Internal Revenue Service

Significant Index No. 4980.00-00

Department of the Treasury

Washington, DC 20224 200150028

Contact Person:

Telephone Number:

In Reference to:

T:EP:RA:T:A1

Date:

AUG 08 2001

In re:

Company B =

Taxpayer's Plan =

Company B Plans =

This letter is in response to your request for rulings regarding a proposed merger of restored pension plans previously maintained by the Taxpayer. You have asked us for a ruling that:

(1) the Taxpayer will not recognize taxable income or gain for federal tax purposes in connection with: (i) the merger of the Company B Plans into the Taxpayer's Plan, (ii) the post-merger purchase of annuities covering the benefits of the Company B Plans' participants with the Taxpayer's Plan's assets, including the five percent benefit increase, any non-guaranteed benefits that were not paid by the Pension Benefit Guaranty Corporation ("PBGC") during the time it was trustee of the Company B Plans and any additional accruals earned after the plan termination

180

dates (and payment of past, unpaid non-guaranteed benefits, plus interest, and post-termination benefit accruals in a lump sum to a consenting Company B Plans' participant or beneficiary if the present value of such amounts does not exceed $5,000), and (iii) the Taxpayer's Plan's reimbursement to the PBGC of $28.9 million for the Company B Plans' benefits paid by the PBGC, with interest accruing at 6.52% from February 1, 2000.

(2) none of the transactions described in ruling request (1) will constitute a deemed or actual reversion of plan assets to the Taxpayer that would cause the Taxpayer to be subject to the excise tax imposed under section 4980 of the Internal Revenue Code (the "Code")

Facts

The Taxpayer is a manufacturer of The Taxpayer's Plan is a substantially overfunded defined benefit plan. On September 27, 1985, the Taxpayer executed a Purchase and Sale Agreement with Company B pursuant to which the Taxpayer sold to Company B a group of businesses that were divisions of the Taxpayer in an asset-sale transaction. In connection with that transaction, Company B assumed sponsorship of six defined benefit plans (the "Company B Plans"). Substantially all of the participants in the Company B Plans formerly were employees of the Taxpayer.

The steel-related businesses Company B purchased from the Taxpayer eventually failed. Between February 1992 and April 1994, the PBGC assumed trusteeship of the Company B Plans and terminated them. In anticipation of these events, on September 21, 1991, the PBGC filed a complaint against the Taxpayer seeking a declaration that the Taxpayer would be liable for the underfunding of the Company B Plans.

In its complaint, the PBGC asserted that the Taxpayer should be held liable under 29 U.S.C. section 1369 as if it remained a contributing sponsor of the Company B Plans as of their termination date. After protracted litigation in the Federal Courts, the PBGC's assertion was affirmed and the Taxpayer was held liable under 29 U.S.C. section 1369.

The Taxpayer proposes to assume responsibility for the Company B Plans from the PBGC pursuant to a Memorandum of Understanding (the "MOU") between the PBGC and the Taxpayer dated July 6, 2000. Under the MOU, (1) upon the Taxpayer's written request, the PBGC will restore the Company B Plans to the

Taxpayer pursuant to section 4047 of the Employee Retirement Income Security Act of 1974 ("ERISA"), (2) the Taxpayer will amend the Company B Plans to increase participants' benefits by five percent going forward, (3) the Taxpayer will merge the Company B Plans into the Taxpayer's Plan, (4) the Taxpayer's Plan will purchase annuities covering the benefits of the Company B Plans' participants, including the five percent benefit increase, any non-guaranteed benefits that were not paid by PBGC during the time it was the trustee of the Company B Plans, and any additional accruals earned after the plan termination dates (past, unpaid non-guaranteed benefits, plus interest, and post-termination benefit accruals may be paid in a lump sum to a Company B Plan participant or beneficiary, provided that the present value of such individual lump-sum does not excess $5,000), (5) the Taxpayer's Plan or the Taxpayer will reimburse the PBGC $28.9 million for the Company B Plans' benefits paid by the PBGC, with interest accruing at 6.52% from February 1, 2000, (6) the PBGC will waive all plan termination insurance premiums due from or on behalf of the Company B Plans from the date of their termination to the date of the plan merger, and (7) the PBGC will release its employer liability claim under section 4062 of ERISA once the Taxpayer satisfies its obligations under the MOU.

