200337013

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

U.I.L. 403.04-00

XXXXXXXXXX
XXXXXXXXXX
XXXXXXXXXX

JUN 18 2003

T:EP:RA:T2

Attn: XXXXXX

Legend:
Employer M = ***
Plan X = ***
Company N = ***
Board O = ***

Dear ***:

This letter is in response to a request for a ruling dated ***, as supplemented by correspondence dated ***, ***, *** and ***, which was submitted on your behalf by your authorized representative, concerning an arrangement described under section 403(b) of the Internal Revenue Code ("Code").

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

Employer M is a not-for-profit corporation described in section 170(b)(1)(A)(vi) of the Code and exempt from taxation under section 501(c)(3) of the Code. Effective ***, Employer M adopted Plan X to provide retirement benefits and savings opportunities for certain of its employees who satisfy the eligibility requirements contained in Article III of Plan X. Plan X was later amended and restated effective ***. Plan X is funded exclusively through the purchase of a group annuity contract issued to Employer M by Company N.

Under Plan X, each employee may enter into a salary reduction agreement for compensation earned after the agreement becomes effective. Employer M also makes contributions on behalf of employees who have satisfied the eligibility requirements and who are employed on the last day of the Plan Year to which the contribution relates. These contributions are applied as premiums on the contract issued to the employer and allocated among eligible participants' accounts.

Article IV, section 4.02 of Plan X provides that every employee shall be eligible to have contributions made on his behalf pursuant to a salary reduction agreement in the amount specified in the salary reduction agreement. The employee may enter into only one salary reduction agreement during any calendar quarter. However, the employee may at any time terminate the salary reduction agreement entirely with respect to amounts not yet earned at the time of termination. The salary reduction agreement under Plan X:

(1) shall be legally binding and irrevocable with respect to compensation earned while the agreement is in effect;

(2) shall terminate any prior salary reduction agreement executed between the employee and the employer under the employer's 403(b) program;

(3) shall continue indefinitely until amended or terminated by either party subject to giving at least 30 days written notice prior to the date of such amendment or termination; and

(4) if the employer elects to cease all salary reduction contributions to its 403(b) program or plan, this agreement shall automatically terminate.

Article IX, section 9.03 of Plan X provides that each contract salary reduction contributions for any calendar year shall not exceed the limit imposed by section 402(g) of the Code. No participant shall be permitted to have salary reduction contribution for any calendar year in excess of $10,500, or such greater amount as determined by the Secretary of Treasury for such calendar year under section 402(g) of the Code. Each contract shall provide that a participant's salary reduction contributions for any calendar year shall not exceed such limit. If the dollar limit is exceeded with respect to any participant for any taxable year on account of the participant's participation in the plan of another employer, the participant may request, but not later than March 1st after the close of such taxable year, that any portion of his "excess deferrals" and attributable income be returned to him. If the excess deferrals are returned, then they are to be returned no later than April 15th after the taxable year for which the excess deferrals occurred.

Article IV, section 4.01(c) of Plan X provides that the annual compensation of each employee will not exceed the annual compensation limit set forth in section 401(a)(17) of the Code as adjusted.

Article IX, section 9.01 of Plan X provides that contributions shall not exceed an amount determined by (1) multiplying twenty (20) percent of his includable compensation by his years of service, and (2) subtracting his prior years exclusion from the result. Contributions shall be treated as made in the taxable year in which they become nonforfeitable.

Article IX , section 9.02(a) of Plan X satisfies the requirements of section 415(c) of the Code. This section provides that the total contributions to Plan X on behalf of a participant for a calendar year shall not exceed the lesser of twenty-five (25) percent of the participant's compensation during such calendar year or $30,000 as adjusted under section 415(d)(1) of the

Code and section 1.415-6(d) of the regulations. When contributions are made in excess of the limits of section 415 of the Code, section 9.02(c) of Plan X provides that the excess shall be considered a forfeiture and therefore will be allocated on a basis to be determined by Board O among the accounts of other participants whose annual additions are not in excess of 415 limitation.

