Uniform Issue List Numbers 401.29-00, 414.07-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

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LEGEND:

State A = X

County B = XX

Entity C = XX

Board D = XXX

Plan X = XXX

Plan Y = XXX

This letter is in response to a request for a private letter ruling submitted on your behalf by your authorized representative dated xxx as supplemented by additional correspondence dated xxx. The request relates to a spinoff involving a cash or deferred arrangement, as described in section 401(k) of the Internal Revenue Code, from one State governmental entity to another of the same State.

The following facts and representations have been submitted on your behalf:

County B and Entity C are segments of the same political subdivision of State A. Board D is the governing body of County B having legislative, administrative, and other powers and duties provided to it by the laws of State A. Entity C was created by legislation of State A as an administrative board to establish and maintain roads and parks in County B and can only perform those duties delegated to it by Board D. Entity C's board members are appointed by and are subject to removal by Board D. Board D also fixes the compensation of Entity C's board members.

In 1985, Entity C adopted Plan X to provide retirement benefits for its employees. Plan X contains a cash or deferred arrangement as described in Code section 401(k). County B sponsors a defined benefit pension plan for its employees as described in section 401(a) of the Code.

Board D and Entity C entered into an agreement to transfer the responsibility for establishment, maintenance and improvement of parks located in County B to County B. Simultaneous with the transfer of these functions, the employees who had previously been employed in the parks department of Entity C will be transferred to and become employed by County B. These employees will continue to perform the same service at the same location for County B that they performed for Entity C. Entity C will spinoff the portion of Plan X that covers its park employees who will transfer to County B. After the spinoff, Entity C will transfer sponsorship and administrative functions of the spun-off portion of Plan X to County B. The park employees transferred from Entity C to County B will participate in the spun-off plan (Plan Y), however, these employees will not participate in County B's defined benefit pension plan.

Based on the foregoing, your authorized representative has requested the following rulings:

(1) That the transfer of sponsorship of a portion of Plan X to County B will not violate Code section 401(k)(4)(B).

(2) That employees of County B who become employed in County B's parks department and formerly employed in the parks department of Entity C may defer portions of their compensation under Plan Y without violating Code section 401(k)(4)(B).

(3) That new employees hired by County B to perform functions for the parks department of County B may participate in and make deferrals of their compensation under Plan Y without violating Code section 401(k)(4)(B).

(4) That the spinoff transaction and transfer of sponsorship and administrative duties to County B will have no effect on the authority of Entity C under section 1116(f) of the Tax Reform Act of 1986 (TRA'86) to continue to sponsor Plan X, allowing for deferrals of compensation by employees who remain employed by Entity C.

Code section 401(k) sets forth the requirements for a qualified cash or deferred arrangement. Section 401(k)(2) provides, in part, that a cash or deferred arrangement is any arrangement which is part of a profit-sharing plan which meets the requirements of section 401(a) and under which covered employees may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee or to the employee directly in cash.

Code section 401(k)(4)(B)(ii) provides that a cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of a plan maintained by a state or local government or a political subdivision thereof, or any agency or instrumentality thereof ("a governmental unit"). Prior to being amended by the Tax Reform Act of 1986 ("TRA"), section 401(k) permitted governmental units to maintain qualified cash or deferred arrangements. Section 1116(f)(2)(B)(i) of TRA provides that section 401(k)(4)(B) does not apply to cash or deferred arrangements adopted by a governmental unit before May 6, 1986.

Section 1.401(k)-1(e)(4) of the Income Tax Regulations provides that a cash or deferred arrangement maintained by a governmental unit is treated as adopted after May 6, 1986, with respect to all employees of any employer that adopts the arrangement after that date. However, if an employer adopted an arrangement prior to that date, all employees of the employer may participate in the arrangement. In addition, if the governmental unit adopted a cash or deferred arrangement prior to that date, then any cash or deferred arrangement adopted by the unit at any time is treated as adopted before that date.

Section 1.401(k)-1(g)(6) of the regulations provides that the term "employer" means the employer within the meaning of section 1.410(b)-9 of the regulations.

Section 1.410(b)-9 of the regulations states that the term "employer" means the employer maintaining the plan and those employers required to be aggregated with the employer under Code sections 414(b), (c), (m), or (o).

Code section 414(l) provides, in part, that a trust which forms a part of a plan shall not constitute a qualified trust under section 401 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, 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).

In the present case, Entity C cannot exist independent of Board D. Entity C can only perform those duties delegated to it by Board D. Entity C's board members are appointed by and are subject to removal by Board D. Board D also fixes the compensation of Entity C's board members. Under these facts, County B and Entity C

are so closely related, it's a reasonable interpretation of the rules under Code sections 414(b), (c), (m) and (o) to treat them as the same governmental unit. Entity C adopted and has continued to maintain Plan X since 1985, and pursuant to section 1.401(k)-1(e)(4) of the regulations, all employees of the employer may participate in the arrangement. In addition, if the governmental unit adopted a cash or deferred arrangement prior to May 6, 1986, then any cash or deferred arrangement adopted by the unit at any time is treated as adopted before that date.

Since County B and Entity C are treated as the same governmental unit, and Entity C adopted Plan X before May 6, 1986, County B, through Entity C, is treated as adopting Plan X prior to May 6, 1986.

Accordingly, with respect to your first ruling request, we rule that the transfer of sponsorship of the spun-off portion of Plan X to County B will not violate Code section 401(k)(4)(B).

With respect to your second ruling request, we rule that employees of County B who become employed in County B's parks department and who were formerly employed in the parks department of Entity C may defer portions of their compensation under Plan Y without violating Code section 401(k)(4)(B), provided that the spinoff satisfies the requirements of Code section 414(l).

With respect to your third ruling request, we rule that new employees hired by County B to perform functions for the parks department of County B may participate in Plan Y and make deferrals of their compensation under Plan Y, provided that the spinoff satisfies the requirements of Code section 414(l), without violating Code section 401(k)(4)(B).

With respect to your fourth ruling request, we rule that the spinoff transaction and transfer of sponsorship and administrative duties to County B will have no effect on the authority of Entity C under section 1116(f) of TRA'86 to continue to sponsor Plan X, allowing for deferrals of compensation by employees who remain employed by Entity C.

This ruling is based on the assumption that Plan X and Plan Y otherwise qualify under Code sections 401(a) and 401(k) and that the related trusts are tax exempt under section 501(a) at all relevant times.

No opinion is expressed as to whether the spinoff satisfies Code section 414(l).

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

A copy of this ruling letter has been sent to your attorney on file with this office.

Sincerely,

Andrew E. Zuckerman, Manager
Employee Plans Technical Group 1

Enclosures
Copy of undeleted ruling letter
Deleted copy of ruling letter
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