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Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:
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Date:

JUN 2 2 2001

Attn:

Legend:

Organization A =

Company B =

Percentage C =

Percentage D =

Plan X =

Plan Y =

Dear

This is in response to your request for a ruling, dated August 27, 1998, supplemented by letters dated December 3, 1998, and February 9, 1999, submitted by your authorized representative concerning proposed contributions to Plan X and Plan Y ("the Plans"), under sections 401 (a)(4), 401 (m), 404, 415, 4972 and 4979 of the Internal Revenue Code ("the Code"). Your authorized representative submitted the following facts and representations in support of the requested ruling.

Organization A is an exempt organization under section 501 (c)(3) of the Code. It has established Plan X and Plan Y ("the Plans") for the benefit of its employees. Plan X is a defined contribution plan qualified under section 401(a) of the Code, and Plan Y is a defined contribution plan operated in compliance with section 403(b) of the Code.

Organization A, as Plan Administrator of the Plans, invested a substantial portion of the assets of both Plans in three group annuity contracts issued by Company B ("contracts"). These contracts maintain separate accounts for each participant in the

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Plans and guarantee a minimum rate of return of four percent. Actual returns are based on investment options contained in the contracts, which are selected by the individual participants. Investment options include pooled equity and fixed income accounts, stock market options including an indexed fund, bonds, and money market accounts. During the past several years, the investment return earned by the participants through the contracts, while meeting or exceeding the terms of the contracts, has been significantly less than the return on other possible investments.

You have represented that some participants in the Plans have expressed their concern about the disappointing performance of the Plans' investments. in order to increase the investment selections, and hopefully to improve their corresponding rate of return on investment, Organization A commenced the process of surrendering the contracts. It intends to reinvest the Plans' funds in other investment vehicles in accordance with the terms of the Plans.

Organization A's actions have triggered withdrawal charges as provided for in the contracts. Generally, the contracts (with the exception of certain amounts that are transferred into the contracts) provide for withdrawal charges equal to eight percent of the account value during the first five Participant Account Years, four percent for the Participant Account Years six through ten, and zero percent thereafter. A Participant Account Year begins when an individual account is established and an ihitial contribution is credited to the account. A Participant Account Year ends on the day immediately preceding the next anniversary of such date. The withdrawal charges are assessed directly against individual accounts. These charges reduce the overall rate of return. However, under the contracts, the charges do not affect the minimum rate of return. You have represented that in two of the contracts, the withdrawal charges are C% and D% of the respective contract values.

The Plan Administrator has expressed concern over its liability for breach of fiduciary duty relating to its selection of the three group annuity contracts. As a result, Organization A proposes to make payments to restore the amounts lost due to the surrender of the contracts. Organization A intends to deposit these payments in an escrow account. This account will be allocated to individual participant account balances which were reduced by the withdrawal charges. The payments and any income earned thereon will be transferred to the Plans, leaving each Plan participant in the same position that would have existed but for the imposition of the withdrawal charges.

Your authorized representative has requested the following rulings:

(1) That the proposed payments will not constitute a contribution for purposes of section 401 (a)(4) of the Code;

(2) That the proposed payments will not constitute a contribution for purposes of section 404 of the Code;

(3) That the proposed payments will not constitute a contribution for purposes of section 401 (m) of the Code;

(4) That the proposed payments will not constitute a contribution and will not be treated as giving rise to an annual addition for purposes of section 415 of the Code;

(5) That the proposed payments will not constitute a contribution for purposes of sections 4972 or 4979 of the Code; and

(6) That the proposed payments will not result in taxable inwme to the Plan participants or beneficiaries.

Section 404(a) of the Code generally provides that contributions paid by an employer to or under a plan, if otherwise deductible, are deductible under section 404, subject-to various limitations under section 404(a).

Section 401(a)(4) of the Code generally provides that the contributions or benefits provided under a qualified plan may not discriminate in favor of highly compensated employees. Whether or not contributions under a defined contribution plan are discriminatory is generally determined by comparing the amount of contributions allocated to accounts of highly compensated employees with the amount of contributions allocated to the accounts of nonhighly compensated employees.

Section 401 (m) of the Code, applicable to tax deferred annuity plans, generally provides that matching contributions by an employer cannot discriminate in favor of highly compensated employees.

Section 415(c) of the Code generally limits the amount of contributions and other additions under a qualified defined contribution plan or tax deferred annuity plan with respect to a participant for any year.

Section 4972(a) of the Code imposes a ten percent (10%) excise tax on the amount of the nondeductible contributions made to any “qualified employer plan”, including a plan qualified under sections 401 (a), 403(a), or 408(k). Section 4979 of the Code imposes a similar tax on excess contributions to tax deferred annuity plans.

Section 402(a) of the Code generally provides that any amount actually distributed to any distributee by an employees’ trust described in section 401(a) which is exempt from tax under section 501 (a) shall not be taxable to a participant until actually distributed to the participant.

Generally, amounts contributed to a qualified retirement plan are subject to Code sections 401(a)(4), 404, 415, and 4972. However, payments to a defined contribution plan are not so subject if they are made by the employer in order to restore value to the plan that was lost due to actions which place the employer under a reasonable risk of liability for breach of fiduciary duty. Payments to a plan made by an employer pursuant to a Department of Labor order or to a court-approved settlement to restore lost value would generally be treated as restorative payments and not subject to the Code sections cited above. However, in general, payments made by an employer to a plan to make up for lost value due to general market fluctuations would not be treated as restorative payments. Also, payments made by an employer to a plan which result in different treatment for similarly situated plan participants would not be treated as restorative payments. A determination as to whether plan payments in other circumstances may be treated as restorative payments would be based on all the facts presented.

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In this case, each of the contracts referenced above exceeded the rate of return guaranteed under its terms. Each participants account was invested according to the direction of the participant. With limited exceptions, the contractual withdrawal charges ranged from no more than ten percent of the contract value during the first four years to zero percent after ten years. The actual surrender charges were approximately five percent. Furthermore, no evidence was presented that the proposed payments to Plans X and Y will be made pursuant to an order or judgment of the Department of Labor, an arbitration proceeding, or a court of competent jurisdiction. Finally, the documentation presented in support of this ruling request shows that some plan participants are dissatisfied that the contracts were surrendered and the surrender charges incurred, solely because other investments, not provided for under the contracts, became more attractive over time. Such facts, without more, are not sufficient to demonstrate a reasonable risk of liability to the employer for breach of fiduciary duty.

Accordingly, in response to ruling requests (1) through (5) we conclude that the proposed payments to the Plans will be subject to Code sections 401(a)(4), 401(m), 404, 415, 4972, and 4979 (as applicable). Based on our determination in the first five requested rulings, we find the sixth ruling request moot.

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

The original of this ruling has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

Frances V Sloan

Frances V. Sloan
Manager, Employee Plans Technical Group 3
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose
Copy of letter to authorized representative

cc:

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