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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

OCT 29 2002

UIL No: 403.00-00

T:EP:RA:T4

Legend:

Employer A
Plan X
Custodian B
State M

Dear :

This is in response to your letter dated September 13, 1999, in which your authorized representative requested a letter ruling concerning the above-named Tax-Sheltered Annuity Program ("Plan X") under section 403(b) of the Internal Revenue Code (the "Code"). That letter was supplemented by letters dated April 25, 2000, December 7, 2000, April 30, 2001, May 15, 2001, August 27, 2001, April 29, 2002, September 16, 2002 and October 2, 2002.

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

Employer A is an educational organization under Code section 170(b)(1)(A)(ii) in State M created by State M's legislative to administer its state university system, community college system and technical college system.

On , the state university system, community college system and technical college system merged into one entity to create Employer A.

The board of trustees of Employer A are appointed by the governor of State M. Under State M statutes, the board possesses all powers necessary to govern the state colleges and universities. It is represented that Employer A is the employer of the state university system, the community college system and the technical college system and that Employer A is an agency of State M.

The statute of State M designates all community colleges, technical colleges and state universities that participate in Plan X. Prior to the merger of the state university system, the community college system and the technical college

system, each of the three systems maintained separate section 403(b) arrangements. Plan X will be funded with group, fixed and/or variable annuity contracts issued by registered insurance companies and/or through custodial accounts that hold investments in compliance with the requirements of section 403(b)(7). Plan X does not permit investment of a participant's funds in life insurance policies.

On , pursuant to State M statute, the 403(b) arrangement of each system was merged into Plan X. Plan X was amended and restated effective .

Salary deferrals from each participating employee of Employer A are deposited with Custodian B on the day such funds are withheld from an employee's paycheck. Custodian B either (1) invests the funds in any of its mutual funds by the close of business on the day such funds are received, or (2) if the participant has not elected to invest in the mutual funds of Custodian B, such funds are wire transferred to the appropriate annuity provider on the day such funds are received by Custodian B.

Section 3.1 of the Plan states that contributions may be made to the Plan by participants pursuant to salary reduction agreements, and that the employer will withhold the amount required pursuant to the salary reduction agreement and contribute such amount to the financial institutions selected by the participant. Section 1(18) defines "Financial Institution" as any insurance company selected by the employer providing fixed annuity contracts, variable annuity contracts or a combination of fixed or variable contracts as an investment vehicle for participants. Financial Institution also includes any other organization permitted by the Internal Revenue Code, IRS regulation and/or IRS guidance to offer annuity contracts and/or custodial accounts as an investment vehicle for participants under the program.

Section 3.1 states that once executed, the salary reduction agreement shall be legally binding and irrevocable with respect to amounts paid while the agreement is in effect. The participant may amend or terminate the salary reduction agreement at any time with respect to amounts not yet paid in such calendar year. Section 4.1 provides that a participant's interests in his or her accounts shall be at all times nonforfeitable.

Section 3.1 states that in no event shall the amount of contributions made pursuant to salary reduction agreement for any participant in any calendar year be (a) in excess of the elective deferral limit, or (2) at a rate that would result in a contribution of less than two hundred dollars ($200) during a full calendar year. Section 1(13) defines the elective deferral limit as the section 402(g) limit, plus in the case of a participant who has completed 15 years of service with the employer,

the least of (1) Three Thousand Dollars ($3,000), Fifteen Thousand Dollars ($15,000) reduced by amounts not included in gross income for prior years, or (3) the excess of Five Thousand Dollars ($5,000) multiplied by the number of years of service of the participant over the contribution made by the employer for the participant in prior calendar years pursuant to elective deferrals by the participant to section 403(b) plans, section 401(k) plans, simplified employee pension plans or eligible deferred compensation plans under Code section 457.

Section 3.2 provides that no contributions shall be made to the Plan other than by a participant pursuant to a salary reduction agreement.

Section 3.4 states that in addition to the elective deferral limit, contributions made by the employer cannot exceed the Contribution Limit. Section 1(8) defines the contribution limit as the limit on annual additions under Code section 415(c).

