Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

Telephone Number:

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Legend:

Employer X =

Plan A =

Plan B =

Dear

This is in response to your ruling request submitted on your behalf by your authorized representative dated July 23, 1999, and supplemented by additional correspondence dated January 11, 2000, June 23, 2000, September 8, 2000, October 27, 2000, January 8, 2001, and January 16, 2001. The ruling request concerns the tax treatment of elective deferrals to a cash or deferred arrangement in coordination with a nonqualified deferred compensation plan. The following facts and representations were submitted by your authorized representative in support of the rulings requested.

Employer X currently maintains both Plans A and B. Plan A is a qualified plan under section 401(a) of the Internal Revenue Code (the "Code"). Employer X represents that Plan A was established effective January 1, 1998 by adopting a nonstandardized prototype plan and includes a qualified cash or deferred arrangement as described under section 401(k) of the Code. Plan B is an unfunded nonqualified plan established to benefit certain highly compensated management employees of

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Employer X. Both Plans A and B operate on a calendar year basis.

Plan A provides that participants in Plan A may make pre-tax contributions to the Plan. No after tax contributions may be made to Plan A. Plan A provides that participants may make elective deferral contributions up to 15% of their compensation for the year. Plan A further provides that a participant's elective deferrals are subject to the limitations in effect for year under sections 402(g) and 415 of the Code and by the actual deferral percentage test and the actual contribution percentage test under sections 401(k) and 401(m) of the Code.

Plan A authorizes Employer X to make matching contributions with respect to participant's elective deferrals. Under Plan A, matching contributions are made for a plan year at the discretion of Employer X, and if made, allocated to participants based on the amount of elective deferrals, pursuant to a discretionary formula. Plan A also authorizes Employer X to make a discretionary profit sharing contribution.

Plan B provides that participants in Plan B may elect to defer up to the lesser of $30,000 or 25% of their compensation for the year. Employer X would credit the accounts of participants of Plan B with matching contributions based upon the same formula as set forth in Plan A. Unlike Plan A, however, contributions and matching contributions are not subject to the limitation of Code sections 402(g) or 415 or the limitations imposed by either the actual deferral percentage test or the actual contribution percentage test of sections 401(k) and 401(m) of the Code.

All deferrals, matching contributions and earning credits under Plan B are general assets of Employer X. Those credits may be maintained as a book account or by the allocation of assets to a Rabbi Trust established by Employer X.

Under Plan B the vesting schedule for contributions, other than those contributions made pursuant to an employee deferral election, is the same as the vesting schedule of Plan A.

Plan B requires that a participant make any election to defer on or before December 31 of the calendar year proceeding the year for which the compensation to which the salary deferral relates is earned. For a new participant, an election could be made within thirty days following a participant's initial selection for membership provided the election relates to compensation for services to be performed subsequent to the election to defer.

The terms of Plan B require eligible participants to indicate their respective deferrals by executing a salary reduction agreement. The salary reduction agreement required by the terms of Plan B, in turn, requires the participant to indicate whether he or she authorizes the distribution, in cash of the salary deferrals after the close of the plan year, or to have the salary deferrals transferred to Plan A. Plan B requires the participant's salary reduction agreement to be made on or before December 31 of the calendar year preceding the calendar year during which the compensation to which the salary deferral relates is earned, and, after this date, the salary reduction agreement becomes irrevocable. Plan B further provides that the amount subject to any election to make a contribution to Plan A will be equal to the lesser of:

(1) the maximum amount of pre-tax deferrals that could be made to Plan A for the calendar year within the limits imposed under (A) Code section 402(g), (B) the actual deferral percentage test under section 401(k), and (C) the actual contribution percentage test under Code section 401(m); or
(2) the amount of the base salary and bonuses such participant actually elects to defer under the terms of Plan B for the calendar year.

Plan B permits the transfer of pre-tax deferrals plus any related matching contribution (but without earnings, gains or losses allocable thereto) from Plan B to Plan A. The transfer must be completed before March 15 of the calendar year following the year in which the salary deferral was made. This transfer provision will enable Employer X to calculate for each participant of Plan B the maximum permitted contribution under Plan A under the limitations of section 401(k), 401(m) and 402(g) of the Code.

