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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

T:EP:RA:T2

Index No.: 4980.00-00

AUG - 6 2003

Attn.:

Legend:

Company M =

Plan X =

Plan Y =

Dear :

This letter is in response to a request submitted by your authorized representative dated August 15, 2002, as supplemented by letters dated November 21, 2002, July 16, 2003, July 29, 2003, concerning the proper treatment of a reversion from its pension plan under section 4980 of the Internal Revenue Code (the "Code").

The following facts and representations have been submitted:

Company M established Plan X, a defined benefit plan, for its employees on January 1, 1956. On December 31, 1992, Company M froze Plan X and, effective January 1, 1993, established Plan Y in order to enhance retirement benefits for its employees. Plan Y is a defined contribution plan with a cash or deferred arrangement as described in section 401(k) of the Code. Participation in Plan Y is offered to all employees of Company M. Both Plan X and Plan Y are qualified plans under section 401(a) and their related trusts are exempt from taxation under section 501(a).

Plan X provided 100 percent vesting for all the participants when it was frozen on December 31, 1992. Since then a majority of the participants took lump sum distributions from Plan X. Currently there are 59 participants receiving monthly benefits from Plan X.

Plan X's assets as of January 1, 2002, amounted to approximately $1,500,000. The actuaries estimated that the actuarial present value of future benefits is approximately $570,000. Thus, the asset surplus as of January 1, 2002, was approximately $930,000.

Company M established Plan Y effective January 1, 1993. Under Plan Y, the participants may elect to defer a percentage of their compensation on a pre-tax basis. Company M also makes discretionary profit sharing contributions to Plan Y, which are allocated on behalf of participants based on their respective compensation for the plan year, which is a calendar year. For 2001, Company M contributed approximately $11,000 to Plan Y.

Company M proposes to terminate Plan X and distribute the vested benefits, including annuity contracts to all participants. Company M proposes to make a direct transfer from Plan X to Plan Y, before any reversion of any excess money is made to Company M. Company M proposes to distribute 25 percent of the surplus to Plan Y or approximately $232,500 and the residual to Company M or approximately $697,500 (which are the January 1, 2002, figures). The actual amount to be transferred to Plan Y will be equal to the excess of:

(a) 25 percent of the maximum amount the employer could receive as an employer reversion without regard to section 4980(d) of the Code, over

(b) an amount equal to the present value of the aggregated increases in the accrued benefits under the terminated plan, Plan X, of any participants or beneficiaries pursuant to a plan amendment adopted during the sixty day period ending on the date of termination and that takes effect immediately on the termination date.

With respect to the contributions to Plan Y, Company M proposes to credit this amount to a suspense account that will be allocated together with the earnings thereof ratably over a period not more than seven years to the account of the participants of Plan Y starting with the year of the reversion. The allocations will be coordinated with the limitations under section 415 of the Code that may apply to certain participants in Plan Y, the replacement plan. The percentage of the active participants in Plan Y who will remain as employees of Company M and who are participating in the replacement plan, Plan Y, is 96.6 percent.

Company M is proposing to pay an excise tax of 20 percent under section 4980 of the Code and will include the residual of the reversion in its taxable income in the year the proposed transaction is effected.

Based on the foregoing, the following rulings are requested:

(1) That Plan Y is a qualified replacement plan of terminated Plan X within the meaning of section 4980(d)(2) of the Code, which would permit Company M

to use a rate of 20 percent on the amount of the reversion, rather than 50 percent.

(2) That the direct transfer of assets from Plan X to Plan Y is not included in Company M's income in the year of the plan asset reversion.

(3) That the transfer of 25 percent of the surplus assets directly from the terminated defined benefit pension plan to Plan Y will not be treated as an employer reversion under section 4980 of the Code and will not subject Company M to the excise tax under section 4980.

(4) That Company M will be subject to an excise tax equal to 20 percent, rather than 50 percent of the residual assets to Company M under section 4980 of the Code as a result of the existence of Plan Y.

Section 61 of the Code defines gross income as all income from whatever source derived (subject to certain exceptions). Section 111(a) 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 that such amount did not reduce the amount of tax imposed by sections 1 through 1400L.

Section 4980(a) of the Code provides for a 20 percent excise tax of the amount of any reversion from a qualified plan. Section 4980(d)(1) provides, in general, that the excise tax under section 4980(a) shall be increased to 50 percent with respect to any employer reversion from a qualified plan unless the employer establishes or maintains a qualified replacement plan, or the plan provides for certain benefit increases which take effect immediately on the termination date.

Section 4980(c)(2)(A) of the Code provides that the term "employer reversion" means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan.

Section 4980(d)(2) of the Code generally established a two-part test to determine whether a plan is a "qualified replacement plan." Initially, the plan must be established or maintained by the employer in connection with a qualified plan termination with respect to which at least 95 percent of the active participants in the terminated plan who remain as employees of the employer after the termination are active participants in the replacement plan. Additionally, a direct transfer must be made from the terminated plan to the replacement plan before any "employer reversion" and the transfer must be in an amount equal to the excess (if any) of (I) 25 percent of the maximum amount the employer could receive as an "employer reversion" (determined without regard to section 4980(d)) over (II) the present value of the aggregate increases in the accrued benefits under the terminated plan of any participants or beneficiaries under a plan amendment which is adopted within 60 days before the plan termination and which takes effect immediately upon plan termination.

