Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Person to Contact:

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Refer Reply to:
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Date: MAY 10 2000

In re: Company =

Salaried Plan =

401(k) Plan =

This letter is in response to a request sent by your authorized representative for rulings with respect to the excise tax applicable to a reversion of surplus assets to the Company on account of the termination of the Salaried Plan and the transfer of a portion of the surplus to the 401(k) Plan. A letter dated May 9, 2000 modified the request.

The Salaried Plan, a defined benefit plan, was established by the Company effective May 1, 1970. On December 22, 1999, the Salaried Plan was amended to provide that future benefit accruals would cease as of May 1, 2000. On that same date, the Salaried Plan was also amended to have an effective termination date of May 1, 2000. On February 29, 2000, the Salaried Plan was amended to provide for increased accrued benefits. The Salaried Plan has received several favorable determination letters to the effect that it is qualified under section 401(a) of the Internal Revenue Code. The Company has requested a determination letter with respect to the termination of the Salaried Plan.

The Salaried Plan includes a provision under which any assets remaining in the trust after the satisfaction of all accrued benefits under the plan, and after payment of termination expenses of the plan, will be returned to the Company. In connection with the termination of the Salaried Plan, there will be surplus assets in the amount of $X. An amount equal to 25% of the maximum reversion available to the Company (determined after the satisfaction of all liabilities of the Salaried Plan but prior to any transfers of surplus assets to the 401(k) Plan or reversion to the Company) will be transferred to the 401(k) Plan. The transfer is expected to take place early in 2001.

The Company established the 401(k) Plan effective August 1, 1984. The 401(k) Plan is a prototype profit sharing plan that includes a cash or deferred arrangement under section 401(k) of the Code. The Service last issued a determination letter with respect to the 401(k) Plan on January 5, 1996. The 401(k) Plan is intended to be a "qualified replacement plan" under section 4980(d).

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Under the 401(k) Plan, the participants may elect to defer a percentage of their compensation on a pre-tax basis and the Company will make a matching contribution based on a certain percentage of each participant's pre-tax contributions. An amount equal to 25% of the maximum reversion to the Company from the Salaried Plan will be transferred to the 401(k) Plan and placed in a suspense account. Under the terms of the 401(k) Plan, amounts held in the suspense account (including income thereon) will be allocated to the accounts of participants in the 401(k) Plan as matching employer contributions. The amounts, plus earnings, will be allocated to participant accounts no less rapidly than ratably over seven years (starting with the year of transfer - i.e., 2001).

The Company has stated that, as of May 1, 1999, there were 201 active employees covered by the Salaried Plan. Of those 201 employees, there were 165 employees who were still employed by the Company as of April 30, 2000. All of the remaining 165 employees are covered and benefiting under the 401(k) Plan

Amounts released from the suspense account in the 401(k) Plan (attributable to the amount transferred from the Salaried Plan and income thereon) will be treated as employer contributions for purposes of sections 401(a), 401(m) and 415 of the Code. The 401(k) Plan further provides that all such amounts allocated from the suspense account will be treated as annual additions for the plan year in which the amounts are allocated to the accounts of participants.

Based on the foregoing, the following rulings are requested:

(1) The 401(k) Plan constitutes a "qualified replacement plan" under Code section 4980(d)(2).

(2) The assets transferred directly from the Salaried Plan to the 401(k) Plan are not includible in the Company's gross income.

(3) The transfer of assets directly from the Salaried Plan to the 401(k) Plan will not be treated as an employer reversion under Code section 4980 and will not subject the Company to an excise tax under Code section 4980 with respect to those assets.

(4) The Company will be subject to an excise tax equal to 20% rather than 50% of the amount of the reversion of the residual assets to the Company under Code section 4980.

Issue 1

Section 4980(a) of the Code provides for a 20% excise tax on the amount of any reversion from a qualified plan. Section 4980(d) provides, in general, that the excise tax under section 4980(a) shall be increased to 50% with respect to any employer reversion from a qualified plan unless the employer either establishes or maintains a qualified replacement plan, or the plan provides for certain benefit increases which take effect immediately on the termination date.

