



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

TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

NOV 7 2005

Uniform Issue List: 415.00-00

*SE: T. EP: R A: T 2*

XXXXXXXXXX  
XXXXXXXXXX  
XXXXXXXXXX  
XXXXXXXXXX

ATTN: XXXXXXXXXXXX

LEGEND:

- System A = \*\*\*
- Plan X = \*\*\*
- City B = \*\*\*
- State C = \*\*\*
- Statute X = \*\*\*
- Statute Y = \*\*\*

Dear \*\*\*:

This is in response to your letter dated February 24, 2005, supplemented by additional correspondence dated October 7, 2005, and November 2, 2005, submitted on your behalf by your authorized representative, in which you request a ruling concerning the applicability of Internal Revenue Code (Code) sections 415(c) and 415(n) to voluntary benefit enhancement provisions recently added to State C law.

The following facts and representations were made in support of your ruling request:

System A manages and administers Plan X, which you represent is a tax-qualified defined benefit governmental retirement plan as described in Code section 401(a) and section 414(d). System A is managed by a board. Plan X provides retirement benefits to eligible employees of City B. By State C law, police officers, firefighters, and

teachers who work for City B participate in the State C Retirement System. All other City B employees are required to participate in Plan X. Plan X requires all City B employees to contribute 3.75 percent of their earnings to Plan X on a payroll deduction basis. Plan X has more than 1800 members, of whom more than 1300 are active employees. Its asset base had a market value of approximately \$ [REDACTED] as of December 31 [REDACTED]. Current yearly benefit payments total approximately \$ [REDACTED].

The law creating Plan X has been modified several times by the State C legislature. Legislation involving Plan X originates locally in City B and either System A or an advisory group made up of System A members (Plan X participants) drafts the legislation and submits it to the State C legislature for passage.

In [REDACTED] the State C legislature amended Plan X by adding Statute X that provides members the ability to make additional contributions to increase the percentage of final average earnings used to calculate retirement benefits. Specifically Statute X provides that in addition to the contributions deducted from the compensation of the members, any member may provide an additional retirement allowance not in excess of the rate computed to be sufficient to provide an additional retirement allowance which, together with his regular retirement allowance, will result in a total retirement allowance not in excess of fifty percent of his final average earnings. Such additional contributions shall become part of his accumulated contributions except in the case of retirement, when they shall be treated as excess contributions returnable to the member in cash or as a member annuity of equivalent actuarial value.

Statute X further provides that any member, or a member's employer, may make additional contributions on behalf of a member at an additional rate determined by the actuary. Any additional contributions made by a member who intends to retire under section 11, paragraph II of Plan X, or additional contributions of the employer, may be used to offset the reduction, or a portion thereof, in retirement benefits for early retirement. Finally, Statute X provides that any additional contributions made under this section shall become part of the member's accumulated contributions and may be withdrawn, in cash, upon the member's retirement in lieu of having such amounts used to offset the reduction for early retirement. You represent that pursuant to administrative regulations, the additional member contributions are limited to after-tax contributions. Statute X was effective on June 6 [REDACTED].

In [REDACTED], the State C legislature made an additional amendment to Plan X by adding Statute Y that provides members the opportunity to make additional contributions to increase the percentage of average final earnings used to determine their benefits upon normal retirement.

Under Plan X, a member who qualifies for a normal retirement benefit is entitled to receive an annual pension in the amount of 1½ percent of the member's final average

earnings multiplied by the number of years of service completed prior to January 1, [REDACTED] plus 2 percent of the members final average earnings multiplied by the number of

years of service completed after December 31, [REDACTED] Statute Y provides that a member may elect to receive a retirement benefit of [REDACTED] percent of the members average final earnings for all years of service or any portion thereof, provided that the member shall be responsible for payment of 50 percent of the actuarially determined cost of the benefit. System A is responsible for the payment of the remaining 50 percent of the actuarially determined cost of the benefit. You represent that the option to purchase additional benefits is only available to active members of Plan X. You further represent that the additional benefits must be purchased with after-tax funds paid in a lump sum and any purchase must be completed prior to retirement.

On March 8, [REDACTED] the Board of Trustees of System A voted to suspend the implementation of Statute Y pending receipt of the private letter ruling from the Internal Revenue Service (Service).

Based on the foregoing, you request the following rulings:

- (1) That the provisions of Code section 415(c) will apply to employee contributions made to Plan X pursuant to Statute X.
- (2) That the provisions of Code section 415(n) will not apply to the enhanced benefit provisions added to Plan X by Statute X.
- (3) That the provisions of Code section 415(c) will apply to employee contributions made to Plan X pursuant to Statute Y.
- (4) That the provisions of Code section 415(n) will not apply to the enhanced benefit provisions added to Plan X by Statute Y.

Code section 415(c) provides the rules for the maximum contributions and other annual additions to defined contribution plans. Section 415(c)(1) provides, in general, that contributions and other additions for a participant may not exceed the lesser of (A) \$40,000, or (B) 100 percent of the participant's compensation.

Code section 415(c)(2) provides that for purposes of paragraph (1), the term "annual addition" means the sum for any year of

- (A) employer contributions,
- (B) the employee contributions, and
- (C) forfeitures.

For purposes of this paragraph, employee contributions under subparagraph (B) are determined without regard to any rollover contributions (as defined in sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) without regard to employee contributions to a simplified employee pension which are excludable from gross income under section 408(k)(6). Further subparagraph (B) of paragraph (1) shall not apply to any contribution for medical benefits (within the meaning of section 419A(f)(2) after separation from service which is treated as an annual addition.

Section 1.415-3(d)(2) of the Income Tax Regulations (regulations) provides that where a defined benefit plan provides for voluntary employee contributions, these contributions are considered a separate defined contribution plan maintained by the employer that is subject to the limitations on contributions and other additions described in section 1.415-6 of the regulations (limitations for defined contribution plans).

Code section 415(n) states the rule relating to the purchase of permissive service credit. Section 415(n)(1) of the Code requires that if an employee makes one or more contributions to a defined benefit governmental plan (within the meaning of Code section 414(d)) to purchase permissive service credit under such plan, the plan must comply with Code section 415(b) by treating the accrued benefit from the additional contributions as an annual benefit or the plan must comply with Code section 415(c) by treating the contributions as annual additions.

Code section 415(n)(3)(A) defines "permissive service credit" as 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.

In this case, Statute X, in pertinent part, allows eligible members of Plan X to make additional contributions to Plan X to increase the percentage of their final average earnings used to determine the member's retirement benefits. Statute Y, as proposed, allows members of Plan X to make additional contributions to Plan X in an amount necessary to increase the percentage of final average earnings used to determine their benefits upon normal retirement from 1½ percent to 2 percent for all years of service. You represent that pursuant to administrative regulations, the additional contributions made by the member pursuant to Statute X are limited to after-tax member contributions. Further, you represent that the additional benefits that are purchased

pursuant to Statute Y must be paid for in a lump sum prior to retirement with after-tax funds.

You represent that Plan X is a contributory defined benefit plan. The additional contributions made to Plan X pursuant to Statute X Statute Y, as proposed, are described as additional after-tax member contributions. Under section 1.415-3(d)(2) of the regulations, voluntary employee contributions made to a defined benefit plan are considered a separate defined contribution plan subject to the limitations on contributions and additions as defined in Code section 415(c) and as further described in section 1.415-6 of the regulations. Because the member contributions made to Plan X pursuant to Statute X and Statute Y, as proposed, are voluntary employee contributions, we conclude, with respect to your first and third ruling requests that the provisions of Code section 415(c) will apply to the employee contributions made to Plan X pursuant to Statute X and that the provisions of Code section 415(c) will apply to the employee contributions made to Plan X pursuant to Statute Y, as proposed.

With regard to your second and fourth ruling requests, Statute X and Statute Y, as proposed, allow members of Plan X to make additional voluntary member contributions to Plan X that increase the percentage of final average earnings used to calculate their retirement benefits, thereby satisfying clauses (i) and (iii) of Code section 415(n)(3)(A). However, code section 415(n)(3)(A)(ii) provides that "permissive service credit" does not include service credit for which the participant has already received credit for under the governmental plan. In this case, the member has already received credit for the years of service for which he or she proposes to make the additional voluntary contributions to Plan X. In this case, Plan X has already provided service credit for the years of service for which the member is making the additional voluntary contributions. As such, these contributions will purchase additional benefits with respect to service which has already been recognized by Plan X. Because the additional member contributions made to Plan X pursuant to Statute X and Statute Y, as proposed, are not contributions that meet the requirements of Code section 415(n)(3)(A)(ii), we conclude, with respect to your third and fourth ruling requests that the requirements of Code section 415(n) do not apply to such contributions.

This ruling is based on the assumption that Plan X meets the requirements of Code section 401(a) and Code section 414(d) at all times relevant to this transaction. The conclusions reached herein only apply to the additional voluntary member contributions made to Plan X pursuant to Statute X and Statute Y, as proposed.

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 as precedent.

If you have any questions regarding this ruling, you may contact \*\*\*, SE:T:EP:RA:T2, at  
\*\*\*

Sincerely,

**(Signed) JOYCE E. FLOYD**

Joyce E. Floyd, Manager  
Employee Plans Technical Group 2

Enclosures:

Deleted copy of ruling letter  
Notice of Intention to Disclose Form 437