Significant Index No. 4980.00-00

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

200214031

DEC 13 2001

COMMISSIONER
TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

T:EP:A2

In re: Request for ruling on behalf of

Company M =
Company S =
Company F =

Plan 1 =

Dear

This letter is in response to your letter, dated August 10, 1999, in which you requested rulings on behalf of Company M related to amounts realized as a result of the conversion of Company S from a mutual insurance company to a stock insurance company, Company F. Your request was amended in a telephone call with and of our office on October 10, 2001, and in a letter dated November 15, 2001. In your request, as amended, you requested rulings that the amounts realized as a result of the conversion of Company S from a mutual insurance company to a stock insurance company, Company F, are assets of Plan 1 and may be distributed to participants of Plan 1, and that Company M will not be subject to an excise tax under section 4980 of the Internal Revenue Code (Code) on such amounts.

Facts

According to the facts as stated, Company M is an S corporation whose primary business is and . Company M is the sponsor of Plan 1, a defined benefit plan with a calendar year plan year. Company M also maintains a profit sharing plan, Plan 2, for its employees. Company M resolved on , to increase certain benefits under Plan 1, and the resulting amendment to Plan 1 was adopted on effective . Plan 1 was terminated, effective , by a board resolution on , which stated that any excess assets were to be used to increase benefits for active plan participants in a manner recognizing length of service and consistent with the requirements of the Code. Company M filed Form 5310 with the Internal Revenue Service (Service) and received a determination letter, dated March 19, 1998, stating that the termination

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did not adversely affect the qualified status of Plan 1. After distribution and receipt of all required benefit election forms, the assets of Plan 1 were distributed during . and ., at which time no surplus assets remained. All participants received 100 percent of their accrued benefit on termination (100 percent of the present value of their accrued benefit in the case of a single sum). The Form 5500 for and a final 5500-C/R (for the plan year beginning . ) were filed on .

At the time of termination of Plan 1, all assets of Plan 1 were invested in two Group Annuity Contracts issued by Company S, a mutual insurance company. Following the termination of Plan 1, Company S became a stock insurance company doing business as Company F. In a letter dated , Company M was notified that shares of stock in Company F (with an approximate market value of $ ) had been issued to Company M on behalf of Plan 1. An account was established on . , by Company M for the sole purpose of holding the stock (or proceeds therefrom). In a letter dated August 10, 1999, Company M requested a ruling from the Service with respect to the treatment of the stock (or proceeds therefrom) resulting from the demutualization of Company S.

Section 10.1.3 of Plan 1, as restated effective January 1, 1994, provides that upon termination or partial termination of the Plan, the rights of each affected participant to benefits accrued to the date of termination or partial termination shall be fully vested to the extent funded. Under this section, after the allocation of the Plan's assets pursuant to the Plan's termination, if surplus assets remain after all liabilities of the Plan have been satisfied in full, such surplus shall revert to the Employer. Section 10.5 of Plan 1 provides that if, after allocation of the Plan assets pursuant to the amendment required by that section, surplus assets remain after all liabilities of the Plan have been satisfied in full, such surplus shall revert to the Employer except that if this provision permitting the reversion to the Employer of surplus assets (if any) has been added to the Plan by way of amendment or restatement where no equivalent Plan provision existed immediately prior to such amendment or restatement, then this provision shall not be treated as effective before the end of the fifth calendar year following the date of adoption of such amendment or restatement.

Section 8.5 of the Plan, as adopted August 12, 1985, and prior to the 1994 restatement (the prior plan), provides that upon termination or partial termination of the Plan the Employer shall amend the Plan so as to provide for the allocation of plan assets as required by law. In such event the rights of each affected Participant to benefits accrued to the date of termination or partial termination shall be fully vested and nonforfeitable to the extent funded. If, after allocation of the Plan assets pursuant to the amendment required by this section, all liabilities of the plan have been satisfied in full and there remain surplus Plan assets not necessary to satisfy the liabilities of the Plan, such surplus shall revert to the Employer.

Company M has stated its belief that the stock issued by Company F on behalf of Plan 1 (or proceeds therefrom) constitutes investment income to Plan 1, the existence of which was unknown and unknowable at the time of termination of Plan 1. Company M has stated its belief that, absent any action on its part, under the terms of Plan 1 the stock (or proceeds therefrom) would revert to Company M as surplus assets. However, Company M has stated that it does not

wish to receive any reversion of this surplus. Company M has stated that it would like all proceeds from the stock issued by Company F to be used to benefit participants of Plan 1. Therefore, Company M proposes to amend Plan 1 to increase the benefits of Plan 1 participants and beneficiaries as of the termination date of Plan 1 to the extent that, after any expenses associated with the calculation and distribution of such benefit increases are paid, no proceeds from the stock issued by Company F remain.

Rulings Requested

Based on the facts as stated, the following rulings have been requested.

1. The proceeds realized as a result of the receipt and subsequent sale of Company F stock may be treated as assets of Plan 1 and may be used to increase benefits of participants and beneficiaries of Plan 1.

2. If all of the proceeds resulting from the receipt and subsequent sale of Company F stock are used to increase benefits of Plan 1 participants and beneficiaries and pay any expenses associated with the calculation and distribution of such benefit increases, then a reversion of surplus assets to Company M will not occur, and Company M will not be subject to an excise tax under Code section 4980 with respect to these proceeds.

Applicable Law

Section 4980 of the Internal Revenue Code provides rules for the tax applicable on the reversion of qualified plan assets to an employer. Section 4980(a) provides for the imposition of a tax of 20 percent of the amount of any employer reversion from a qualified plan. Section 4980(b) provides that the tax under section 4980(a) is to be paid by the employer maintaining the plan. Section 4980(d) provides, in general, that section 4980(a) is applied by substituting "50 percent" for "20 percent" with respect to any employer reversion from a qualified plan unless (A) the employer establishes or maintains a qualified replacement plan, or (B) the plan provides benefit increases meeting the requirements of section 4980(d)(3).

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(c)(2)(B)(i) provides that the term employer reversion does not include, except as provided in regulations, any amount distributed to or on behalf of any employee (or his beneficiaries) if such amount could have been so distributed before termination of such plan without violating any provision of section 401.

Section 401(a)(4) and the regulations thereunder provide that qualified plans must not discriminate in favor of highly compensated employees (within the meaning of section 414(q)).

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

Rationale

Plan 1 was terminated, effective , by a board resolution on , which stated that any excess assets were to be used to increase benefits for active plan participants in a manner recognizing length of service and consistent with the requirements of the Code. Plan 1 was amended on , to increase benefits effective . Following termination, Plan 1's assets were distributed during and , and all participants received the full value of their accrued benefits. Following these distributions, there were no surplus assets that could revert to Company M.

All of the assets of Plan 1 were held in two annuity contracts of Company S. After the termination of Plan 1, the increase in benefits effective on the first day of the year of termination, and subsequent distribution of assets, Plan 1 had no remaining assets. Following the termination of Plan 1 and distribution of assets, the mutual insurance company that had held Plan 1's assets, Company S, became a stock insurance company, Company F. In , Company M received notice that shares of stock in Company F had been issued to Company M on behalf of Plan 1. Once the stock was issued, Company M established an account solely for the purpose of holding any proceeds from this stock. The stock was eventually sold and the proceeds deposited in this account. Company M has not held or used any of the assets held in this account. Because the assets resulting from the demutualization of Company S were not known or held by Plan 1 at the time of termination, the assets could not be distributed to participants at that time. The demutualization of Company S and the subsequent issuance of Company F stock on behalf of Plan 1, in effect, caused Plan 1 to have assets after its date of termination and subsequent distribution of assets. Section 10.5 of Plan 1 provides that, on termination, assets remaining after all Plan liabilities have been satisfied in full revert to Company M. As all liabilities under Plan 1 as of the date of termination were satisfied, these additional assets could revert to Company M under the terms of Plan 1. Company M has stated that it does not want to receive any of the assets resulting from the demutualization of Company S, and would like these assets distributed to Plan 1 participants as benefit increases. For these purposes, Company M will amend Plan 1 to increase participants' benefits in a manner that is nondiscriminatory and that does not violate the limitations of section 415 of the Code.

Under Code section 4980(c)(2)(A), an employer reversion is defined as the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from a qualified plan. The assets resulting from the demutualization of Company S, subsequent issuance of Company F stock on behalf of Plan 1, and sale of such stock, may be treated as assets of Plan 1 for purposes of section 4980 of the Code. Because Plan 1 is treated as having assets, it is possible for the participants of Plan 1 to receive these assets if participants' benefits under Plan 1 are increased. For purposes of Code section 4980, the assets held in the account created solely to hold such assets are treated as assets held by a defined benefit plan. For these purposes, Plan 1 will be treated as still existing and may be amended to increase benefits, provided such increases do not cause the plan to fail to satisfy qualification requirements, including the requirements that benefits be nondiscriminatory in amount, and not exceed the limitations of section 415 of the

Code. Section 4980(c)(2)(B)(i) of the Code provides that the term employer reversion does not include amounts distributed to or on behalf of any employee (or his beneficiaries) if such amounts could have been so distributed before termination of the plan without violating section 401. Accordingly, if Plan 1 is amended to increase benefits and such increases do not violate section 401, the assets of Plan 1 (net of expenses) may be distributed to the participants and beneficiaries of Plan 1, and such distributions will be treated as distributions from Plan 1, eligible for the same tax treatment as other distributions from Plan 1. Because Company M will not receive any surplus amounts from Plan 1 following such distributions, no reversion subject to tax under section 4980 will occur.

Holdings

1. The proceeds realized as a result of the receipt and subsequent sale of Company F stock are assets of Plan 1 and may be used to increase benefits of Plan 1 participants and beneficiaries.

2. If all of the proceeds resulting from the receipt and subsequent sale of Company F stock are used to increase benefits of Plan 1 participants and beneficiaries and pay any expenses associated with the calculation and distribution of such benefit increases, then a reversion of surplus assets to Company M will not occur and Company M will not be subject to an excise tax under Code section 4980 with respect to these proceeds.

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 by others as precedent.

If you have questions please call at (not a toll-free number). In any correspondence relating to this letter, please refer to as well.

Sincerely yours,

Martin L. Pippins

Martin L. Pippins, Manager
Employee Plans Actuarial Branch 2
Tax Exempt and Government Entities Division

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