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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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In re:

This letter is in response to a request by your authorized representative for rulings on the excise tax applicable to a reversion of surplus assets to the Company on account of the termination of the DB Plan and the transfer of a portion of the surplus to the 401(k) Plan. Letters dated October 30, 2001, and November 16, 2001, modified the request.

The DB Plan, a defined benefit plan, was established by the Company effective January 1, 1975. The DB Plan was amended to provide that future benefit accruals would cease as of October 15, 1998. The DB Plan has been terminated and the Service issued a favorable determination letter with respect to the termination. All benefits have been distributed to the participants from the DB Plan.

The DB Plan includes a provision under which any assets remaining in the trust after the satisfaction of all accrued benefits under the plan, and after payment of termination expenses of the plan, will be returned to the Company. In connection with the termination of the DB Plan, there will be an amount of surplus assets ("the surplus"). An amount equal to 25% of the maximum reversion available to the Company (determined after the satisfaction of all liabilities of the DB Plan but prior to any transfers of surplus assets to the 401(k) Plan or reversion to the Company) will be transferred to the 401(k) Plan.

The Company established the 401(k) Plan effective January 1, 1988. The 401(k) Plan is a non-standardized prototype profit sharing plan that includes a cash or deferred arrangement under section 401(k) of the Internal Revenue Code. The 401(k) Plan has been amended to provide for a suspense account for the transfer of the surplus. The 401(k) Plan, as amended, is intended to be a "qualified replacement plan" under section 4980(d).

Under the 401(k) Plan, the participants may elect to defer a percentage of their compensation on a pre-tax basis and the Company will make a matching contribution based on a certain percentage of each participant's pre-tax contributions. It was represented in the October 30, 2001 letter that an amount equal to 25% of the surplus, which is 25% of the maximum reversion to the Company from the DB Plan, will be transferred to the 401(k) Plan and placed in a suspense account. Under the terms of the 401(k) Plan, amounts held in the suspense account (including income thereon) will be allocated to the accounts of participants in the 401(k) Plan as matching employer contributions. The amounts, plus earnings, will be allocated to participant accounts no less rapidly than ratably over seven years from the date of transfer.

The Company has stated that, as of November 30, 1998, there were 189 active employees covered by the DB Plan. Of those 189 employees, there are 54 employees who are still currently employed by the Company. Of the remaining 54 employees, there are 52 employees that are active participants benefiting under the 401(k) Plan

Amounts released from the suspense account in the 401(k) Plan (attributable to the amount transferred from the DB Plan and income thereon) will be treated as employer contributions for purposes of sections 401(a), 401(m) and 415 of the Code. The 401(k) Plan further provides that all such amounts allocated from the suspense account will be treated as annual additions for the plan year in which the amounts are allocated to the accounts of participants.

Based on the foregoing, the following rulings are requested:

(1) The 401(k) Plan constitutes a "qualified replacement plan" within the meaning of Code § 4980(d)(2).

(2) The assets transferred directly from the DB Plan to the 401(k) Plan are not includible in the Company's gross income.

(3) The transfer of assets directly from the DB Plan to the 401(k) Plan will not be treated as an employer reversion under Code § 4980 and will not subject the Company to an excise tax under Code § 4980 with respect to those assets.

(4) The Company will be subject to an excise tax equal to 20% rather than 50% of the amount of the reversion of the residual assets to the Company under Code § 4980.

(5) The use of the amounts transferred from the DB Plan to the 401(k) Plan (and the earnings thereon) to make employer discretionary matching contributions under the 401(k) Plan satisfies the allocation requirements under Code § 4980(d)(2)(C).

Section 401(m)(4)(A) of the Code provides that matching contributions are considered as employer contributions on behalf of an employee.

Section 4980(a) of the Code provides for a 20% excise tax on the amount of any reversion from a qualified plan. Section 4980(d) provides, in general, that the excise tax under § 4980(a) shall be increased to 50% with respect to any employer reversion from a qualified plan unless the employer either establishes or maintains a qualified replacement plan, or the plan provides for certain benefit increases which take effect immediately on the termination date.

Section 4980(c)(2)(A) of the Code provides that the term "employer reversion" means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan.

Section 4980(d)(2) of the Code, in relevant part, defines a "qualified replacement plan" as a qualified plan established or maintained by the employer in connection with a qualified plan termination for which:

(A) At least 95% of the active participants in the terminated plan who remain as employees of the employer after the termination are active participants in the replacement plan, and
(B) A direct transfer is made from the terminated plan to the replacement plan before any employer reversion, and the transfer is an amount equal to 25% of the maximum amount the employer could receive as an employer reversion without regard to that section, and
(C) Meets the allocation requirements described below.