Section 5.1 of the Program provides that distribution of a participant's accounts shall commence as soon as practicable only after the participant attains age 59 1/2, dies, becomes disabled, or there is a severance from employment, provided the participant submits a claim for benefits.

Section 5.3 provides that all distributions of each account under the Plan shall be determined and made by in accordance with Code section 401(a)(9) and regulations promulgated thereunder, including the minimum distribution incidental benefit requirement.

Based on the foregoing facts and representation, the following rulings are requested:

(1) The program satisfies the requirements of Code section 403(b).
(2) All distributions from the Program will be taxed under Code sections 72 and 403(b)(1).

Regarding ruling request (1), section 403(b)(1) of the Code as amended by the Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA), and applicable for plan years beginning after December 31, 2001, provides that amounts contributed by an employer to purchase an annuity contract for an employee are excludable form the gross income of the employee in the year contributed, provided (1) the employee performs services for an employer which is exempt from tax under section 501(a) as an organization described in section 501(c)(3), or the employee performs services for an educational institution (as defined in section 170(b)(1)(A)(ii)) which is a state, a political subdivision of a state, or an agency or instrumentality of one or more of the foregoing; (2) such annuity contract is not subject to section 403(a); (3) the employee's rights under

the contract are nonforfeitable, except for failure to pay future premiums; (4) except in the case of a contract purchased by a church, such contract is purchased under a plan which meets the nondiscrimination requirements of section 403(b)(12); and (5) in the case of a contract purchased under a plan which provides a salary reduction agreement, the contract meets the requirements of section 401(a)(30). In addition, a custodial account is treated as an annuity contract for purposes of the Code.

Section 401(a)(30) provides, in the case of a trust which is part of a plan under which elective deferrals (within the meaning of Code section 402(g)(3)) may be made with respect to any individual during a calendar year, such trust shall not constitute a qualified trust unless the plan provides that the amount of such deferrals under such plan and all other plans, contracts or arrangements of the employer maintaining such plan may not exceed the amount of the limitation in effect under Code section 402(g)(1) for taxable years beginning in such calendar year. Section 402(g)(1) and (g)(4) of the Code provide, generally, that the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals exceeds $7,000, as adjusted for cost of living increases.

Section 402(g)(7) of the Code provides that in the case of a qualified employee of a qualified organization, with respect to employer contributions to purchase an annuity contract under section 403(b) under a salary reduction agreement, the limitation of section 402(g)(1), as modified by section 402(g)(5), for any taxable year shall be increased by whichever of the following is least: (i)$3,000, (ii) $15,000 reduced by amounts not included in gross income for prior taxable years by reason of this paragraph, or (3) the excess of $5,000 multiplied by the number of years of service of the employee with the qualified organization over the employer contributions made by the organization for the participant in prior calendar years (determined in the manner prescribed by the Secretary). A "qualified organization" for these purposes means any educational organization, hospital, home health service agency, church, convention of churches, and includes any organization described in section 414(e)(3)(B)(ii), and a "qualified employee" means any employee who has completed 15 years of service with the qualified organization.

Section 403(b)(1) provides further that the employee shall include in gross income the amounts actually distributed under such contract in the year distributed as provided in section 72 of the Code.

Section 403(b)(10) of the Code requires that arrangements pursuant to section 403(b) must satisfy requirements similar to those of section 401(a)(9) and similar to the incidental death benefit requirements of section 401(a). In addition, this

section provides that any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of the transfer.

Section 401(a)(9) of the Code, in general, provides for a mandatory benefit commencement date of April 1 following the plan year in which the participant attains age 70 1/2 or retires, whichever is later, and specifies required minimum distribution rules for the payment of benefits from qualified plans.

Section 403(b)(7) of the Code provides that the amounts paid by a qualifying employer to a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as amounts contributed by the employer for an annuity contract for his employee if the amounts are to be invested in regulated investment company stock to be held in that custodial account, and under the custodial account no such amounts may be paid or made available to any distributee before the employee dies, attains age 59 1/2, severs from employment, becomes disabled (within the meaning of section 72(m)(7)), or in the case of contributions made pursuant to a salary reduction agreement, encounters financial hardship.

