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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

U.I.L. 401.29-02

MAR 18 2005

T:EP:RA:T2

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Attn: **********

Legend:

State A = **********

Council B = **********

System S = **********

Plan X = **********

Plan T = **********

Plan U = **********

Plan V = **********

Plan W = **********

Plan Y = **********

Plan Z = **********

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

This is in response to your letter dated January 23, 2004, and supplemented by correspondence dated November 22, 2004, and January 6, 2005, submitted on your behalf by your authorized representative in which you request a ruling concerning the proposed transfer of certain contributions from Plan X based on the following facts and representations.

Council B is a statutory body responsible for the establishment of tax-qualified retirement plans enacted by the State A Legislature. Council B has delegated to System S the authority to administer tax qualified plans established by the State A Legislature. State A provides retirement income through a variety of plans to State A employees. The following retirement plans are maintained by State A and are the subject of this ruling request: (1) Plan T; (2) Plan U; (3) Plan V; (4) Plan W; (5) Plan Y; and (6) Plan Z (the "Plans"). The retirement benefit provided under the Plans is generally based on the participant's number of years of service ("service credit"), final or career average compensation, and the particular plan's benefit formula. You represent that the Plans are defined benefit plans that meet the requirements for qualification under Code section 401(a) and are governmental plans within the meaning of Code section 414(d).

In addition to the above Plans, State A also maintains Plan X, a Code section 401(k) plan, which was created in accordance with the State A laws in 1985. Plan X was originally adopted December 18, 1985, and was most recently amended and restated on October 25, 2001. Certain amendments to Plan X were adopted on February 28, 2002. You represent that Plan X meets the requirements for qualification under Code section 401(a).

Any member of the State A legislature and any person who works full time for any of the following entities is eligible to participate in Plan X: (1) any department, agency, board, commission, authority or other institution of State A authorized to pay remuneration to employees for direct personal services; (2) county departments of family and children services within State A; (3) electing county departments of health within State A; (4) electing county school boards or independent boards of education within State A; (5) electing regional community service boards within State A; and (6) the State A Lottery Corporation. Employees eligible to participate in Plan X may elect to defer compensation in Plan X in accordance with the terms and conditions of Plan X.

Effective February 28, 2002, Section 7.13 was added to Plan X. Section 7.13 of Plan X entitled "Transfers to Purchase Permissive Service Credit" provides that "notwithstanding any other provision of the plan to the contrary, a participant can instruct the plan administrator to transfer amounts from his or her account by way of a trustee-to-trustee transfer to any defined benefit governmental plan (as defined in section 414(d)) where the participant informs the plan administrator that such transfer is for the purchase of permissive service credits under such

defined benefit governmental plan. For purposes of this section "permissive service credits" shall mean service credits recognized by the defined benefit governmental plan in question for purposes of calculating a participant's benefit under such plan, which such participant has not yet received, and which such participant may receive only by making a voluntary additional contribution, in an amount determined by the defined benefit governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit. Amounts transferred from a participant's account pursuant to this section shall not be considered a distribution for any purpose under the plan."

In conjunction with a transfer of contributions from Plan X to one of the Plans, a permanent record will be maintained for each Plan X participant who elects to make a transfer. The participant who elects to transfer amounts from Plan X to one of the Plans is a participant in that particular defined benefit governmental plan. The Plan X transfer shall be limited to a defined benefit governmental plan (i.e., one of the Plans) that is qualified under the provisions of Code section 401(a) and which meets the following requirements:

First, funds representing the Plan X transfer amount will be nonforfeitable and will be commingled with other assets in the particular defined benefit governmental plan to which the Plan X amount will be transferred. Second, no interest will be accrued on (nor will any gains and losses be allocated to) the funds representing the Plan X transfer amount; rather the Plan X transfer amounts operate to purchase additional years of service ("service credit") in the particular defined benefit plan and thereby result in increased benefits for the participant under the particular defined benefit governmental plan based on the years of service purchased and the particular defined benefit plan's benefit formula. The increased additional benefit under the defined benefit plan will be actuarially equivalent to the dollar amount of the amount transferred from Plan X. Third, the defined benefit governmental plan accounting systems will report such additional credit as purchased on the date of the Plan X transfer. Finally, the participant in the defined benefit governmental plan on whose behalf an amount is transferred from Plan X will only be entitled to a distribution of the Plan X transfer amounts from the particular defined benefit governmental plan upon the earlier of separation from service, death, or disability.