Section 4980(d)(2)(B)(iii) of the Code provides that, in the case of any amount transferred under section 4980(d)(2)(b)(i) from a terminated plan to a qualified replacement plan, such amount (I) shall not be included in the gross income of the employer, (II) no deduction shall be allowed with respect to such transfer, and (III) such transfer shall not be treated as an employer reversion for purposes of section 4980.

Section 4980(d)(2)(C)(1) of the Code provides that, if the replacement plan is a defined contribution plan, the amount transferred to the replacement plan must be: (I) allocated under the plan to the accounts of participants in the plan year in which the transfer occurs; or (II) credited to a suspense account and allocated from such account to accounts of participants no less rapidly than ratably over the seven plan year period beginning with the year of the transfer. Section 4980(d)(4)(B) provides, in part, that the allocation of any amount (or income allocable thereto) to any amounts under section 4980(d)(2)(C) shall be treated as an annual addition for purposes of section 415.

Of the active employees who were participants in Plan X and who are still employed by Company M, it has been represented that 96.6 percent of these employees are active participants in Plan Y and will receive an allocation under Plan Y. Thus, at least 95 percent of the active participants in Plan X who remain as employees of Company M after Plan X's termination will be active participants in Plan Y.

Under the terms of Plan X, any amount transferred from Plan X into the suspense account in Plan Y will be allocated no less rapidly than ratably over the seven-year-period beginning with the year of the transfer. The allocations will be correlated with the limitations under section 415 of the Code that may apply to certain participants in Plan Y.

The direct transfer from Plan Y to Plan X will be made before any reversion of any excess money is made to Company M. The amount to be transferred to Plan Y will be equal to the excess of

(a) 25 percent of the maximum amount the employer could receive as an employer reversion without regard to section 4980(d) of the Code, over

(b) an amount equal to the present value of the aggregated increases in the accrued benefits under the terminated plan of any participants or beneficiaries pursuant to a plan amendment adopted during the sixty day period ending on the date of termination and that takes effect immediately on the termination date.

Since at least 25 percent of the excess assets remaining after the termination of Plan X will be directly transferred to the trust which holds the Plan Y assets, the requirements of section 4980(d)(2) of the Code will be met with respect to Plan Y. Accordingly, with respect to the first ruling request, we conclude that Plan Y constitutes a qualified replacement plan within the meaning of section 4980(d)(2), provided that an

amount equal to at least 25 percent of the maximum amount Company M could receive as a reversion is directly transferred from Plan X to Plan Y.

With respect to ruling requests number two, three and four, we conclude that if an amount that is equal to at least 25 percent of the maximum amount which Company M could receive as an employer reversion is directly transferred from Plan X to Plan Y, such amount transferred from Plan X to Plan Y, in accordance with Code section 4980(d)(2)(B)(iii), is not includible in the gross income of Company M, no deduction is allowable with respect to the amount transferred, the amount transferred is not treated as an employer reversion for purposes of section 4980 and will not be subject to the excise tax under section 4980; Company M will be subject to an excise tax equal to 20 percent, rather than 50 percent of the employer reversion because Plan Y is treated as a replacement plan within the meaning of section 4980(d)(2); and the employer reversion received by Company M is subject to the 20 percent excise tax under section 4980(a) and is includible in Company M's gross income under section 61.

These rulings are based on the assumptions that Plan X and Plan Y are qualified under section 401(a) of the Code and that their related trusts are tax-exempt under section 501(a) at all times relevant to this ruling.

No opinion is expressed as to the whether the Code section 401(h) account Company M maintains for its retired employees prior to and subsequent to the termination of Plan X, or whether the funding of such account prior to and subsequent to the termination of Plan Y meets the requirements of Code section 401(h).

This ruling letter 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.

If you have any questions, please contact .

We have sent a copy of this letter to your authorized representative pursuant to a Form 2848 (power of attorney) on file with our office.

Sincerely yours,

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:
Deleted copy of letter ruling
Form 437

200344026

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: AUG 07 2003

Contact Person:

Identification Number:

Telephone Number:

SIN: 4945.00-00

T:EO:BR4

Employer Identification Number:

F=
B=
C=
D=
X=

Dear Sir or Madam:

This is in reference to your representative's letter of July 30, 2003, requesting advance approval of your grant procedures under section 4945(g) of the Internal Revenue Code.

The information submitted shows that the grants will be administered by F, a publicly supported organization, under its B. F selects individual scholarship recipients through its C competition. The initial phase of the competition is the X Test, which is given annually in participating high schools by high school officials. After the test, F identifies and honors students scoring in a group that represents the top two percent of graduating high school seniors nationwide, and designates a number that represents less than one percent of the graduating high school seniors in each state as semifinalists. The semifinalists then take a second test to "confirm" their earlier performance. Those who repeat their performance, who demonstrate high academic standing in high school and who meet other standard requirements are designated as finalists.

