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

JUN 28 2001

Uniform Issue List: 402.08-01; 402.07-00

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Legend:
Taxpayer = **********
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Employer = **********
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Plan = **********

Dear **********:

This is in response to a letter dated July 7, 2000, as supplemented by additional correspondence dated March 7 and April 16, 2001, in which your authorized representative requested a private letter ruling on your behalf concerning issues arising under section 402 of the Internal Revenue Code ("Code").

With regard to your ruling request, your authorized representative has submitted the following facts and representations:

The Taxpayer, a former officer of the Employer, retired on **********, after 19 years of service with the Employer and more than five years of participation in the Employer's Plan. Taxpayer has attained age 59½, but not age 70½. The Plan is a profit sharing plan with a cash or deferred arrangement qualified under Code §§ 401(a) and 401(k), with a related trust that is tax-exempt under Code § 501(a). Prior to ****, the Plan was a thrift plan, accepting employee after-tax and matching contributions. Throughout the Taxpayer's participation in the Plan, a portion of the Taxpayer's Plan accounts were invested in shares of stock of the Employer and its predecessors ("Employer Securities"). The Employer Securities purchased for the Taxpayer by the Plan satisfy the definition of such

150

securities found in section 402(e)(4)(E) of the Code. Assets so invested included employer contributions, employee pre-tax contributions, and employee after-tax contributions.

The Taxpayer has not participated in any other plan requiring aggregation with the Plan for purposes of determining the balance to the credit of his account. Before 1987, the Taxpayer made a withdrawal, pursuant to the Plan's provisions as they existed at that time, of a portion of the after-tax contributions in his account.

The Taxpayer now intends to elect a distribution of his entire account balance within one taxable year. Taxpayer will direct the Plan trustee to distribute the Employer Securities and remaining after-tax contributions directly to him, and to transfer his remaining account balance directly to an individual retirement account described in section 408(a) of the Code ("the IRA"). The purpose of the distribution is to defer taxation on the net unrealized appreciation ("NUA") attributable to the Employer Securities distributed from the Plan to the extent permitted under Code § 402(e)(4)(B) and applicable regulations.

Based on the facts and representations presented by your authorized representative, you request the following rulings:

1. That a distribution to the Taxpayer within a single taxable year of the Taxpayer of all Employer Securities and any after-tax contributions credited to him under the Plan, coupled with a direct rollover to an eligible retirement plan of the remaining balance to the credit of the Taxpayer pursuant to an election under section 401(a)(31)(A) of the Code, constitutes a lump sum distribution under section 402(e)(4)(D); and

2. That the net unrealized appreciation in the qualifying securities of the Employer corporation that are distributed to the Taxpayer as part of the lump sum distribution will not be includible in the Taxpayer's gross income in the year of the distribution.

With respect to the ruling requests, Code § 402(a) provides that an amount actually distributed to a taxpayer by a trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the taxpayer in the year of distribution under section 72 (relating to annuities).

Code § 402(e)(4)(B) provides in pertinent part that, for purposes of Code §§ 402(a) and 72, in the case of any lump sum distribution which includes securities of the employer corporation, there shall be excluded from gross income the NUA attributable to that part of the distribution which consists of securities of the employer corporation.

Code § 402(e)(4)(C) provides that, for purposes of subparagraph (B), NUA and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Secretary [of the Treasury].

Section 1.402(a)-1(b)(1)(i)(a) of the Income Tax Regulations ("Regulations") provides that if a distribution from a trust described in Code section 401(a) constitutes a total distribution of the balance to the credit of an employee, then the amount to be excluded from the distributee's income is the entire NUA attributable to that part of the total distribution which consists of securities of the employer corporation.

Section 1.402(a)-1(b)(2)(i) of the Regulations defines NUA in securities of the employer corporation as the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust.

Code § 402(e)(4)(D) defines a "lump sum distribution," for purposes of this paragraph, as the distribution or payment within 1 taxable year of the recipient of the balance to the credit of an employee that becomes payable to the recipient-(I) on account of the employee's death, (II) after the employee attains age 59 1/2, (III) on account of the employee's separation from service, or (IV) after an employee has become disabled (within the meaning of section 72(m)(7)), from a trust that forms part of a plan described in Code § 401(a) and which is exempt from tax under section 501 or from a plan described in section 403(a).

