Significant Index Nos. 72.20-00; 401.29-00; 402.00-00; 404.00.00; 415.00-00

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

20134902

AUG 27 2013

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Taxpayer =

DB Plan =

DC Plan =

State =

Dear

This letter is in response to your request of June 5, 2003, as modified by your letters of March 15, 2005, and June 20, 2008, for rulings concerning the federal tax consequences of certain proposed transactions between the DB Plan and the DC plan. In particular, you have requested rulings that:

(1) Amounts transferred upon disability retirement from the DC Plan to the DB Plan under the disability provisions of the Plans are not subject to section 414(k) of the Internal Revenue Code ("Code").

(2) The transfer of assets from the DC plan to the DB Plan (upon disability retirement) or from the DB Plan to the DC Plan (upon recovery from disability) are permissible plan transfers that will not result in taxation under sections 72(t), 401(k), 402, or 404 of the Code.

(3) The transfer of assets from the DC plan to the DB Plan (upon disability retirement) or from the DB Plan to the DC Plan (upon recovery from disability) will not result in constructive receipt to an affected participant or otherwise subject the participant to taxes under sections 72(t) or 401(k) of the Code.

(4) The transfer of assets from the DC plan to the DB Plan (upon disability retirement) or from the DB Plan to the DC Plan (upon recovery from disability) with respect to any affected participant will not affect the determination of either the participant's annual benefit under section 415(b) of the Code or the determination of the annual addition to the participant's account under section 415(c) of the Code.

Facts

The Taxpayer administers qualified government retirement plans for the State. The State maintains a defined benefit plan and trust (the "DB Plan") and a defined contribution plan and trust (the "DC Plan"). The DB Plan and the DC Plan were previously the subject of PLR 200130057.

State employees may actively participate in either the DB Plan or DC Plan. State employees eligible to participate in the DB Plan are enrolled by default in the DB Plan, but may at any time before the end of the fifth month following the employee's month of hire, elect to participate in the DC Plan. In addition, all employees have an additional one-time opportunity, at the employee's discretion, to switch from the DB Plan to the DC Plan. Similarly, all employees have an additional one-time opportunity, at the employee's discretion, to switch from the DC Plan to the DB plan.

Subsequent to the issuance of PLR 200130057, State law was amended and statutes were created to allow participants in the DC Plan who become totally and permanently disabled[1] to receive a disability benefit ("Disability Retirement"). In order to receive disability benefits, a disabled DC Plan participant must transfer all monies accumulated in his or her individual accounts to a ministerial account within the DB Trust Fund (the "Disability Account").

The amount of the Disability Retirement benefit of a DC Plan participant is generally determined in the same manner as the Disability Retirement benefit of a participant who was a participant in the DB Plan at the time of his or her disability.[2]

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[1] The applicable laws of the State provide that "A participant shall be considered totally and permanently disabled, if in the opinion of the division, he or she is prevented, by reason of a medically determinable physical or mental impairment, from rendering useful or efficient service as an officer or employee".

[2] In both cases the amount of each monthly payment is computed in the same manner as for a normal retirement benefit under the DB Plan except that (1) disability option actuarial equivalency tables are used, (2) average monthly compensation and creditable service are determined as of the date of disability (as opposed to the date of retirement), and (3) the otherwise determined monthly payment may not be less than certain specified percentages of average monthly compensation depending on whether the participant was injured in the line of duty. For example, for participants injured in the line of duty, the Disability Retirement benefit generally may not be less than forty-two percent of average monthly compensation as of the date of disability. Retirement benefits under the DB Plan are generally determined based on final average compensation and years of service.

If a disabled DC Plan participant recovers from his disability, the net difference between the amount transferred to the Disability Account, including earnings, and the total disability benefits paid to the participant, is redeposited in individual accounts within the DC Plan, as directed by the participant. (If the now recovered participant does not return to covered employment, nonvested amounts are held in a suspense account and forfeited if the participant does not return to covered employment within five years).

In determining the net difference between the amount of a recovered participant's account balance transferred to the Disability Account and the total disability benefits paid to the participant, paid disability benefits are first subtracted from the vested portion of the transferred amounts and second from the nonvested portion of such amounts.[3]

A disabled DC Plan participant may elect, in lieu of receiving benefits under the disability provisions of the DC Plan, to receive benefits under the normal benefit provisions of the DC Plan (i.e., the benefit provisions available to a nondisabled employee who terminates employment).

Law

Section 72(t) of the Code provides that if any taxpayer receives any amount from a qualified retirement plan (as defined in section 4974(c)), the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion of such amount which is includible in gross income.

Section 401(k) of the Code generally provides that a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan shall not be considered as not satisfying the requirements of subsection (a) merely because the plan includes a qualified cash or deferred arrangement.

Section 402(a) of the Code provides that except as otherwise provided in that section, any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under 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 414(k) of the Code provides that a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall –

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[3] For example, if $40,000 (consisting of $26,000 of vested amounts and $14,000 of nonvested amounts) was transferred from the DC Plan upon a participant's disability and $10,000 was paid from the Disability Account prior to the participant's recovery, subsequent to the participant's recovery $30,000 would be transferred to the participant's individual account in the DC Plan (consisting of $16,000 of vested amounts and $14,000 of nonvested amounts).

(1) for purposes of section 410 (relating to minimum participation standards), be treated as a defined contribution plan,

(2) for purposes of section 72(d) (relating to treatment of employee contributions as separate contract), 411(7)(A) (relating to minimum vesting standards), 415 (relating to limitations on benefits and contributions under qualified plans), and 401(m) (relating to nondiscrimination tests for matching requirements and employee contributions, be treated as consisting of a defined contribution plan to the extent benefits are based on the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan, and

(3) for purposes of section 4975 (relating to tax on prohibited transactions), be treated as defined benefit plan.

Section 404 of the Code provides, in part, that if contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee compensation, such contributions or compensation shall not be deductible, but if they would otherwise be deductible, they shall be deductible under that section, subject to the limitations on the amounts deductible in any year described therein.

Section 415(b)(1) of the Code provides that benefits with respect to a participant exceed the limitation of that subsection if, when expressed as an annual benefit (within the meaning of paragraph (2)), such annual benefit is greater than the lesser of -----

(A) $160,000, or

(B) 100 percent of the participant's average compensation for his high three years.

Section 415(b)(2)(A) of the Code provides that for purposes of paragraph (1), the term "annual benefit" means a benefit payable annually in the form of a straight life annuity (with no ancillary benefits) under a plan to which employees do not contribute and under which no rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) are made.

Section 415(c)(1) of the Code provides that contributions and other additions with respect to a participant exceed the limitation of that subsection if, when expressed as an annual addition (within the meaning of paragraph (2)) to the participant's account, such annual addition is greater than the lesser of -----

(A) $40,000, or

(B) 100 percent of the participant's compensation

Section 415(c)(2) of the Code provides that for purposes of paragraph (1), the term "annual addition" means the sum for any year of -----

(A) employer contributions,

(B) the employee contributions, and

(C) forfeitures

For purposes of that paragraph, employee contributions under subparagraph (B) are determined without regard to any rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) without regard to employee contributions to a simplified employee pension which are excludable from gross income under 408(k)(6). Subparagraph (B) of paragraph (1) shall not apply to any contribution for medical benefits (within the meaning of section 419A(f)(2)) after separation from service which is treated as an annual addition.

Section 4974(c) of the Code provides that for purposes of that section, the term "qualified retirement plans" means ---

(1) a plan described in section 401(a), which includes a trust exempt from tax under section 501(a),

(2) an annuity plan described in section 403(a),

(3) an annuity contract described in section 403(b),

(4) an individual retirement account described in section 408(a), or

(5) an individual retirement annuity described in section 408(b).