Law

Section 61 of the Code provides that "gross income" includes all income from whatever source derived (except as otherwise provided in Subtitle A of the Code). Section 1.61-1(a) of the Income Tax Regulations provides, in part, that gross income means all income from whatever source derived, unless excluded by law.

Section 111(a) of the Code provides that gross income does not include income attributable to the recovery during any taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter. This section constitutes the codification of the so-called exclusionary portion of the tax benefit rule. The balance of the tax benefit rule, known as the "inclusionary" portion, has been clarified in Rev. Rul. 68-104 (1968-1 CB 361), which requires that when an amount, previously deducted from gross income, generates a tax benefit and is then recaptured in a subsequent year, that recaptured amount is includible under section 61 in gross income in the year of recapture.

The tax benefit rule was originally fashioned by the judiciary in order to approximate the results produced by a tax system on transactional rather than annual accounting. The rule was applied in the United States Supreme Court in Hillsboro National Bank v. Commissioner, 460 U.S. 370 (1983). The tax benefit rule as

formulated by the Supreme Court in Hillsboro, provided that a taxpayer includes income when an event occurs in a subsequent year which is "fundamentally inconsistent" with a deduction taken in a prior year, unless a nonrecognition provision of the Code prevents inclusion. Thus under Hillsboro, an actual recovery of the amount in question is not necessary. The determination that must be made under the Hillsboro test is whether the subsequent event would have foreclosed the earlier deduction if the subsequent event and the event giving rise to the deduction had occurred in the same year. If the subsequent event would have foreclosed the deduction, the event is fundamentally inconsistent and the taxpayer must include the amount as income in the year of the subsequent event.

Section 401(a)(12) of the Code provides that a trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that in the case of any merger or consolidation with, or transfer of asset or liabilities to, any other plan after September 2, 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated.

Section 404(a) of the Code provides if contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued by an employer on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under this chapter, but, if they would otherwise be deductible, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year.

Section 411(d)(6)(A) of the Code provides that a plan shall be treated as not satisfying the requirements of this section if the accrued benefit of a participant is decreased by an amendment of the plan, other than an amendment described in section 412(c)(8) or section 4281 of the Employment Retirement Income Security Act of 1974.

Section 414(l)(1) of the Code provides that a trust which forms a part of a plan shall not constitute a qualified trust under section 401 and a plan shall be treated as not described in section 403(a) unless in the case of any merger or consolidation of the plan with, or in the case of any transfer of assets or liabilities of such plan to, any other trust plan after September 2, 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled

to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated).

Section 4980 of the Code imposes an excise tax on the amount of any employer reversion from a qualified plan. Section 4980(c)(1) defines the term "qualified plan" to include any plan meeting the requirements of section 401(a). Such term shall include any plan which, at any time, has been determined by the Secretary to be a qualified plan. Section 4980(c)(2) provides, in general, 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.

Title 29 C.F.R. section 4047.5 provides for the repayment of PBGC payments of guaranteed benefits upon restoration of a plan pursuant to ERISA section 4047. These are amounts paid by the PBGC from its single-employer insurance fund (the fund established pursuant to ERISA section 4005(a)) to pay guaranteed benefits and related expenses of a plan while it was terminated and are a debt of the restored plan.

Analysis

The first issue is whether the Taxpayer will recognized taxable income or gain for federal tax purposes with respect to the proposed merger of the Company B Plans into the Taxpayer's Plan. In this case the tax benefit rule must be applied to determine whether the merger of the Company B Plans and the Taxpayer's Plan is fundamentally inconsistent with the premises upon which the original deduction under Code section 404(a)(1) was based. In applying this test, Hillsboro requires that the facts and circumstances of this case be considered in light of the "purpose and function of the provisions granting the deduction." Hillsboro, 460 U.S. at 385.

