



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: 200836035
Release Date: 9/5/08
UIL Code 4980-00-00

JUN 11 2008

Attn: *****

LEGEND:

- Company A = *****
- Company B = *****
- Company C = *****
- Plan X = *****
- Plan Y = *****
- Date 1 = *****
- Date 2 = *****
- Date 3 = *****
- Date 4 = *****
- Date 5 = *****
- Date 6 = *****
- Amount M = *****

Dear

This letter is in response to your letter dated May 15, 2007, as supplemented by correspondence dated December 17, 2007, and June 9, 2008, submitted by your authorized representative in which you request rulings concerning the proper treatment under section 4980 of the Internal Revenue Code ("Code"), of a transfer of surplus assets from a terminated defined benefit plan to an ongoing 401(k) plan designated as a "qualified replacement plan."

The following facts and representations have been submitted:

Company A is a wholly controlled nonprofit affiliate of Company B.

Company A sponsors Plan X, a defined benefit plan qualified under section 401(a) of the Code. Effective Date 1, Plan X was frozen, benefit accruals under the plan ceased, and the plan was terminated.

On Date 2, the Internal Revenue Service issued a favorable determination letter stating that the termination of Plan X did not adversely affect its qualification for federal tax purposes. On Date 3, a group annuity contract with Company C was purchased to settle the liability associated with benefits accrued under Plan X, not otherwise offered or paid as

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lump sum cash-outs. All known benefit liabilities of Plan X have been settled. Due to actuarial error, after satisfaction of all liabilities as described, as of Date 4, approximately Amount M in surplus assets remained in Plan X.

One hundred percent of the employees who participated in Plan X and who were still employed by Company A after Date 1 are covered by Plan Y, a defined contribution plan maintained by Company B, that received its most recent favorable determination letter on Date 5, and is intended to qualify as a "qualified replacement plan" within the meaning of section 4980 of the Code. Plan Y has a calendar year plan year.

Plan X was amended to provide certain long service employees with increased accrued benefits upon plan termination. Plan X has also been amended to clarify the provisions applicable to the transfer of surplus assets to Plan Y as a "qualified replacement plan". It is contemplated that one hundred percent of the surplus assets will be directly transferred to Plan Y. Plan Y has been amended to permit the receipt of the surplus assets from Plan X and to provide for a suspense account to hold the surplus assets to be transferred from Plan X pending their release and allocation to participant accounts.

It is intended that all amounts held in the suspense account, including earnings, will be allocated as employer matching contributions for all participants in Plan Y, including but not limited to former Plan X participants, no less rapidly than ratably over the seven-plan-year period beginning in the year of transfer. Under Plan Y, employer matching contributions are made on a payroll-by-payroll basis. It is anticipated that amounts will be allocated as employer matching contributions from the suspense account on a payroll-by-payroll basis as well. The minimum amount that will be allocated as employer matching contributions each pay date will be determined by multiplying the amount in the suspense account as of the pay date by a fraction, the numerator of which is one and the denominator of which is the estimated number of pay dates remaining in the seven-plan-year period.

If amounts in the suspense account are not allocated as employer matching contributions, Company B may decide to allocate all or a portion of the amounts in the suspense account as employer nonelective contributions. It is anticipated that amounts will be allocated as employer nonelective contributions from the suspense account on a payroll-by-payroll basis or on an annual basis. If the annual allocation alternative is utilized, the minimum amount that will be allocated as employer nonelective contributions each plan year from the suspense account will be determined by multiplying the amount in the suspense account as of the first day of the plan year by a fraction, the numerator of which is one and the denominator of which is the number of years remaining in the seven-plan-year period.

If the ratable allocation requirement of section 4980 of the Code is deemed to require an annual allocation, Company A will transfer the surplus assets to Plan Y at the beginning of the plan year following the plan year in which a ruling is issued. However, a transfer may be made in the year of the ruling if it is determined that an appropriate annual allocation can be accomplished under Plan Y in the time period specified under Code section 4980.

The allocation of any amount to any participant account shall be treated as an annual addition for purposes of section 415 of the Code. Company A does not intend to take a reversion of any of the surplus assets. However, if necessary, amounts that may not be allo-

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cated as a result of the limitations under Code section 415 within the appropriate time frame required by Code section 4980 will be transferred from Plan Y to Company A at the end of the seven-plan-year period and treated as a reversion to Company A subject to the applicable excise taxes under Code section 4980 at that time.

