200321019

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

FEB 2 5 2003

UIL: 401.26-00
415.00-00

T:EP:RA:T:A2

Re:

Plan A =

Plan B =

Dear

This letter is in response to your request for a ruling with respect to the proposed creation of Plan B and its effect on Plan A. Your original request was dated April 4, 2001, ~~and~~ was subsequently modified by a letter dated October 25, 2002. You have asked us to rule on the following issues:

(1) The adoption, operation, and funding of Plan B will not cause Plan A to lose its qualified status under § 401(a) of the Internal Revenue Code (Code).

(2) Contributions made to Plan B will be deductible by the employers under § 404 of the Code.

Facts

According to the facts as stated in your ruling request, Plan A is a qualified multiemployer defined benefit pension plan operated under the Employee Retirement Income Security Act of 1974, as amended (ERISA).

Plan A provides collectively bargained pension benefits for its participants. It is governed by a Board of Trustees, half of whom are union representatives and half of whom are employer representatives.

Plan A's benefits are subject to the maximum annual benefit limitations of § 415(b) of the Code. Because some of Plan A's participants are or soon may be receiving benefits that are adversely affected under the rules of § 415(b), the Trustees have proposed to create Plan B. Most of the participants whose benefits are impacted by the limitations of § 415(b) are those who chose to retire before age 50 with a minimum of 25 years of service.

Plan B is designed to provide, on a nonqualified basis, the additional benefits that a participant would receive under Plan A if there were no benefit limitations under § 415(b). Plan B provides that on a monthly basis the administrator of both Plan A and Plan B will allocate a portion of total employer contributions to Plan B. This amount will consist of (1) excess benefits that cannot be paid under Plan A because of the limitations imposed by § 415(b), (2) FICA and FUTA taxes that would otherwise be payable on the excess benefit, and (3) sufficient funds to pay all of Plan B's administrative expenses, including attorneys' fees, accounting fees, and any taxes payable by Plan B. The remainder of the employer contributions will then be allocated to Plan A. Upon receipt of the contributions to Plan A, they cannot be shifted to Plan B.

As an unfunded plan, Plan B is intended to serve as a passthrough entity for excess benefit payments. Plan B will not permit any accumulation of assets.

A participant's benefit under Plan B equals the amount payable under Plan A that exceeds the amount limited by § 415(b) of the Code. This amount under Plan B is further increased to reflect employment taxes due on that amount, so that payments to the participant, net of the employment taxes, are the same amounts the participant would receive if the amounts were not subject to employment taxes.

In order to make contributions to Plan B, it is anticipated that the participation agreement between the union and Plan A's trust will be amended to require the union to make its monthly contributions to Plans A and B into a collection account, direct the administrative manager to allocate and transfer the amount of contributions to fund Plan B's current benefits, associated employment taxes and related expenses into Plan B's trust, and direct the administrative manager to transfer the amounts remaining in the collection account in Plan A's trust. Other participating employers of Plan A may choose to amend their collective bargaining agreements to provide additional funding sources for Plan B, but this will be determined in collective bargaining. If the union's contributions alone are insufficient to fund Plan B's on-going obligations, Plan B's benefits will be reduced as discussed above. This envisions that the participating employers of Plan B will serve as the funding sources for the excess benefits of all participants in Plan B, regardless of whether the participants' employers have agreed to become participating employers of Plan B.

Applicable Law

Section 3(36) of Title I of ERISA provides that the term "excess benefit plan" means a plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by § 415 of the Code on plans to which that section applies, without regard to whether the plan is funded. To the extent that a separable part of a plan (as determined by the Secretary of Labor) maintained by an employer is maintained for such purpose, that part shall be treated as a separate plan, which is an excess benefit plan.

Section 401(a)(16) of the Code provides that a qualified plan must not provide for benefits or contributions that exceed the limitation of § 415.

Section 404 of the Code provides deduction rules for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan. Section 404(a) provides that, if contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation are not deductible under that chapter; but, if they would otherwise be deductible, they shall be deductible under that section, subject, however, to the limitations in that section as to the amounts deductible in any year. Section 404(a)(5) provides that contributions or compensation deferred under a plan not included in § 404(a)(1), (2), or (3), are deductible in the taxable year in which an amount attributable to the contribution is includible in the gross income of the employees participating in the plan, but in the case of a plan in which more than one employee participates, only if separate accounts are maintained for each employee.

Section 412 of the Code provides minimum funding standards that pension plans must satisfy. Section 412(h) provides exceptions to § 412 for certain plans.

Section 415 of the Code provides limitations on benefits and contributions that may be provided under qualified plans. Section 415(b) provides limitations that qualified defined benefit plans must satisfy. Section 415(b)(1) provides, in general, that the annual benefit a participant can receive under a qualified defined benefit plan must not exceed the lesser of a specified dollar amount or 100 percent of the participant's average compensation for his high three years. The specified dollar amount effective January 1, 2003 is $160,000. However, as provided in § 654 of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and Q&A-8 of Rev. Rul. 2001-51, 2001-45 I.R.B. 427, the compensation limitation under § 415(b)(1)(B) does not apply to multiemployer defined benefit plans for limitation years beginning after December 31, 2001.

