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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200243052

Uniform Issue List: 402.07-00

JUL 30 2002

T:EP:RA:T1

Attn:

Legend:

Corporation A =

Taxpayer B =

Plan X =

Plan Y =

Dear :

This is in response to a ruling request dated April 9, 2002, as supplemented by additional correspondence dated June 18, 2002, June 26, 2002, and July 24, 2002, from your authorized representative, concerning section 402(e)(4)(B) of the Internal Revenue Code ("Code").

The following facts and representations have been submitted:

Corporation A maintains Plan X for the benefit of its employees. Plan X is a combined profit sharing and stock bonus plan, with the stock bonus plan satisfying the ESOP requirements of Code sections 409 and 4975(e). The stock bonus/ESOP component of Plan X is funded with employer matching contributions under Code section 401(m) and is invested primarily in Corporation A's stock. The profit sharing component is funded with elective deferrals made under section 401(k), and is invested in assets other than Corporation A's stock. Plan X also allows employees to make after-

tax contributions, which are invested in the profit sharing component of the plan. Corporation A also sponsors Plan Y, a defined benefit plan.

During 2002, Corporation A will amend Plan X and Plan Y so that upon normal or early retirement, participants will be able to elect that part or all of their Plan X distribution be rolled over to Plan Y, where it will be used to increase the amount of the individual's pension. According to the Plan, normal retirement means termination of employment of a participant (except termination by his death) occurring on or after the date he or she attains normal retirement age. Early retirement means any termination of employment of a participant (except termination by his or her death) (i) after he or she has both attained age 55 and completed 10 years of elapsed time and (ii) before he or she attains normal retirement age. Plan X will allow participants to receive part or all of the Company stock portion of their distribution in-kind, while allowing a rollover of the remainder of any Company stock which was not distributed to the participant in-kind.

During the later part of 2002, Taxpayer B will elect to take a lump sum distribution from Plan X. Part of the lump sum distribution will be rolled over to Plan Y, while the remainder will be received in the form of Corporation A's stock. The actual distribution will take place in the early part of 2003.

Based on the foregoing facts and representations, you have requested the following ruling: that in the case where a participant receives his or her entire benefit in the form of shares of Corporation A's stock, a rollover of a portion of the lump sum distribution to Plan Y will not adversely affect the employee's ability to exclude net unrealized appreciation on the shares of Corporation A's stock distributed in-kind from gross income and to obtain long term capital gain treatment on such appreciation to the extent realized when the shares are sold.

Code section 402(a) provides that, except as otherwise provided in this section, any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the year in which distributed, under section 72 (relating to annuities).

Code section 402(e)(4)(B) provides that, for purposes of subsection (a) and section 72, in the case of any lump sum distribution which includes securities of the employer corporation, there shall be excluded from gross income the net unrealized appreciation attributable to that part of the distribution which consists of securities of the employer corporation.

Code section 402(e)(4)(C) provides that, for purposes of subparagraph (B), net unrealized appreciation and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Secretary.

Code section 402(e)(4)(D) provides that, for purposes of this paragraph, the term "lump sum distribution" means the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient (I) on account of the employee's death, (II) after the employee attains age 59-1/2 , (III) on account of the employee's separation from service, or (IV) after the employee has become disabled (within the meaning of section 72(m)(7)), from a trust which forms a part of a plan described in section 401(a) and which is exempt from tax under section 501.

Code section 402(c)(4) provides that, for purposes of this subsection, the term "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust; except that such term shall not include (A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made (i) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (ii) for a specified period of 10 years or more, (B) any distribution to the extent such distribution is required under section 401(a)(9), and (C) any hardship distribution described in section 401(k)(2)(B)(i)(IV).

Code section 402(c)(8)(B)(i) defines "eligible retirement plan" as (i) an individual retirement account described in section 408(a), (ii) an individual retirement annuity described in section 408(b) (other than an endowment contract), (iii) a retirement plan qualified under section 401(a), and (iv) an annuity plan described in section 403.

