Internal Revenue Service

Department of the Treasury

Washington, DC 20224

200109052

Significant Index No. 4980.00-00

Person to Contact:

Telephone Number:

Refer Reply to:

T:EP:RA:T:A2

Date:

DEC 08 2000

In re: Request for ruling on behalf of

Company R =
Company S =

Company F =
Company P =

Plan 1 =

Plan 2 =

Date X =
Date Y =

This letter is in response to your request, dated February 3, 2000, for rulings on behalf of Company R that include rulings that Plan 2 is a qualified replacement plan as described in section 4980(d)(2) of the Internal Revenue Code (Code), and that the rate of excise tax imposed under section 4980 on the reversion to Company R resulting from the termination of Plan 1 is 20 percent. The request was modified in a phone call with of our office on November 27, 2000, and in a letter dated December 4, 2000.

Facts

According to the facts as stated, Company R, a state-chartered is a wholly owned subsidiary of Company S, a state-chartered business corporation. Company F, a federal savings association, is a wholly owned subsidiary of Company P, a corporation. On

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the above-stated Date Y, pursuant to an Agreement and Plan of Merger dated as of the above-stated Date X, Company S acquired Company P. As a result of the merger and acquisition, Company P merged with and into Company S, and Company F merged with and into Company R. As a consequence of these transactions, Company R became the legal successor in interest to Company F.

Prior to the merger, Company F maintained the above-named Plan 1 and, as a result of the merger, Company R succeeded Company F as sponsor of Plan 1. Plan 1 received a favorable determination letter from the Service dated October 27, 1995. Benefit accruals under Plan 1 were ceased effective November 16, 1998, and Plan 1 was terminated effective December 31, 1998. Benefits under Plan 1 were not increased upon cessation of benefit accruals or upon plan termination. Plan 1 received a favorable determination letter on termination dated June 16, 1999. While Company R had anticipated the necessity of additional contributions to satisfy all liabilities of Plan 1 on termination, a favorable interest rate environment resulted in Plan 1 assets exceeding liabilities under Plan 1. Company R is currently purchasing annuities and paying single-sum distributions to satisfy liabilities on termination under Plan 1. Company R expects to have excess assets after all liabilities under Plan 1 have been satisfied. Section 9.1(d) of Plan 1 provides that, on plan termination, assets remaining after satisfaction of all liabilities to participants and beneficiaries are returned to the employer.

Company R also maintains the above-named Plan 2, a section 401(k) plan that received a favorable determination letter dated November 21, 1995. Eligible employees of Company R and Company S, and certain other corporations and unincorporated trades or businesses that belong to Company S's controlled group, may make elective deferrals under Plan 2, with Company R making matching contributions according to a matching contribution schedule. Pursuant to the merger, Plan 2 was amended to recognize service with Company F and the members of its controlled group for purposes of vesting and eligibility to participate in Plan 2. As a result of this amendment, substantially all employees of Company F, who were accruing benefits under Plan 1 immediately prior to the merger, became eligible to participate in Plan 2 immediately upon the consummation of the merger, with participation beginning effective January 1, 1999. Substantially all of Company F's employees who have remained in the employ of Company R or another adopting employer continue to be eligible to participate in Plan 2.

Company R wants to transfer an amount equal to 25 percent of the excess assets resulting from the termination of Plan 1 to Plan 2. Such transfer will be made as soon as practicable, and in any event, within 30 days after receipt of a positive response from the Service to this private letter ruling request. Company R proposes to amend Plan 2 to provide for the acceptance and ultimate disposition of such excess amounts from Plan 2. The proposed amendment is included in the ruling request as Article C of Plan 2. The amendment will provide that the amounts transferred to Plan 2 from Plan 1 will be held in a suspense account, and all earnings on amounts held in the suspense account will be added to the suspense account. On each date when Company R is obligated under Plan 2 to remit matching contributions to Plan 2, such amounts will be taken from amounts held in the suspense account, and subsequently transferred to the accounts of participants who are to receive the matching contributions. As long as there is a balance in the suspense account, Company

