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Internal Revenue Service

Department of the Treasury
Washington, DC 20224

SIN: 414.03-00

Person To Contact:

Telephone Number:

Refer Reply To: T:EP:RA:T3

Date: MAR 27 2001

Legend:

City M =

State S =

Plan A =

Plan B =

Plan C =

Plan P =

Employer D =

Employer E =

Employer F =

Employer G =

Employer H=

Employer I =

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This is in response to a request for a ruling letter submitted on your behalf by your authorized representative on October 18, 2000, as supplemented by letters dated January 31, 2001 and March 15, 2001. This request concerns the consequences under section 401(k)(4)(B) of the Internal Revenue Code of adopting Plan P and extending Plan P to additional governmental entities related to City M.

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

On June 25, 1985 City M applied for a determination letter from the Internal Revenue Service for Plan A. Included in the submission was the Plan A written document and the associated trust document, both signed by the appropriate officials. Plan A is a defined contribution plan with a cash or deferred arrangement within the meaning of section 401(k) ("CODA"). Plan A, in general, provides that the employer under the plan is City M and that the employees covered under Plan A are employees of City M employed by the employer in a Mayoral Agency of City M in titles not certified to or represented by a collective bargaining representative, an elected official of City M and employees working for such an elected official in titles not certified by a collective bargaining representative and who receives compensation from City M. A favorable determination letter on Plan A was issued by the Service on November 12, 1985.

On January 24, 1986, City M applied for determination letters from the Service for Plan B and Plan C. Included in these submissions were the Plan B and Plan C written documents and the associated trust documents, all signed by the appropriate officials. Plans B and C are both defined contribution plans with a CODA. The employer under these plans is City M. Plan B, in general, provides that covered employees are persons employed by City M in a title certified to or represented by a collective bargaining agreement who receive compensation from City M, and who are civilian or non-uniformed employees. Plan C, in general, provides that covered employees are persons employed by City M in a title certified to or represented by a collective bargaining agreement who receive compensation and who are uniformed employees. Plans B and C contain provisions contemplating their adoption by ancillary agencies and instrumentalities of City M. Favorable determination letters on Plans B and C were issued by the Service on November 24, 1987.

City M proposes at this time to restate Plans A, B and C (Plans) into Plan P, a defined contribution plan containing a CODA, covering employees of City M and the employees of Employers D through I, as described below.

Employer D is the board of education of City M. The seven members of the board are all appointed; two by the mayor of City M and one by the highest elected official from each of the five separate administrative regions into which City M is divided.

Employer E was formed in 1970 to run certain municipal hospitals previously run by City M. It is governed by a sixteen member board of directors consisting of five City M officials, Ten outside members appointed by the mayor and one selected by Employer E's administrative officer.

Employer F's purpose is to develop construct manage and maintain low cost housing for low income families in City M. It is governed by three members all of whom are appointed by the mayor of City M.

Employer G's purpose is to design, construct, reconstruct, improve, etc., and otherwise provide for educational facilities for Employer D, the board of education. Employer G has three board members. One board member is appointed by the mayor of City M. One Is appointed by Employer D, whose entire board is appointed by City M officials and one is appointed by the Governor of State S. Thus, two of the three board members are appointed directly or indirectly by City M. Further, Employer G receives 99 percent of its operating and capital budgets from City M and City M maintains exclusive budgetary control over its expenditures.

Employer H was created to assist City M in financing its extensive water system. Employer H's board of directors consists of seven members, four of whom are commissioners of City M agencies, two of whom are appointed by the mayor of City M and one of whom is appointed by the governor of State S.

Employer I includes the junior colleges of the City M university system. Employer I receives its operating funds from two sources, student tuition and governmental aid. The governmental aid comes exclusively from City M's general fund. In addition, five of the fifteen members of the board of trustees are appointed by City M and the operating and capital budgets must be submitted to the mayor of City M for his review and approval. You represent that Employers D through I are governmental entities as described in Code section 414(d).

Based on the foregoing, you request rulings to the following effect :

1. The proposed adoption of Plan P in so far as it covers employees of City M will not cause Plan P to fail to comply with section 401(k)(4)(B).

2. The extension of Plan P to cover the employees of Employers D through I will not cause Plan P to fail to comply with section 401(k)(4)(B).