Section 1.402(a)-1(b)(1)(i) of the Regulations provides that the amount of net unrealized appreciation which is excludable from gross income shall not be included in the basis of the securities in the hands of the distributee at the time of distribution for purposes of determining gain or loss on their subsequent disposition. In the case of a total distribution the amount of net unrealized appreciation which is not included in the basis of the securities in the hands of the distributee at the time of distribution shall be considered as a gain from the sale or exchange of a capital asset held for more than six months to the extent that such appreciation is realized in a subsequent taxable transaction. However, if the gain realized by the distributee in a subsequent taxable transaction exceeds the amount of the net unrealized appreciation at the time of distribution, such excess shall constitute a long-term or short-term capital gain depending upon the holding period of the securities in the hands of the distributee.

Rev. Rul. 81-122, 1981-1 C.B. 202, states that the amount of net unrealized appreciation that is not included in the basis of the securities in the hands of a distributee at the time of distribution is considered a gain from the sale or exchange of a capital asset held for more than one year to the extent it is realized in a subsequent transaction. Section 311 of TRA '97 reduces the capital gains tax rate on the sale or exchange of certain assets held for more than 18 months from 28 percent to 20 percent (10 percent in the case of gain that would otherwise be taxed at 15 percent), effective generally for

amounts properly taken into account after May 6, 1997. The maximum capital gains tax rate continues to apply to the sale or exchange of assets held for 18 months or less but more than one year.

Notice 98-24, 1998-1 C.B. 929 states that the amount of net unrealized appreciation which is not included in the basis of the securities in the hands of the distributee at the time of distribution is considered a gain from the sale or exchange of a capital asset held for more than 18 months to the extent that such appreciation is realized in a subsequent taxable transaction. Accordingly, for a sale or other disposition of employer securities that occurs after May 6, 1997, the actual period that an employer security was held by a qualified plan need not be calculated in order to determine whether, with respect to the net unrealized appreciation, the disposition qualifies for the rate for capital assets held for more than 18 months. However, with respect to any further appreciation in the employer securities after distribution from the plan, the actual holding period in the hands of the distributee determines the capital gains rate that applies. The notice also states that it applies to sales or other dispositions of employer securities that occur before the later of January 1, 2001, or the date further guidance is issued.

In this case, upon normal or early retirement, participants will be able to elect that part or all of their Plan X distribution be rolled over to Plan Y, where it will be used to increase the amount of the individual's pension. Plan X will allow participants to receive part or all of the Company stock portion of their distribution in-kind, while allowing a rollover of the remainder of any Company stock which was not distributed to the participant in-kind.

Neither the Code nor Income Tax Regulations promulgated thereunder, preclude a distribution from being treated as a lump sum distribution under Code section 402(e)(4)(D) for purposes of Code section 402(e)(4)(B) even if a portion of the distribution is rolled over into the Trust attached to another qualified plan.

Therefore, we conclude that in cases where a participant receives his or her entire benefit in the form of shares of Corporation A's stock, a rollover of a portion of the lump sum distribution to Plan Y will not adversely affect the employee's ability to exclude net unrealized appreciation on the shares of Corporation A's stock distributed in-kind from gross income and to obtain long term capital gain treatment on such appreciation to the extent realized when the shares are sold.

This ruling is based on the assumption that both Plan X and Plan Y meet the requirements Code section 401(a) at all relevant times. In addition, the ruling is conditioned on Taxpayer B taking the lump sum distribution by March 31, 2003.

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.

Copies of this ruling have been sent to your authorized representatives pursuant to a power of attorney on file in this office.

Should you have any questions concerning this letter ruling, please contact T:EP:RA:T1 of my staff at (202) 283-9610.

Sincerely yours,

Andrew E. Zuckerman,
Manager, Employee Plans
Technical Group 1
Tax Exempt and Government
Entities Division

Enclosures:
Deleted Copy of the Ruling
Notice 437

cc