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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

U.I.L. 402.09-00
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JAN 17 2003

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Legend:

Taxpayer A: xxxxx xxxxx

Employer M: xxxxx xxxxx

Plan X: xxxxx xxxxx

State C: xxxxx xxxxx

Dear xxxxx:

This is in response to your ruling request dated May 1, 2001, as supplemented by letters dated October 2, 2001, April 15, 2002, April 25, 2002, October 8, 2002, October 15, 2002, January 14, 2003, and January 15, 2003, submitted by your authorized representative concerning issues arising under section 402 of the Internal Revenue Code ("Code").

With regard to your ruling request, your authorized representative has submitted the following facts and representations:

Employer M, a corporation organized under the laws of State C, sponsors Plan X for the benefit of its employees. Plan X is a qualified plan under section 401(a) of the Code and its related trust is tax-exempt under section 501(a) of the Code. Plan X was amended and restated effective January 1, 2000, to add a cash or deferred arrangement feature ("CODA") as described in section 401(k)(2) of the Code. Taxpayer A, a former employee of Employer M, was an active participant in Plan X for 18 years ending in 1997.

In the letter dated May 1, 2001, your authorized representative references the definitions of "normal retirement age" and "early retirement age" under Plan X. Section 3.42 of Plan X defines "normal retirement age" as the last day of the month in which the participant attains age 65, provided the participant has completed five

years of vesting service with the employer. Section 3.17 of Plan X defines "early retirement age" as age 55, provided the participant has completed ten years of vesting service with the employer.

Taxpayer A separated from the service of Employer M in 1997. At the time of separation, Taxpayer A was 52 years old and he had completed at least ten years of vesting service with Employer M. Thus, when Taxpayer A separated from the service of Employer M, he satisfied the service requirement of the early retirement benefit provisions under Plan X but he did not satisfy the age requirement of such.

It is represented that under section 8.6 of Plan X a participant who terminates employment, whether voluntarily or involuntarily, for any reason other than attainment of normal retirement age, attainment of early retirement age, disability or death is entitled to his or her benefit but payment of such vested accrued benefit will not commence until attainment of normal retirement age, attainment of early retirement age, disability or death occurs.

When Taxpayer A attained age 55, he satisfied the age requirement of the early retirement benefit under Plan X. Upon satisfying the age requirement as well as the service requirement for early retirement eligibility under Plan X, Taxpayer A commenced receipt of his early retirement benefit in the latter part of the 2001 calendar year.

In the letter dated May 1, 2001, your authorized representative set forth language of section 8.7 of Plan X which states that an eligible plan participant may elect to receive his or her vested accrued benefit either in one lump sum or in annual or more frequent periodic installments of substantially equal amounts.

Taxpayer A elected to receive his early retirement benefit from Plan X in annual installment payments. Your authorized representative represents that such payment arrangement is in accordance with conditions set forth in section 8.7 of Plan X and that the annual installment payments to Taxpayer A have been determined by a method that is acceptable for purposes of calculating the minimum distributions required under Code section 401(a)(9). It is represented, furthermore, that because the method used to distribute Taxpayer A's benefit is an acceptable method for calculating the minimum distributions required under Code section 401(a)(9), payments under such method are considered to be substantially equal periodic payments within the meaning of Code section 72(t)(2)(A)(iv), as set forth in Notice 89-25, 1989-1 C.B. 662.

The ruling, as initially submitted on behalf of Taxpayer A, contained three rulings, the first of which was whether the series of payments Taxpayer A commenced receiving in 2001 constitute a series of substantially equal periodic payments under section 72(t)(2)(A)(iv) of the Code. In a letter dated October 15, 2002, you withdrew your first ruling request. You asked that we issue the remaining rulings based on proposed transactions to take place when Taxpayer A has attained

age 59 1/2 upon termination of the annual installment payments. The remaining rulings concern whether the proposed distribution from Plan X to Taxpayer A meets the requirements of a "lump sum distribution", as defined under Code section 402(e)(4)(D) in addition to those requirements of an "eligible rollover distribution" under Code section 402(c)(4).

Regarding methods of distribution of an early retirement benefit under Plan X, your authorized representative stated further that section 8.7(a)(ii) of Plan X provides that a participant who does elect to receive his or her early retirement benefit in annual installment payments may, after the commencement of such payments, exercise an option to "elect a single sum distribution of his [or her] remaining installments at any time in accordance with procedures established by the Administrator". Your authorized representative confirmed that section 8.7(a)(ii) would allow Taxpayer A, upon attainment of age 59 ½, to change the method of distribution by which he receives his early retirement benefit from annual installment payments to a lump sum payment of the remaining balance in his account.