It is represented that Plan A will be amended to provide that any amount transferred to Plan A by Plan B will consist only of amounts attributable to Plan B deferrals that the participant could have deferred directly to Plan A.

The determination of the amount of pre-tax deferrals transferred from Plan B to Plan A will be calculated pursuant to the provisions of Plan A and Plan B as reflected in the election form associated with both Plan A and Plan B. Plan B requires Employer X to contribute this amount to Plan A unless the participant has previously elected to have such amount distributed to himself in the form of cash. These provisions preclude employer discretion with respect to the amount of pre-tax deferrals transferred from Plan B to Plan A on behalf of any participant. The election form for Plan B also serves as the election form for Plan A.

With respect to the foregoing, the following rulings are requested:

(1) Assuming that Plan A otherwise satisfies the requirements for a qualified cash or deferred arrangement and that the elective deferral and actual deferral percentage limitations of sections 402(g) and 401(k)(3) of the Code are not exceeded, elective deferrals made by participants under Plan A that are initially held by the Company pursuant to the terms of Plan B will be excluded from gross income under Code section 402(e)(3).

(2) For purposes of satisfying section 402(g) of the Code, elective deferrals under Plan A made by participants for a given plan and calendar year that are initially held by the Company pursuant to the terms of Plan B will be treated as having been made in the calendar year in which they would have been otherwise received as wages by the participants.

Section 401(k)(2) of the Code provides, in pertinent part, that a qualified cash or deferred arrangement is any arrangement which is a part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan which meets the requirements of section 401(a), and under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash.

Section 1.401(k)-1(a)(3)(i) of the Income Tax Regulations ("Regulations") provides that a cash or deferred election is any election (or modification of an earlier election) by an employee to have the employer either (A) provide an amount to the employee in the form of cash or some other taxable benefit that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation. A cash or deferred election includes a salary reduction agreement between an employee and employer under which a contribution is made under a plan only if the employee elects to reduce cash compensation or to forgo an increase in cash compensation.

Under section 1.401(k)-1(a)(3)(ii) of the Regulations, a cash or deferred election can only be made with respect to an amount that is not currently available to the employee on the date of the election. Under section 1.401(k)-1(a)(3)(iii) of the Regulations, cash or another taxable amount is currently available to the employee if it has been paid to the employee or if the employee is able currently to receive the cash or other taxable amount at the employee's discretion.

Under section 1.401(k)-1(b)(4)(i) of the Regulations, an elective contribution is taken into account for purposes of the actual deferral percentage test for a plan year only if (A) the elective contribution is allocated to the employee's account under the plan as of a date within that plan year, and (B) the elective contribution relates to compensation that either (1) would have been received by the employee in the plan year but for the employee's election to defer under the arrangement, or (2) is attributable to services performed by the employee in the plan year and, but for the employee's election to defer, would have been received by the employee within two and one-half months after the close of the plan year. An elective contribution is considered allocated as of a date within the plan year only if (i) the allocation is not contingent upon the employee's participation in the plan or performance of services on any date subsequent to that date, and (ii) the elective contribution is actually paid to the trust no later than the end of the 12-month period immediately following the plan year to which the contribution relates.

Section 402(e)(3) of the Code provides, in pertinent part, that contributions made by an employer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement (as defined in section 401(k)(2) shall not be treated as distributed or made available to employee nor as contributions made to a trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contribution will be made to the trust or received by the employee in cash.

Under section 402(g)(1) of the Code, the elective deferrals of any individual for any taxable year are included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds $7,000 (as adjusted under section 402(g)(5) of the Code), notwithstanding section 402(e)(3) of the Code regarding elective deferrals under a qualified cash or deferred arrangement.

