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Internal Revenue Service

Department of the Treasury

Washington. DC 20224

2.I.N.: 403.04-00

contact Person:

Telephone Number:

In Reference to:
T:EP:RA:T2

Date:
DEC 9

Legend:

Employer M :
Plan x

Dear:

This is in response to a ruling request dated March 10, 1998, as supplemented by letters dated May 13, 1998, July 2, 1998, January 11, 1999, March 9, 1999, March 11, 1999, April 30, 1999, May 3, 1999, June 25, 1999, July 1, 1999, July 13, 1999, August 18, 1999, and October 1, 1999, submitted on your behalf by your authorized representative, with respect to an arrangement described in section 403(b)(l) of the Internal Revenue Code.

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

Employer M is an organization described in section 501(c)(3) of the Code. Employer M established Plan X for the benefit of its employees, effective February 1, 1978. Plan X became subject to ERISA effective December 1, 1991, and was most recently amended and restated effective December 1, 1995. Plan X is in the form of a plan document and an adoption agreement ("Adoption Agreement"), both adopted by Employer M on December 1, 1995. An amendment to Plan X was adopted on June 20, 1998, to conform Plan X to the requirements of the Small Business Job Protection Relief Act of 1997 and the Uniformed Services Employment and Reemployment Rights Act of 1994. In addition, in a letter dated October 1, 1999, proposed amendments as stated in their final form to Plan X were submitted.

Pursuant to section 1.1(20) of Plan X and section B of the Adoption Agreement, an employee is a person who is a common-law employee of the Employer other than (a) a nonresident alien who receives no earned income within the meaning of section 911 (d)(2) of the Code from the employer or an associated company which constitutes income from sources within the United States (within the meaning of section 861 (a)(3)) and (b) leased employees within the meaning of section 414(n).

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The two types of contributions that may be made to Plan X on behalf of a participant are employer contributions under section 4.1 of Plan X and employee elective contributions under section 4.2. Section I of the Adoption Agreement limits employer contributions to those equal to fifty percent of the first six percent of an active participant's compensation that is contributed by the active participant to the plan pursuant to a salary reduction agreement. Section 1.1(12) requires for years beginning after December 13, 1993, that the annual compensation of each participant taken into account under the plan for such plan year shah not exceed $150,000, as adjusted for cost of living increases. Section J of the Adoption Agreement provides that the salary reduction contributions made by participants will be voluntary and no minimum amount is required to be made as a contribution. Amounts transferred from other section 403(b) of the Code plans shall be set up in a separate rollover account pursuant to section 4.8.

Pursuant to section 4.4 of Plan X, the sum of the contributions made by the employer for any participant for any calendar year pursuant to sections 4.1 and 4.2 shall not exceed the lesser of the participant's (a) Exclusion Allowance or (b) Contribution Limit. The term "Exclusion Allowance" is defined in section 1.1(24), as amended by the proposed amendments, as twenty percent of the employee's includable compensation multiplied by his or her includable years over the aggregate of his or her prior contribution. The term "Contribution Llimit" is defined in section 1.1(14), as amended by the proposed amendments, as the limit on "annual additions" under section 4 15(c) of the Code.

In addition, section 4.2 of the Plan provides, in part, that the amount of contributions made pursuant to the salary reduction agreement for any participant for any calendar year shall not be in excess of the elective deferral limit. Section 1 1 (18), as amended by the proposed amendments, defines "elective deferral limit", in part, as meaning the greater of nine thousand five hundred dollars or seven thousand dollars as increased by the Secretary of the Treasury in accordance with section 402(g)(5). Section 1 . 1 (18) also provides that in the event that during the calendar year the participant also electively deferred any amounts pursuant to a salary reduction agreement under any qualified cash or deferred arrangement, the elective deferral limit under this plan shall be reduced by any elective deferral for such calendar year to any such plan.

Under section 5.1 of Plan X, a participant's interest in his employee contribution account is at all times nonforfeitable. A participant's interest in his employer contribution account shall be limited to his or her vested interest. Under section F of the Adoption Agreement, a participant's vested interest is 100 percent immediate.