Under the facts of this case, the Company B Plans are being merged with the Taxpayer's Plan that is maintained by the Taxpayer. Thus, there is no actual recovery by the Taxpayer which would require the Taxpayer to recognize income for federal tax purposes. The assets of the separate plans will be the assets of the merged plan. However, under the tax benefit rule no actual recovery is necessary. More relevant in this case is whether the merger is fundamentally inconsistent with the original deductions taken. The facts indicate that the Company B Plans and the Taxpayer's Plan are all defined benefit plans providing retirement income to participants and beneficiaries. The merger of the Company B Plans with the Taxpayer's Plan is consistent with the use Congress intended under ERISA and section 404(a) of the Code when it granted the earlier deduction under section 404(a) to provide for definitely determinable retirement benefits to participants and beneficiaries. This finding is consistent with the following

statement by Congress in connection with the Omnibus Budget Reconciliation Act of 1987:

> As under current law, there will be no income or excise tax consequences if excess assets are transferred or merged between defined benefit plans maintained by an employer or employers within the same controlled group. In addition, as under current law, a transfer of excess assets from a defined benefit plan to a defined contribution plan (even if such transfer is between plans of a single employer) will give rise to ordinary income based on tax benefit principles, and such a transfer will subject the employer to the excise tax on employer reversions. H.R. Rep. No. 391 (I), 100th Cong., 1st Sess. 143.

There has been no change in the applicable law. Mergers of defined benefit plans of an employer or within a controlled group do not result in income or excise tax consequences. Because the Company B Plans were originally maintained within the Taxpayer's controlled group, and as restored the Company B Plans will be within the Taxpayer's controlled group, this principle applies to the plan mergers at issue in this case.

The merger of the Company B Plans and the Taxpayer's Plan is not fundamentally inconsistent with the premises upon which the original deductions under section 404(a)(1) are based. The plans as merged will still provide for definitely determinable retirement benefits to participants and beneficiaries of the Taxpayer's Plan and the Company B Plans. Accordingly, the merger of the Company B Plans with the Taxpayer's Plan will not cause the Taxpayer to recognize income for federal income tax purposes under section 61.

The second issue is whether the Taxpayer will recognize taxable income or gain for federal tax purposes in connection with the purchase of annuities covering the benefits of Company B Plans' participants with merged plan assets, including the five percent benefit increase, any non-guaranteed benefits that were not paid by the PBGC during the time it was trustee of the Company B Plans, and any additional accruals earned after the plan termination dates (and payment of past, unpaid non-guaranteed benefits, plus interest, and post-termination benefit accruals in a lump sum to consenting Company B Plans' participants or beneficiaries if the present value of such amounts does not exceed $5,000).

In applying the tax benefit rule, Hillsboro requires that the facts and circumstances of this case be considered in light of the "purpose and function of the provisions granting the deduction." Hillsboro, 460 U.S. at 385. Under the facts of this case, the underfunded Company B Plans, which were originally maintained by the Taxpayer, will also be maintained by the Taxpayer after restoration and will be merged into the overfunded Taxpayer's Plan that is maintained by the Taxpayer. Assets of the merged plan will be used to pay the benefits identified in the ruling request. The Company B Plans and the Taxpayer's Plan are both defined benefit plans providing definitely determinable retirement benefits to participants and beneficiaries. The merger of the Company B Plans with the Taxpayer's Plan is consistent with the use Congress intended under ERISA and section 404(a)(1) when it granted the earlier deductions under section 404 (a)(1). As noted above, Congress has stated that there will be no income tax consequences if excess assets are merged between defined benefit plans maintained by an employer. Accordingly, the payment of benefits from the merged plan will not cause the Taxpayer to recognize income for federal tax purposes under section 61.

