Internal Revenue Service

Department of the Treasury

Washington, DC 20224

200009065

Contact Person:

Telephone Number:

In Reference to:

OP:E:EP:T:2

Date:

DEC 7

S.I.N.: 414.07-00

Legend:

Corporation A =
Plan X =
Plan Y =
State B =

Dear:

This letter is in response to your ruling request dated November 16, 1998, as supplemented by letters dated April 1, 1999, April 9 , 1999, May 19, 1999, June 14, 1999, June 15, 1999, July 26, 1999, August 26, 1999, and November 30, 1999, submitted on your behalf by your authorized representatives concerning the effect of certain legislation upon Plan X.

The following facts and representations have been submitted:

Corporation A is an instrumentality of State B and administers Plan X. Plan X is a multiple employer plan, covering a wide variety of state and local government agencies. Plan X is governed by the Board of Trustees of Corporation A. Plan X is a defined benefit plan qualified under section 401(a) of the Internal Revenue Code and section 414(d) as a governmental plan.

The governing provisions of Plan X are statutorily promulgated by State B's legislature. Membership in Plan X is mandatory for all eligible employees of a participating employer on the entry date of such employer; and any employee other than a state elected official who is employed by a participating employer after the entry date of such employer.

Effective July 1, 1998, the state employees' contribution rate is three percent of allowable annual compensation not in excess of twenty-five thousand dollars and three and one-half percent of allowable annual compensation in excess of twenty-five thousand dollars. Prior to the current

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provisions, members individually had the opportunity to elect to have compensation in excess of twenty-five thousand dollars included in the computation of contributions. Legislation adopted by State B's legislature revised the contribution system.

Pursuant to the provisions of section 414(h)(2) of the Code, the employers pick up and pay the contributions that would otherwise be payable by members. This was effective with respect to compensation earned after December 31, 1988. Therefore, member contributions with respect to compensation earned prior to January 1, 1989, has been treated as post-tax contributions includible in the member's investment in the contract. Contributions with respect to compensation earned after December 31, 1988, are treated as pick-up contributions, not includible in the member's investment in the contract. In addition, every state agency that is a participating employer contributed an amount equal to twelve and one-half percent of the monthly compensation of each member, not to exceed the allowable annual compensation defined in plan document.

For county and municipal employers, prior to July 1, 1998, the total employer and employee contributions equaled sixteen percent of the allowable monthly compensation of each member. Each participating employer set the amount of the employer contributions and employee contributions to total sixteen percent of the allowable monthly compensation of each member for compensation not in excess of twenty-five thousand dollars. However, for the total of sixteen percent, the allocation to the employer contributions could not exceed twelve and one-half percent and the allocation to employee contributions could not exceed eight and one-half percent. Further, the employer contributions had to be twelve and one-half percent and the employee contributions had to be three and one-half percent of the allowable monthly compensation of each member for compensation of twenty-five thousand dollars or more.

Beginning July 1, 1998, and for years thereafter, the total employer and employee contributions equal sixteen percent of the allowable monthly compensation of each member; provided, however, each participating employer may set the amount of the employer and employee contribution to equal sixteen percent of the allowable monthly compensation of each member; provided, the employer contribution will not exceed twelve and one-half percent and the employee contribution will not exceed eight and one-half percent. For compensation for services on or after July 1, 1998, there will be no maximum compensation level for retirement purposes.

For a member who joined Plan X on or after July 1, 1992, eligibility for a normal retirement benefit occurs at the earlier of the first day of the month on or after the member's 62th birthday or the date on which the sum of the member's age and participation service equals ninety. If the member began participation before July 1, 1992, then the eligibility requirements

are the same except that the age and service threshold is eighty. Early retirement is available on the first of the month on or following age fifty-five and ten years of service. The normal retirement benefit is the product of two percent of final average compensation multiplied by years of credited service.

Prior to the new legislation, the basic benefit structure was (a) two percent of the member's average compensation up to twenty-five thousand dollars (for service prior to July 1, 1994) or up to forty thousand dollars (if the member had elected to pay the additional contributions) multiplied by the member's years of credited service prior to July 1, 1994, plus (b) two percent of the member's average compensation (based on the highest three of the last ten years) multiplied by the member's years of credited service from July 1, 1994. There was also a phase out of the compensation limit between 1996 and June 30, 1998.

The new basic benefit structure is now simply two percent of the member's average compensation for the high three of their last ten years of service, multiplied by the member's years of credited service.

State B's legislature has adopted legislation, which contained revisions to various benefit features and systems within Plan X. This bill, along with other legislation noted above, formed part of a significant effort on the part of State B's legislature to improve benefits within various retirement systems affecting public employees. With the enactment of this legislation and related measures, the legislature, with the support of affected groups and Plan X's administrators, was attempting to simplify benefit calculations and make the system of benefits readily understandable to members.

One of these changes affected certain members of Plan X who (by making certain voluntary contributions) elected to increase the maximum compensation level for purposes of benefit computation. The legislation now reads as revised as follows:

> Any active member, as of July 1, 1998, whose compensation for service exceeded twenty-five thousand dollars per annum prior to July 1, 1994, and who, prior to July 1, 1998, had voluntarily elected to increase the maximum compensation level pursuant to statutes in effect at that time, shall have transferred, pursuant to this section and the procedures established by the Board of Corporation A, the employee contributions made on compensation for service which is in excess of twenty-five thousand dollars per annum prior to July 1, 1994, with an amount which represents the actuarial assumed earnings of Plan X of seven and one-half percent (7.5%) compounded annually until the date of transfer. It is the intent of the Legislature that the excess contributions shall be

transferred directly to an account established for the employee in the Plan Y. The provisions for transfer contained in this section shall not take effect until the Board receives official written notice that this distribution satisfies the tax qualification requirements for governmental plans applicable to such refunds or transfers as specified in the Code, as amended from time to time and as applicable to governmental plans and the relevant regulatory provisions and guidance related thereto.

The transfer will leave Plan X members with exactly the same defined benefit after the transfer as they had before the transfer.

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

1. That the transfer of excess contributions paid on an after-tax basis, not considered "picked up" under section 414(h)(2) of the Code, that are directly transferred to accounts established for the employees in Plan X, are not subject to taxation at the time of transfer.

2. That the tax basis for the after-tax contributions directly transferred to Plan Y will also be transferred to Plan Y.

3. That the transfer of excess contributions "picked up" under section 414(h)(2) of the Code and directly transferred to accounts established for the employees in Plan Y are not subject to taxation at the time of transfer.

4. That amounts directly transferred to Plan Y are not annual additions to that Plan within the meaning of section 415(c) of the Code.

5. Assuming that Plan X is a qualified governmental plan under sections 401(a) and 414(d) of the Code, the transfer of excess contributions will not adversely affect Plan X's status under section 414(d).

With respect to the first ruling request, section 402(a) of the Code provides, in general, that the amount actually distributed to any distributee 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). However, Revenue Ruling 67-213, 1967-2 C.B. 149, provides that where the interests of participants are transferred by the trustee of a trust forming part of one qualified plan to the trustee of another trust forming part of another qualified plan, no amounts will be considered distributed or made available to the participants.

Therefore if the proposed amounts of the participants' after-tax contributions are transferred directly from Plan X to Plan Y, the amounts transferred would not be considered as distributed or made available to the participants. On this basis, we conclude with respect to ruling request one that the transfer of excess contributions paid on an after-tax basis, not considered "picked up" under section 414(h)(2) of the Code, that are directly transferred to accounts established for the employees in Plan X, are not subject to taxation at the time of transfer.

With respect to the second ruling request, Rev. Rul. 67-213 provides that funds transferred directly from a qualified plan to another qualified plan are not considered as having been distributed or made available to participants. In Rev. Rul. 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 associated earnings. In this case, the transfer is being made directly from the trust of a qualified pension plan to the trust of another qualified pension plan. Since the funds are being transferred directly from one trust to another, the funds are not considered to be distributed to the participants for whom the transfers were made. To the extent the transferred funds are derived from employee contributions, they continue to be funds derived from employee contributions. The net amount earned will be includible in the employees' gross income when distributions are made from a plan, as provided in section 402(a) of the Code.

Accordingly, with respect to the second ruling request, we conclude that the tax basis for the after-tax contributions directly transferred to Plan Y will also be transferred to Plan Y.

With respect to the third ruling request, as noted previously with respect to the first ruling request, Revenue Ruling 67-213 provides that where the interests of participants are transferred by the trustee of a trust forming part of one qualified plan to the trustee of another trust forming part of another qualified plan, no amounts will be considered distributed or made available to the participants. Accordingly, the transfer of excess contributions "picked up' under section 414(h)(2) of the Code and directly transferred to accounts established for the employees in Plan Y are not subject to taxation at the time of transfer.

With respect to the fourth ruling request, section 415(a)(1) of the Code provides that a defined contribution plan is not a qualified plan if contributions and other additions made to the plan with respect to any participant in a limitation year exceed the limitation of section 415(c). Section 415(c) limits the amount of annual contributions and other additions to a participant's account in a defined contribution plan.

Section 1.415-6(b)(2) of the Income Tax Regulations (concerning contributions to defined contribution plans) provides, in clause (iv), that the transfer of funds from one qualified plan to another will not be considered an annual addition for the limitation year in which the transfer occurs. Section 1.415-6(b)(3) of the regulations (concerning employee contributions to defined contribution plans) provides, in clause (iv), that the term "annual additions does not include the direct transfer of employee contributions from one qualified plan to another."

Because the relevant amounts are being transferred directly from Plan X to Plan Y, we conclude with respect to the fourth ruling request that amounts directly transferred to Plan Y are not annual additions to that Plan within the meaning of section 415(c) of the Code.

With respect to the fifth ruling request, section 414(d) of the Code provides that a governmental plan means a plan established and maintained for its employees by the Government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Revenue Ruling 89-49, 1989-1 C.B. 117, provides that a plan will not be considered a governmental plan merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. One of the most important factors to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision is the degree of control that the federal or state government has over the organization's everyday operations. Other factors include: (1) whether there is specific legislation creating the organization; (2) the source of funds for the organization; (3) the manner in which the organization's trustees or operating board are selected; and (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit. Although all of the above facts are considered in determining whether an organization is an agency of a government, the mere satisfaction of one or all of the facts is not necessarily determinative.

The facts submitted show that the legislation previously discussed was enacted solely to provide for the transfer of the excess contributions from Plan X to Plan Y. The legislation pertaining to these transfers will not affect State B's control over Corporation A or limit Corporation A's being an instrumentality of State B. Therefore, as Plan X will still be maintained by an agency of State B, it will still be established as a governmental plan within the meaning of section 414(d) of the Code. On this basis, we conclude that assuming that Plan X is a qualified governmental plan under sections 401(a) and 414(d), the transfer of excess contributions will not adversely affect Plan X's status under section 414(d).

These rulings are based on the assumption that Plan X and Plan Y will be qualified under section 401(a) of the Code at the time of the proposed transactions.

No opinion is expressed as the federal tax consequences of the transactions described above under any other provisions of the Code.

This ruling is directed only 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

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

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd
Chief, Employee Plans
Technical Branch 2

Enclosures:
Deleted Copy of this Letter
Notice of Intention to Disclose