Internal Revenue Service

Department of the Treasury

200044044

Washington, DC 20224

Uniform Issue List: 403.04-04

Contact Person:

Telephone Number:

In Reference to:
T:EP:RA:T1

Date:
8/11/2000

Attn:

Legend:

Employer A =

Plan X =

Custodian W =

Dear :

This is in response to a ruling request dated July 23, 1999, as supplemented by additional correspondence dated March 24, 2000, and April 12, 2000, from your authorized representative concerning an arrangement described under section 403(b) of the Internal Revenue Code ("Code").

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

Employer A is an organization described in Code section 501(c)(3). Employer A adopted Plan X, effective October 1, 1998, for the benefit of its employees.

Plan X is intended to qualify as a tax-deferred custodial account under Code section 403(b)(7). Pursuant to section 2 of the group custodial agreement under Plan X ("Custodial Agreement"), each participant 's contributions are held in a separate

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account. Sections 1.13 and 4.1 of the Custodial Agreement provide that the participant's funds are to be invested exclusively in the securities of one or more regulated investment companies, as defined in Code sections 403(b)(7)(C) and 851(a). The custodial account is maintained by Custodian W, a bank qualified to serve as a custodian under Code section 401(f)(2).

Plan X provides for salary reduction contributions and matching contributions. Section 3.1 of Plan X states that Employer Contributions to Plan X shall equal the sum of contributions made pursuant to a salary reduction agreement and employer matching contributions. Section 3.1(a) of Plan X provides that pursuant to a written agreement, a participant's compensation will be reduced and this amount will be contributed on their behalf as an elective contribution. The participant may modify or terminate this agreement with respect to amounts not yet currently available. Section 3.11 of Plan X and section 3.2 of the Custodial Agreement provide that a participant's elective contributions and the earnings thereon are fully vested and nonforfeitable at all times. Section 3.1(b) of Plan X provides that each matching contribution shall equal one-hundred percent of the first five percent (5%) of compensation contributed to Plan X as an elective contribution.

Section 3.2 of Plan X provides that a participant's elective deferrals will not exceed the limitations on elective deferrals under Code section 402(g). Section 3.8 of Plan X provides that the sum of the employer contributions, employee contributions, and forfeitures shall not exceed the limitations on contributions set forth in Code section 415. Specifically, section 3.8 of Plan X states that the maximum annual addition credited to a participant's account for any limitation year shall equal the lesser of (1) $30,000 or (2) twenty-five percent (25%) of the Participant's Code section 415 compensation for such limitation year.

Section 3.10 of Plan X provides that the Administrative Committee may from time to time adopt rules and procedures for the purpose of limiting vested employer contributions (which include elective deferrals) on behalf of a participant for any year, to an amount which does not exceed the participant's Exclusion Allowance for the year. Specifically, section 3.10 of Plan X states that vested employer contributions shall mean the sum of (1) employer contributions made during the year for which the Exclusion Allowance is being determined to the extent such contributions are vested under section 3.11 when made; (2) employer contributions which were not vested under section 3.11 when made, to the extent such contributions first become vested during the year for which the Exclusion Allowance is being determined; and (3) any other amounts contributed to any plan or annuity contract which would be required to be taken into account for the year under section 1.403(b)-1(b)(1) and (2). Section 1.27 of Plan X states the term "Exclusion Allowance" shall mean, for any year, the excess, if any, of (a) the amount determined by multiplying twenty percent of the participant's includible compensation by the participant's years of service over (b) the amount of Aggregate

Employer Contributions on behalf of the participant for all prior years. Under section 1.5 of Plan X, the term "Aggregate Employer Contributions" means (a) amounts previously contributed by the employer for the benefit of a participant under Plan X or any other plan or arrangement, which were excludable from the participant's gross income for federal income tax purposes by virtue of such plan or arrangement meeting the requirements of Code section 403(b), 401(a), or 404(a)(2); (b) amounts contributed on behalf of the participant to this Plan or for the purchase of an annuity contract within the meaning of Code section 403(b) which exceeded the limitations of Code section 415(c) applicable to the participant; and (c) such other amounts as may be included in Aggregate Employer Contributions under rules prescribed by the Committee.

Section 6.7 of Plan X states that in no event will any distribution be made prior to the occurrence of a distribution event described in Code section 403(b)(7)(A)(ii). Section 4.3 of Plan X provides that, unless a participant otherwise directs, a participant's accounts shall be distributed to him not later than the 60th day after the close of the Plan year in which the latest of the following events occurs: (a) the attainment of age 65, (b) the 10th anniversary of the date on which the participant commenced participation in Plan X, or (c) the termination of the participant's service. In addition, section 4.3 of Plan X and section 6.3 of the Custodial Agreement provide that minimum distributions must commence no later than April 1 of the calendar year following the calendar year in which the participant attains age 70 & ½, or in the case of an individual other than a 5% owner as defined in Code section 416(i)(1)(B), the calendar year in which the participant retires. Section 4.6 of Plan X and section 6.3 of the Custodial Agreement provide that the minimum distribution requirements set forth in Code section 401(a)(9)(B)(i) and (ii), respectively, shall apply if a participant dies before his entire interest is distributed or if he dies before the distribution of his interest has begun.

