



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200617037

JAN 31 2006

U.I.L. 402.08-00

T. EP. RA. T2

Legend:

- Taxpayer A = *****
- Plan X = *****
- Employer K = *****
- IRA X = *****
- Company B = *****
- Amount D = *****
- Amount E = *****
- Amount F = *****
- Amount G = *****

Dear *****:

This is in response to your letter dated August 11, 2005, as supplemented by correspondence dated September 26, 2005, October 3, 2005, and October 26, 2005. Your request for a ruling was revised in correspondence dated October 27, 2005, and further supplemented by correspondence dated October 28, 2005. You ask whether a plan loan offset amount is an eligible rollover distribution that

can be rolled over to an eligible retirement plan under section 402(c)(3) of the Internal Revenue Code (the "Code").

The following facts and representations have been submitted under penalties of perjury in support of your request.

Taxpayer A was employed by Employer K. During his employment with Employer K, Taxpayer A participated in Plan X, a plan described in Code section 401(k), maintained by Employer K. Taxpayer A states that during his employment with Employer K, he obtained a loan in the amount of Amount G from Plan X to use as a down payment on his first home. Taxpayer A terminated employment with Employer K in . Taxpayer A states that on , he received a letter from the administrator of Plan X indicating that the outstanding balance of his loan from Plan X would be in default effective

. The letter also states that the outstanding loan balance as of (Amount F), will be deemed a taxable event. Taxpayer A states that his Plan X account Balance at the time of his termination of employment with Employer K was Amount D.

Documentation submitted by Taxpayer A shows that in a letter dated , he mailed to Company B two checks to be rolled over into IRA X. One check in the amount of Amount E dated , was issued by Employer K that represented the balance in Taxpayer A's Plan X account. This check was made payable to Company B for the benefit of Taxpayer A's IRA X. The other check dated , in the amount of Amount F, was drawn on Taxpayer A's personal checking account, payable to Company B, for deposit in IRA X. This check was intended to cover the amount of the outstanding loan balance that Taxpayer A obtained from Plan X and which was placed in default by Employer K on . Documentation submitted by Taxpayer A shows that both checks in the sum of Amount D were rolled over into IRA X within the applicable 60-day rollover period.

Taxpayer A received two Forms 1099-R from Employer K for tax year . One Form 1099-R indicated a gross distribution in the amount of Amount E, with a distribution code "G" (direct rollover); the other Form 1099-R indicated a gross distribution in the amount of Amount F, with a distribution code of "1" (Early distribution). Taxpayer A filed his tax return and included Amount F, the outstanding loan balance, in his gross income for that year, even though Amount F had been rolled over into IRA X within 60 days of the date that Employer K treated the loan as in default.

Based upon the foregoing facts and representation, you ask whether Amount F is a plan loan offset amount that is an eligible rollover distribution that can be rolled over to an eligible retirement plan under Code section 402(c)(3).

Section 402(c) of the Code provides rules governing rollover of amounts from exempt trust to eligible retirement plans, including IRAs.

Code section 402(c)(1) provides, generally, that if any portion of an eligible rollover distribution from a qualified trust is paid to the employee in an eligible rollover distribution and the employee transfers any portion of the property received in such distribution to an "eligible retirement plan", and in the case of a distribution of property other than money, the amount so transferred consists of property distributed, such distribution (to the extent transferred) shall not be includible in gross income for the taxable year in which paid.

Code section 402(c)(8) defines "eligible retirement plan" as (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; (v) an annuity plan described in section 403(a); (v) an eligible deferred compensation plan described in section 457(b) maintained by an eligible employer as described in section 457(e)(1)(A); and (vi) an annuity contract described in section 403(b).

Section 402(c)(2) of the Code provides that the maximum amount of an eligible rollover distribution to which paragraph (1) applies shall not exceed the portion of such distribution which is includible in gross income (determined without regard to paragraph (1)).

Section 402(c)(4) of the Code defines "eligible rollover distribution" as any distribution to any employee of all or a portion of the balance to the credit of an 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 specified period of 10 years or more,
- (B) any distribution to the extent the distribution is required under section 401(a)(9), and
- (C) any distribution which is made upon hardship of the employee.

Section 1.402(c)-2, Q&A-9(a) of the Income Tax Regulations (the "Regulations") provides that a distribution of a plan loan offset amount is an eligible rollover distribution if it satisfies Q&A-3 (definition of eligible rollover distribution). Thus, an amount equal to the plan loan offset amount can be rolled over by the employee (or spousal distribute) to an eligible retirement plan within the 60-day

period under Code section 402(c)(3), unless the plan offset amount fails to be an eligible rollover distribution for another reason.

Section 1.402(c)-2, Q&A-9(b) of the Regulations provides that for purposes of Code section 402(c), a distribution of a plan loan offset amount is a distribution that occurs when, under the plan terms governing a plan loan, the participant's accrued benefit is reduced (offset) in order to repay the loan (including the enforcement of the plan's security interest in a participant's accrued benefit). A distribution of a plan loan offset amount can occur in a variety of circumstances, e.g., where the terms governing a plan loan require that, in the event of the employee's termination of employment or request for a distribution, the loan be repaid immediately or treated as in default. A distribution of a plan loan offset amount also occurs when, under the terms governing the plan loan, the loan is accelerated, or treated as if it were in default (e.g., where the plan treats a loan as in default upon an employee's termination of employment or within a specified period thereafter). A distribution of a plan loan offset is an actual distribution, not a deemed distribution under Code section 72(p).

Under section 1.402(c)-2, Q&A-9(a) of the Regulations, a plan loan offset amount is an eligible rollover distribution if it otherwise satisfies 1.402(c)-2, Q&A-3 of the Regulations (definition of "eligible rollover distribution"). Further, section 1.402(c)-2, Q&A-9(b) of the Regulations provides that a distribution of a plan loan offset amount can occur when, under the plan terms governing the loan, for example, it requires that, in the event of termination of employment, the loan be treated as in default. Section 1.402(c)-2, Q&A-9(b) further states that a distribution of a plan loan is an actual distribution and not a deemed distribution under Code section 72(p).

In this case, Employer K, as a result of Taxpayer A's termination of employment with Employer K, treated his outstanding loan balance (Amount F) as in default, effective . Documentation submitted by Taxpayer A shows that on , a date that is within the 60-day period beginning on , Amount F was deposited into IRA X, an eligible retirement plan as described in Code section 402(c)(8). Because Employer K treated Amount F, a plan loan offset amount, as in default, we conclude that it is an eligible rollover distribution that is eligible to be rolled over into an eligible retirement plan, such as IRA X.

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 thereto.

This 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.

This ruling assumes that Plan X satisfies the requirements of Code section 401(a) at all times relevant to this transaction. This ruling further assumes that IRA X satisfies the requirements of Code section 408(a) at all times relevant to this transaction.

If you have any questions concerning this ruling, please contact

*****SE:T:EP:RA:T2.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:

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