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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Uniform Issue List No. 401.00-00

JAN 27 2003

T:EP:RA:T3

LEGEND

Company A:

Plan X:

Dear

This is in response to a request for a private letter ruling dated March 29, 2002, as supplemented by a letter dated October 8, 2002, submitted by your authorized representative on your behalf, concerning a proposed restorative payment by Company A to Plan X. In support of this request, your authorized representative has submitted the following facts and representations.

Company A established Plan X for the benefit of its employees effective July 1, 1978, and terminated it shortly after contributions were frozen as of August 6, 2000. Plan X is a profit sharing plan and is intended to be qualified under section 401(a) of the Internal Revenue Code ("Code"). Plan X also contains a cash or deferred arrangement as described in Code section 401(k).

In December 1995, Company A retained a new plan administrator. Pursuant to the new plan administrator's suggestion, all of Plan X's assets were invested in four annuity contracts issued by the same company. Each annuity contract stated that a contingent deferred sales charge may be imposed on partial withdrawals or on surrender of the contract. The contracts further stated that the amount of any contingent deferred sales charge will be the lesser of 6% of the total premiums paid in the 84 month period preceding the date of withdrawal or surrender; or 6% of the amount withdrawn or surrendered. The annuity contracts did permit a limited withdrawal right after the first contract year without imposition of the surrender charge. Withdrawals were restricted

under this limited right to no more than 10% of the total premiums paid in the preceding 84 months or 10% of the accumulation value of the contract as of the first date of withdrawal during a contract year, if greater.

In June 1999, Company A moved to allow participants to direct investment of future contributions into other options because annual distributions exceeded the 10% maximum. Company A intended to cease contributions to the annuity contracts, wait the requisite 84 months, and liquidate them. However, in August 2000, the assets of Company A were acquired by another company and Plan X was terminated. Many Plan X participants began to request distributions of their total account balances. Liquidation of Plan X assets will exceed the 10% limit described above and thus will result in the imposition of surrender charges.

Company A has received inquiries, including threats of litigation, from attorneys representing some participants and is concerned that it may face claims alleging its personal liability to Plan X and Plan X participants because of improper fiduciary conduct. Therefore, Company A proposes to make a payment to Plan X (the "proposed payment") which will restore to participants' accounts the amount of the loss which will result from the imposition of the surrender charges on liquidation of the annuity contracts. No portion of the proposed payment will be made to the accounts of participants who were also Plan X fiduciaries.

Based on the preceding facts and representations, your authorized representative has requested the following rulings on your behalf:

1. The proposed payment by Company A will be deductible under Code section 162 as an ordinary and necessary business expense, and will not be deductible under Code section 404;
2. The proposed payment by Company A will not be treated as an excess contribution to Plan X under Code section 404 and will not be subject to the excise tax on excess contributions under Code section 4972;
3. The proposed payment by Company A will be treated as a restorative payment to Plan X and, therefore, allocated as such, rather than as a contribution under Code section 404; and
4. The proposed payment by Company A will not be subject to limitations on allocations under Code section 415(c).

Section 404(a) of the Code generally provides that contributions paid by an employer to or under a plan, if otherwise deductible, are deductible under section 404, subject to the limitations under section 404(a).

Section 415(c) of the Code generally limits the amount of contributions and other additions under a qualified defined contribution plan or tax deferred annuity plan with respect to a participant for any year.

Section 4972(a) of the Code imposes a ten percent excise tax on the amount of the nondeductible contributions made to any "qualified employer plan", including a plan qualified under section 401(a).

Section 402(a) of the Code generally provides that any amount actually distributed to any distributee by an employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall not be taxable to a participant until actually distributed to the participant.

Generally, amounts contributed to a qualified retirement plan are subject to various Code sections including sections 404, 415, and 4972. However, Revenue Ruling 2002-45, 2002-29 I.R.B. 116, provides that a payment made to a qualified defined contribution plan is not treated as a contribution to the plan, and accordingly is not subject to these Code sections, if the payment is made to restore losses to the plan resulting from actions by a fiduciary for which there is a reasonable risk of liability for breach of a fiduciary duty under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and plan participants who are similarly situated are treated similarly with respect to the payment ("restorative payments").

In this case, the annuity contracts in which the assets of Plan X are invested provide for a contingent deferred sales charge of the lesser of six percent of the total premiums paid in the 84 month period preceding the date of withdrawal or surrender, or six percent of the amount withdrawn or surrendered. After the first contract year, distributions were not subject to the contingent deferred sales charge unless they exceeded 10 percent of the total premiums paid in the preceding 84 months or 10 percent of the accumulation value of the contract as of the first date of withdrawal during a contract year, if greater. Such facts, together with the other facts described above, are not sufficient to demonstrate a reasonable risk of liability to the employer for breach of fiduciary duty.

Accordingly, with respect to requested rulings (1) through (4), we conclude that the proposed payments are employer contributions and would be subject to Code sections 404, 415, and 4972. Our conclusion makes it unnecessary to respond to that part of your first requested ruling which concerned Code section 162.

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

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

If you have any questions about this letter, please contact
Please refer to T:EP:RA:T:3.

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