



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

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Uniform Issue List: 401.04-01

SE: T. EP: RA. T 3

Legend:

Taxpayer A =  
Bank P =  
Company M =  
State K =  
Plan X =  
Plan Y =

Dear

In a letter dated October 27, 2005, which modifies and incorporates by reference a letter dated September 13, 2004, your authorized representative requested a private letter ruling on your behalf concerning the distribution restrictions under section 1.401(a)(4)-(5)(b) of the Income Tax Regulations ("regulations").

The following facts and representations have been asserted in support of your ruling request:

Company M is incorporated under the laws of State K and maintains Plan X, a defined benefit pension plan, for the benefit of its employees. Plan X's original effective date is . Company M is Plan X's administrator. Plan X is intended to qualify under section 401(a) of the Internal Revenue Code ("Code"). Taxpayer A is a former employee and officer of Company M and a participant in Plan X.

The normal form of benefit under Plan X is a life annuity for an unmarried participant and a joint and 50% survivor annuity for a participant who is married. Plan X provides for optional forms of distribution which include a lump sum payment for participants retiring from active employment.

Company M represents that Plan X imposes restrictions on the benefits that are payable to an individual who is a highly compensated employee, or former highly compensated

employee, and who is one of the 25 individuals with the largest amount of compensation in the current or any prior year ("Restricted Employee"). Company M also represents that these restrictions are intended to comply with the rules set forth in section 1.401(a)(4)-(5)(b) of the regulations.

Plan X provides that a Restricted Employee may receive a distribution in excess of the "Restricted Amount" if, prior to the receipt of the Restricted Amount, the Restricted Employee enters into a written agreement with the plan administrator to secure repayment to Plan X of the Restricted Amount. Company M represents that the term "Restricted Amount" as used herein is defined in Revenue Ruling 92-76, 1992-2 C.B. 76 ("Rev. Rul. 92-76"). Rev. Rul. 92-76 defines the Restricted Amount as the excess of the accumulated amount of distributions made to the employee over the accumulated amount of the employee's nonrestricted limit. The employee's nonrestricted limit is equal to the payments that could have been distributed to the employee, commencing when distribution commenced to the employee, had the employee received payments in the form described in section 1.401(a)(4)-5(b)(3)(i)(A) and (B) of the regulations. An "accumulated amount" is the amount of a payment increased by a reasonable amount of interest from the date the payment was made (or would have been made) until the date for the determination of the Restricted Amount.

Plan X provides that an acceptable method by which an individual may secure repayment of the Restricted Amount is by entering into an agreement for promptly depositing in escrow with an acceptable depository, property having a fair market value equal to at least 125% of the Restricted Amount. Plan X provides that the escrow arrangement may permit a Restricted Employee to withdraw from the escrow account amounts in excess of 125% of the Restricted Amount and may also permit a Restricted Employee to receive any income from the property placed in escrow. However, if the fair market value of the property in the escrow account falls below 110% of the remaining Restricted Amount, the Restricted Employee must deposit additional property to bring the value of the property held by the depository up to 125% of the remaining Restricted Amount. The individual's right to receive income from the escrowed property will be subject to the individual's obligation to deposit additional property as described in the preceding sentence. Plan X provides that the escrowed property may be released to the Restricted Employee when the plan administrator certifies to the depository that the Restricted Employee is no longer obligated to repay any Restricted Amount.

Company M also maintains a defined contribution plan for the benefit of its employees, Plan Y. Plan Y contains a cash or deferred arrangement as described in section 401(k) of the Code. Company M is Plan Y's administrator. Plan Y is intended to qualify under section 401(a). Taxpayer A is also a participant in Plan Y.

Plan Y provides for immediate 100% vesting. The normal form of benefit under Plan Y is a life annuity for an unmarried participant and a joint and 50% survivor annuity for a participant who is married. Plan Y allows lump sum distributions and partial withdrawals as optional forms of distribution.

Company M represents that Taxpayer A is a Restricted Employee under Plan X and therefore is subject to the restrictions under Plan X and section 1.401(a)(4)-(5)(b) of the regulations. Taxpayer A has accrued benefits under Plan X and is eligible for an early retirement benefit from Plan X effective

Taxpayer A desires to take a lump sum distribution of his benefit under Plan X. Pursuant to Plan X, Taxpayer A and his spouse will execute the appropriate consent forms waiving a qualified joint and survivor annuity. The lump sum distribution will be rolled over by direct trustee-to-trustee transfer to an Individual Retirement Account ("IRA") as described in Code section 408(a). Pursuant to the restrictions of Plan X and section 1.401(a)(4)-(5)(b)(3) of the regulations, Taxpayer A and Company M, as Plan X's administrator, prior to the distribution of the lump sum benefit, will enter into a repayment agreement ("Repayment Agreement") to secure repayment to Plan X of the Restricted Amount.