Section 403(b)(7)(B) of the Code states that a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as an organization described in section 401(a) solely for purposes of subchapter F and subtitle F with respect to amounts received by it (and income from investment thereof).

Section 403(b)(11) of the Code provides, generally, that section 403(b) annuity contract distributions purchased under a plan which provides a salary reduction agreement (within the meaning of section 402(g)(3)(C)) may be paid only when the employee attains age 59 ½, has a severance of employment, dies, becomes disabled (within the meaning of section 72(m)(7)), or in the case of hardship. Such contract may not provide for the distribution of any income attributable to such contributions in the case of hardship.

Section 401(f)(2) of the Code provides that a custodial account shall be treated as a qualified trust under section 401 if the assets thereof are held by a bank (as defined in section 408(n)) or another person who demonstrates to the satisfaction of the Secretary that the manner in which he holds the assets will be consistent with the requirements of section 401.

Section 401(g) of the Code requires that the contract be nontransferable.

Section 415(a)(2) of the Code provides, in relevant part, that an annuity contract described in section 403(b) shall not be considered described in section 403(b) unless it satisfies the section 415 limitations. In the case of an annuity contract

described in section 403(b), the preceding sentence applies only to the portion of the annuity contract exceeding the section 415(b) or 415(c) limitations.

In this case, you represent that Employer A, an educational organization described in section 170(b)(1)(A)(ii) of the Code and an agency of State M that is described in section 403(b)(1) of the Code, has established Plan X for the benefit of its employees. A participant's salary reduction contributions (and earnings thereon) are fully non-forfeitable at all times. Plan X does not meet the requirements of section 403(a) of the Code. The restrictions of transferability of annuity contracts are present in Plan X as required by section 401(g) of the Code.

Plan X satisfies the requirement, under sections 403(b)(7)(A)(ii) and 403(b)(11) of the Code, that no such amounts shall be distributed before the participant's attainment of age 59 1/2, death, disability, severance from employment or hardship.

Plan X satisfies the distribution requirements of section 403(b)(10) of the Code because the minimum distribution and incidental death benefit requirements are met. Similarly, the direct trustee-to-trustee transfer provision satisfies section 401(a)(31).

Plan X limits contributions in accordance with sections 402(g) and 415 of the Code. Plan X contains language that demonstrates compliance with the applicable salary reduction rules in section 1.403(b)-1(b)(3) of the regulations. Finally, Plan X satisfies the applicable requirements of section 403(b)(7) of the Code.

Therefore, with respect to ruling request one, we conclude that Plan X satisfies the requirements of section 403(b) of the Code.

Ruling request two concerns the taxation of amounts contributed to Plan X. Section 403(b)(1) of the Code provides, in effect, that the amounts contributed by an educational organization for an employee are excludable from the employee's gross income in the taxable year in which such amounts are contributed. Therefore, concerning ruling request two, we conclude that the amounts received under Plan X by the participants shall be included in the employee's gross income for the taxable year in which distributed as provided for in section 72 and section 403(b)(1) of the Code.

This ruling is contingent upon the adoption of the amendments to Plan X that were submitted by correspondence dated August 27, 2001, April 29, 2002, September 16, 2002 and October 2, 2002, and will have no effect unless such amendments are adopted.

This ruling does not extend to any operational violations of section 403(b) of the Code, now or in the future. This ruling is limited to the form of Plan X, excluding any form defects which may violate the nondiscrimination requirements of section 403(b)(12) of the Code.

This letter ruling 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.

A copy of this ruling is being sent to your authorized representative in accordance with a power of attorney on file in this office.

This letter ruling was written by Lou Leslie (ID # 50-21652) of this Group 4 who can be reached at (202) 283-9572.

Sincerely yours,

Al Pipkin, Manager
Employee Plans Technical Group 4