Section 401(k) sets forth the requirements for a qualified cash or deferred arrangement. Section 401(k)(2) provides, in part, that a qualified cash or deferred arrangement is any arrangement which is part of a profit sharing plan which meets the requirements of section 401(a) 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 401(k)(4)(B)(ii) of the Code provides that a cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a state or local government or a political subdivision thereof, or any agency or instrumentality thereof (a "governmental unit"). Prior to being amended by the Tax Reform Act of 1986 ("TRA"), section 401(k) permitted such governmental units to maintain a qualified cash or deferred arrangement. Section 1116(f)(2)(B)(i) of TRA provides that section 401(k)(4)(B) does not apply to cash or deferred arrangements adopted by a governmental unit before May 6, 1986.

Section 1.401(k)-1(e)(4)(ii) of the Income Tax Regulations provides that a cash or deferred arrangement maintained by a governmental unit is treated as adopted after May 6, 1986, with respect to all employees of any employer that adopts the arrangement after that date. However, if an employer adopted an arrangement prior to that date, all employees of the employer may participate in the arrangement. Section 1.401 (k)-1(e)(4)(iv) of the regulations provides that if the governmental unit adopted a cash or deferred arrangement prior to that date, then any cash or deferred arrangement adopted by the unit at any time is treated as adopted before that date.

Section 1.401 (k)-1(g)(6) of the regulations provides as a definition of the word "employer" for 401(k) plans, that the term means the employer within the meaning of section 1.410(b)-9 of the regulations.

Section 1.410(b)-9 of the regulations states that the term "employer" means the employer maintaining the plan and those employers required to be aggregated with the employer under section 414(b), (c), (m), or (o) of the Code.

Based on all the facts submitted we have determined, that City M has timely adopted Plans A, B, and C, all with CODAs, for purposes of section 1116(f)(2)(B) of TRA. Therefore, pursuant to section 1.401(k)-1(e)(4)(iv) of the regulations, we conclude with regard to ruling request one that City M may adopt Plan P, a new 401(k) plan for it's employees without violating section 401(k)(4)(B).

A ruling that Plan P may cover employees of Employers D through I, without failing to comply with section 401(k)(4)(B), depends on a determination that such employers are required to be aggregated with City M under Code section 414(b) or (c).

Announcement 95-48, 1995-23 I.R.B. 13, extended the effective date of certain nondiscrimination rules for qualified plans maintained by governments or by organizations exempt from income tax under section 501 (a) of the Code. Announcement 95-48 provides that the Service and Treasury recognize "that difficult issues arise for governmental and tax-exempt employers in determining which entities must be aggregated under sections 414(b) and (c) (relating to the definition of employer). Until further guidance is issued, governmental and tax-exempt employers may apply a reasonable, good faith interpretation of sections 414(b) and (c) in determining which entities must be aggregated."

In Notice 96-64, 1996-2 C.B. 229, the Service addresses certain issues relating to the nondiscrimination rules that apply to qualified plans maintained by governments and by tax-exempt organizations. Section VII of Notice 96-64 provides that, until further guidance is issued, governments and tax-exempt organizations may apply a reasonable, good faith interpretation of existing law in determining which entities must be aggregated under section 414(b) and (c). The notice also provides that when further guidance is issued, it will be applied on a prospective only basis and will not be effective before plan years beqinninq in 2001. Section VII of Notice 96-64 also requests comments on an appropriate aggregation standard for tax-exempt organizations under sections 414(b), (c), and (o) of the Code.

Section 6.03 of Revenue Procedure 2001-4, 2001-1 I.R.B. 121, provides that the Service ordinarily will not issue letter rulings on matters involving a plan's qualified status under Code sections 401 through 420 and section 4975. However, this section further provides that letter rulings may be issued in three limited circumstances: (1) when the taxpayer has demonstrated to the Service's satisfaction that the qualification issue involved is unique and requires immediate guidance; (2) when, as a practical matter, it is not likely that such issue will be addressed through the determination letter process; and, (3) when the Service determines that it is in the interest of sound tax administration to provide guidance to the taxpayer with respect to such qualification issue.

Section 8.01 of Rev. Proc. 2001-4 provides that the Service ordinarily will not issue a letter ruling in certain areas because of the factual nature of the problem involved or because of other reasons. The Service may decline to issue a letter ruling when appropriate in the interest of sound

tax administration or on other grounds whenever warranted by the facts or circumstances of a particular case.

Pursuant to Rev. Proc. 2001-4, we will not issue letter rulings involving issues relating to the aggregation of tax-exempt organizations under section 414(b) or (c) of the Code until guidance is issued. Accordingly, we are unable to issue a ruling with respect to your second ruling request. However, taxpayers may apply a reasonable, good faith interpretation of existing law in determining which entities must be aggregated under sections 414(b) and (c).

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 submitted with the request.

Sincerely yours,

Frances V. Sloan

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

Enclosures:
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