The Repayment Agreement will provide that the Restricted Amount will be repaid to the Plan X trustee if Plan X terminates and repayment is necessary. The repayment obligation under the Repayment Agreement will be secured by depositing with Bank P property having a fair market value equal to at least 125% of the Restricted Amount. Pursuant to the Repayment Agreement, Taxpayer A will roll over the lump sum cash payment from Plan X into an IRA by direct trustee-to-trustee transfer. The IRA custodian will be Bank P. The Repayment Agreement will provide that Bank P will divide the IRA into two separate accounts. The first account, identified as "Restricted Assets," will consist of assets having an initial fair market value of at least 125% of the Restricted Amount. The second account, identified as "Unrestricted Assets," will consist of the assets exceeding 125% of the Restricted Amount, if any. The Repayment Agreement will be secured by (i) an assignment by Taxpayer A to Plan X of his rights in the Restricted Assets, and (ii) an agreement that Bank P will hold the Restricted Assets of the IRA for the benefit of Plan X during the period of restriction. If the initial assets of the IRA do not have an initial fair market value of at least 125% of the Restricted Amount, Taxpayer A will roll over to the IRA with Bank P, by direct trustee-to-trustee transfer, a cash distribution from Taxpayer A's vested account balance under Plan Y. The value of the property rolled over from Plan Y will have a fair market value sufficient to bring the fair market value of the IRA to at least 125% of the Restricted Amount.

The Repayment Agreement will provide that in the event the fair market value of the Restricted Assets in the IRA falls below 110% of the Restricted Amount, Taxpayer A will

either cause the Unrestricted Assets of the IRA to be reclassified as part of the Restricted Assets in an amount sufficient to bring the fair market value of the assets in the Restricted Assets to at least 125% of the Restricted Amount, or will establish an "Escrow Account" of the type described in Rev. Rul. 92-76 with Bank P and deposit into the Escrow Account sufficient funds so that the aggregate fair market value of the assets in the Escrow Account and the Restricted Assets of the IRA equal at least 125% of the Restricted Amount.

The Repayment Agreement will provide that Taxpayer A may withdraw from the IRA and/or Escrow Account amounts in excess of 125% of the Restricted Amount. Taxpayer A will also have the right to receive the income from the IRA property and/or Escrow Account subject to his obligation to deposit additional property if the fair market value of the Restricted Assets and the Escrow Account falls below 110% of the Restricted Amount.

If distributions are required to be made from the IRA to Taxpayer A or his beneficiaries pursuant to Code section 408(a)(6) because of his age or his death while the obligation under the Repayment Agreement still exists, such distributions will first be made from the Unrestricted Assets of the IRA. If the Unrestricted Assets are exhausted, then the Restricted Assets will be used to make the required distributions. If the required distributions cause the fair market value of the Restricted Assets and Escrow Account to fall below 110% of the Restricted Amount, then Taxpayer A, or his beneficiaries as the case may be, will be required to deposit in the Escrow Account sufficient assets to bring the aggregate fair market value of the Restricted Assets and the Escrow Account to 125% of the Restricted Amount.

The Repayment Agreement will provide for the termination of Taxpayer A's repayment obligation and a release of the security for such obligation at the time that repayment is no longer required by section 1.401(a)(4)-5(b) of the regulations, Rev. Rul. 92-76 and Plan X.

Based on the foregoing facts and representations, the following rulings are requested:

1. The Repayment Agreement will satisfy the requirements of Rev. Rul. 92-76 and will not violate the provisions of section 1.401(a)(4)-5(b)(3) of the regulations.
2. A single cash payment by Plan X to Taxpayer A in payment of Taxpayer A's entire accrued benefit will constitute an eligible rollover distribution under section 402(c)(4) of the Code (to the extent that it otherwise qualifies under section 402(c)(4) of the Code), and the rollover of the payment into the IRA within the 60 day period described in section 402(c)(3) of the Code will be treated as a transfer of all amounts received in the payment in accordance with section 402(c)(1) of the Code, where the Restricted Assets

of the IRA are at least 125% of the Restricted Amount.

3. A single cash payment by Plan Y to Taxpayer A in payment of all or a portion of Taxpayer A's entire accrued benefit will constitute an eligible rollover distribution under section 402(c)(4) of the Code (assuming it otherwise qualifies under section 402(c)(4) of the Code), and the rollover of the payment into the IRA within the 60 day period described in section 402(c)(3) of the Code will be treated as a transfer of all amounts received in the payment in accordance with section 402(c)(1) of the Code, where the initial Restricted Class of the assets of the IRA is at least 125% of the Restricted Amount.