Such term includes any plan, contract, account, or annuity which, at any time, has been determined by the Secretary to be such a plan, contract, account, or annuity.

Section 1.415(b)-1(c) of the regulations provides rules for adjusting a form of benefit other than a straight life annuity to an actuarially equivalent straight life annuity.

Section 1.415(c)-1(b)(1)(i) of the regulations provides that the term annual addition means, for purposes of that section, the sum, credited to a participant's account for any limitation year, of ----

(A) Employer contributions;

(B) Employee contributions; and

(C) Forfeitures.

Section 1.415(c)-1(b)(1)(iii) of the regulations provides that the direct transfer of a benefit or employee contribution from a qualified plan to a defined contribution plan does not give rise to an annual addition.

Revenue Ruling 67-213, 1967-2 C. B. 149, involves the transfer of funds directly from a trust forming part of a pension plan under section 401(a) of the Code to a trust forming part of a stock bonus plan. The revenue ruling provides that if a participant's interest in a qualified plan is transferred from the trust of a qualified plan to the trust of another qualified plan without being made available to the participant, no taxable income will be recognized by such transfer.

Analysis

Ruling 1

Section 414(k) of the Code provides that a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account is treated as a defined benefit plan for certain purposes and a defined contribution plan for certain other purposes. In this case, the disability benefit of a disabled participant who was formerly a participant in the DC Plan is determined in a similar manner to a disabled participant who was a participant in the DB Plan at the time of his disability. That is, the disability benefit of disabled participant who was formerly a participant in the DC Plan is determined without regard to the balance of the participant's account in the DC Plan at the time of his disability. Thus, the DB Plan is not a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account. Accordingly, amounts transferred upon disability retirement from the DC Plan to the DB Plan under the disability provisions of the Plans are not subject to section 414(k) of the Code.

Rulings 2 and 3

Section 72(t) of the Code provides for an additional tax on any amount received from a "qualified retirement plan" (as defined in section 4974(c), which includes plans described in section 401(a)). The additional tax for the taxable year in which such amount is received is equal to 10 percent of the portion of such amount which is includible in gross income, except where such income is distributed on or after an employee attains the age of 59½, or on account of one or more exceptions provided for under section 72(t)(2) of the Code.

Section 72(t) does not apply in this case to the transfers because the transfers do not result in any amounts being includible in the participant's gross income. Accordingly, the transfers will not result in the trigger of an additional tax under section 72(t) and

will not result in constructive receipt to an affected participant or otherwise subject the participant to taxes under section 72(t) of the Code.

Section 401(k) of the Code provides that a plan shall not be considered as not satisfying the requirements of section 401(a) merely because the plan includes a qualified cash or deferred arrangement. In PLR 200130057 it was ruled that transfers from the DB Plan to the DC Plan or from the DC Plan to the DB Plan did not constitute cash or deferred arrangements within the meaning of Code section 401(k). In any event, distributions from plans that include cash or deferred arrangements are generally taxed under section 402(a) of the Code, not section 401(k). Accordingly, any transfers from the DB Plan to the DC Plan upon recovery from disability or from the DC Plan to the DB Plan upon disability will not result in the trigger of an additional tax under section 401(k) and will not result in constructive receipt to an affected participant or otherwise subject the participant to taxes under section 401(k) of the Code.

Section 402(a) of the Code provides, in effect, that contributions made by an employer to a trust described in section 401(a) are not taxable to the employees on whose behalf they are made until the year or years in which such contributions are actually distributed to them.

Revenue Ruling 67-213, 1967-2 C.B. 149, involves the transfer of funds directly from a trust forming part of a qualified plan under Code section 401(a) to a trust forming part of another qualified plan. The revenue ruling provides that if a participant's interest in a qualified plan is transferred from the trust of a qualified plan to the trust of another qualified plan without being made available to the participant, no taxable income will be recognized to the participant by reason of such transfer.

