Department of the Treasury
Internal Revenue Service
Washington, D.C. 20224

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Uniform Issue List:72.07-02

T:EP:RA:T3

Attention:

LEGEND:

Plan X =

State B =

Employer C =

Dear :

This is in response to correspondence dated December 20, 2006, as supplemented by correspondence dated March 2, 2007, submitted on your behalf by your authorized representatives, concerning the taxability of certain distributions from Plan X.

The following facts and representations have been made on your behalf:

Plan X is a governmental plan qualified under section 401(a) and described in section 414(d) of the Internal Revenue Code ("Code").

Plan X is a defined benefit pension plan, created and maintained by State B statutes to provide retirement benefits to civilian (non-law enforcement) employees of Employer C. Benefits are funded by a combination of employer and mandatory employee contributions. Plan X's normal retirement benefit is a lifetime annuity for a retired employee, based upon the participant's age and years of credited service and payable in monthly installments upon the participant's retirement, with a continuing lifetime annuity for surviving spouses. However, various options are available for the settlement of benefits. Among these options, an employee may elect upon retirement or separation from service to withdraw the employee's accumulated contributions to Plan X. Such option to withdraw employee contributions upon separation from service was available on May 5, 1986 to all Plan X participants.

Effective August 28, 2003, Plan X was amended to include a partial lump-sum distribution among the options available to a participant retiring or separating from service. Under this option, a participant who is eligible to retire and receive a retirement allowance, and who meets certain service requirements, may elect instead to receive a portion of the benefit in a lump-sum payment by notification to Plan X when applying for retirement benefits. For a participant making this election, the base pension which the participant would otherwise have received is reduced on an actuarially equivalent basis to reflect the lump-sum payment. The lump-sum payment is paid before or with the participant's first regular annuity payment.

Plan X does not accept after-tax employee contributions from non-state retirement plans that may be attributable to employee contributions made prior to 1987, or from state plans that did not have a withdrawal feature on May 5, 1986.

Based upon the facts and representations stated above, the following rulings are requested:

1. A lump-sum payment from Plan X is eligible for the special tax treatment under section 72(e)(8)(D) of the Code, as modified by section 1011A(b)(11) of the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA").

2. A lump-sum payment paid before or with the first annuity payment under Plan X will be treated as having been received before the annuity starting date, and will be taxable only to the extent such payment exceeds the participant's investment in the contract as of December 31, 1986.

3. Any portion of a Plan X lump-sum payment received in excess of the pre-1987 investment in the contract will be taxable pursuant to the pro-rata basis recovery rule of section 72(e)(8)(B) of the Code.

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 72(a) of the Code provides that, in general, gross income includes any amount received as an annuity (whether for a period certain or during one or more lives) under an annuity, endowment, or life insurance contract.

Section 72(d)(1)(D) of the Code provides a special rule where a lump sum is paid in connection with the commencement of annuity payments. In general, in connection with the commencement of annuity payments under any qualified employer retirement plan, if the taxpayer receives a lump-sum payment (1) such payment shall be taxable under section 72(e) as if received before the annuity starting date, and (2) the investment in the contract for purposes of this section shall be determined as if such payment had been so received. (This does not apply in any case where the primary annuitant has attained age 75 on the annuity starting date unless there are fewer than 5 years of guaranteed payments under the annuity. In addition, there is a necessary adjustment if annuity payments are not made on a monthly basis.)

Section 72(e) of the Code generally applies to amounts received under an annuity contract which are considered to be amounts not received as an annuity.

Section 72(e)(2)(A) of the Code provides the general rule that if any amount distributed from an annuity contract is received on or after the annuity starting date, such amount will be included in gross income.

Section 72(e)(2)(B) of the Code provides the general rule that if any amount distributed from an annuity contract is received before the annuity starting date, such amount (1) will be included in gross income to the extent allocable to income on the contract, and (2) will not be included in gross income to the extent allocable to the investment in the contract.

Section 72(e)(8) of the Code provides for an extension of section 72(e)(2)(B) to qualified plans. Section 72(e)(8)(A) provides, in pertinent part, that in the case of any amount received before the annuity starting date (1) from a trust described in section 401(a) which is exempt from tax under section 501(a), or (2) from a contract purchased by such a trust, section 72(e)(2)(B) shall apply to such amounts.

Section 72(e)(8)(B) of the Code provides that for purposes of section 72(e)(2)(B), the amount allocated to the investment in the contract shall be the portion of the amount described in section 72(e)(8)(A) which bears the same ratio to such amount as the investment in the contract bears to the account balance. The determination under the preceding sentence shall be made as of the time of the distribution or at such other time as the Secretary may prescribe.

Section 72(e)(8)(D) of the Code provides that in the case of a plan which on May 5, 1986 permitted withdrawal of any employee contributions before separation from service, section 72(e)(8)(A) shall apply only to the extent that amounts received before the annuity starting date (when increased by amounts previously received under the contract after December 31, 1986) exceed the investment in the contract as of December 31, 1986.

Section 1011A(b)(11) of TAMRA created a special rule for state plans. In the case of a plan maintained by a state which on May 5, 1986 permitted withdrawal by the employee of employee contributions (other than as an annuity), section 72(e) of the Code shall be applied (1) without regard to the phrase "before separation from service" in section 72(e)(8)(D), and (2) by treating any amount received (other than as an annuity) before or with the first annuity payment as having been received before the annuity starting date.

With respect to the requested rulings, section 72(e)(8)(D) of the Code provides that, in the case of a trust or contract that is part of a plan that on May 5, 1986 permitted a participant to receive a distribution of any portion of such participant's employee contributions under the trust or contract before such participant's separation from service, the rules of section 72(e)(8)(A) and (B) shall apply in determining the portion of any nonannuity distribution after December 31, 1986 that is allocable to such participant's investment in the trust or contract only to the extent that the amount of the nonannuity distribution is greater than the remaining amount of the participant's total investment in the trust or contract on December 31, 1986 (i.e., the participant's investment in the trust or contract on December 31, 1986, reduced by nonannuity distributions made after December 31, 1986 and before

the date of the nonannuity distribution in question that are not included in gross income on account of section 72(e)(8)(D)). In the case of a nonannuity distribution that is greater than such remaining amount of the participant's investment in the trust or contract on December 31, 1986, the portion of the distribution that is allocable to such remaining amount is to be disregarded in applying the rules of section 72(e)(8)(A) and (B) to the portion of the distribution that is greater than such remaining amount.

In this case, Plan X is maintained by State B and permitted the withdrawal of employee contributions upon retirement or separation from service. This option was available to all Plan X participants on May 5, 1986. Effective August 28, 2003, Plan X was amended to include a partial lump-sum distribution among the options available to a participant retiring or separating from service. The lump-sum payment is paid before or with the participant's first regular annuity payment.

Accordingly, with respect to your ruling requests, we conclude the following:

1. A lump-sum payment from Plan X is eligible for the tax treatment under section 72(e)(8)(D) of the Code, as modified by section 1011A(b)(11) of the Technical and Miscellaneous Revenue Act of 1988 ("TAMRA").

2. A lump-sum payment paid before or with the first annuity payment under Plan X will be treated as having been received before the annuity starting date, and will be taxable only to the extent such payment exceeds the participant's investment in the contract as of December 31, 1986.

3. Any portion of a Plan X lump-sum payment received in excess of the pre-1987 investment in the contract will be taxable pursuant to the pro-rata basis recovery rule of section 72(e)(8)(B) of the Code.

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 expresses no opinion with respect to whether Plan X satisfies the requirements for qualification under section 401(a) of the Code.

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

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representatives. Should you have any concerns regarding this letter, please contact , ID# , , at .

Sincerely yours,

Frances V. Sloan

, Manager
Employee Plans Technical Group
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy of letter ruling
Notice of Intention to Disclose