R will not make cash contributions to Plan 2. Section C-4(a) of Plan 2 provides that a minimum percentage of the assets held in the Plan 2 suspense account must be removed from the suspense account and allocated to participants each year. These minimum percentage requirements are intended to insure that the suspense account amounts are allocated ratably over a seven-plan-year period, beginning in the year of the transfer. In the first plan year ending after the transfer of excess assets from Plan 1 to the Plan 2 suspense account, at least 15 percent of the amount actually transferred must be removed from the suspense account and allocated to participants. In the second through the sixth plan year ending after the transfer, the minimum percentages of the balance credited to the suspense account on the first day of the plan year that must be removed and allocated to participants that year are, respectively, 17 percent, 20 percent, 25 percent, 34 percent, and 50 percent. In the seventh plan year ending after the transfer of excess assets from Plan 1 to the Plan 2 suspense account, 100 percent of the balance held in the suspense account, including all investment earnings for such plan year, must be removed from the suspense account and allocated to participants, such that the balance in the suspense account at the end of the plan year is equal to zero.

To the extent that the amount determined under section C-4(a) of Plan 2 (the minimum percentage amount) for any plan year exceeds the contributions required of Company R under Plan 2 (matching contributions), section C-4(b) provides that any excess amount will be allocated as an additional contribution for the plan year among the active participants in proportion to their compensation actually paid during the plan year, subject to the limitations of Code section 415. Section C-4(c) of Plan 2 provides that if Plan 2 is terminated before the entire balance held in the suspense account has been allocated to participants, any remaining balance will be allocated among the participants for the plan year in proportion to their compensation for the portion of the plan year preceding the termination date, subject to the limitations of Code section 415. Section C-4(c) of Plan 2 further provides that any amount that cannot be so allocated due to the limitations of Code section 415 will be returned to the Employer and treated as an employer reversion to which Code section 4980 is applicable.

Rulings Requested

Based on the facts as stated, the following rulings have been requested.

1. Assuming that Plan 2, as amended to include Article C, is at all relevant times a qualified plan under Code section 401(a), Plan 2 will constitute a "qualified replacement plan" within the meaning of Code section 4980(d)(2) of the Code, maintained by Company R in connection with the termination of Plan 1.

2. Company R will not be subject to an excise tax under Code section 4980 with respect to the amount transferred from Plan 1 to Plan 2 in accordance with section 4980(d)(2)(B).

3. The amount transferred from Plan 1 to Plan 2 in accordance with section 4980(d)(2)(B) is not includible in the gross income of the employer for federal income tax purposes.

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4. The rate of excise tax imposed on Company R with respect to the employer reversion from Plan 1 that is subject to section 4980 of the Code will be 20 percent.

Applicable Law

Section 4980 of the Internal Revenue Code provides rules for the tax applicable on the reversion of qualified plan assets to an employer. Section 4980(a) provides for the imposition of a tax of 20 percent of the amount of any employer reversion from a qualified plan. Section 4980(b) provides that the tax under section 4980(a) is to be paid by the employer maintaining the plan. Section 4980(d) provides, in general, that section 4980(a) is applied by substituting "50 percent" for "20 percent" with respect to any employer reversion from a qualified plan unless (A) the employer establishes or maintains a qualified replacement plan, or (B) the plan provides benefit increases meeting the requirements of section 4980(d)(3). Section 4980(d)(3) provides that the requirements of that paragraph are met if a plan amendment to the terminated plan is adopted in connection with the termination of the plan which provides pro rata increases in the accrued benefits of all qualified participants which (i) have an aggregate present value not less than 20 percent of the maximum amount which the employer could receive as an employer reversion without regard to that subsection, and (ii) take effect immediately on the termination date.

