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

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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

MAR 05 2002

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Re:

Dear

This letter is in response to your request for a ruling on behalf of Company A and its affiliates with respect to the above-named defined benefit plan.

Company A is the parent company of a controlled health care group, which includes both tax-exempt and for-profit entities. The Plan is sponsored by Company B and includes only employees of Company A and affiliate Companies B and C. Companies A, B, and C have always been tax-exempt organizations under § 501(c)(3) of the Internal Revenue Code (Code). Since 1987, the Plan has been subject to the full funding limitation under § 412 of the Code, and no contributions have been made to the Plan since 1986. The Plan's assets exceed its benefit liabilities on a plan termination basis. Company B did not generate any unrelated business income until 1993. Furthermore, Company B has never generated any unrelated business taxable income. Also, no tax deduction has ever been taken for contributions to the Plan. It is the intention of Company B to terminate the Plan and distribute residual assets to itself as provided in § 9.3 of the Plan.

In a letter dated October 16, 2000, you requested a ruling that the proposed asset reversion to Company B upon termination of the Plan will not be includible in income as unrelated business taxable income under § 511 of the Code, and that the excise tax imposed under § 4980 of the Code will not apply to such asset reversion.

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Section 401(a)(2) of the Code generally prohibits, prior to the satisfaction of all liabilities with respect to employees and beneficiaries of the trust of the plan, the diversion of trust assets for purposes other than for the exclusive benefit of the employees or beneficiaries for whom an employer maintains a qualified pension plan.

Section 501(c)(3) of the Code describes as exempt from tax organizations organized and operated exclusively for charitable and other exempt purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and which does not engage in other prohibited activities.

Section 511 of the Code imposes a tax on the unrelated business taxable income of certain tax-exempt organizations, including those described in §§ 401(a) and 501(c)(3).

Section 512(a)(1) of the Code defines the term "unrelated business taxable income" as gross income derived by an exempt organization from any unrelated trade or business regularly carried on by it, less certain deductions and modifications.

Section 513(a)(1) of the Code provides that the term "unrelated trade or business" means, in the case of any organization subject to the tax imposed by § 511, any trade or business the conduct of which is not substantially related (aside from the need of such organization for income of funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis of its exemption under § 501.

Section 1.401-2(b)(1) of the Income Tax Regulations (Regulations) provides, however, that if a defined benefit pension plan terminates and assets remain after the satisfaction of all liabilities to plan participants and beneficiaries, and if such excess is attributable to actuarial error, then the employer is permitted to recover the excess assets. Generally, if the excess assets are recovered from a qualified defined benefit pension plan upon termination, then the excess is included in gross income by the employer.

Section 1.513-1(b) of the Regulations provides that for purposes of § 513 of the Code the term "trade or business" has the same meaning it has in § 162 of the Code, and generally includes any activity carried on for the production of income from the sale of goods or performance of services.

Section 1.513-1(c) of the Regulations provides that, in determining whether a trade or business from which a particular amount of gross income derives is "regularly carried on", within the meaning of § 512, regard must be had to the frequency and continuity with which the activities productive of the income are conducted and the manner in which they are pursued. This requirement must be applied in light of the purpose of the unrelated business income tax to place exempt organization business activities upon the same tax basis as the non-exempt business endeavors with which they compete.

Section 1.513-1(d)(1) of the Regulations provides that gross income derives from an "unrelated trade or business", within the meaning of § 513(a) of the Code, if the conduct of the trade or business which produces the income is not substantially related (other than through the production of funds) to the purposes for which the exemption is granted.

Section 4980(a) of the Code provides for a tax of 20 percent on the amount of any reversion of plan assets to the employer from a qualified plan. Section 4980(c)(1)(A) provides, in part, that the term "qualified plan" means any plan meeting the requirements of § 401(a) or § 403(a) of the Code other than a plan maintained by an employer if such employer has, at all times, been exempt from tax under subtitle A.

Section 61 of the Code defines gross income as "all income from whatever source derived." Section 111(a) of the Code provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by Chapter 1 of Subtitle A of the Code. This section constitutes the codification of the "exclusionary" portion of the tax benefit rule. The balance of the tax benefit rule is known as the "inclusionary" aspect. The "inclusionary" aspect requires that the amounts previously deducted from gross income (which thereby effected a tax benefit) are recovered in subsequent years, such recoveries are includible under § 61 gross income for the year of recovery. See Rev. Rul. 68-104, 1968-1 C.B. 361.

Organizations described in § 501(c)(3) of the Code generally are exempt from taxation and would derive no tax benefit from contributions to a qualified pension plan. However, an organization described in § 501(c)(3) could receive a tax benefit from a contribution to a qualified plan if it deducted the amount of the contribution from its unrelated business taxable income.

The information submitted with the ruling request indicates that Companies A, B, and C have at all times been exempt from tax under § 501(c)(3) of the Code, have never had unrelated business taxable income, and have at no time deducted any amounts contributed to the Plan from unrelated business taxable income. Based on this information, the proposed asset reversion received by Company B upon termination of the Plan will not be includible in income as unrelated business taxable income under § 511 of the Code, and there will be no excise tax under § 4980(a) of the Code.

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

If you require further assistance in this matter, please contact

Sincerely yours,

Martin L. Pippins

Martin L. Pippins, Manager
Employee Plans Actuarial Group 2
Tax Exempt & Government Entities
Division

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