With respect to the remaining ruling requests, you represent that as of December 31, 2000, the balance of Taxpayer A's account in Plan X was valued at $1,209,000.00. Of this total dollar amount, approximately 68 percent of it was invested in Employer M common stock with a value at or near $828,000.00, and a cost basis of $300,000.00. The remaining percentage of the total valued amount was invested in cash or cash equivalents. Taxpayer A proposes to take a distribution of the entire amount standing to his credit in a lump sum distribution and make a tax free rollover to an eligible retirement plan. Taxpayer A proposes to have Plan X distribute directly to him the Employer M common stock and transfer the remaining account balance to an eligible retirement plan. The purpose of this distribution is to defer taxation on the net unrealized appreciation ("NUA") attributable to the Employer M common stock distributed from Plan X to the extent permitted under section 402(e)(4)(B) of the Code.

It is represented that Taxpayer A has not received any distributions from Plan X since attaining eligibility for early retirement under Plan X other than the periodic payments that commenced in 2001. Taxpayer A does not participate in any other plan maintained by Employer M.

Based on these facts, the following rulings have been requested:

1. That if on account of Taxpayer A attaining age 59 ½, a distribution is made directly to Taxpayer A, within one taxable year, of all Employer M stock credited to Taxpayer A's account under Plan X and, within the same taxable year, all remaining Plan X assets to Taxpayer A's credit, other than Employer M stock, are, pursuant to the election by Taxpayer A under Code section 402(c) or Code section 401(a)(31), rolled over or paid directly (in a trustee-to-trustee transfer) to an IRA, then such payouts from Plan X may properly be treated in the aggregate as constituting a qualifying lump sum distribution under Code section 402(e)(4)(B), thus

allowing Taxpayer A to receive special tax treatment, including the deferral of income recognition on NUA in Employer M stock until such time as Taxpayer A disposes of the stock.

2. That for purposes of the requirements for deferral of income recognition of NUA under Code section 402(e)(4)(B), (without reference to the five year plan participation requirement under Code section 402(d)(4)(F)), Taxpayer A, on account of attaining age 59 ½ and receiving the distribution of his total account balance in Plan X within one taxable year, may make a tax-free rollover of the assets distributed to him, other than the Employer M stock, to an IRA without affecting the status of the distribution as a qualifying lump sum distribution under Code section 402(e)(4)(B).

Section 402(a) of the Code provides that 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 taxable year of the distributee in which distributed, under section 72 (relating to annuities).

Section 401(k)(2)(B) of the Code provides that under a qualified CODA, amounts held by the trust which are attributable to employer contributions made pursuant to the employee's election

(i) may not be distributable to participants or other beneficiaries earlier than--
- (I) severance from employment, death, or disability,
- (II) an event described in paragraph (10),
- (III) in the case of a profit-sharing or stock bonus plan, the attainment of age 59 1/2,
- (IV) in the case of contributions to a profit-sharing plan or stock bonus plan to which section 402(e)(3) applies, upon hardship of the employee, and

(ii) will not be distributable merely by reason of the completion of a stated period of participation or the lapse of a fixed number of years.

Section 402(e)(4)(D) of the Code defines a "lump sum distribution", for purposes of this paragraph, as the distribution or payment within one taxable year of the recipient of the balance to the credit of an employee that becomes payable to the recipient--
- (I) on account of the employee's death,
- (II) after the employee attains age 59 ½,
- (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 or from a plan described in section 403(a).

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

Section 402(e)(4)(C) of the Code provides that, for purposes of subparagraph (B), NUA and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Secretary [of the Treasury].

Section 1.402(a)-1(b)(1)(i)(a) of the Income Tax Regulations ("regulations") provides that if a distribution from a trust described in Code section 401(a) constitutes a total distribution of the balance to the credit of an employee, then, the amount to be excluded from the distributee's income is the entire NUA attributable to that part of the total distribution which consists of securities of the employer corporation.

Section 1.402(a)-1(b)(2)(i) of the regulations defines NUA in securities of the employer corporation as the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust.

References herein to the term, "qualified trust" in citations regarding Code section 401(a)(31) or regarding Code section 402 are references to an employees' trust described in section 401(a) which is exempt from tax under section 501(a).

References below to the term, "eligible plan" in citations regarding Code section 401(a)(31) are references to a plan that is distributing benefits. References below to the term, "eligible retirement plan" in citations regarding Code section 401(a)(31) or regarding Code section 402 are references to a plan that is receiving benefits.

Section 402(c)(4) of the Code provides that 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 period of 10 years or more,

(B) any distribution to the extent such distribution is required under section 401(a)(9), and

(C) any distribution which is made upon hardship of the employee as provided for under Code section 401(k)(2)(B)(i)(IV).

Section 402(c)(8)(B) of the Code states that an "eligible retirement plan" means--

(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 qualified trust,
(iv) an annuity plan described in section 403(a),
(v) an eligible deferred compensation plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A), and
(vi) an annuity contract described in section 403(b).

Section 402(c)(3) of the Code provides, generally, that the section 402(c)(1) rollover rule shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

Section 401(a)(31)(A) of the Code provides that a trust shall not constitute a Code section 401(a) qualified trust unless the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution --

(i) elects to have such distribution paid directly to an eligible retirement plan, and
(ii) specifies the eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

Section 401(a)(31) of the Code refers to section 402(f)(2)(A) for the meaning of the term "eligible rollover distribution" as used in section 401(a)(31) of the Code. Section 402(f)(2)(A) in turn refers to the Code section 402(c)(4) definition of "eligible rollover distribution" which is cited herein on page 5.