Section 4980(d)(2) provides that, for purposes of that subsection, the term "qualified replacement plan" is a qualified plan established or maintained by the employer in connection with a qualified plan termination with respect to which the participation, asset transfer, and allocation requirements of sections 4980(d)(2)(A), (B), and (C) are met.

Section 4980(d)(2)(A) requires that at least 95 percent 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.

Sections 4980(d)(2)(B) (i) and (ii) require that a direct transfer from the terminated plan to the replacement plan be made before any employer reversion, and that the transfer be an amount equal to the excess (if any) of 25 percent of the maximum amount which the employer could receive as an employer reversion without regard to section 4980(d), over the amount equal to the present value of the aggregate increases in the accrued benefits under the terminated plan of any participants or beneficiaries pursuant to a plan amendment adopted during the 60-day period ending on the date of termination of the qualified plan, and which takes effect immediately on the termination date. Section 4980(d)(2)(B)(iii) provides that in the case of the transfer of any amount under section 4980(d)(2)(B)(i), such amount is not includible in the gross income of the employer, no deduction is allowable with respect to such transfer, and the transfer is not treated as an employer reversion for purposes of section 4980.

Section 4980(d)(2)(C)(i) provides that, in general, in the case of any defined contribution plan, the portion of the amount transferred to the replacement plan be allocated under the plan to (I) the accounts of participants in the plan year in which the transfer occurs, or (II) be credited to a suspense account and allocated from such account to accounts of participants no less rapidly than

ratably over the 7-plan-year period beginning with the year of the transfer. Section 4980(d)(2)(C)(ii) provides that if, by reason of any limitation under section 415, any amount credited to a suspense account under section 4980(d)(2)(C)(i)(II) may not be allocated to a participant before the close of the 7-year period, such amount shall be allocated to the accounts of other participants, and if any portion of such amount may not be allocated to other participants by reason of any such limitation, it shall be allocated to the participant as provided in section 415.

Section 4980(d)(2)(C)(iii) of the Code provides that any income on any amount credited to a suspense account under section 4980(d)(2)(C)(i)(II) shall be allocated to accounts of participants no less rapidly than ratably over the remainder of the period determined under such clause (after coordination with section 415 limitations as provided in clause (ii)).

Rationale

Section 4980(d)(2) provides that a qualified replacement plan is a qualified plan established or maintained by the employer in connection with a termination, which satisfies the requirements of sections 4980(d)(2)(A), (B), and (C). Section 4980(d)(2)(A) requires that at least 95 percent of the active participants in the terminated plan who remain as employees of the employer after the termination be active participants in the replacement plan. You have stated that substantially all employees of Company F became eligible to participate in Plan 2 immediately following the merger and acquisition, with participation beginning effective January 1, 1999. Thus, when Plan 1 was terminated effective December 31, 1998, all active participants of Plan 1 were eligible to participate in Plan 2. Therefore, because Plan 2 will cover more than 95 percent of the participants of Plan 1 who remain employees of Company R (or Company R's controlled group) after the termination of Plan 1, the requirements of section 4980(d)(2)(A) are met.

Section 4980(d)(2)(B) requires a direct transfer from the terminated plan to the replacement plan, before any employer reversion, in an amount equal to the excess, if any, of 25 percent of the maximum amount which the employer could receive as an employer reversion without regard to such subsection, over the amount used to increase benefits that is described in section 4980(d)(2)(B)(ii). You have stated that benefits were not increased on the cessation of benefit accruals or on plan termination, and that all participants received the full value of their accrued benefits. While Company R did not expect to have excess assets, a favorable interest environment resulted in Plan 1 assets exceeding the amount required to satisfy all liabilities under Plan 1. Because Company R is still in the process of purchasing annuity contracts, the exact amount of excess assets is not yet determinable. Following a favorable response to this ruling request, Company R intends to transfer an amount equal to 25 percent of the excess assets from Plan 1 to Plan 2. Because Company R will transfer an amount equal to 25 percent of Plan 1's assets remaining after all benefit liabilities under section 401(a)(2) of the Code have been satisfied to Plan 2, the requirements of section 4980(d)(2)(B) are met.