Section 6.5(ii) of Plan X requires that payment of benefits to a participant shall commence not later than April 1st following the calendar year in which the participant has attained both age 70 ½ and retired from service of the employer. Section 6.4 requires

notwithstanding anything else in Plan X to the contrary, the payment of benefits shah be in accordance with the requirements of section 401 (a)(9) of the Code and the regulations thereunder.

Under section 8.1 of Plan X, as amended by the proposed amendments, subject to the restrictions of sections 8.1(b), (c) and (d), to the extent provided in the Adoption Agreement, and subject to any rules of the applicable funding agent, a participant may make in-service withdrawals from the vested value of his or her account which is invested in investment funds maintained by the funding agent, upon thirty days prior written notice to the Committee (under section 10.2, the Committee is responsible for administering and interpreting Plan X). The Adoption Agreement may limit such withdrawals to certain circumstances, including after the attainment of age 59 ½, after incurring a disability, and/or upon incurring a hardship. Withdrawals shall only be permitted from the vested value of a participant's account which is invested in investment funds maintained by the funding agent. Unless otherwise provided in the Adoption Agreement, no withdrawals shall be permitted from employer contribution accounts until such amount is fully vested. Qualified nonelective contributions shah be subject to the withdrawal limitation set forth in the definition of such term in section (43) of Article 1.

Section 8.1(b)(1) of Plan X, as amended by the proposed amendments, provides if in-service withdrawals are permitted in the Adoption Agreement, withdrawals attributable to the following amounts shall be subject to the restrictions of section 8.1(b)(2): (A) amounts which were originally contributed after December 31, 1988, pursuant to a salary reduction agreement within the meaning of section 402(g)(3)(C) of the Code to an annuity contract within the meaning of section 403(b)(l); or(B) amounts originally contributed to a custodial account within the meaning of section 403(b)(7).

Section 8.1 (b)(2) of Plan X, as amended by the proposed amendments, provides that distributions attributable to the amounts described in section 8.1(b)(1) may only be made on or after: (A) if permitted in the Adoption Agreement, when the participant attains age 59 ½; (B) when the participant separates from service; (C) if permitted in the Adoption Agreement, the participant's disability (within the meaning of section 72(m)(7) of the Code; (D) the participant's death; or (E) if permitted in the Adoption Agreement and under section 4.1 (b)(3), a case of hardship.

Section 8.1(b)(3) of Plan X, as amended by the proposed amendments, states that in the case of any (i) contributions which are originally made pursuant to a salary reduction agreement to an annuity described in section 403(b)(1) of the Code after December 31, 1988, or (ii) contributions by the employer which am described in section 4.1 to such section 403(b) annuity contract, hardship distributions may not include any income attributable to such contributions. In the case of amounts attributable to funds which were originally contributed to a custodial account

described in section 403(b)(7), hardship distributions may only be made from (i) amounts held in such account as of December 31, 1988, and (ii) contributions (but not any income thereon) made to such account after December 31, 1988, pursuant to a salary reduction agreement.

Section 8.1(d) of Plan X, as added by the proposed amendments, provides that if a participant is married as of the proposed date of such withdrawal, such withdrawal shah require the consent (obtained in accordance with the provisions of section 6.6 hereof within ninety days prior to the date of withdrawal) of the participant's spouse.

Section 4.8(b)(l) of Plan X permits a distributee to elect to have any portion of an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee in a direct rollover. Section 4.8(b)(2)(iv) defines a direct rollover as a payment by Plan X to the eligible retirement plan specified by the distributee.

In the letter dated March 10, 1998, it is stated that Plan X does not meet the requirements of section 403(a) of the Code.

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

1. Plan X, as amended by the proposed amendments, satisfies the requirements of section 403(b) of the Code.

2. Amounts contributed for a participant by Employer M to a participant's account under Plan X will be excluded from the gross income of the participant for the taxable year to the extent that such amounts do not exceed the limitations of section 402(g) of the Code, the participant's exclusion allowance, and section 415 on annual additions for that year.

With respect to the ruling requests, section 403(b)(1) of the Code provides, in part, that amounts contributed by an employer to purchase an annuity contract for an employee are 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 the 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 any one or more of the foregoing; (2) the 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 under a plan which provides a salary reduction agreement, the plan meets the requirements of section 401(a)(30).

Section 403(b)(2) of the Code provides, in part, that the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of--

(i) the amount determined by multiplying 20 percent of his or her includible compensation by the number of years of service over,

(ii) the aggregate of the amounts contributed by the employer for annuity contracts and excludable from the gross income of the employee for any prior taxable year.

Section 403(b)(10) of the Code requires that arrangements pursuant to section 403(b) must satisfy requirements similar to the requirements of section 401(a)(9) and similar to the incidental death benefit requirements of section 401 (a) with respect to benefits accruing after December 3 1, 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), regarding direct rollovers, are met.

Section 401(a)(9) of the Code, generally, provides that benefits commence by April 1 of the calendar year following the later of the calendar year in which the employee attains age 70 ½, or the calendar year in which the employee retires, and specifies required minimum distribution rules for the payment of benefits from retirement plans.

Section 403(b)(11) of the Code provides, generally, that section 403(b) annuity contract distributions attributable to contributions made pursuant to a salary reduction agreement (within the meaning of section 402(g)(3)(C)) may be paid only when the employee attains age 59 ½ separates from service, dies, becomes disabled (within the meaning of section 72(m)(7)), or in the case of hardship. Such contract may not provide for the distributions of any income attributable to such contributions in the case of hardship.

The withdrawal restrictions of section 403(b)(11) of the Code apply with respect to taxable years beginning after December 31, 1988, but only with respect to distributions which are attributable to assets other than assets held as of the close of the last year beginning before January 1, 1989. See section 1011A(c)(11) of TAMRA, which amended the effective date provisions applicable to section 403(b)(11) found in section 1123(e)(2) of the Tax Reform Act of 1986, P.L. 99-514.

Section 403(b)(l)(E) of the Code provides that in the case of a contract purchased under a plan which provides a salary reduction agreement, the contract must meet 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 plan, providing for

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elective deferrals, to the limitation in effect under section 402(g)(l) for taxable years beginning in such calendar year.

Section 403(b)(7) of the Code provides that "amounts paid by an employer" described in section 501(c)(3) which is exempt from tax under section 501(a) to a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as amounts contributed to an annuity contract for the employee if: (1) such amounts are invested in stock or a regulated investment company, and (2) under the custodial account no such amounts may be paid or made available to any distributee before the employee dies, attains age 59 ½, separates from service, becomes disable (within the meaning of section 72(m)(7)), or in the case of contributions made pursuant to a salary reduction agreement (within the meaning of section 3121(a)(l)(D)), encounters financial hardship.

Section 402(g)(l) of the Code provides, 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 $7,000, as adjusted under section 402(g)(5).

Section 402(g)(3)(C) of the Code provides that the term "elective deferrals" includes, in part, with respect to any taxable year, any employer contribution to purchase an annuity contract under section 403(b) under a salary reduction agreement.

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 4 15 limitations and the amount of the contributions for such portion shall reduce the exclusion allowance as provided in section 403(b)(2).

In this case, Employer M, an employer described in section 501(c)(3) of the Code, has established Plan X as its section 403(b) program for its employees. All contributions and the earnings thereon are fully vested and nonforfeitable at all times. Plan X does not meet the requirements of section 403(a).

Plan X satisfies the restrictions, under section 403(b)(11) of the Code, that amounts attributable to elective deferrals shall not be distributable earlier than upon the attainment of age 59 ½, separation from service, death, disability, or hardship. In addition, Plan X satisfies the section 403(b)(10) requirements and limits contributions in accordance with the requirements of sections 403(b)(2) and 415.

Accordingly, based on the foregoing laws and facts, we conclude with respect to the first

and second ruling requests as follows:

1. Plan X, as amended by the proposed amendments, satisfies the requirements of section 403(b) of the Code.

2. Amounts contributed for a participant by Employer M to a participant's account under Plan X will be excluded from the gross income of the participant for the taxable year to the extent that such amounts do not exceed the limitations of section 402(g) of the Code, the participant's exclusion allowance, and section 415 on annual additions for that year.

This ruling is limited to the form of Plan X, as amended, excluding any form defects that may violate the nondiscrimination requirement of section 403(b)(12) of the Code. This ruling does not extend to any operational violations of section 403(b) with respect to Plan X, now or in the future.

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.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd
Chief, Employee
Plans Technical Branch 2

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