Section 401(a)(31)(B)(i) of the Code provides that a trust which is part of an eligible plan shall not constitute a Code section 401(a) qualified trust unless the plan of which such trust is a part provides that if--

(I) a distribution described in clause (ii) in excess of $1,000 is made, and

(II) the distributee does not make an election under subparagraph (A) and does not elect to receive the distribution directly,

the plan administrator shall make such transfer to an individual retirement plan of a designated trustee or issuer and shall notify the distributee in writing (either separately or as part of the notice under Code section 402(f)) that the distribution may be transferred to another individual retirement plan.

Section 401(a)(31)(B)(ii) of the Code states that for purposes of clause (i) the term "eligible plan" means a plan which provides that any nonforfeitable accrued benefit for which the present value (as determined under section 411(a)(11)) does not exceed $5,000 shall be immediately distributed to the participant.

Generally, a direct trustee-to-trustee transfer described in section 401(a)(31) of the Code constitutes a "direct rollover" of an "eligible rollover distribution" and is entitled to tax-deferred treatment pursuant to section 402(c) of the Code.

Section 1.401(a)(31)-1 of the regulations, Question and Answer 5, provides that an eligible rollover distribution that is paid to an eligible retirement plan in a direct rollover is not currently includible in the distributee's gross income under Code section 402(c) and is exempt from the 20-percent withholding imposed under Code section 3405(c)(2).

Section 1.401(a)(31)-1 of the regulations, Question and Answer 14, provides, in pertinent part, that a direct rollover is a distribution and rollover of the eligible rollover distribution and not a transfer of assets and liabilities.

In this case, Taxpayer A has not attained age 59 ½ but has retired and separated from the service of Employer M. Upon attainment of age 59 ½, Taxpayer A intends to elect to receive a distribution of the full amount standing to his credit under Plan X within one taxable year. Shares of Employer M's corporation securities will be paid directly to Taxpayer A. The remaining balance will be distributed by means of a direct rollover to an IRA described under Code section 408(a).

Distribution of Taxpayer A's entire account balance in the above manner is, therefore, a "lump sum distribution" as that term is defined in Code section 402(e)(4)(D). Furthermore, neither the Code nor the regulations promulgated thereunder preclude a distribution from being treated as a lump sum distribution under section 402(e)(4)(D) for purposes of section 402(e)(4)(B) even if a portion of the distribution is either rolled over or directly transferred into an IRA.

Accordingly, with respect to your ruling requests, we conclude as follows:

As to ruling request one, where on account of Taxpayer A attaining age 59 ½, a distribution is made directly to Taxpayer A, within one taxable year, of all Employer M stock credited to Taxpayer A's account under Plan X and, within the same taxable year, all remaining Plan X assets to Taxpayer A's

credit, other than Employer M stock, are, pursuant to the election by Taxpayer A under Code section 402(c) or Code section 401(a)(31), rolled over or paid directly (in a trustee to trustee transfer) to an IRA, then such payouts from Plan X may properly be treated in the aggregate as constituting a qualifying lump sum distribution under Code section 402(e)(4)(B), thus allowing Taxpayer A to receive special tax treatment, including the deferral of income recognition on NUA in Employer M stock until such time as Taxpayer A disposes of the stock.

As to ruling request two, for purposes of the requirements for deferral of income recognition of NUA under Code section 402(e)(4)(B), (without reference to the five year plan participation requirement under Code section 402(d)(4)(F)), Taxpayer A, on account of attaining age 59 ½ and receiving the distribution of his total account balance in Plan X within one taxable year, may make a tax-free rollover of the assets distributed to him, other than the Employer M stock, to an IRA without affecting the status of the distribution as a qualifying lump sum distribution under Code section 402(e)(4)(B).

These rulings are based on the assumption that Plan X is qualified under sections 401(a) and 401(k) of the Code and that its related trust is tax-exempt under section 501(a) at all times relevant to this ruling.

This letter ruling further assumes that Taxpayer A's distributions from Plan X were made, and will be made, in accordance with the terms of Plan X. This letter ruling also assumes that the IRA, as referenced above and as proposed by Taxpayer A, will meet the requirements of Code section 408(a) at all times relevant to this ruling. This ruling also assumes that no payments other than the series of periodic payments that commenced in 2001 are made to Taxpayer A before he attains age 59 1/2.

This ruling expresses no opinion as to whether the series of periodic payments made to Taxpayer A meet the requirements of Notice 89-25. In addition, no opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations, which may be applicable. Further, Taxpayer A may not rely on this ruling to the extent the analysis and conclusions are affected by other guidance.

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

A copy of this ruling letter has been sent to your authorized representative in accordance with the power of attorney on file in this office.

If you have any questions about this ruling, please contact
T:EP:RA:T2

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:
Deleted copy of ruling letter
Notice of Intention to Disclose, Form 437

CC: