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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Release Number: **201149032**
Release Date: 12/9/2011
Date: September 13, 2011
UIL Code: 501.00-00
72.00-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

City =
State =

Dear

We have considered your request dated, December 5, 2007 and revised by letter dated June 7, 2011, for a ruling with regard to your adopted plan of dissolution under section 501(c)(11) of the Internal Revenue Code (Code) and the resulting tax treatment of distributions made to your members.

Facts:

You are recognized as exempt under section 501(c)(11) of the Code as a teachers' retirement fund association of a purely local character. You are not a qualified retirement plan under section 401(a) of the Code. You accumulate and manage funds to provide retirement, death, and disability benefits to retired and permanently disabled teachers who are your members. Memberships are available to professional employees of City's public schools and the City educational association who are in good health and age fifty or younger at the time of application. Your members pay dues according to the class of membership that they select. When a member reaches age 65, they become eligible to receive a retirement benefit that is a monthly annuity, not a guaranteed annuity. Your revenue consists solely of amounts received from assessments on the teaching salaries of your members and income in respect of your investments.

Over the years, the number of new members has decreased due to the availability of more attractive retirement and annuity plans. With a decreasing membership, your governance and administrative costs have become more prohibitive. As a result, your trustees decided to dissolve and distribute your assets to your members in satisfaction of all existing obligations to provide current or future retirement benefits. Neither your original Articles of Incorporation nor your Constitution specifies procedures for dissolution. As a result, you filed revised articles with the State Secretary of State providing procedures for dissolution and amended your Constitution to provide for dissolution as authorized under State nonprofit laws.

Your trustees adopted a plan of dissolution, and upon receipt of a favorable ruling, plan to submit the plan to the members for approval. Upon such approval, you plan to dissolve, liquidate, and wind up your affairs in accordance with the plan of dissolution.

The plan of dissolution provides that your trustees shall determine and pay your obligations and liabilities and create a reserve to pay unknown or contingent liabilities and costs incurred related to the dissolution. On the termination date, all dues and benefits will cease. From the funds remaining after payment of your obligations and liabilities, you will make the distributions in the following order:

1. To current annuitants, a lump sum equal to the actuarial equivalent of their future monthly benefit, but not less than dues paid, plus 3 percent interest, compounded annually, reduced by the aggregate amount of monthly benefits paid to the annuitant through the termination date.
2. To active members with more than ten years of membership, a lump sum equal to the actuarial equivalent of the member's accrued benefit, but not less than the aggregate dues paid by the member, plus 3 percent interest, compounded annually through the termination date.
3. To active members with less than ten years of membership, a lump sum equal to the aggregate dues paid by the member, plus 3 percent interest, compounded annually through the termination date.
4. To current annuitants and active members, any funds remaining distributed pro rata based on the person's membership classification.

Rulings Requested:

1. Your dissolution and liquidation, according to the plan of dissolution, will not adversely affect your exempt status under section 501(c)(11) of the Code.

2. Amounts distributed to members according to your plan of dissolution will not be subject to section 72(q) of the Code.

Law:

Section 72 of the Code provides rules that govern the income taxation of all amounts received under annuity contracts and amounts received during the insured's life from life insurance policies and endowment contracts.

Section 72(b) of the Code provides rules for taxing a distribution that is taxable under section 72 and is received as an annuity. An "annuity" is a series of periodic payments for a fixed period or over someone's lifetime.

Section 72(q) of the Code imposes a 10 percent penalty if any taxpayer receives any amount under an annuity contract.

Section 501(c)(11) of the Code states that teachers' retirement fund associations of a purely local character are exempt from federal tax, if:

A. No part of their net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual, and
B. The income consists solely of amounts received from public taxation, amounts received from assessments on the teaching salaries of members, and income in respect of investments.

Section 1.72-2(b)(2) of the Income Tax Regulations (regulations) states that amounts subject to section 72 in accordance with subparagraph (1) of this section are considered as "amounts received as an annuity" only in the event that all of the following tests are met:

i. They must be received on or after the "annuity starting date" as that term is defined in paragraph (b) of section 1.72-4;
ii. They must be payable in periodic installments at regular intervals (whether annually, semiannually, quarterly, monthly, weekly or otherwise) over a period of more than one full year from the annuity starting date; and
iii. Except as indicated in subparagraph (3) of this paragraph, the total of the amounts payable must be determinable at the annuity starting date either directly from the terms of the contract or indirectly by the use of either mortality tables or compound interest computations, or both, in conjunction with such terms and in accordance with sound actuarial theory.

