B Member to benefit from the Survivor Contribution through Plan Y. Statute U only permits a transfer of Survivor Contributions from Plan X to Plan Y and does not entitle the Group B Member to interest earnings on those contributions. Therefore, the transfer amount will be the actual dollar amount of the Survivor Contributions previously made by the Group B Member. You represent that such amounts are still in Plan X and are not being held in a reserve or segregated fund of any kind in Plan X. Statute U provides that it was the intent of the State B legislature that (i) the excess contributions which were paid on a pre-tax basis and considered picked up by the employer under Code section 414(h)(2) would be transferred directly into an account established for that member in Plan Y, and (ii) the excess contributions which were paid on an after-tax basis and not considered picked up under Code section 414(h)(2) would be transferred directly to Plan Z.

Plan Y is a money purchase plan qualified under Code section 401(a) and is a governmental plan under section 414(d). State B is the sole employer participating in Plan Y and you represent that Group B Members are already actively participating in Plan Y and will continue to do so after the transfer of the Survivor Contributions. Plan Y received a favorable determination letter on January 31, 2000. Plan Z is an eligible deferred compensation plan established by a state government and described in section 457(b) of the Code. Plan Z received a private letter ruling confirming its status on July 7, 1999.

All transfers will take place pursuant to procedures (Rules N) established by Board M. In addition, Board M is authorized to promulgate any rules necessary to implement the provisions of Statute U. However, the provisions of Statute U shall not become effective unless Board M receives a written ruling from the

Internal Revenue Service that affirmatively states that the provisions of Statute U will not adversely affect the qualified plan status of Plan X under federal law.

The rules of Plan Y will govern the investment and distribution of the transferred funds once the transfer has been made. For example, investments will be made as selected by the Group B Member in accordance with the terms of Plan Y; a Group B Member is entitled to a distribution of his or her account on separation from service as a result of Early Retirement, Normal Retirement, death, Disability, or Termination of Service; and the benefits from payable from Plan Y are subject to the requirements of Code section 401(a)(9).

Therefore, Board M anticipates that all transfers, whether of pre-tax picked up contributions or after-tax contributions which were not picked-up, will be directed to Plan Y.

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

1. That the direct transfers of excess contributions (the Survivor Contributions) to accounts established for Group B Members in Plan Y are not subject to taxation at the time of transfer.

2. That excess contributions (the Survivor Contributions) paid to Plan X on an after-tax basis which were not picked up under Code section 414(h)(2), and transferred directly to accounts established for Group B Members in Plan Y, the tax basis associated with the excess contributions will also be transferred to Plan Y.

3. That only excess contributions (the Survivor Contributions) picked up under Code section 414(h)(2), and transferred directly to Plan Y must be tested against the limitations on annual additions imposed by Code section 415(c).

Code section 402(a) provides that, except as otherwise provided in this section, any amount actually distributed by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the year in which so distributed under section 72 (relating to annuities).

Code section 72(t) provides for an additional tax on any amount received from a "qualified retirement plan" (as defined in section 4974(c), which includes plans described in section 401(a)). The additional tax for the taxable year in which such amount is received is equal to 10-percent of the portion of such amount which is includible in gross income, except where such income is distributed on

or after an employee attains age 59½, or on account of one or more of the exceptions provided under Code section 72(t)(2).

Code section 401(a) provides that a trust created or organized in the United States and forming part of a qualified stock bonus, pension, or profit sharing plan of a employer constitutes a qualified trust only if the various requirements set out in section 401(a) are met.

Section 1.401-1(b)(1)(i) of the Income Tax Regulations (the "regulations") provides, in part, that a pension plan within the meaning of section 401(a) is a plan established and maintained by an employer primarily to provide for the payment of definitely determinable benefits to its employees over a period of years, usually for life, after retirement. This section also provides that a pension plan may provide for the payment of a pension due to disability, and may also provide for incidental benefits.

Revenue Ruling 56-693, 1956-2 C.B. 282, as modified by Revenue Ruling 60-323, 1960-2 C.B. 148, provides that a pension plan fails to meet the requirements of Code section 401(a) if it permits an employee to withdraw any part of the employee's accrued benefit (other than a benefit attributable to voluntary employee contributions) prior to certain distributable events; e.g., retirement, death, disability, severance of employment, or termination of the plan.

Revenue Ruling 67- 213, 1967-2 C.B. 149, involves the transfer of funds directly from the trust forming part of a qualified pension plan to the trust forming part of a qualified stock bonus plan. The revenue ruling provides, in part, that if a participant's interest in a qualified plan is transferred from the trust forming part of that plan to the trust forming part of another qualified plan without being made available to the participant, no taxable income will be recognized by reason of such transfer.

In this case, Board M, pursuant to Statute U and Rules N it adopted to implement the provisions of Statute U, proposes to transfer in a trustee to trustee transfer at the election of the Group B Member, the survivor contributions that were made by such member from Plan X to an account established on behalf of such member in Plan Y. The survivor contributions that were made to Plan X by such members consist of both pre-tax (picked-up contributions) and post-tax (after-tax contributions) contributions. Plan X and Plan Y are assumed to be plans that satisfy the requirements for qualification under Code section 401(a). Pursuant to Statute U and Rules N, Group B Members who are single as of September 1, 2005, and who made the additional three percent survivor contributions to Plan X can elect, prior to December 1 2005, to have such contributions transferred from Plan X to Plan Y. It has been represented that pursuant to Statute U and Rules N, the transferred amounts will not be distributed to nor made available to the Group B Members, but will be transferred directly from Plan X to Plan Y. The

only option available to a Group B Member is an election to transfer the Survivor Contribution from Plan X to Plan Y. A Group B Member will not have an option to receive a distribution of the Survivor Contribution. A Group B Member who does not apply for a transfer remains subject to the survivor benefit election under Plan X.

