200019046

Internal Revenue Service

Department of the Treasury

Washington, DC 2

UIL: 403.00-00

Contact Person:

Telephone Number:

In Reference to:

Date: T:EP:RA:T3

FEB 16, 2000

Legend:

Employer M =
Plan X =

Dear

This letter is in response to a request for a ruling dated September 27, 1996, as supplemented by correspondence dated December 17, 1998, January 7, 1999, May 10, 1999, August 10, 1999 and September 23, 1999, which was submitted on your behalf by your authorized representative, concerning an arrangement described under sections 403(b) and 403(b)(7) of the Internal Revenue Code.

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

Employer M is a not-for-profit private business school which meets the requirements of Code section 501(c)(3) and which is exempt from federal income tax under Code section 501(a).

Effective July 1, 1995, Employer M adopted Plan X for the benefit of its eligible employees. Plan X is intended to meet the requirements of Code section 403(b)(1). Plan X is funded with group, fixed and variable annuities and Code section 403(b)(7) custodial accounts.

All employees of Employer M are permitted to make salary reduction contributions in any whole dollar amount under Plan X. Compensation is limited to $150,000 annually, as adjusted by the Secretary of Treasury for cost-of-living changes. Plan X also provides for discretionary employer matching contributions on behalf of each employee who satisfies the requirements in the preceding sentence, provided that the employee (1) is scheduled to complete 1,000 hours of service in the plan year, (2) is a regular faculty member, (3) is actually credited with 1,000 hours of service in the plan year, or (4) is an adjunct faculty member who teaches more than 24 credit hours during the plan year. The employer matching contributions, if any, must constitute a uniform percentage of employee salary reduction contributions for the plan year.

To commence participation in Plan X, an Employer M employee must submit a salary reduction agreement to Employer M which provides that the participant's salary will be reduced by a specific amount or percentage of compensation and contributed to Plan X

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Salary reduction and employer matching contributions are fully vested and nonforfeitable at all times. A participant is eligible for normal or delayed retirement upon or following attainment of age 65, and is eligible for early retirement after attaining age 55.

Contributions on behalf of a participant under Plan X may in no event exceed the amount of the participant's exclusion allowance as determined under Code section 403(b)(2) for any taxable year (Plan Sections 2.10 and 4.05).

The maximum annual additions to a participant's account during any plan year (when aggregated with the total annual additions to the accounts of the participant under any other 403(b) plan and any defined contribution plan maintained by Employer M) shall not exceed the lesser of (1) 25 percent of his compensation as defined under Code section 415 for such year, or (2) $30,000, as adjusted periodically by the Secretary of Treasury for cost-of-living changes (Plan Section 4.04). Finally, Plan X also provides that in no event may the salary reduction contributions made on behalf of any participant exceed $9,500 (or, if greater, the $7,000 limit of Code section 402(g), as such limit is adjusted by the Secretary of Treasury for cost-of-living changes) (Plan Section 4.02(a)). In computing this limitation on salary reduction contributions, deferrals during a calendar year under a cash or deferred arrangement described under Code section 401(k) or under a simplified employee pension plan are to be taken into account.

Except as discussed below, the only events upon which distributions from Plan X shall be made are a participant's termination of employment on account of normal, delayed, early or disability retirement, his separation from service prior to normal, delayed, early or disability retirement, or his death.

Participants are, however, permitted to take in-service withdrawals of salary reduction contributions (but not earnings on such contributions) in the event of a demonstrated hardship, provided that Employer M approves the participant's application for such withdrawals in accordance with uniform and nondiscriminatory rules adopted by Employer M.

Unless a participant elects otherwise, distributions under Plan X automatically will be made in the form of a nontransferable annuity. Married participants receive their benefits in the form of a qualified joint and survivor annuity, and single participants receive their benefits in the form of a single life annuity. Participants are, however, permitted to elect to receive their benefits in the form of a single lump sum or in such other nontransferable annuity or periodic payment forms as may be approved for Plan X by Employer M and the funding agent. Moreover, a distributee may direct the rollover of all or any portion of his interest in Plan X to an individual retirement account described in Code section 408(a), an individual retirement annuity described in Code section 408(b), or another annuity described in Code Section 403(b), provided that if the distributee is the spouse of a participant, the rollover may be directed only to an individual retirement account or to an individual retirement annuity (Plan Sections 6.03(d)(4) and 6.11). Notwithstanding the foregoing, the value of a participant's nonforfeitable benefit under Plan X automatically will be distributed in a single lump sum if such value does not exceed $3,500 ($5,000 beginning July 1, 1998).