In this case, no benefits are made available or paid to the participant at the time of the transfers. The transfers from the DC Plan to the DB Plan upon disability and back to the DC Plan upon recovery and reemployment occur automatically based on the type of retirement selected by the participant and the participants' recovery, if any, from disability. No participant or beneficiary of either of the plans will receive a distribution of any assets at the time of the transfer, and the assets will remain in trusts that are qualified under Code section 401(a) and exempt from tax under section 501(a). Accordingly, as was the case with the transfers considered by Rev. Rul. 67-213, the transfer of assets from the DC Plan to the DB Plan (upon disability retirement) and back to the DC Plan (upon recovery from disability) are plan transfers that will not be a taxable event under section 402 and will not result in actual or constructive receive of income.

Section 404 of the Code provides rules for determining the deduction for contributions of an employer to an employee's trust or annuity plan. Distributions from employee's trusts or annuity plans are generally taxed under section 402 of the Code, not section 404. Accordingly, any transfers from the DB Plan to the DC Plan

upon recovery from disability or from the DC Plan to the DB Plan upon disability will not result in the trigger of an additional tax under section 404 of the Code.

Ruling 4

Section 415(b) of the Code and the regulations thereunder provide that a participant's annual benefit generally means a benefit payable in the form of a straight life annuity (or the actuarial equivalent thereof). In this case because neither the transfers of assets from the DC plan to the DB Plan or the transfer of assets from the DB Plan to the DC Plan are benefits payable or made available to participants, the transfers do not affect the determination participants' annual benefits. Accordingly, neither the transfers of assets from the DC plan to the DB Plan upon disability or the transfer of assets from the DB Plan to the DC Plan upon recovery affect the determination of a participant's annual benefit under section 415(b) of the Code.

Section 415(c) of the Code and the regulations thereunder provide that an annual addition to a participant's account is the sum of employer contributions, employee contributions, and forfeitures credited to a participant's account for any year. Section 1.415(c)-1(b)(1)(iii) of the regulations provides that transfers of a benefit or a employee contribution from a qualified plan to a defined contribution plan does not give rise to an annual addition.

Thus, because the transfer of assets from the DB Plan to the DC Plan is the transfer from a qualified plan to a defined contribution plan no annual addition arises. Similarly, because there are no participants' accounts in the DB Plan, the transfer of assets from the DC Plan to the DB Plan is also not an annual addition. Accordingly, neither the transfers of assets from the DC plan to the DB Plan upon disability or the transfer of assets from the DB Plan to the DC Plan upon recovery affect the determination of the annual addition to a participant's account under section 415(c) of the Code.

Conclusions

(1) Amounts transferred upon disability retirement from the DC Plan to the DB Plan under the disability provisions of the Plans are not subject to section 414(k) of the Code.

(2) The transfer of assets from the DC plan to the DB Plan (upon Disability Retirement) or from the DB Plan to the DC Plan (upon recovery from disability) will not result in taxation under sections 72(t), 401(k), 402, or 404 of the Code.

(3) The transfer of assets from the DC plan to the DB Plan (upon Disability Retirement) or from the DB Plan to the DC Plan (upon recovery from disability)

will not result in constructive receipt to an affected participant or otherwise subject the participant to taxes under sections 72(t) or 401(k) of the Code.

(4) The transfer of assets from the DC plan to the DB Plan (upon Disability Retirement) or from the DB Plan to the DC Plan (upon recovery from disability) with respect to any affected participant will not affect the determination of either the participant's annual benefit under section 415(b) of the Code or the determination of the annual addition to the participant's account under section 415(c) of the Code.

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

We are furnishing a copy of this letter to the enrolled actuary for the plan in accordance with a power of attorney (Form 2848) on file.

If you have any questions on this ruling letter, please contact l

Sincerely,

David M. Ziegler, Manager
Employee Plans Actuarial Group 2