With respect to ruling request one, participants may make an irrevocable election to defer compensation under Plan A and Plan B no later than December 31 of the calendar year preceding the year the compensation to which the salary deferral relates is earned. Plan B provides for the transfer of salary deferrals plus any related matching contributions from Plan B to Plan A. The amount to be transferred is determined in accordance with the provisions of Plan A and Plan B. Plan A requires Employer X to contribute such amount to Plan A. These provisions preclude employer discretion with respect to the amount of elective deferrals that will be transferred from Plan B to Plan A. The transfer must be completed on or before March 15 of the calendar year following the year for which the deferral was made under Plan B. If Participant's Plan B salary deferral is more than the salary deferral participant authorized to be made to Plan A, then the difference will be refunded to the participant. Any refund will be taxable income for the year with respect to which the deferral was made.

In addition, for purposes of the actual deferral percentage test under 401(k)(3) of the Code for a calendar year plan year, elective deferrals irrevocably and prospectively elected under Plan B made by the participant for a calendar year plan year that are initially held in the general assets of Employer X and then contributed to Plan A will be treated as having been made under Plan A in the calendar year in which the compensation to which the deferrals relate was earned by the participant,

provided that the elective deferrals are allocated to the participant's account by the end of that calendar plan year and the elective deferrals continue to relate to compensation that either would have been received by the participant in the calendar year plan year but for the participant's election, or is attributable to services performed by the participant in the calendar year plan and would have been received by the Participant within 2-1/2 months after the calendar year plan year for participant's election. An election to make a contribution to Plan A is a cash or deferred election within the meaning of section 1.401(k)-1(a)(3)(i) of the Regulations because it is an election to have Employer X provide a benefit under a plan deferring compensation rather than providing an amount in cash to the employee.

Accordingly, we conclude that, assuming Plan A otherwise satisfies the requirements for a qualified cash or deferred arrangement and that the elective deferral and actual deferral percentage limitations of sections 402 (g) and 401 (k) (3) of the Code are not exceeded, elective deferrals made by the participants under Plan A that are initially held by Employer X pursuant to the terms of Plan B will be excluded from gross income under section 402 (e) (3) of the Code when contributed to Plan A, provided such contribution is timely paid and allocated.

With respect to ruling request two, the participant will make an irrevocable election to have his maximum permissible contribution to Plan A transferred from Plan B to Plan A. If the amount permitted to be transferred from Plan B exceeds the permissible contribution that the participant authorized to be contributed to Plan A, then the excess amount will be distributed to the participant. The amount distributed will be taxable income in the year it was earned, rather than the year it was actually distributed. If the maximum permissible deferral under Plan A is contributed to Plan A, it would be subject to the 402(g) limitation applicable to the year when it was earned rather the year in which it was contributed to Plan A.

Accordingly, with respect to ruling request two, we conclude that for purposes of satisfying the limitations of section 402(g) of the Code, contributions made to Plan A by Employer X on behalf of the participants (assuming that such contributions are timely made and timely allocated to participant's account under Plan A), which are initially

held by Employer X pursuant to the terms of Plan B, will be treated as deferrals under Plan A having been made in the year in which they would have been taxable to the participant but for the election under Plan B to have such salary contributed to Plan A.

The above rulings are based on the assumption that at all times relevant to these rulings, Plan A is qualified under section 401 (a) of the Code, and its cash or deferred arrangement is qualified under section 401 (k) (2) of the Code and that the required amendments as proposed by the taxpayer's authorized representative in his above mentioned correspondence are made to the respective Plans. Employer X established Plan A by adopting a nonstandardized prototype plan. Amending Plan A to provide for the transfer of elective deferrals from Plan B may affect the prototype status of Plan A. No opinion is expressed as to the prototype status of Plan A.

Title I of Employee Retirement Income Security Act of 1974 (ERISA) is within the jurisdiction of the Department of Labor. Accordingly, we express no opinion as to whether the subject transactions comply with Title I of ERISA. Finally, no opinion is expressed as to the income tax consequences of establishing Plan B and participating in it except as expressly stated herein.

This ruling is directed only to the taxpayer that requested it and applied only with respect to Plan A as submitted with this request. Section 6110(k)(3) of the Code provides that this private letter ruling may not be used or cited as precedent.

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

Sincerely yours,

John G. Riddle, Jr.

John G. Riddle, Jr.
Manager, Employee Plans
Technical Group 4
Tax Exempt and Government
Entities Division

Enclosures:

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Notice 437

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