Section 4980(d)(2)(B)(iii), in general, provides that in the case of a transfer to a qualified replacement plan in an amount equal to 25% of the maximum amount which the employer could receive as an employer reversion, such amount transferred shall not be includible in the gross income of the employer and such transfer shall not be treated as an employer reversion for purposes of § 4980.

Section 4980(d)(2)(C)(i) of the Code provides, that if the replacement plan is a defined contribution plan, the amount transferred to the replacement plan must be:

(I) Allocated under the plan to the accounts of participants in the plan year in which the transfer occurs, or
(II) Credited to a suspense account and allocated from such account to accounts of participants no less rapidly than ratably over the seven-plan-year period beginning with the year of the transfer.

Section 4980(d)(4)(B) of the Code provides, in part, that the allocation of any amount (or income allocable thereto) to any account under § 4980(d)(2)(C) shall be treated as an annual addition for purposes of § 415.

Of the 54 employees who were participants in the DB Plan and are still employed by the Company, 52 of them are active participants in the 401(k) Plan. The percentage of the active participants in the DB Plan (the terminated plan) who remain employees of the Company after the termination and who are active participants in the 401(k) Plan is 96.3%. Thus, at least 95% of the active participants in the DB Plan who remain as employees of the Company after the termination are active participants in the 401(k) Plan.

The DB Plan provides that 25% of the maximum amount that could revert to the Company will be transferred to the 401(k) Plan prior to any reversion to the Company. The Service has issued a favorable determination letter with respect to the 401(k) Plan. Under the terms of the 401(k) Plan, as amended, the amount transferred to the 401(k) Plan from the DB Plan will be allocated no less rapidly than ratably over the seven-year-period beginning with the year of the transfer.

Therefore, with regards to your first ruling request, the 401(k) Plan constitutes a "qualified replacement plan" within the meaning of § 4980(d)(2) of the Code. However, the 401(k) Plan will cease to be a "qualified replacement plan" in any year in which less than 95% of the active participants in the DB Plan who remain as employees of the Company after the termination are active participants in the 401(k) Plan.

As stated above, the 401(k) Plan is a "qualified replacement plan". The amount transferred to the 401(k) Plan equals 25% of the surplus amount. Therefore, with regards to your second ruling request, the assets transferred directly from the DB Plan to the 401(k) Plan are not includible in the Company's gross income. Furthermore, with regards to your third ruling request, the Company will not be subject to the excise tax under § 4980 with respect to the transfer of 25% of the surplus from the DB Plan.

With regards to your fourth ruling request, because the 401(k) Plan is a "qualified replacement plan", the excise tax on the reversion of assets from the DB Plan to the Company will be imposed at a tax rate of 20% of the reversion amount. The reversion amount is determined after the transfer of assets (equal to 25% of the surplus) to the 401(k) Plan.

Code § 4980(d)(2)(C) does not specify a method for allocating amounts from a suspense account to participant accounts. Thus, with regards to your fifth ruling request, the use of amounts transferred from the DB Plan to the 401(k) Plan to make employer discretionary matching contributions satisfies the requirements of § 4980(d)(2)(C).

Accordingly, with respect to your five ruling requests:

1. The 401(k) Plan constitutes a "qualified replacement plan" within the meaning of § 4980(d)(2) of the Code. However, the 401(k) Plan will cease to be a "qualified replacement plan" in any year in which less than 95% of the active participants in the DB Plan who remain as employees of the Company after the termination are active participants in the 401(k) Plan.

2. The assets transferred directly from the DB Plan to the 401(k) Plan are not includible in the Company's gross income.

3. The Company will not be subject to the excise tax under § 4980 with respect to the transfer of 25% of the surplus from the DB Plan.

4. The excise tax on the reversion of assets from the DB Plan to the Company will be imposed at a tax rate of 20% of the reversion amount. The reversion amount is determined after the transfer of assets (equal to 25% of the surplus) to the 401(k) Plan.

5. The use of amounts transferred from the DB Plan to the 401(k) Plan to make employer discretionary matching contributions satisfies the requirements of § 4980(d)(2)(C).

This ruling letter is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

These rulings are based on the assumptions that the DB Plan and the 401(k) Plan are qualified under § 401(a) of the Code and that their related trusts are tax-exempt under § 501(a) at all times relevant to this ruling.

We have sent a copy of this letter to your authorized representative pursuant to a Form 2848 (power of attorney) on file with our office. If you have any questions, please contact me. Or, you may contact

Sincerely,

James E. Holland, Jr., Manager
Employee Plans Actuarial Group 1
Tax Exempt and Government Entities
Division