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

1) that Employer A's Plan and Custodial Agreement satisfy the requirements of Code section 403(b)(7);

2) that the Custodial Agreement will be treated as a qualified trust under Code section 401 for purposes of Subchapter F and Subtitle F with respect to amounts received by the Custodian and earnings thereon;

3) that amounts contributed by Employer A pursuant to Plan X and the Custodial Agreement on behalf of a participant, and any earnings thereon, to the extent that such contributions do not exceed the exclusion allowance for such taxable year as provided in Code section 403(b)(2) and subject to the limitations Code section 415(c), shall not be taxable in the year contributed.

Regarding ruling request (1), Code section 403(b)(1) provides that amounts contributed by an employer to purchase an annuity contract for an employee are excludable from gross income of the employee in the year contributed to the extent of an applicable "exclusion allowance", provided (A) the employee performs services for an employer which is exempt from tax under Code section 501(a) as an organization described in Code section 501(c)(3), or the employee performs services for an educational institution (as defined in Code 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; (B) the annuity contract is not subject to Code section 403(a); (C) the employee's rights under the contract are nonforfeitable except for failure to pay future premiums; (D) except in the case of a contract purchased by a church, such contract is purchased under a plan which meets the nondiscrimination requirements of Code section 403(b)(12); and (E) in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of Code section 401(a)(30). In addition, a custodial account described in Code section 403(b)(7) is treated as an annuity contract for purposes of the Code.

Code section 401(a)(30) provides, in the case of a trust which is part of a plan under which elective deferrals (within the meaning of Code section 402(g)(3)) may be made with respect to any individual during a calendar year, such trust shall not constitute a qualified trust unless the plan provides that the amount of such deferrals under such plan and all other plans, contracts, or arrangements of an employer maintaining such plan may not exceed the amount of the limitation in effect under Code section 402(g)(1) for taxable years beginning in such calendar year. Code section 402(g)(1) 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 (as adjusted for COLAs under Code section 402(g)(5).

Code section 403(b)(7) provides that under the custodial account no such amount may be paid or made available to any distributee before the employee dies, attains age 59 & ½, separates from service, becomes disabled (within the meaning of Code section 72(m)(7)), or in the case of contributions made pursuant to a salary reduction agreement, encounters financial hardship.

Code section 403(b)(10) provides in general that Code section 403(b) shall not apply to a custodial account described in Code section 403(b)(7) unless requirements similar to the requirements in Code section 401(a)(9) are met. Code section 401(a)(9)(A) provides a trust shall not constitute a qualified trust unless the plan provides that the entire interest of each employee will be distributed to such employee not later than the required beginning date of section 401(a)(9)(C).

Code section 403(b)(10) further provides that any amount transferred in a direct trustee-to-trustee transfer in accordance with Code section 401(a)(31) shall not be includible in gross income for the taxable year of the transfer. Code section

401(a)(31)(A) provides a trust shall not constitute a qualified trust unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distributions: (i) elects to have such distribution paid directly to an eligible retirement plan, and (ii) specified the eligible retirement plan to which such distribution is to be paid, such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

It has been submitted that the participant's funds are to be invested exclusively in the securities of one or more regulated investment companies, as defined in Code sections 403(b)(7)(C) and 851(a). In addition, Plan X states that in no event will any distribution be made prior to the occurrence of a distribution event described in Code section 403(b)(7)(A)(ii). Finally, Plan X satisfies the other requirements of section 403(b). For these reasons, we conclude with respect to ruling request (1) that Plan X and the Custodial Agreement satisfy the requirements of Code section 403(b)(7).

Regarding ruling request (2), section 403(b)(7) provides that amounts paid by a qualifying employer to a custodial account which satisfies the requirements of Code 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 distributions are restricted as indicated above.

Code section 401(f)(2) provides that a custodial account shall be treated as a qualified trust under Code section 401 if the assets thereof are held by a bank (as defined in Code 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 Code section 401.

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

Employer A has entered into the Custodial Agreement with Custodian W, a bank qualified to serve as a custodian under Code section 401(f)(2). The amounts paid to Plan X will be invested in stock of regulated investment companies. Therefore, we conclude, with respect to ruling request (2), that the custodial accounts under Plan X will be treated as a qualified trust under Code section 401 solely for purposes of Subchapter F and Subtitle F with respect to amounts received by Custodian W and earnings thereon.

Regarding ruling request (3), Code section 415(c), which applies to defined contribution plans and 403(b) plans which are treated as defined contributions plans,

provides that contributions and other additions with respect to a participant cannot exceed the limitation when expressed as an annual addition to the participant's account, such annual addition is greater than the lesser of (1) $30,000 , or (2) 25 percent of the participant's compensation.

Code section 403(b)(1) further provides that the employee shall include in his gross income the amounts received under such contract for the year received as provided in section 72.

Code section 403(b)(2) provides the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of (i) the amount determined by multiplying 20 percent of his includible compensation by the number of years of service, over (ii) the aggregate of the amounts contributed by the employer for annuity contracts and excludible from the gross income of the employee for any prior year.

Therefore, concerning ruling request (3), we conclude, that because Plan X satisfies the requirements of Code section 403(b) (including 403(b)(1)(E)), contributions made to Plan X are not required to be included in the gross income of employees in the taxable year in which they are made to the extent that the contributions do not exceed the limits under Code sections 403(b)(2) or 415.

However, this ruling does not address whether Plan X satisfies the nondiscrimination and coverage requirements of Code section 403(b)(12).

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

A copy of this ruling is being sent to your authorized representative pursuant to a power of attorney on file in this office.

Sincerely yours,

(Signed) John Swioca

Manager, Employee Plans
Technical Group 1
Tax Exempt and Government
Entities Division

Enclosures:
Deleted Copy of the Ruling
Notice 437

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