Once the Plan X amounts are transferred to the particular defined benefit governmental plan, they will be held in that particular defined benefit governmental plan's trust. It is represented that the transfer of the Plan X amounts will result in increased benefits under the particular defined benefit governmental plan, based on the years of service purchased and the defined benefit plan formula. You further represent that Plan X amounts will only be transferred if the Plan X participant making the transfer is fully vested in his or her benefits in the particular defined benefit plan, or if the transfer results in the purchase of sufficient years of service to enable the Plan X participant to become fully vested in his or her benefits in the defined benefit governmental plan.

You state that only participant elective (or rollover) contributions to Plan X can be transferred to the particular defined benefit governmental plan. Thus, only amounts in the participant's Plan X Deferred Compensation Contribution Sub-Account (including any amounts contributed as Catch-Up Contributions) and the Plan X Rollover Sub-Account can be transferred.

You further state that the participant's benefit in Plan X is solely dependent upon the participant's account balances under Plan X. Upon a request by a Plan X participant who elects to transfer to one of the Plans, the trustee of Plan X will transfer a specific dollar amount from the participant's Plan X accounts directly to the trustee of the particular defined benefit governmental plan. Once the transfer is made from Plan X, the Plan X participant's account balances in Plan X will be reduced dollar-for-dollar by the amount of the transfer. Therefore, the amounts transferred will only provide a benefit to the participant in the particular defined benefit governmental plan and the participant will have no expectation that he or she will receive a benefit from both plans (Plan X and the particular defined benefit governmental plan) based on the amounts transferred.

Based upon the above facts and representations, the following rulings have been requested:

1. The amounts representing the Plan X transfers that are transferred from Plan X on behalf of and at the direction of a Plan X participant to one of the Plans in order to purchase service credit for the participant in the particular defined benefit governmental plan will not, pursuant to Code section 402, result in ordinary income to the participant under Code section 72 by reason of such transfer.

2. The amounts representing the Plan X transfers that are transferred from Plan X on behalf of and at the direction of a Plan X participant to one of the Plans to purchase service credit on behalf of the participant under the particular defined benefit governmental plan will not constitute either an impermissible actual distribution or a constructive distribution under Code section 401(k)(2)(B), nor will the Plan X transfers constitute a violation of the separate accounting requirements under section 1.401(k)-1(e)(3) of the Income Tax Regulations.

3. The amounts representing the Plan X transfers that are transferred from Plan X on behalf of and at the direction of a Plan X participant to one of the Plans in order to purchase service credit for the participant will not constitute either an "annual benefit" within the meaning of Code section 415(b)(2)(A), for purposes of determining limitations for defined benefit plans, nor will the Plan X transfer amounts constitute an "annual addition" within the meaning of Code section 415(c)(2), for purposes of determining limitations for defined contribution plans.

4. The special rules of Code section 415(n) relating to the purchase of permissive service credit do not apply to the amounts transferred from Plan X.

5. The amounts representing Plan X transfers that are transferred from Plan X on behalf of and at the direction of a participant to a particular defined benefit governmental plan to purchase service credit will not be considered a designated distribution for the year of the transfer subject to withholding requirements under Code section 3405 and tax reporting under Code section 6047(d).

With respect to ruling request one, section 402(a) of the Code provides that, except as otherwise provided in this subsection, any amount actually distributed to any distributee by any employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed, under section 72 (relating to annuities).

Code section 72(t) 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 amount is distributed on or after an employee attains age 59 ½, or on account of one or more exceptions provided for under section 72(t)(2) of the Code.

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

In the instant case, you represent that amounts are being transferred at the election of the Plan X participant by way of a trustee-to-trustee transfer directly from Plan X to one of the Plans and that no amount will be distributed or made available to the participant. You further represent that Plan X and the Plans are qualified plans as described in Code section 401(a). Accordingly, it is concluded that amounts representing the Pan X transfer amounts that are transferred from Plan X on behalf of and at the direction of a participant in Plan X to one of the particular defined benefit governmental plans (the Plans) in order to purchase service credit for the participant will not result in ordinary income to the

participant under section 72 of the Code pursuant to section 402 by reason of such transfer.

With respect to ruling request two, section 1.401-1(b)(1)(i) of the Income Tax Regulations provides, in part, that a pension plan is a plan established and maintained by an employer primarily to provide for the payment of definitely determinable benefits to employees over a period of years, usually for life, after retirement. This section also provides that a pension plan may provide for the payment of a pension due to disability, and may also provide for incidental benefits.

Revenue Ruling 56-693, 1956-2 C.B. 282, as modified by Revenue Ruling 60-323, 1960-2 C.B. 148, provides that a pension plan fails to meet the requirements of section 401(a) if it permits an employee to withdraw any part of the employee's accrued benefit (other than a benefit attributable to voluntary employee contributions) prior to certain distributable events; e.g., retirement, death, disability, severance of employment, or termination of the plan.

Code section 401(k)(2)(B) provides that a plan meeting the requirements of section 401(k) may not make distributions prior to a participant's severance from employment, death, disability or attainment of age 59 1/2. Section 401(k)(2)(B) does allow for plan distributions upon an employee's hardship (without regards to amounts described in section 402(e)(3)), or a plan termination.

Section 1.401(k)-1(d)(6)(iv) of the Regulations provides that the distribution limitations of paragraph (d) (as also stated in section 401(k)(2)(B) of the Code) generally continue to apply to amounts attributable to elective contributions (including amounts treated as elective contributions) that are transferred to another qualified plan of the same employer or another employer. Thus, the transferee plan will generally fail to satisfy the requirements of section 401(a) and this section if the transferred amounts may be distributed before the times specified in paragraph (d).

Section 1.401(k)-1(e)(3) of the Regulations sets forth the separate accounting requirement for qualified cash or deferred arrangements. Section 1.401(k)-1(e)(3) provides that a cash or deferred arrangement satisfies the requirements of this section only if the portion of the employee's benefit that is subject to the nonforfeitability and distribution limitation requirements i.e., in pertinent part, the employee's retirement, death, disability, or separation from service, or termination of the plan, is determined by an acceptable separate accounting between that portion and any other benefits. Separate accounting is not acceptable unless gains, losses, withdrawals, and other credits or charges are separately allocated on a reasonable and consistent basis to the accounts subject to the nonforfetability requirement and the distribution limitation requirement and to other accounts.

We have already ruled in ruling request number one that the subject transfers will not cause a taxable event. Accordingly, in regards to ruling request two, we

conclude that the amounts representing the Plan X transfer amounts that are transferred from Plan X on behalf of and at the direction of a participant to a particular defined benefit governmental plan (the Plans) to purchase service credit on behalf of the participant under the particular defined benefit plan will not constitute either an impermissible actual distribution or a constructive distribution under section 401(k)(2)(B) of the Code.

With respect to separate accounting, section 1.401(k)-1(e)(3) of the Regulations provides, in pertinent part, that a cash or deferred arrangement will satisfy the separate accounting requirement if the portion of the employee's benefit that is subject to that requirement is nonforfeitable and satisfy certain distribution limitations. In this case, since the Plan X transfer amounts will be nonforfeitable under the terms of the Plans and since all benefits provided under the Plans, including the Plan X transfer amounts, will be subject to withdrawal and distribution restrictions that meet the requirements of sections 401(a) and 401(k)(2)(B) of the Code, separate accounting is deemed satisfied. Accordingly, with respect to ruling request two, we further conclude that the Plan X transfer amounts will not constitute a violation of the separate accounting requirements under section 1.401(k)-1(e)(3) of the Regulations.

With respect to ruling request three, section 415(a)(1)(A) of the Code provides that a defined benefit plan is not a qualified plan if the plan provides for the payment of benefits with respect to a participant which exceed the limitations of section 415(b). Section 415(b) limits the amount of annual benefits in a defined benefit plan.

Section 415(a)(1)(B) of the Code provides that a defined contribution plan is not a qualified plan if contributions and other additions made to the plan with respect to any participant in a taxable year exceed the limitation of section 415(c). Section 415(c) limits the amount of annual contributions and other additions to a participant's account in a defined contribution plan.

Section 415(n) of the Code generally provides that if an employee makes a contribution to purchase permissive service credit under a governmental plan, the plan may satisfy the Code section 415 limits either by treating the accrued benefit derived from all such contributions as an annual benefit in applying the Code section 415(b) limit or by treating the contributions as annual additions for purposes of Code section 415(c).

Section 415(n)(3) defines permissive service credit to mean service credit

(i) recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,

(ii) which such participant has not received under such governmental plan, and

(iii) which such participant may receive only by making a voluntary additional contribution, in an amount, determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.

Section 1.415-3(b)(1)(iv) of the Regulations provides that when there is a transfer of funds from one qualified plan to another, the annual benefit attributable to the assets transferred does not have to be taken into account by the transferee plan in applying the limitations of section 415.