Article VI, section 6.10 of Plan X provides that rollover amounts may be contributed or transferred directly to Plan X if such amounts are distributed or transferred directly from a 403(b) plan or a conduit individual retirement arrangement.

Article V, section 5.02 of Plan X provides that if a participant terminates employment before reaching his normal retirement age, that portion of his account attributable to employer contributions shall not be distributable until the first day of the month coinciding with or next following his sixty-fifth (65) birthday. Distributions may commence on an earlier date selected by the participant after he attained age sixty-two (62) if the participant has terminated employment with the employer and completed at least ten (10) years of vesting service.

Article V, Section 5.06 of Plan X provides that the portion of a participant's account attributable to salary reduction contributions is distributable at any time following the participant's termination of employment with Employer M as long as the amounts attributable to salary reduction contributions were credited to the participant's account on December 31, 1988 and are distributable prior to termination of employment.

Article V, section 5.04 of Plan X provides for disability benefits for a participant who becomes disabled within the meaning of section 2.06(c).

Article VII, section 7.05 of Plan X provides that where a participant voluntarily or involuntarily ceases to be an employee, other than by reason of death or retirement, he shall, as of the date he attains age sixty-five (65), be entitled to the vested portion of his account.

Article V, section 5.06 of Plan X provides that the portion of the participant's account attributable to salary reduction contributions is distributable at any time following the participant's termination of employment.

Article VII, section 7.01 of Plan X provides that a participant's right to retirement benefits derived from employer contributions made pursuant to a salary reduction agreement are at all times fully vested. However, Article VI, section 6.09 of Plan X provides that all rights and benefits found in Articles VI and VIII are subject to the rights afforded to any alternate payee under a qualified domestic relations order.

Article V, section 5.03 of Plan X provides, in relevant part, that distribution of a participant's account will not be delayed beyond the required commencement date under section 401(a)(9) of the Code, which is normally April 1 of the year following the participant's attainment of age seventy and one-half (70½).

Article VI, section 6.06 of Plan X provides that for benefits accrued on or after January 1, 1987, the participant and any beneficiary is to receive for each calendar year at least the amounts required to be distributed under section 401(a)(9) of the Code and the Treasury regulations ("regulations") thereunder.

Article VIII, section 8.03 of Plan X provides, in part, that on the death of a participant prior to the commencement of retirement benefit payments the balance of the vested portion of the participant's account is payable to the beneficiary under such option as the beneficiary may elect under the contract.

A proposed amendment to the plan under Article V, section 5.07 of Plan X states that any portion of an eligible distribution may be paid directly to an eligible retirement plan as specified by the distributee in a direct rollover. However, in no event shall a distribution be made to more than one eligible retirement plan except in the case of a distribution consisting of both cash and employer securities.

Article VI, section 6.10 of Plan X provides that an eligible rollover distribution is any distribution of all or any portion of the balance to the credit of the distributee, excluding any distribution that is one of a series of substantially equal periodic payments (not less frequently than annually) made for the life (or life expectancy) of the distributee or the joint lives (or joint life expectancies) of the distributee and the distributee's designated beneficiary, for a specified period of ten years or more, or effective January 1, 1999, a hardship distribution described in section 401(k)(2)(B)(i)(IV) of the Code; any distribution to the extent such distribution is required under section 401(a)(9) of the Code; and any distribution made to a non-spouse beneficiary.

Article XII, section 12.04 of Plan X provides that benefits payable under Plan X shall not be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, charge, garnishment, execution or levy of any kind, either voluntary or involuntary. Any attempt to anticipate, alienate, sell, transfer, assign, pledge, encumber, charge or otherwise dispose of any right to benefits payable hereunder, shall be void. The section further states that for plan years beginning after December 31, 1984, the preceding provisions shall also apply to the creation, assignment, or recognition of a right to any benefit payable with respect to a Participant pursuant to a domestic relations order, unless such order is determined to be a qualified domestic relations order.

Article XII, section 12.09 of Plan X provides that in the event of a conflict between the provisions of Plan X and the terms of the Contract, the provisions of Plan X will control, except as provided in section 6.08.

Based on the foregoing facts and representations, you request the following rulings:

1. Plan contributions shall be treated under section 403(b) of the Code as amounts contributed by Employer M for annuity contracts; and

2. Plan contributions, and earnings thereon, shall not be taxable in the year contributed, to the extent that such contributions satisfy the applicable limits under section 402(g)(2), 403(b)(2) and 415 of the Code, but instead will be taxable under section 72 of the Code in the year in which such amounts are received by the participant.

Section 403(b)(1) of the Code provides, in part, that amounts contributed by an employer to purchase an annuity contract for an employee is excludable from the gross income of the employee in the year contributed to the extent of the applicable "exclusion allowance," provided (1) the employee performs services for an employer which is exempt from tax under section 501(a) as an organization described in section 501(c)(3), or the employee performs services for an educational institution (as defined in section 170(b)(1)(A)(ii)) which is a state, a political subdivision of a state, or an agency or instrumentality of one or more of the foregoing; (2) such annuity contract is not subject to section 403(a); (3) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums; (4) such contract is purchased under a plan which meets the nondiscrimination requirements of paragraph 12, except in the case of a contract purchased by a church; and (5) in the case of a contract purchased under a plan which provides a salary reduction agreement, the contract meets the requirements of section 401(a)(30).

Section 403(b)(1) of the Code provides further that the employee shall include in his gross income the amounts actually distributed under such contract in the year distributed as provided in section 72 of the Code.

Section 403(b)(2) of the Code provides that the exclusion allowance equals twenty percent (20%) of the employee's includible compensation multiplied by the employee's years of service with the employer less amounts previously excludable.

Section 403(b)(3) of the Code defines includible compensation to mean the amount of compensation received from the employer in the employee's most recent one-year period of service which is includible in the employee's gross income.

Section 403(b)(10) of the Code requires that arrangements pursuant to section 403(b) must satisfy requirements similar to those of section 401(a)(9) and similar to the incidental death benefit requirements of section 401(a) with respect to benefits accruing after December 31, 1986, in taxable years ending after such date. In addition, this section requires that, for distributions made after December 31, 1992, the requirements of section 401(a)(31) are met regarding direct rollovers.

Section 403(b)(11) provides, in pertinent part, that distributions made from an annuity contract described in section 403(b)(1) attributable to contributions made pursuant to a salary reduction agreement within the meaning of section 402(g)(3)(C) may be made only when the employee separates from service.

Section 401(a)(9) of the Code, generally, provides for a mandatory benefit commencement date at age seventy and one-half (70 ½) and specifies required minimum distribution rules for the payment of benefits from qualified plans.

For taxable years beginning after December 31, 1996, section 1404(a) of the Small Business Job Protection Act of 1996 ("SBJPA") amended section 401(a)(9) to provide that the term required beginning date means, in the case of an employee, who is not a 5-percent owner, April 1 of the calendar year following the later of (a) the calendar year in which the employee attains age 70 ½, or (b) the calendar year in which the employee retires.

Section 401(g) of the Code requires that the contract be nontransferable.

Section 401(a)(31) of the Code requires a qualified plan to provide a distributee of an eligible rollover distribution with the option of having the distribution directly rollover to an eligible retirement plan.

Effective for tax years beginning after December 31, 1995, section 1450(a) of SBJPA provides that the frequency that an employee is permitted to enter into a salary reduction agreement, the salary to which such an agreement may apply, and the ability to revoke such an agreement shall be determined under the rules applicable to cash or deferred elections under section 401(k) of the Code.

For taxable years beginning after December 31, 1995, section 1450(c) of SBJPA of 1996 amended section 403(b)(1)(E) to provide that in the case of a contract under a salary reduction agreement, the contract meets the requirements of section 401(a)(30). Section 401(a)(30) requires a section 403(b) arrangement which provides for elective deferrals to limit such deferrals under the arrangement, in combination with any other qualified plans or arrangements, of an employer maintaining such plans or arrangements, providing for elective deferrals, to the limitation in effect under section 402(g)(1) for taxable years beginning in such calendar year.

Sections 402(g)(1) of the Code provide, generally, that the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals exceeds $11,000. This amount is increased by $1,000 for each year through 2006.

Section 402(g)(4) of the Code provides that the limitation under paragraph (1) shall be increased (but not to an amount in excess of $9,500) by the amount of any employer contributions for the taxable year used to purchase an annuity contract under section 403(b) under a salary reduction agreement.

Section 402(g)(7) of the Code provides that in the case of a qualified employee of a qualified organization, with respect to employer contributions to purchase an annuity contract under section 403(b) under a salary reduction agreement, the limitation of section 402(g)(1), as modified by section 402(g)(4), for any taxable year shall be increased by whichever of the following is the least: (i) $3,000, (ii) $15,000 reduced by amounts not included in gross income for prior taxable years by reason of this paragraph, or (iii) the excess of $5,000 multiplied by the number of years of service of the employee with the qualified organization over the employer contributions described in paragraph (3) made by the organization on behalf of such employee for prior taxable years (determined in any educational organization, hospital, home health service

agency, health and welfare organization described in section 414(e)(3)(B)(ii), and a "qualified employee" means any employee who has completed 15 years of service with the qualified organization).

Section 415(a)(2) of the Code provides, in relevant part, that an annuity contract described in section 403(b) shall not be considered described in section 403(b) unless it satisfies the section 415 limitations. In the case of an annuity contract described in section 403(b), the preceding sentence applies only to the portion of the annuity contract exceeding the section 415 limitations and the amount of the contribution for such portion shall reduce the exclusion allowance as provided for by section 403(b)(2).

Under section 415(c)(1) of the Code, contributions to a section 403(b) plan for a limitation year are generally limited to the lesser of (A) $30,000 or (B) 25% of compensation. In this case, you represent that Employer M, an employer described in section 501(c)(3) of the Code, which is exempt from taxation under section 501(a) has established Plan X as its section 403(b) program for its employees. A participant's salary reduction contributions and the earnings thereon are fully vested and nonforfeitable at all times. Plan X is not an annuity contract described in section 403(a) of the Code. The annuity contracts are nontransferable as required by section 401(g).

Plan X satisfies the distribution requirements under section 403(b)(10) and limits contributions in accordance with sections 402(g), 403(b)(2) and 415 of the Code. Plan X also provides Participants with an election to make a direct rollover distribution.

Furthermore, plan contributions are not includible in the participants' gross income in the year contributed to the extent that such contributions do not exceed the applicable limits under sections 402(g), 403(b)(2) and 415 of the Code, but instead will be includible in the participants' gross income in the taxable year such amounts are distributed under section 72 of the Code.

Therefore, based on the foregoing law and facts, with respect to your ruling requests we conclude that Plan contributions shall be treated under section 403(b) of the Code as amounts contributed by Employer M for annuity contracts. We further conclude that plan contributions, and earnings thereon, shall not be taxable in the year contributed, to the extent that such contributions satisfy the applicable limits under sections 402(g)(2), 403(b)(2) and 415 of the Code, but instead will be taxable under section 72 of the Code in the year in which such amounts are received by the participant.

This ruling is limited to the form of Plan X, excluding any form defects, which may violate the nondiscrimination requirements of section 403(b)(12) of the Code. This ruling does not extend to any operational violations of section 403(b) of the Code by Plan X, now or in the future.

This ruling is contingent upon the adoption of the amendment to Plan X as submitted with your correspondence dated ***.

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.

In accordance with a power of attorney on file in this office, a copy of this ruling is being sent to your authorized representative.

If you have any questions, please contact ***, ***, *** at ***.

Sincerely yours,

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:
Notice 437