Section 4980(d)(2)(C) requires, generally, that in the case of any defined contribution plan, the portion of the amount transferred to the replacement plan be allocated under the plan to the accounts of participants in the plan year in which the transfer occurs, or credited to a suspense

account and allocated to accounts of participants no less rapidly than ratably over the 7-plan-year period beginning with the year of the transfer. Under the terms of Article C of Plan 2, amounts transferred from Plan 1 to Plan 2 must be allocated to the accounts of participants according to a minimum percentage schedule, beginning with the allocation of at least 15 percent (slightly more than 1/7) of the amount in the suspense account created for this purpose under Plan 2 in the first plan year after the transfer. Over the next five plan years, the percentages of the balances credited to the suspense account on the first day of each plan year that must be allocated are, respectively, 17 percent, 20 percent, 25 percent, 34 percent, and 50 percent. One hundred percent of any amount remaining in the suspense account, including interest earnings for that plan year, must be distributed in the seventh plan year ending after the transfer. Therefore, the amount transferred from Plan 1 to Plan 2 is credited to a suspense account and allocated (along with earnings attributable to the suspense account) to accounts of participants no less rapidly than ratably over the 7-plan-year period beginning with the year of the transfer, which satisfies the requirements of section 4980(d)(2)(C). Therefore, Plan 2 is a qualified replacement plan within the meaning of Code section 4980(d)(2).

Section 4980(c)(2) provides, generally, that "employer reversion" means the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from a qualified plan. Section 4980(d)(2)(B)(iii) provides that in the case of the transfer of the amount described in section 4980(d)(2)(B)(i) to a qualified replacement plan, such amount is not includible in the gross income of the employer, nor is a deduction allowed with respect to such transfer, and such transfer is not treated as an employer reversion for purposes of section 4980. Because Company R will directly transfer an amount equal to 25 percent of the maximum amount which the employer could receive as an employer reversion without regard to section 4980(d)(2)(B) from Plan 1 to a qualified replacement plan, such amount transferred will not be includible in Company R's gross income, nor be deductible, and is not treated as an employer reversion for purposes of section 4980. Therefore, such amount will not be subject to the tax imposed under section 4980(a). Note, however, that amounts transferred to Plan 2 in excess of the amount described in section 4980(d)(2)(B)(i) will be treated as an employer reversion for purposes of section 4980, will be includible in Company R's gross income, and will be subject to the excise tax under Code section 4980 as described below.

Section 4980(a) provides for the imposition of a tax of 20 percent of the amount of any employer reversion from a qualified plan. Section 4980(d)(1) provides that "50 percent" is substituted for "20 percent" in section 4980(a) with respect to any employer reversion from a qualified plan unless the employer establishes or maintains a qualified replacement plan, or the plan provides benefit increases meeting the requirements of section 4980(d)(3). Because Company R maintains a qualified replacement plan, the rate of tax imposed upon any amounts treated as an employer reversion from Plan 1 will be 20 percent.

Holdings

1. Assuming that Plan 2, as amended to include Article C, is at all relevant times a qualified plan under Code section 401(a), Plan 2 will constitute a "qualified replacement plan" within the meaning of Code section 4980(d)(2), maintained by Company R in connection with the termination of Plan 1.

2. Company R will not be subject to an excise tax under Code section 4980 with respect to the amount transferred from Plan 1 to Plan 2 in accordance with section 4980(d)(2)(B).

3. The amount transferred from Plan 1 to Plan 2 in accordance with section 4980(d)(2)(B) is not includible in the Company R's gross income for federal income tax purposes.

4. The rate of excise tax imposed on Company R with respect to the employer reversion from Plan 1 that is subject to section 4980 of the Code is 20 percent.

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

Sincerely yours,

Martin L. Pippins

Martin L. Pippins, Manager
Employee Plans Actuarial Branch 2
Tax Exempt and Government Entities Division