Based on the foregoing facts and correspondence, the following rulings have been requested:

1. That Plan Y constitutes a "qualified replacement plan" within the meaning of Code section 4980(d)(2), with respect to Plan X.
2. That 100 percent of the surplus assets from Plan X may be transferred to Plan Y and, being an amount that is at least 25 percent of the maximum amount which Company A could receive as an employer reversion, reduced by the present value of the aggregate increases in the accrued benefits under Plan X pursuant to the Fourth Amendment to Plan X which was adopted on Date 6 (within 60 days before the plan termination date of Date 1), and made effective on the plan termination date of Date 1 (hereafter referred to as "as reduced"), will be treated as follows: (a) the amount transferred is not includible in the gross income of Company A, (b) no deduction is allowable with respect to the amount transferred, (c) the amount transferred is not treated as an employer reversion for purposes of Code section 4980, and (d) the amount transferred is not subject to an excise tax under Code section 4980.
3. That the amounts transferred to the suspense account established for this purpose in Plan Y may be allocated to the accounts of all participants in Plan Y, including but not limited to former Plan X participants, entitled to employer matching contributions (or as employer nonelective contributions if Plan Y decides to allocate all or a portion of the released amounts in such fashion) at the time amounts are released from the suspense account.
4. That the amounts transferred to the suspense account in Plan Y may be allocated as future employer matching contributions or as employer nonelective contributions, or both, as determined from time to time by Company B.
5. That the amounts transferred to the suspense account will be deemed "allocated ratably" over a seven-plan-year period as required by Code section 4980: (a) if they are allocated as employer matching contributions on a payroll-by-payroll basis so that the minimum amount that will be allocated each pay date will be determined by multiplying the amount in the suspense account as of the pay date by a fraction, the numerator of which is one and the denominator of which is the estimated number of pay dates remaining in the seven-plan-year period ending on December 31 of the seventh plan year inclusive of the year of the surplus asset transfer, subject to the limitations of Code section 415, or (b) if they are allocated as employer nonelective contributions either on a payroll-by-payroll basis (in at least the minimum amount previously described) or on an annual basis so that the minimum amount allocated

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each year will be determined by multiplying the amount in the suspense account as of the first day of the plan year by a fraction, the numerator of which is one and the denominator of which is the number of years remaining in the seven-plan-year period.

6. That, should amounts transferred to the suspense account in Plan Y not be allocated as a result of the limitations under Code section 415, they may be transferred from Plan Y to Company A and treated as a reversion subject to a 20 percent excise tax under Code section 4980 at the end of the seven-plan-year allocation period required by Code section 4980, or upon earlier termination of Plan Y.

Section 61 of the Code defines gross income as all income from whatever source derived (subject to certain exceptions).

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)(1) provides, in pertinent part, 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 either establishes or maintains a "qualified replacement plan", or the plan provides for certain benefit increases which take effect immediately on the termination date.

Section 4980(c)(2) of the Code generally defines the term "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 provides that a "qualified replacement plan" is a qualified plan established or maintained by the employer in connection with a qualified plan termination, which satisfies the participation, asset transfer and allocation requirements of sections 4980(d)(2)(A), (B), and (C).

Section 4980(d)(2)(A) of the Code requires that at least 95 percent of the active participants in the terminated plan who remain as employees of the employer after the termination be active participants in the replacement plan.

Section 4980(d)(2)(B) of the Code requires that a direct transfer from the terminated plan to the replacement plan be made before any employer reversion, and that the transfer be an amount equal to the excess (if any) of (i) 25 percent of the maximum amount which the employer could receive as an employer reversion without regard to section 4980(d), over (ii) the amount equal to the present value of the aggregate increases in the accrued benefits under the terminated plan of any participants or beneficiaries pursuant to a plan amendment adopted during the 60-day period ending on the date of termination of the qualified plan, and which takes effect immediately on the termination date.

Section 4980(d)(2)(B)(iii) of the Code provides that in the case of the transfer of any amount under section 4980(d)(2)(B)(i) from a terminated plan, such amount is not includible in the gross income of the employer, no deduction is allowable with respect to such transfer, and the transfer is not treated as an employer reversion for purposes of section 4980.

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Section 4980(d)(2)(C)(i) 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)(2)(C)(ii) of the Code provides that if, by reason of any limitation under section 415, any amount credited to a suspense account under section 4980(d)(2)(C)(i)(II) may not be allocated to a participant before the close of the seven-plan-year period, such amount shall be allocated to the accounts of other participants, and if any portion of such amount may not be allocated to other participants by reason of any such limitation, it shall be allocated to the participant as provided in section 415.

Section 4980(d)(2)(C)(iii) of the Code provides that any income on any amount credited to a suspense account under clause (i)(II) shall be allocated to accounts of participants no less rapidly than ratably over the remainder of the period determined under such clause (after application of clause (ii)).

Section 4980(d)(2)(C)(iv) of the Code provides that if any amount credited to a suspense account under clause (i)(II) is not allocated as of the termination date of the replacement plan, (I) such amount shall be allocated to the accounts of the participants as of such date, except that any amount which may not be allocated by reason of any limitation under section 415 shall be allocated to the accounts of other participants, and (II) if any portion of such amount may not be allocated to other participants under subclause (I) by reason of such limitation, such portion shall be treated as an employer reversion to which this section applies.

Revenue Ruling 2003-85, 2003-32 I.R.B. 291, provides that in accordance with section 4980(d)(2)(B)(iii) of the Code, the direct transfer of an amount that is at least 25 percent of the maximum amount which the employer could receive as an employer reversion from a terminated plan which was transferred to a "qualified replacement plan" is not includible in the employer's gross income. In addition, the Service held that no deduction was allowable with respect to the amount transferred, and the amount transferred was not treated as an employer reversion. Further, the Service concluded that the amount that the employer received was subject to the 20 percent excise tax under section 4980 (a) of the Code and was includible in income under section 61.

With respect to ruling request one, you have represented that all active participants of Plan X who remain employees of Company A are eligible to participate in Plan Y. Therefore, because Plan Y will cover 100 percent of the participants of Plan X who remain in the employ of Company A, the requirements of Code section 4980(d)(2)(A) are met.

You have represented that 100 percent of the surplus assets will be transferred to Plan Y. Because this amount is at least equal to the excess of 25 percent of the maximum amount that Company A could receive as a reversion, the requirements of Code section 4980(d)(2)(B), as interpreted by Rev. Rul. 2003-85 are satisfied.

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You have represented that the amount transferred from Plan X to Plan Y is expected to be allocated under the plan to the accounts of participants in the plan year in which the transfer occurs, or credited to a suspense account and allocated to accounts of participants no less rapidly than ratably over the seven-plan-year period beginning with the year of the transfer, and that the allocations will otherwise be made in accordance with the requirements of Code section 4980(d)(2)(C). Therefore, we conclude that Plan Y is a "qualified replacement plan" within the meaning of Code section 4980(d)(2) with respect to Plan X.

With respect to ruling request number 2, having ruled that Plan Y is a qualified replacement plan with respect to Plan X, we now rule that, in accordance with Rev. Rul. 2003-85, 100 percent of the surplus assets may be transferred to Plan Y, and, being an amount that is at least 25 percent of the maximum amount that Company A could receive as an employer reversion, the amount transferred will not be includible in Company A's gross income, no deduction will be allowable with respect to the amount transferred, the amount will not be treated as an employer reversion for purposes of Code section 4980, and the amount transferred will not be subject to the excise tax under Code section 4980.

With respect to ruling requests number three and number four, section 1.401(m)-1(a)(2)(i) of the Income Tax Regulations ("Regulations") provides that matching contributions are, (A) Any employer contribution (including a contribution made at the employer's discretion) to a defined contribution plan on account of an employee contribution to a plan maintained by the employer; (B) Any employer contribution (including a contribution made at the employer's discretion) to a defined contribution plan on account of an elective deferral; and (C) Any forfeiture allocated on the basis of employee contributions, matching contributions, or elective deferrals.

Section 1.401(m)-1(a)(2)(ii) of the Regulations provides, in pertinent part, that whether an employer contribution is made on account of an employee contribution or an elective deferral is determined on the basis of all the relevant facts and circumstances, including the relationship between the employer contribution and employee actions outside the plan.

Section 1.401(m)-1(a)(2)(iii) of the Regulations provides generally that employer contributions are not matching contributions made on account of elective deferrals if they are contributed before the cash or deferred election is made or before the employees' performance of services with respect to which the elective deferrals are made (or when the cash that is subject to the cash or deferred elections would be currently available, if earlier). In addition, an employer contribution is not a matching contribution made on account of an employee contribution if it is contributed before the employee contribution.