Section 1.501(c)(9)-4(d) of the regulations states that it will not constitute prohibited inurement if, upon termination of a plan established by an employer, any remaining assets are applied to provide, either directly or through insurance, life, sick, accident or other permissible employee welfare benefits. Similarly, a distribution to members upon the dissolution of the association will not constitute prohibited inurement of the amount distributed to members is determined on the basis of objective and reasonable standards which do not result in either unequal payments to similarly situated members or in disproportionate payments to officers, shareholders, or highly compensated employees of the employer.

In Water Quality Asso. Employees' Ben. Corp. v. United States, 795 F.2d 1303 (1986), the court noted that section 501(c)(11) was similar in purpose and time to section 501(c)(9). Section 501(c)(9) was first enacted as section 103(16) of the Revenue Act of 1928, ch. 852, 45 Stat. 791. Section 501(c)(11) was first enacted in the same statute, section 103(17) of the Revenue Act of 1928, ch. 852, 45 Stat. 791. The court stated that section 501(c)(11) "introduced into the law a new kind of exempt organization, namely, teachers' retirement fund associations of a purely local character." H.R. Conf. Rep. No. 1882, 70th Cong., 1st Sess. At 13-14, 1939-1 C.B. (Part 2) 444, 447.

Analysis:

Ruling Request 1

Section 501(c)(11) of the Code does not expressly describe the effect of dissolution on exempt status. This section does state that no part of such an organization's net earnings inures (other than through payment of retirement benefits) to the benefit of any private shareholder or individual. Without regulations available with respect to section 501(c)(11), we can look to the section 501(c)(9) regulations for guidance on the tax treatment. The regulations under section 501(c)(9), were enacted under the same statute as section 501(c)(11) and have a similar purpose. See Water Quality Asso. Employees' Ben. Corp. v. United States, 795 F.2d 1303 (1986).

Organizations that are exempt under sections 501(c)(9) and 501(c)(11) of the Code are both organized and operated to provide benefits to their members and are subject to the proscription against inurement. Under section 1.501(c)(9)-4(d) of the regulations, the dissolution of an organization will not constitute prohibited inurement if the amounts distributed to members are determined based on objective and reasonable standards which do not result in either unequal payments to officers, shareholders, or highly compensated employees of an employer contributing to or otherwise funding the employees' association.

You propose to dissolve your organization and distribute your assets, after payment of liabilities; first, to your annuitants; second, to your active members with more than ten years membership; and third, to your newest active members. Here, the amounts of your distributions will be either the actuarial value of the annuitants' future benefits or the accrued amount of the active members' benefits. Finally, if any assets remain, you will make pro rata distributions based on the members' selected membership classification. Distributing your assets using criteria such as length of time in membership, expected or accrued benefit amounts and self-selected membership classification do not cause either unequal payments to similarly situated members or disproportionate payments to officers, shareholders, or highly compensated employees. Your plan of distribution appears to be in accordance with the plain and ordinary meaning of section 501(c)(11) of the Code and appears to satisfy the requirements of section 1.501(c)(9)-4(d) of the regulations, and prohibited inurement will not occur under the facts and circumstances described in your ruling request. Therefore, your plan of dissolution will not adversely affect your status as an organization described in section 501(c)(11) of the Code.

Ruling Request 2

Section 72 of the Code provides rules that govern the income taxation of all amounts received under annuity contracts and amounts received during the insured's life from life insurance policies and endowments contracts. Section 72(b) provides rules for taxing a distribution that is taxable under section 72 and is received as an annuity. An "annuity" is a series of periodic payments for a fixed period or over someone's lifetime. See Black and Skipper, Life Insurance, 100 (11th ed. 1987). See also section 1.72-2(b)(2) of the regulations for amounts considered as "amounts received as an annuity".

The plan is a plan of dissolution that results in a one-time lump sum distribution of assets. The plan is neither an annuity contract, nor in the form of an annuity. Accordingly, section 72 does not apply to the lump sum payments in question.

Section 72(q) of the Code imposes a 10 percent penalty on amounts received by a taxpayer under an annuity contract. The legislative history of section 72(q) indicates that Congress intended to deter the use of annuity contracts for short-term investment and income tax deferral. Since the payments in question are not subject to section 72, the payments are not subject to the 10 percent penalty imposed under section 72(q).

Conclusion:

Accordingly, based on the foregoing, we rule as follows:

1. Your dissolution and liquidation according to your plan of dissolution will not adversely affect your exempt status under section 501(c)(11) of the Code.

2. Amounts distributed to members according to your plan of dissolution will not be subject to section 72(q) of the Code.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, Notice of Intention to Disclose. A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

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.

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolve questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Ronald Shoemaker
Manager, Exempt Organizations
Technical Group 2

Enclosure
Notice 437