The third issue is whether the Taxpayer will recognize taxable income or gain for federal tax purposes in connection with the Taxpayer's Plan reimbursement (after the merger) of $28.9 million to the PBGC for the Company B Plans' benefits paid by the PBGC, with interest accruing at 6.25% from February 1, 2000.

Pursuant to Title 29 C.F.R. section 4047.5 and the terms of the MOU, PBGC may require the merged Taxpayer's Plan to pay $28.9 million to the PBGC. This amount is debt of the restored Company B Plans terminated by PBGC. Section 4047.5(a) provides the general rule that amounts paid by the PBGC from its insurance fund to pay guaranteed benefits and related expenses under a plan while it was terminated are a debt of the restored plan.

In applying the tax benefit rule, Hillsboro requires that the facts and circumstances of this case be considered in light of the "purpose and function of the provisions granting the deduction." Hillsboro, 460 U.S. at 385. Under the Hillsboro test, the Taxpayer's Plan would recognize taxable income if the reimbursement payment to the PBGC for amounts expended to provide plan benefits to Company B Plans' participants is "fundamentally inconsistent" with the deductions provided under section 404(a)(1) for employer contributions to the Taxpayer's Plan.

The $28.9 million is essentially reimbursement to the PBGC of amounts used to pay guaranteed benefits and related expenses under the Company B Plans. The use of this amount is not inconsistent with the reason that the original deductions were taken, under the same reasoning applicable to the use of assets of the

Taxpayer's Plan to pay benefits under the Company B Plans as merged. Accordingly, the payment to the PBGC of amounts used to pay guaranteed benefits and related expenses under the Company B Plans from the merged plan will not cause the Taxpayer to recognize income for federal tax purposes under section 61 of the Code.

The fourth issue is whether any of the transactions described in the ruling requests will constitute a deemed or actual reversion of plan assets to WCI that would cause the Taxpayer to be subject to the excise tax imposed under section 4980 of the Code.

Under the facts of this case no reversion within the meaning of section 4980 will occur. The analysis above of the prior issues under the tax benefit rule determined that the proposed merger and payments will not be inconsistent with the deductions previously taken on account of the Taxpayer's Plan. Under the same analysis the merger of the Company B Plans and the Taxpayer's Plan does not create an employer reversion within the meaning of section 4980. Accordingly, the merger will not cause the Taxpayer to be subject to the excise tax under section 4980.

Conclusions

Assuming that at all times relevant to these rulings (1) the Company B Plans and the Taxpayer's Plan (before and after the merger) are qualified under section 401(a) and their respective related trusts, if any, are tax-exempt under section 501(a), (2) no amendments to the Taxpayer's Plan will cause the Taxpayer's Plan to fail to satisfy section 411(d)(6), and (3) the merger of the Company B Plans and the Taxpayer's Plan will satisfy the requirements of sections 401(a)(12), 411(d)(6) and 414(l) it is ruled that:

(1) the Taxpayer will not recognize taxable income or gain for federal tax purposes in connection with: (i) the merger of the Company B Plans into the Taxpayer's Plan, (ii) the post-merger purchase of annuities covering the benefits of the Company B Plans' participants with the Taxpayer's Plan's assets, including the five percent benefit increase, any non-guaranteed benefits that were not paid by PBGC during the time it was trustee of the Company B Plans and any additional accruals earned after the plan termination dates (and payment of past, unpaid non-guaranteed benefits, plus interest, and post-termination benefit accruals in a lump sum to a consenting Company B Plans' participant or beneficiary if the present value of such amounts does not exceed $5,000), and (iii) the Taxpayer's Plan's

reimbursement to the PBGC of $28.9 million for the Company B Plans' benefits paid by the PBGC, with interest accruing at 6.52% from February 1, 2000.

(2) none of the transactions described in ruling request (1) will constitute a deemed or actual reversion of plan assets to the Taxpayer that would cause the Taxpayer to be subject to the excise tax imposed under section 4980 of the Code.

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

A copy of this ruling is being furnished to your authorized representative pursuant to a power of attorney (Form 2848) on file.

Sincerely,

James E. Holland Jr.

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