You have represented that the amount to be transferred from Plan X will be credited to a suspense account in Plan Y for allocation to participants' accounts in Plan Y with the balance to be allocated at least ratably over a seven-plan-year period, and such allocations are to be coordinated with the limitations of Code section 415 as they may apply to certain participants. We have ruled that this transaction, generally satisfies the allocation requirements of Code section 4980(d)(2)(C). Code 4980(d)(2)(C) does not specify a method for allocating amounts from a suspense account to participant accounts. Therefore, we con-

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clude that the use of amounts transferred from Plan X to Plan Y to make nonelective contributions satisfies the requirements of 4980(d)(2)(C). However, in accordance with section 1.401(m)-1(a)(2)(iii) of the Regulations, the surplus amounts contributed to the suspense account under Plan Y cannot be used as matching contributions on account of elective deferrals to the extent that the amounts are contributed to the plan before the cash or deferred election is made or before the employees' performance of services with respect to which the elective deferrals are made. Also, the amounts cannot be used as matching contributions with respect to any employee contribution to the extent that the amounts are contributed to Plan Y before the employee contribution is made. Accordingly, we conclude that the amounts transferred to the suspense account established in Plan Y, may be allocated to the accounts of the participants in Plan Y, including but not limited to former Plan X participants, at the time amounts are released from the suspense account. We further conclude that the amounts may be allocated as employer nonelective contributions, but may not be allocated as matching contributions.

With respect to ruling request number five, we concluded earlier that the amounts transferred to the suspense account will be deemed allocated ratably over a seven-plan-year period as required by Code section 4980 if they are allocated as employer nonelective contributions but not as matching contributions. As such, they may be allocated on an annual basis so that the minimum amount allocated each year will be determined by multiplying the amount in the suspense account as of the first day of the plan year by a fraction, the numerator of which is one and the denominator of which is the number of years remaining in the seven-plan-year period.

With respect to ruling request six, we have ruled that Plan Y is a qualified replacement plan with respect to Plan X, that the transfer of 100 percent of the surplus assets from Plan X to Plan Y, will not be treated as a reversion to Company A, and that no excise tax will apply. However, this treatment depends on there being a transfer to the qualified replacement plan of at least the excess of 25 percent of the maximum possible reversion amount over the amount equal to the present value of the aggregate increases in the accrued benefits under Plan X pursuant to the Fourth Amendment to Plan X. You have indicated that the amount transferred to Plan Y will be credited to a suspense account that will be allocated together with the earnings thereon ratably over a period of no more than seven years to the accounts of the participants in Plan Y, starting with the year of the transfer. The allocations will be coordinated with the limitations under section 415 of the Code that may apply to certain participants. As a result of the application of the limitations under Code section 415, at the end of the seven-plan-year allocation period required under Code section 4980 or upon termination of Plan Y, a portion of the transferred amount may remain and be transferred to Company A as a reversion. This will not cause Plan Y to fail to be a qualified replacement plan with respect to Plan X, provided that the amount received by Company A is less than 75 percent of the amount that is the sum of the amount that could have been received initially as a reversion, plus the present value of the aggregate increases in the accrued benefits under Plan X pursuant to the Fourth Amendment to Plan X. Accordingly, we conclude that, should amounts transferred to the suspense account in Plan Y not be allocated as a result of the limitations under Code section 415, they

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may be transferred from Plan Y to Company A and treated as a reversion subject to the 20 percent excise tax under Code section 4980(d) at the end of the seven-plan-year period required by Code section 4980, or upon earlier termination of Plan Y, provided they total an amount that is less than 75 percent of the amount that is the sum of the amount initially transferred to Plan Y, plus the present value of the aggregate increases in the accrued benefits under Plan X pursuant to the Fourth Amendment to Plan X.


This ruling letter is based on the assumption that Plan X and Plan Y are qualified under section 401(a) of the Code and that their related trusts are tax-exempt under section 501(a) of the Code at all times relevant to this ruling.

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

Copies of this ruling letter are being sent to your authorized representatives in accordance with a power of attorney on file in this office.

If you have any questions regarding this ruling letter, please contact *****; ID ****SE:T:EP:RA:T4 at *****.

Sincerely yours,



Donzell H. Littlejohn, Manager
Employee Plans Technical Group 4

Enclosures:
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Form 437