Section 4980(d)(2) of the Code, in relevant part, defines a "qualified replacement plan" as a qualified plan established or maintained by the employer in connection with a qualified plan termination for which:

(A) At least 95% of the active participants in the terminated plan who remain as employees of the employer after the termination are active participants in the replacement plan, and
(B) A direct transfer is made from the terminated plan to the replacement plan before any employer reversion, and the transfer is an amount equal to 25% of the maximum amount the employer could receive as an employer reversion without regard to that section, and
(C) Meets the allocation requirements described below.

Section 4980(d)(2)(C)(i) of the Code provides, that if the replacement plan is a defined contribution plan, the amount transferred to the replacement plan must be:

(I) Allocated under the plan to the accounts of participants in the plan year in which the transfer occurs, or
(II) Credited to a suspense account and allocated from such account to accounts of participants no less rapidly than ratably over the seven-plan-year period beginning with the year of the transfer.

Section 4980(d)(4)(B) of the Code provides, in part, that the allocation of any amount (or income allocable thereto) to any account under section 4980(d)(2)(C) shall be treated as an annual addition for purposes of section 415.

All of the salaried employees who were participants in the Salaried Plan and are still employed by the Company are active participants in the 401(k) Plan. The percentage of the active participants in the Salaried Plan (the terminated plan) who remain employees of the Company after the termination and who are active participants in the 401(k) Plan is 100%. Thus, at least 95% of the active participants in the Salaried Plan who remain as employees of the Company after the termination are active participants in the 401(k) Plan.

The Salaried Plan provides that 25% of the maximum amount that could revert to the Company will be transferred to the 401(k) Plan prior to any reversion to the Company. The Service has issued a favorable determination letter with respect to the 401(k) Plan. Under the terms of the 401(k) Plan, as amended, the amount transferred to the 401(k) Plan from the Salaried Plan will be allocated no less rapidly than ratably over the seven-year-period beginning with the year of the transfer.

We therefore conclude with regards to Issue One, that the 401(k) Plan constitutes a "qualified replacement plan" within the meaning of section 4980(d)(2) of the Code.

Issues 2 and 3

Section 4980(c)(2)(A) of the Code provides that the term "employer reversion" means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan. Section 4980(d)(2)(B)(iii), in general, that in the case of a transfer to a qualified replacement plan in an amount equal to 25% of the maximum amount which the employer could receive as an employer reversion, such amount transferred shall not be includible in the gross income of the employer and such transfer shall not be treated as an employer reversion for purposes of section 4980.

As we ruled in Issue 1, the 401(k) Plan is a "qualified replacement plan" and the amount transferred to the 401(k) Plan equals 25% of the surplus amount. Therefore, the assets transferred directly from the Salaried Plan to the 401(k) Plan are not includible in the Company's gross income. Furthermore, the Company will not be subject to the excise tax under section 4980 with respect to the transfer of 25% of $X from the Salaried Plan.

Issue 4

Section 4980(a) of the Code imposes an excise tax of 20% of the amount of any employer reversion from a qualified plan. Section 4980(d) provides that the excise tax under section 4980(a) shall be increased to 50% for any employer reversion unless the employer either establishes or maintains a qualified replacement plan, or the plan provides for certain benefit increases which take effect immediately on the termination date.

Because we ruled in Issue one that the 401(k) Plan is a "qualified replacement plan", the excise tax on the reversion of assets from the Salaried Plan to the Company will be imposed at a tax rate of 20% of the reversion amount, determined after the transfer of assets to the 401(k) Plan.

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

This ruling is based on the assumptions that the Salaried Plan and the 401(k) Plan are qualified under section 401(a) of the Code and that their related trusts are tax-exempt under section 501(a) at all times relevant to this ruling.

Sincerely,

James E. Holland, Jr., Manager
Employee Plans Actuarial Group 1
Tax Exempt and Government Entities
Division