4. The assignment to the trustee of Plan X of Taxpayer A's interest in the Restricted Assets of the IRA of an amount sufficient to secure the Restricted Amount will not prevent qualification of this IRA under section 408(a)(4) of the Internal Revenue Code.

5. The assignment referred to in ruling request (4) above will not result in a deemed distribution to the IRA owner under section 408(e)(4) of the Code.

The sixth requested ruling was withdrawn by your authorized representative in the letter dated October 27, 2005.

Section 401(a) of the Code provides the requirements for the qualification of employees' retirement plans. Section 401(a)(4) of the Code provides that neither the contributions nor the benefits under a plan may discriminate in favor of employees who are highly compensated.

Section 1.401(a)(4)-5(b)(1) of the regulations provides that a defined benefit plan must incorporate certain provisions restricting benefits and distributions so as to prevent the prohibited discrimination that may occur in the event of early termination of the plan. Section 1.401(a)(4)-5(b)(2) of the regulations requires a defined benefit plan to provide that, in the event of plan termination, the benefit of any highly compensated employee (and any highly compensated former employee) is limited to a benefit that is nondiscriminatory under section 401(a)(4) of the Code. In any one year, the total number of employees whose benefits are subject to restriction under section 1.401(a)(4)-5(b) of the regulations may be limited by a plan to a group of not less than 25 highly compensated employees and former employees. If this group is so limited under a plan, the group must consist of those highly compensated employees and former employees with the greatest compensation in the current or any prior plan year.

Section 1.401(a)(4)-5(b)(3)(i) of the regulations further requires a defined benefit plan to provide that the annual payments to an employee subject to restrictions on distributions must be limited to an amount equal in each year to the payments that would be made to

the employee under: (1) a straight life annuity that is the actuarial equivalent of the accrued benefit and other benefits to which the employee is entitled under the plan (other than a social security supplement); and (2) the amount of the payments that the employee is entitled to receive under a social security supplement.

Section 1.401(a)(4)-5(b)(3)(iv) of the regulations provides that the above referenced restrictions do not apply, if any of the following conditions is satisfied:

- (1) After taking into account payment to or on behalf of the restricted employee of all benefits payable to or on behalf of that restricted employee under the plan, the value of plan assets must equal or exceed 110% of the value of current liabilities, as defined in Section 412(l)(7) of the Code;
- (2) The value of the benefits payable to or on behalf of the restricted employee must be less than 1% of the value of current liabilities before distribution; or
- (3) The value of the benefits payable to or on behalf of the restricted employee must not exceed the amount described in section 411(a)(11)(A) of the Code (restrictions on certain mandatory distributions).

Section 1.401(a)(4)-5(b)(3)(v) of the regulations provides that, for purposes of paragraph (b), any reasonable and consistent method may be used for determining the value of current liabilities and the value of plan assets.

Rev. Rul. 92-76 holds that a lump sum distribution in an amount in excess of that otherwise permitted under section 1.401(a)(4)-5(b) of the regulations may be made, provided there is adequate provision for repayment of any part of the distribution representing the Restricted Amount in the event the plan is terminated while the restrictions are still applicable. Rev. Rul. 92-76 states that one permissible method of securing the agreement for repayment of the Restricted Amount is the deposit with an acceptable depository of property having a fair market value equal to 125% of the amount that would be repayable if the plan terminated on the date of the distribution by the trust. Also under Rev. Rul. 92-76, if the market value of such property falls below 110% of the Restricted Amount, the employee is obligated to deposit whatever additional property is necessary to bring the value up to 125% of the Restricted Amount.

With respect to ruling request (1), Taxpayer A will enter into an agreement with the trustee of Plan X under which all or a portion of the Plan X distribution would be contributed to an IRA. Taxpayer A will enter into a further agreement with the IRA

custodian (or trustee) in order to secure his obligation to repay the Restricted Amount. This depositary arrangement with the IRA custodian (or trustee) is comparable to the arrangement established in Rev. Rul. 92-76. Under the Repayment Agreement, an amount equal to at least 125% of the restricted portion will be placed in the Restricted Assets. Adequate provisions are made in the event the value of the Restricted Assets in the IRA fall below 110% of the Restricted Amount. The Repayment Agreement also provides adequately for repayment in the event that the requirements of section 408(a)(6) of the Code reduce the value of the Restricted Assets in the IRA to less than the Restricted Amount. Accordingly, we conclude, with respect to your ruling request (1), that the Repayment Agreement will satisfy the requirements of Rev. Rul. 92-76 and will not violate the provisions of section 1.401(a)(4)-5(b)(3) of the regulations.