Code § 402(c)(4) provides that the term "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust except the following distributions:

(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 period of 10 years or more,

(B) any distribution to the extent the distribution is required under Code section 401(a)(9), and

(C) any hardship distribution described in Code section 401(k)(2)(B)(i)(IV).

Code § 402(c)(8) defines an "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 retirement plan described in section 401(a), and (iv) an annuity plan described in section 403(a).

Code § 402(c)(3) provides, generally, that the section 402(c)(1) rollover rule shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

Section 401(a)(31)(A) of the Code provides that a trust shall constitute a section 401(a) qualified trust only if the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution --

(i) elects to have such distribution paid directly to an eligible retirement plan, and

(ii) specifies the eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be made in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

Section 401(a)(31)(B) of the Code provides that subparagraph (A) shall apply only to the extent that the eligible rollover distribution would be includible in gross income if not transferred as provided in subparagraph (A) (determined without regard to sections 402(c) and 403(a)(4)).

The term "eligible rollover distribution" when used in section 401(a)(31) of the Code has the same meaning as when used in section 402(c).

The term "eligible retirement plan" when used in section 401(a)(31) of the Code includes IRAs defined in sections 408(a) and 408(b) of the Code.

Generally, a direct trustee-to-trustee transfer described in section 401(a)(31) of the Code constitutes a "direct rollover" of an "eligible rollover distribution" and is entitled to tax-deferred treatment pursuant to section 402(c) of the Code.

Section 1.401(a)(31)-1 of the Regulations, Question and Answer 5, provides that an eligible rollover distribution that is paid to an eligible retirement plan in a direct rollover is not currently includible in the distributee's gross income under Code § 402(c) and is exempt from the 20-percent withholding imposed under section 3405(c)(2).

Section 1.401(a)(31)-1 of the Regulations, Question and Answer 14, provides, in pertinent part, that a direct rollover is a distribution and rollover of the eligible rollover distribution and not a transfer of assets and liabilities.

In this case the Taxpayer, who has not attained age 70 1/2, has retired and separated from the service of the Employer. As a result of said separation from service, the Taxpayer intends to elect to receive a distribution of the full amount standing to his credit under the Employer's Plan within a single taxable year. Shares of the Employer corporation's securities and remaining after- tax contributions in his account will be paid directly to the Taxpayer; the remaining balance will be distributed by means of a direct rollover to an IRA described under Code § 408(a).

Distribution of the Taxpayer's entire account balance in the above manner is, therefore, a "lump sum distribution" as that term is defined in Code § 402(e)(4)(D). Furthermore, neither the Code nor the regulations promulgated thereunder preclude a distribution from being treated as a lump sum distribution under section 402(e)(4)(D) for purposes of section 402(e)(4)(B) even if a portion of the distribution is either rolled over or directly transferred into an IRA.

Accordingly, with respect to your ruling requests, we conclude and rule as follows:

1. That a distribution to the Taxpayer within a single taxable year of the Taxpayer of all Employer Securities and any after-tax contributions credited to him under the Plan, coupled with a direct rollover to an eligible retirement plan of the remaining balance to the credit of the Taxpayer pursuant to an election under section 401(a)(31)(A) of the Code, constitutes a lump sum distribution under section 402(e)(4)(D) of the Code; and

2. That the NUA in the qualifying securities of the Employer corporation that are distributed to the Taxpayer as part of the lump sum distribution will not be includible in the Taxpayer's gross income in the year of the distribution.

These rulings are based on the assumption that the Plan is qualified under sections 401(a) and 401(k) of the Code and its related trust is tax-exempt under section 501(a) at all times relevant to this ruling.

This letter ruling further assumes that the Taxpayer's distributions from the Plan were made, and will be made, in accordance with the Plan's terms. It also assumes that Taxpayer's IRA, referenced above, meets the requirements of Code section 408(a).

This ruling 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 by others as precedent.

Copies of this ruling have been sent to your authorized representative in accordance with a power of attorney on file in this office. Should you have any questions pertaining to this letter, you may contact ********** of this office at **********.

Sincerely,

John Swieca

John Swieca, Manager
Employee Plans Technical Group 1
Tax Exempt and Government
Entities Division

Enclosures:

- Deleted Copy of this Letter
- Notice of Intention to Disclose, Notice 437
- Copy of Notification Letter (Form 1155) to Authorized Representative

155