Accordingly, with respect to your first ruling request, we conclude that the proposed trustee-to-trustee transfer of a Group B Members' survivor contributions from Plan X to Plan Y shall not be deemed to be an actual or constructive distribution to the Group B Member of the amounts transferred and as a result shall not be subject to taxation at the time of the transfer under Code sections 402(a) and 72(t).

The second ruling request asks that the tax basis associated with the survivor contributions that were paid to Plan X on an after-tax basis and not picked up under Code section 414(h)(2) will also be transferred to Plan Y. Revenue Ruling 67-213 provides that funds transferred directly from one qualified plan to another are not considered as having been distributed to the participants. In Revenue Ruling 67-213, funds were transferred directly from the trust forming part of a qualified pension plan to the trust forming part of a qualified stock bonus plan. Because no distribution was considered to take place as a result of the transfer, the transferred funds continue to be funds derived from employer contributions and did not constitute employee contributions.

In this case, the transfer is being made from the trust of one qualified plan, Plan X, to the trust of another qualified plan, Plan Y. Since the funds are being transferred from one trust to the other, the funds are not considered to be distributed to the participants for whom the transfers are made. The contributions that are the subject of your second ruling request are after-tax employee contributions that were made to Plan X by the Group B Members and which were not picked up by the employer under Code section 414(h)(2). You represent that these contributions were made to Plan X to receive an additional benefit in the form of a survivor benefit and that the Group B Member's basis directly relates to this benefit. You further state that since the enactment of Statute U, all Group B Member contributions are established at a level to fund survivor benefits and that all such member contributions will be picked up and assumed by State B under Code section 414(h)(2). Thus, the funds that are no longer required to provide the additional benefit is being transferred from Plan X to Plan Y. These contributions have already been included in the Group B Members' gross income and the distribution of such from Plan Y will be allocable to income under section 72 and includible in gross income upon distribution to the extent provided for in section 72(d)(1)(D).

Accordingly, with respect to your second ruling request we conclude that tax basis associated with the survivor contributions that were made to Plan X with

after-tax contributions and transferred directly to accounts established for Group B Members in Plan Y will also be transferred from Plan X to Plan Y.

Your third ruling request asks that only the survivor contributions that were picked up by State B under Code section 414(h)(2) and transferred directly from Plan X to Plan Y must be tested against the limitations on annual additions imposed by Code section 415(c). Since these amounts were considered picked up by State B under Code section 414(h)(2) when they were made to Plan X, they were treated as employer contributions and, as such, were not considered annual additions to a separate defined contribution plan for purposes of Code section 415(c) when they were made to Plan X, and but for the proposed transfer to Plan Y, would be tested against the limits contained in Code section 415(b) when distributed from Plan X.

However, Code section 415(a) provides, in part, that a defined contribution plan that exceeds the limitations on contributions and additions set forth in Code section 415(c) is not a qualified plan under Code section 401(a). Code section 415(c)(1) provides, in general, that contributions and other additions with respect to a participant exceed the limitation of this subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account, such annual addition is greater than the lesser of (A) $40,000, or (B) 100 percent of the participant's compensation.

Code section 415(c)(2) provides, in general, that for purposes of paragraph (1), the term "annual addition" means the sum for any year of (A) employer contributions, (B) the employee contributions, and (C) forfeitures.

Section 1.415(c)-1(b) of the Final Income Tax Regulations (the "regulations") which were published in the Federal Register on April 5, 2007, describes the amounts that are considered to be annual additions for purposes of applying the limitations on contributions and other additions for purposes of Code section 415(c)(1). Section 1.415(c)-1(b) (1)(iii) of the regulations provides, in part, that the direct transfer of a benefit or employee contributions from a qualified plan to a defined contribution plan does not give rise to an annual addition.

However, section 1.415(c)-1(b)(4) of the regulations provides that the Commissioner may in an appropriate case, considering all of the facts and circumstances, treat transactions between the plan and the employer, transactions between the plan and the employee, or certain allocations to participants' accounts as giving rise to annual additions. In ruling request number three, the amounts that are being transferred from Plan X to Plan Y is not considered a benefit under Plan X or employee contributions as such amounts were treated as employer contributions and picked up by State B under Code section 414(h)(2) when they were made to Plan X and not tested under Code section 415(c). These amounts will not be tested against the limits

contained in 415(b) as they are being transferred from Plan X to Plan Y. In order to ensure that these contributions would be tested at some point, we conclude that under the authority provided in section 1.415(c)-1(b)(4) of the regulations, the survivor contributions that were picked up by State B under Code section 414(h)(2) and transferred directly from Plan X to Plan Y must be tested against the limitations on annual additions imposed by Code section 415(c).

These rulings are based on the assumption that Plan X and Plan Y meet the requirements for qualification under Code section 401(a) and qualify as governmental plans as defined in Code section 414(d). No opinion is expressed as to the validity of the pick up arrangement of Plan X and Plan Y with respect to the pick up of mandatory employee contributions.

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

A copy of this letter is being furnished to your authorized representative pursuant to a power of attorney (Form 2848) on file in this office.

Should you have any questions concerning this matter, please contact SE:T:EP:RA:T:2.

Sincerely,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:
Deleted copy of this ruling
Notice 437