With respect to your second and third ruling requests, section 402(c)(1) of the Code provides, generally, that if any portion of an eligible rollover distribution from a qualified trust is transferred to an eligible retirement plan, the portion of the distribution so transferred shall not be includible in gross income in the taxable year in which paid.

Section 402(c)(3) of the Code provides, generally, that section 402(c)(1) of the Code shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

Section 402(c)(4) of the Code defines "eligible rollover distribution" as any distribution to an employee of all or any portion of the balance to the credit of an employee in a qualified trust except the following distributions:

(A) Any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made:

(i) For the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or

(ii) For a period of 10 years or more,

(B) Any distribution to the extent the distribution is required under section 401(a)(9) of the Code, and

(C) any distribution which is made upon hardship of the employee.

Section 402(c)(8)(B) of the Code defines eligible retirement plan in pertinent part as including an individual retirement account described in section 408(a) of the Code.

Rev. Rul. 92-76 holds that an otherwise eligible lump sum distribution consisting, in part, of benefits restricted under section 1.401(a)(4)-5(b)(3) of the regulations, may be considered a lump sum distribution, even though a portion of the distribution may have to be returned to the plan. In this regard, a lump sum distribution is also an eligible rollover distribution to the extent it is otherwise eligible for rollover.

Accordingly, with respect to ruling request (2), we conclude that a single cash payment by Plan X to Taxpayer A in payment of Taxpayer A's entire accrued benefit will constitute an eligible rollover distribution under section 402(c)(4) of the Code (to the extent that it otherwise qualifies under section 402(c)(4) of the Code), and the rollover of the payment into the IRA within the 60 day period described in section 402(c)(3) of the Code will be treated as a transfer of all amounts received in the payment in accordance with section 402(c)(1) of the Code, where the initial Restricted Assets of the IRA are at least 125% of the Restricted Amount.

With respect to ruling request (3), we conclude that a single cash payment by Plan Y to Taxpayer A in payment of all or a portion of Taxpayer A's entire vested account balance will constitute an eligible rollover distribution under section 402(c)(4) of the Code (to the extent that it otherwise qualifies under section 402(c)(4) of the Code), and the rollover of the payment into the IRA within the 60 day period described in section 402(c)(3) of the Code will be treated as a transfer of all amounts received in the payment in accordance with section 402(c)(1) of the Code, where the Initial Restricted Assets of the IRA are at least 125% of the Restricted Amount.

With respect to ruling request (4), section 408(a)(4) of the Code requires that, in order for an IRA to be qualified, the written instrument creating the IRA must provide that the individual's interest in his or her account must be nonforfeitable. Under this provision, an IRA custodian (or trustee) or an employer would be precluded from asserting any claim to the assets in an IRA.

Taxpayer A will enter into the Repayment Agreement, which is secured by the assignment of his rights in the Restricted Assets of the IRA. The assignment will be in the amount necessary to satisfy the repayment obligation under section 1.401(a)(4)-5(b)(3) of the regulations and Rev. Rul. 92-76. Since the potential return of the Restricted Amount to Plan X's trustee would not derive from any claim by the IRA custodian (or trustee) or Company M, but from Plan X's right under certain circumstances to the restricted amount, no forfeiture would occur in violation of section 408(a)(4) of the Code.



Accordingly, with respect to ruling request (4), we conclude that the assignment to the trustee of Plan X of Taxpayer A's interest in the Restricted Assets of the IRA of an amount sufficient to secure the Restricted Amount will not prevent approval of the IRA under section 408(a)(4) of the Internal Revenue Code.

With respect to ruling request (5), section 408(e)(4) of the Code provides that, if an individual for whose benefit an IRA is established uses the IRA account balance or any portion thereof as security for a loan, that portion is treated as a distribution to that individual. However, in this case, since the contingent obligation to return certain restricted amounts to Plan X is not a loan, section 408(e)(4) of the Code is not applicable.

Accordingly, with respect to ruling request (5), we conclude that the assignment referred to in ruling request (4) above will not result in a deemed distribution to the IRA owner under section 408(e)(4) of the Code.

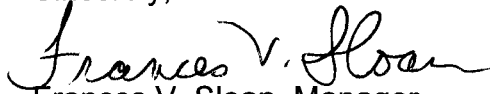
This letter ruling is based on the assumption that Plan X and Plan Y meet the requirements of section 401(a) of the Code at all times relevant hereto.

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

If you wish to inquire about this ruling, please contact

Please address all correspondence to SE:T:EP:RA:T3.

Sincerely,



Frances V. Sloan, Manager  
Employee Plans Technical Group 3

Enclosures:

Deleted Copy of this Letter

Notice of Intention to Disclose, Notice 437

cc: