TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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SEP - 4 2001

Uniform Issue List: 403.00-00, 401.00-00

T:EP:RA:T3

Legend:

Employer A =

Employer B =

Hospital H =

District I =

Employer J =

Nursing Home K =

Employer L =

Corporation M =

Center N =

Employer O =

Plan X =

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Dear :

This is in response to your request for a ruling submitted by your authorized representative, dated May 5, 2000, concerning distributions from an arrangement described in section 403(b) of the Internal Revenue Code. A letter dated July 17, 2000, supplemented the request.

Employer A, a tax exempt organization under Section 501(c)(3) of the Internal Revenue Code (the "Code"), sponsors Plan X for the benefit of its employees. Plan X is a 403(b) plan invested in custodial accounts and annuity contracts. Employer A owns and/or manages various hospitals and convalescent homes. As a result of Employer A's decision to concentrate its business activities, five groups of its employees were terminated. Many of these former employees continued to perform the same job for a different employer ("transferred employees"), as further described below.

In ****, Employer A decided that the laboratory services necessary for its hospitals would operate more efficiently if such services were outsourced. Under this outsourcing plan, laboratory services are provided by a third party reference laboratory. The new reference laboratory (Employer B) has a few employees at the hospital to provide laboratory services on an emergency basis. Most of the samples are processed at a separate laboratory facility. It is represented that Employer B is unrelated to Employer A. On **********, the Employer A laboratory employees were terminated from Employer A employment and, for the most part, hired by Employer B. Employer A is the recipient of some services from the transferred employees, now employed by Employer B.

Employer A managed Hospital H, pursuant to a series of contract service agreements with District I (a political subdivision of the state). On **********, Employer A's contract was terminated and District I leased the hospital to Employer J, a non-profit corporation, unrelated to Employer A. As a result approximately **** of Employer A's Hospital H employees were terminated by Employer A and hired by Employer J.

On **********, Employer A agreed to sell Nursing Home K to Employer L, an unrelated for profit corporation. As a result of the sale, *** Nursing Home K employees terminated by Employer A were hired by Employer L to continue their work at the nursing home.

In **********, Employer A entered into a management agreement pursuant to which Corporation M, an unrelated for profit entity, agreed to manage Center N, a convalescent facility owned by Employer A. Effective ********** Corporation M leased Center N. As a result, 32 Center N employees were terminated from Employer A's employment and were hired by Employer M to continue their work in Center N.

On **********, Employer A outsourced its materials management employees. These employees handle warehousing, inventory and distribution of drugs and supplies. As a result, approximately *** employees were terminated by Employer A and hired by Employer O or one of its affiliates, all unrelated to Employer A. Employer A will be the recipient of services provided by the employees transferred to Employer O

Employer A proposes to have Plan X make distributions to all the transferred employees prior to January 1, 2002.

Based on the foregoing, you request the following rulings:

1. A distribution to former Employer A laboratory services employees now employed by Employer B will constitute a distribution on account of separation from service under Code Sections 403(b)(7)(A)(ii) and 403(b)(11)(A).

2. A distribution to former Employer A's Hospital H employees now employed by Employer J will constitute a distribution on account of separation from service under Code Sections 403(b)(7)(A)(ii) and 403(b)(11)(A)

3. A distribution to former Employer A's Nursing Home K employees now employed by Employer L will constitute a distribution on account of separation from service under Code Sections 403(b)(7)(A)(ii) and 403(b)(11)(A).

4. A distribution to former Employer A's Center N employees employed by Corporation M will constitute a distribution on account of separation from service under Code Sections 403(b)(7)(A)(ii) and 403(b)(11)(A)

5. A distribution to former Employer A's materials maintenance employees employed by Employer O will constitute a distribution on account of separation from service under Code Sections 403(b)(7)(A)(ii) and 403(b)(11)(A).

Section 403(b)(7)(A) provides, in pertinent part, that amounts paid an employer described in 403(b)(1)(A) to a custodial account which satisfies the requirements of section 401(f)(2) shall be treated as amounts contributed by such employer for a section 403(b)(1) annuity for his employee if- (ii) under the custodial account no such amounts may be distributed before the employee separates from service.

Section 403(b)11 provides, in pertinent part, that distributions made from an annuity contract described in section 403(b)(1) attributable to contributions made pursuant to a salary reduction agreement within the meaning of section 402(g)(3)(C) may be made only when the employee separates from service.

The term "separation from service" used in sections 403(b)(7)(A)(ii) and 403(b)(11) is also used in section 402(d)(4). For tax years beginning prior to January 1, 2000, section 402(d) provided special forward averaging treatment for lump sum distributions from plans qualified under section 401(a). Section 402(d)(4)(A) provided that a lump sum distribution was a distribution or payment within one taxable year of the recipient of the balance to the credit of an employee which becomes payable to the recipient upon one of several events, including a "separation from service". Special forward averaging treatment of lump sum distributions was generally repealed by sections 1401(a) and (c)(2) (subject to limited grandfather treatment) as part of the Small Business Job Protection Act of 1996, P.L. 104-188.

Revenue Ruling 79-336, 1979-2 C.B. 187 provides that for purposes of the special forward averaging treatment of lump sum distributions under the earlier section 402(d), an employee will be considered separated from service within the meaning of section 402(d)(4)(A) (formerly section 402(e)(4)(A)) only upon the employee's death, retirement, resignation, or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, or consolidation, etc. of the former employer (i.e. the "Same Desk Rule).

With regard to ruling requests 1, 4, and 5, the former Employer A employees who have been hired by Employer B, M, and O respectively, will be providing services back to Employer A, and thus will be considered employed in a continuation of the same trade or business. Accordingly, based on the facts presented, we conclude, with respect to ruling requests 1, 4 and 5, that there has not been a sufficient

change of employment status to constitute a separation from service as defined in sections 403(b)(7)(A)(ii) and 403(b)(11) of the Code.

With respect to the second and third ruling requests, the former Employer A employees were hired by Employers J and L respectively, both unrelated to Employer A. In addition, these former Employer A employees will not be providing services back to Employer A. Thus, these employees will not be considered employed in a continuation of the same trade or business. Accordingly, based on the facts presented, we conclude, with respect to ruling requests 2 and 3 that there has been a sufficient change of employment status to constitute a separation from service as defined in sections 403(b)(7)(A)(ii) and 403(b)(11) of the Code.

The above rulings are based on the assumption that Plan X will be otherwise qualified under sections 403(b) at the time that the above transaction takes place, and that the proposed distributioins all occur prior to January 1, 2002.

Rulings were also requested raising an issue concerning plans of a taxpayer unrelated to the parties requesting these rulings. We previously informed your authorized representative that we would not address these ruling requests.

This ruling is directed only to the taxpayer who requested it and applies only to Plan X as proposed to be amended as of the date of this ruling. .Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent

If you have any questions concerning these rulings, please contact ********** (ID ********) at **********. Please refer to T:EP:RA:T3.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans, Technical Group 3
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose
Copy of Letter to Authorized Representative

CC:

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