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All distributions are determined and made in accordance with the Proposed Treasury Regulations under Code section 401(a)(9), including the minimum distribution incidental benefit requirement of Proposed Income Tax Regulations section 1.401(a)(9)-2. The entire Plan interest of a participant must be distributed to him or her in full or at least commence: (A) no later than the April 1st following the calendar year in which the participant attains age 70 1/2, if he or she attains age 70 1/2 before January 1, 1999; and (B) no later than the April 1st following the later of the calendar year in which the participant retires or attains age 70 1/2 , if he or she attains age 70 1/2 after December 31, 1998 (Plan Sections 6.03(d) and (e)).

Plan X also provides that benefits payable thereunder shall not be subject to the claims of any creditor of a participant, shall not be subject to attachment or garnishment or other legal process by any such creditor, and may not be pledged, assigned or otherwise encumbered by any participant. The foregoing restrictions shall not apply to qualified domestic relations orders or to the enforcement of federal tax liens (Plan Section 11.02).

Based upon the foregoing, you request a ruling that Plan X meets the requirements of Code section 403(b).

Section 403(b)(1) of the Code provides that amounts contributed by an employer to purchase an annuity contract for an employee are excludable from the gross income of the employee in the year contributed to the extent of the applicable "exclusion allowance", provided (1) the employee performs services for an employer which is exempt from tax under section 501(a) of the Code as an organization described in section 501(c)(3), or the employee performs services for an educational institution (as defined in section 170(b)(1)(A)(ii) of the Code) which is a state, a political subdivision of a state, or an agency or instrumentality of any one or more of the foregoing; (2) the annuity contract is not subject to section 403(a) of the Code; (3) the employee's rights under the contract are nonforfeitable except for failure to pay future premiums; (4) such contract is purchased under a plan which meets the nondiscrimination requirements of paragraph (12), except in the case of a contract purchased by a church; and, (5) in the case of a contract purchased under a plan which provides a salary reduction agreement, the contract meets the requirements of section 401(a)(30).

Section 403(b) (1) of the Code provides further that the employee shall include in his gross income the amounts actually distributed under such contract in the year distributed as provided in section 72 of the Code. In addition, except as provided in section 403(b)(7)(B), a custodial account described in section 403 (b) (7) is treated as an annuity contract for all purposes of the Code.

Section 403(b)(7) of the Code provides that the amounts paid by a qualifying employer to a custodial account which satisfies the requirements of section 401(f) (2) shall be treated as amounts contributed by the employer for an annuity contract for his employee if the amounts are to be invested in regulated investment company stock to be held in that custodial account, and under the custodial account no such amounts may be paid or made available to any

distributee before the employee dies, attains age 59 1/2, separates from service, becomes disabled (within the meaning of section 72(m)(7)), or, in the case of contributions made pursuant to a salary reduction agreement, encounters financial hardship.

Section 403(b)(7)(B) of the Code states that a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as an organization described in section 401(a) solely for purposes of subchapter F and subtitle F with respect to amounts received by it (and income from investment thereof).

Section 401(f)(2) of the Code provides that a custodial account shall be treated as a qualified trust under section 401 if the assets thereof are held by a bank (as defined in section 408(n)), or another person who demonstrates to the satisfaction of the Secretary that the manner in which he will hold the assets will be consistent with the requirements of section 401.

Section 403(b)(10) of the Code requires that arrangements pursuant to section 403(b) of the Code must satisfy requirements similar to the requirements of section 401 (a) (9) and similar to the incidental death benefit requirements of section 401(a) with respect to benefits accruing after December 31, 1986, in taxable years ending after such date. In addition, this section requires that, for distributions made after December 31, 1992, the requirements of section 401(a) (31) regarding direct rollovers are met.

Section 401(a) (9) of the Code, generally, provides for a mandatory benefit commencement date (A) no later than the April 1st following the calendar year in which the participant attains age 70 1/2, if he or she attains age 70 1/2 before January 1, 1997; and (B) no later than the April 1st following the later of the calendar year in which the participant retires or attains age 70 1/2 , if he or she attains age 70 1/2 after December 31, 1996.

Section 403(b) (11) of the Code provides, generally, that section 403(b) annuity contract distributions attributable to contributions made pursuant to a salary reduction agreement (within the meaning of section 402(g)(3)(C)) may be paid only when the employee attains age 59 1/2, separates from service, dies, becomes disabled (within the meaning of section 72(m)(7)), or in the case of hardship. Such contract may not provide for the distribution of any income attributable to such contributions in the case of hardship.

Section 401(g) of the Code requires that the contract be nontransferable.

Section 403(b)(1)(E) of the Code provides that in the case of a contract purchased under a plan which provides a salary reduction agreement, the contract must meet the requirements of section 401(a)(30). Section 401(a)(30) requires a section 403(b) arrangement which provides for elective deferrals to limit such deferrals under the arrangement, in combination with any other qualified plans or arrangements providing for elective deferrals, to the limitation in effect under section 402(g) (1) for taxable years beginning in such calendar year.

Section 402(g)(1) of the Code provides, generally, that the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals exceeds $7,000.

Section 402(g)(4) of the Code provides that the limitation under paragraph (1) shall be increased (but not to an amount in excess of $9,500) by the amount of any employer contributions for the taxable year used to purchase an annuity contract under section 403(b) under a salary reduction agreement.

Section 402(g) (8) of the Code provides that in the case of a qualified employee of a qualified organization, with respect to employer contributions to purchase an annuity contract under section 403(b) under a salary reduction agreement, the limitation of section 402(g)(1), as modified by section 402(g)(4), for any taxable year shall be increased by whichever of the following is the least: (i) $3,000, (ii) $15,000 reduced by amounts not included in gross income for prior taxable years by reason of this paragraph, or (iii) the excess of $5,000 multiplied by the number of years of service of the employee with the qualified organization over the employer contributions described in paragraph (3) made by the organization on behalf of such employee for prior taxable years (determined in the manner prescribed by the Secretary). A "qualified organization" for these purposes means any educational organization, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches and includes any organization described in section 414(e)(3)(B)(ii), and a "qualified employee" means any employee who has completed 15 years of service with the qualified organization.

Section 415 (a) (2) of the Code provides, in relevant part, that an annuity contract described in section 403(b) shall not be considered described in section 403(b), unless it satisfies the section 415 limitations. In the case of an annuity contract described in section 403(b), the preceding sentence applies only to the portion of the annuity contract exceeding the section 415 limitations and the amount of the contribution for such portion shall reduce the exclusion allowance as provided in section 403(b)(2).

In this case, you represent that Employer M, an employer described in section 403(b) of the Code, has established Plan X as its section 403(b) program for its employees. A participant's salary reduction contributions and the earnings thereon are fully vested and nonforfeitable at all times. Plan X does not meet the requirements of a section 403(a) annuity contract. The restrictions on transferability are present in Plan X as required by section 401(g) of the Code.

Plan X satisfies the limits, under section 403(b)(11) of the Code, that amounts attributable to elective deferrals shall not be distributable earlier than upon the attainment of age 59 1/2, separation from service, death, disability, or hardship. In addition, Plan X satisfies the section 403(b)(10) requirements and limits contributions in accordance with sections 403(b)(2) and 415 of the Code and satisfies the requirements of section 403(b) (7) of the Code.

Accordingly, based on the foregoing law and facts, we conclude with respect to your ruling request that Plan X satisfies the requirements of section 403(b) of the Code.

This ruling is limited to the form of Plan X excluding any form defects which may violate the nondiscrimination requirements of section 403(b) (12) of the Code. This ruling does not extend to any operational violations of section 403(b) by Plan X, now or in the future.

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.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3
Tax Exempt and Government Entities Division

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

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