Significant Index No. 401.00-00

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

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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

JAN 24 2002

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In Re:

State A =
Municipal System =
City of B =
Certain Municipal System Accounts:
C Account =
D Account =
E Account =

This is in response to the request from your representative for a ruling that transfers of assets from the C Account to the D and E Accounts will not affect the qualified status of the Municipal System.

State A has established a retirement board (the "Retirement Board") to manage certain retirement systems for government employees. One of the State A retirement systems is the Municipal System. The Municipal System is a contributory plan, intended to qualify under section 401 of the Internal Revenue Code. The Municipal System is maintained by State A and 63 municipalities, housing authorities and water and sewer districts (collectively, the "Municipalities") within State A. The Municipal System is a governmental plan within the meaning of section 414(d).

All assets of the Municipal System are held within accounts ("Municipality Accounts") maintained for the Municipalities. A particular Municipality may have one or more Municipality Accounts. Assets may be transferred from one Municipality Account to another Municipality Account under the laws of State A only upon receipt of a favorable private letter ruling from the Internal Revenue Service. All assets within the individual Municipality Accounts are pooled together for investment purposes.

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Each Municipality Account has three separate reserves: a Members' Contribution Reserve, an Employer's Accumulation Reserve, and a Retirement Reserve. For each Municipality Account, employee contributions are credited to individual sub-accounts within that account's Members' Contribution Reserve and Municipality contributions are credited to that account's Employer's Accumulation Reserve.

All retirement benefits from a Municipality Account are paid from the Retirement Reserve of that Municipality Account. Amounts are credited to the Retirement Reserve upon the granting of a retirement allowance to an employee, at which time the accumulated value of that employee's Members' Contribution Reserve sub-account is transferred to the Retirement Reserve along with a transfer from the Employer's Accumulation Reserve of that Municipality Account of an amount equal to the excess of the actuarial value of the retirement allowance less the value of the employee's Members' Contribution Reserve sub-account. Thus, the assets of any particular Municipality Account are, in effect, only available to pay the benefits of employees covered under that Municipality Account.

All income from investments, on any of the three reserves within a Municipality Account, including gains and losses from investment transactions are credited (or charged) to that Municipality Account's Retirement Reserve. Annually, the value of the assets of the Retirement Reserve within a Municipality Account is compared to the actuarial liabilities of that Retirement Reserve. If the value of the assets exceeds the actuarial liabilities, the excess is transferred from the Retirement Reserve of that Municipality Account to the Employer's Accumulation Reserve of that Municipality Account. If the value of the actuarial liabilities exceeds the assets, an amount equal to the deficiency is transferred from the Employer's Accumulation Reserve of that Municipality Account to the Retirement Reserve of that Municipality Account.

Three accounts are maintained for the City of B within the Municipal System: the C Account, the D Account, and the E Account. The C Account is overfunded. The D and E Accounts have unfunded liabilities.

Law

Section 401(a)(2) of the Internal Revenue Code (the "Code") provides that a trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section if under the trust instrument it is impossible, at any time, prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of his employees or their beneficiaries.

Section 1.414(l)-1(b)(1) of the Income Tax Regulations provides that a plan is a "single plan" if and only if, on an ongoing basis, all of the plan assets are available to pay benefits to employees who are covered by the plan and their beneficiaries. Furthermore, that section provides that more than one plan will exist if a portion of the plan assets is not available to pay some of the of the benefits. This will be so even if each plan has the same benefit structure or plan document, or if all or part of the assets are invested with separate accounting with respect to each plan.

Revenue Ruling 81-100, 1981-1 C.B. 326 provides, in part, that a group trust, formed by the pooling the assets of individual trusts, is exempt from taxation under section 501(a) of the Code with respect to its funds which equitably belong to participating trusts described in section 401(a) only if the group trust instrument expressly limits participation to employer's pension trusts which are exempt under section 501(a) of the Code by qualifying under section 401(a).

Revenue Ruling 81-137, 1981-1 C.B. 232 provides that if the assets of a subdivision of a trust are only available to provides benefits for employees of that subdivision, each subdivision constitutes a single plan, and furthermore the minimum funding standards of section 412 of the Code and section 302 of ERISA are separately determined for each of the single plans.

Analysis

The total assets of the Municipal System consist of the sum of the assets within each of the Municipal Accounts within the Municipal System. Under the laws of State A, the assets of any particular Municipal Account are only available to pay the benefits of the employees covered under that Municipal Account. Thus, because all of the assets of the Municipal System are not available to pay benefits for all covered employees the Municipal System is not a single plan. Moreover, because the assets of any particular Municipal Account are only available to pay the benefits for that Municipal Account, each Municipal Account constitutes a single plan. Therefore the C, D, and E Accounts each constitute a separate plan.

Because the C, D, and E Accounts are separate plans, in order to satisfy section 401(a)(2) of the Code no part of the corpus or income of any one of these Municipality Accounts may be used for purposes other than for the exclusive benefit of the employees or their beneficiaries whose retirement benefits are provided through that Municipality Account. The proposed transfer of assets from the C Account to the D or E Account would be a use of such assets for purposes other than for the exclusive benefit of the employees or beneficiaries whose retirement benefits are provided through the C Account.

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Furthermore, because the assets of the individual Municipality Accounts within the Municipal System are pooled together for investment purposes, the Municipal System is, in effect, a group trust within the meaning of Rev. Rule 81-100. Thus, the Municipal System is exempt from taxation under section 501(a) of the Code only if all of the Municipality Accounts qualify under section 401(a).

Therefore we hold that:

> The transfer of assets from the C Account to the D or the E Account would not satisfy the requirements of section 401(a) of the Code and therefore would adversely affect the qualified status of the C account under section 401 and the tax exempt status of the Municipal System under section 501(a).

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

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

If you have any questions concerning this matter, please contact
(not a toll free number).

Sincerely,

James E. Holland, Jr.

James E. Holland, Jr., Acting Manager
Employee Plans Technical

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