You have entered into an agreement with F whereby you have agreed to sponsor a specific number of scholarships each year, to be awarded to children and/or relatives of employees of D. Under the B, F may award "special scholarships" to high-scoring students below the finalist level, if there are an insufficient number of finalists.

The selection of individual grant recipients is made by selection committees designated by F. The members of the selection committee are totally independent and separate from you. F confirms the individual scholarship recipient's enrollment at the educational institution, makes

payment of the award through the appropriate financial aid office of the educational institution, and supervises and investigates the use of the grant funds by the recipients in their educational program.

The scholarships will not be used as a means of inducement to recruit employees nor will a grant be terminated if an employee leaves the company. Scholarships will only be awarded to students who plan to enroll in an institution that meets the requirements of section 170(b)(1)(A)(ii) of the Code and which may be further limited by F. The recipient will not be restricted in his/her course of study.

Section 4945 of the Code provides for the imposition of taxes on each taxable expenditure of a private foundation.

Section 4945(d)(3) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of section 4945(g).

Section 4945(g)(1) of the Code provides that section 4945(d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary, if it is demonstrated to the satisfaction of the Secretary that the grant constitutes a scholarship or fellowship grant which is subject to the provisions of section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii).

Rev. Proc. 76-47, 1976-2 C.B. 670 sets forth guidelines to be used in determining whether a grant made by a private foundation under an employer-related program to a child of an employee of the particular employer to which the program relates is a scholarship grant subject to the provisions of section 117(a). If a private foundation's program satisfies the seven conditions set forth in sections 4.01 through 4.07 of Rev. Proc. 76-47 and meets the percentage test described in section 4.08, the Service will assume the grant will be subject to the provisions of section 117(a).

Section 4.08 of Rev. Proc. 76-47 provides a percentage test guideline. It states that in the case of a program that awards grants to children of employees of a particular employer, the program meets the percentage test if the number of grants awarded under that program in any year to such children does not exceed 25 percent of the number of employees' children who (i) were eligible, (ii) were applicants for such grants, and (iii) were considered by the selection committee in selecting the recipients of grants in that year, or 10 percent of the number of employees' children who can be shown to be eligible for grants (whether or not they submitted an application) in that year.

F will supply statistical information on applications received and grants made which will enable you to maintain the records required by Rev. Proc. 76-47. You have agreed that your scholarship program will meet the requirements of Rev. Proc. 76-47, and that special

scholarship awards will be in compliance with either the 25 or 10 percent test of section 4.08 applicable to a program that awards grants to children of employees of a particular employer.

If you wish to meet the 10 percent test, "eligible" employees' children shall include all employees' children who take the required tests in the applicable year and otherwise meet the minimum requirements for eligibility established by you. In addition, if you wish to meet the 10 percent test you must obtain an actual count to show the number of employees' children who are eligible for grants, whether or not they submitted an application in the applicable year.

Accordingly, based upon the information presented, and assuming the program will be conducted as proposed, with a view to providing objectivity and non-discrimination in the awarding of scholarship grants, we rule that your grants to F for the awarding of scholarship grants to children and/or relatives of employees of D comply with the requirements of section 4945(g)(1) of the Code. Thus, such expenditures made in accordance with those procedures will not constitute "taxable expenditures" within the meaning of section 4945(d)(3) of the Code.

The recipient of the scholarship is responsible for determining whether all or part of the scholarship is includible in gross income under section 117 of the Code. We understand that F will advise the recipient that amounts granted are taxable income, if the aggregate scholarship amounts received by the recipient exceed tuition and fees (not including room and board) required for enrollment or attendance at the educational institution and fees, books, supplies, and equipment required for courses of instruction.

This ruling is based on the understanding that there will be no material change in the facts upon which it is based and that no grants will be awarded to relatives of members of selection committees, or for a purpose inconsistent with the purposes described in section 170(c)(2)(B) of the Code. Any changes in the procedure must be reported to your key district office for exempt organization matters.

This ruling will remain in effect as long as the procedures in awarding grants under your program remain in compliance with sections 4.01 through 4.08 of Rev. Proc. 76-47. Records should be maintained to show that you meet the applicable percentage test of section 4.08 thereof.

Please note that this ruling is only applicable to grants awarded under the B competition. Before you enter into any other scholarship or educational loan program you should submit a request for advance approval of that program, and the requirements of Rev. Proc. 76-47 must be met in the aggregate. Your procedures for awarding scholarships to students designated as finalists under C are considered to satisfy the facts and circumstances test of Rev. Proc. 76-47 and, therefore, only those scholarships offered to individuals below the finalist level under your B will be counted in determining whether the percentage test of Rev. Proc. 76-47 is met with respect to special scholarship awards made under the B competition and any scholarship awards made under any other such program.

We are informing the TE/GE key district office of this ruling. Please keep a copy of this ruling with your organization's permanent records.

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

Sincerely,

Gerald V. Sack

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4