Section 1.404(a)-12(b) of the regulations provides that, in general, a deduction is allowable for a contribution only in the taxable year of the employer in which or with which ends the taxable year of an employee in which an amount attributable to such contribution is includible in the employee's gross income as compensation, and then only to the extent allowable under § 404(a) of the Code. In the case of a funded plan under which more than one employee participates, no deduction is allowable under § 404(a)(5) of the Code for any contribution unless separate accounts are maintained for each employee.

Section 1.414(l)-1(b)(1) of the regulations provides that, for purposes of that section, a plan is a "single plan" if and only if, on an ongoing basis, all of the plan assets are

available to pay benefits to employees who are covered by the plan and their beneficiaries.

Rationale

Section 401(a)(16) of the Code provides that a qualified plan must satisfy § 415. Section 415(b) provides limitations that benefits provided under a qualified defined benefit plan must satisfy. Thus, where a participant's benefit under Plan A's benefit formula exceeds the limitation under § 415(b) applicable to the participant, adjusted as necessary for the commencement age and the form in which the benefit will be paid, the participant's benefit under Plan A must be limited (reduced) so that it does not exceed such limitation.

Section 3(36) of Title I of ERISA provides that an excess benefit plan is a plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations under § 415 of the Code applicable to the employee, without regard to whether the plan is funded. Plan B is intended to be an excess benefit plan under § 3(36) of ERISA.

Section 1.414(l)-1(b)(1) of the regulations provides that a plan is a single plan, for purposes of that section, if and only if all the plan assets are available to pay benefits to participants and beneficiaries. The assets of Plan A are not available to pay benefits under Plan B, and the assets of Plan B are not available to pay benefits under Plan A. Therefore, Plan A and Plan B do not constitute a single plan. Plan B is separate from Plan A and provides benefits on a nonqualified basis, which supplement the benefits that certain participants under Plan A receive from Plan A. Furthermore, the benefit provided to a participant under Plan B cannot be provided under Plan A because it would cause the participant's Plan A benefit to exceed the limitation of § 415 of the Code. Thus, the existence of Plan B, an excess benefit plan, does not affect the qualified status of Plan A.

The contribution rate(s) for employers sponsoring Plans A and B is established as part of the collective-bargaining agreements. In order to provide promised benefits to participants in Plan A, and because Plan A is a qualified defined benefit plan subject to § 412, an actuary must determine the contributions required to avoid a funding deficiency in Plan A's funding standard account for each plan year. Such actuarial calculations are independent of the contribution rate(s) established by the collective-bargaining agreements. Furthermore, the minimum funding requirements for Plan A are independent of the amounts contributed to Plan A. Thus, the funding and allocation of employer contributions to Plan B pursuant to the collective-bargaining agreements will not affect the qualified status of Plan A.

Section 404(a) of the Code provides the general deduction timing rules applicable to a stock bonus plan, pension, profit sharing, or annuity plan, or if compensation is paid or

accrued on account of any employee under a plan or arrangement for deferring compensation, regardless of the section of the Code under which the amounts might otherwise be deductible. Pursuant to § 404(a)(5), contributions or compensation deferred under a nonqualified plan or arrangement, if otherwise deductible, are deductible in the taxable year in which an amount attributable to the contribution are includible in the gross income of the employees participating in the plan, but in the case of a plan in which more than one employee participates, only if separate accounts are maintained for each employee.

Section 1.404(a)-12(b)(3) of the regulations provides that the deduction is allowable for contributions paid only in the taxable year in which or with which ends the taxable year of an employee in which an amount attributable to the contribution is includible in his or her income as compensation, and then only to the extent allowable under § 404(a) of the Code.

Because employees who participate in Plan B are fully vested in their benefits when employer contributions are made and separate accounts are maintained for each employee, each employer who participates in Plan B is entitled to the deduction under § 404(a)(5) of the Code in an amount equal to the amount included in income by their respective employees, assuming all other requirements for deductibility are met. The deduction is allowable in the taxable year in which or with which ends the taxable year of the employee in which the amount is includible in the employee's income as compensation.

Holdings

(1) The adoption, operation, and funding of Plan B will not cause Plan A to lose its qualified status under § 401(a) of the Internal Revenue Code (Code).

(2) Contributions made to Plan B will be deductible by the employers under § 404 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.

This letter does not consider the more general issue of Plan A's qualified status, specifically, whether Plan A complies with all the requirements under the Code for qualification. This letter addresses only the impact (if any) of the adoption, operation, and funding of Plan B on the purportedly otherwise qualified status of Plan A. Additionally, except as specifically ruled above, no opinion is expressed regarding the subject transaction under any provision of the Code, including the consequences to participants under §§ 83 and 402(b) of the Code. Moreover, we express no opinion regarding the federal employment tax aspects of the transaction described above.

If you require further assistance in this matter, please contact at

Sincerely yours,

Martin L. Pippins

Martin L. Pippins, Manager
Employee Plans Actuarial Group 2