Section 1.415-3(d)(1) of the Regulations provides that mandatory contributions to a defined benefit plan are considered a separate defined contribution plan that is subject to the limitations on contributions and other additions described in section 1.415-6.

Section 1.415-6(b)(2)(iv) of the Regulations provides that the transfer of funds from one qualified plan to another will not be considered an annual addition for the limitation year in which the transfer occurs.

You represent that Plan X and the Plans are all qualified plans as described in Code section 401(a). Thus, the proposed transfers of amounts from Plan X to the Plans are transfers from one qualified plan to another. Therefore, with respect to ruling request three it is concluded as follows: as provided under section 1.415-3(b)(1)(iv) of the regulations, the amounts representing the Plan X transfer amounts that are transferred from Plan X on behalf and at the direction of the participant to a particular defined benefit governmental plan (the Plans) in order to purchase service credit for the participant in the defined benefit plan do not constitute an "annual benefit" within the meaning of section 1.415(b)(2)(A) of the Code, for the purpose of determining limitations for defined benefit plans. Furthermore, as provided under section 1.415-6(b)(2)(iv) of the Regulations, the Plan X transfer amounts will not constitute an "annual addition" within the meaning of section 415(c)(2) of the Code, for purposes of determining limitations for defined contribution plans. In addition, with respect to ruling request number four, because the Plan X transfer amounts are transferred amounts and not contributions, the special rules of Code section 415(n) relating to the purchase of permissive service credit do not apply to the Plan X transfer amounts. This ruling relates only to transfers that are equal to one hundred percent of the actuarial cost of the service being purchases.

With respect to ruling request five, sections 3405(a)(1) and (b)(1) of the Code provide generally that the payor of any periodic payment or nonperiodic distributions must withhold amounts from such payments and distributions. Sections 3405(e)(2) and (3) define a "periodic payment" and "nonperiodic distributions" to mean all designated distributions.

Section 3405(e)(1)(A) of the Code defines the term "designated distribution" to include any distribution or payment from or under an employer deferred compensation plan. A-3 of section 35.3405-1T of the Regulations provides that an employer deferred compensation plan is any pension, annuity, profit-sharing, stock bonus, or other plan that defers the receipt of compensation. A-22 of section 35.3405-1T also provides that a retirement plan maintained by a state or local government on behalf of its employees is a plan that defers the receipt of compensation.

Section 3405(e)(1)(B)(ii) of the Code provides, however, that the term "designated distribution" shall not include any portion of any distribution or payment which it is reasonable to believe is not includible in income. A-2 of section 35.3405-1T of the Regulations provides similarly that a designated distribution does not include any portion of a distribution which it is reasonable to believe is not includible in income.

Section 6047(d) of the Code provides, in part, that an employer maintaining a qualified plan (or the plan administrator) from which designated distributions (as defined in Code section 3405(e)(1)) may be made, must make returns and reports regarding such plan to the Secretary, to the participants and beneficiaries of such plan, and to such other persons as the Secretary may by regulations prescribe.

It has been represented that the transfers to the defined benefit plans (the Plans) will not be within the control of a participant but will be transferred by the trustee of Plan X directly to the trustee of the particular defined benefit plans. Further, such transfers will be subject to withdrawal and distribution restrictions so that a participant may not withdraw or receive a distribution of amounts representing the Plan X transfer amounts prior to retirement, death, disability, or severance from employment. We have also ruled with respect to ruling requests one and two that the amounts transferred to the defined benefit plans (the Plans) from Plan X will not result in ordinary income to the participant under section 402 of the Code nor will the transfer constitute a distribution under section 401(k)(2)(B). Thus, we conclude with respect to ruling request five that the amounts transferred from Plan X on behalf of and at the direction of a Plan X participant to a particular defined benefit plan to purchase service credit under the defined benefit plan will be transferred in a permissible transfer and therefore will not be considered a designated distribution for the year of the transfer subject to the withholding requirements of section 3405 of the Code or to the reporting requirements of section 6047(d).

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 other as precedent.

This ruling assumes that Plan T, Plan U, Plan V, Plan W, Plan X, Plan Y and Plan Z satisfy the requirements for qualification under Code section 401(a). This

ruling further assumes that the Plans satisfy the requirements for governmental plans as described in Code section 414(d) at all times relevant to this transaction.

A copy of this ruling is being sent to your authorized representative in accordance with a Power of Attorney (Form 2848) on file in this office.

If you have any questions about this ruling, you may contact **********SE:T:EP:RA:T2.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:

Deleted Copy of Letter Ruling
Notice of Intention to Disclose