200319011

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

FEB 14 2003

T:EP:RA:T4

Uniform Issue List No. 0403.04-00

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Attention: **********
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Legend:

Employer C = **********

Plan X = **********
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Custodian M = **********
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Ladies and Gentlemen:

This is in response to letters dated ********** in which your authorized representative requested a letter ruling concerning Plan X under section 403(b)(7) of the Internal Revenue Code.

The following facts and representations have been submitted in support of this request.

Employer C provides management services to not-for-profit corporations that provide health care and psychiatric

services to residents in its area. By letter dated , the Service issued a ruling which determined that Employer C was exempt from tax under section 501(a) of the Code as an organization described in section 501(c).

Effective January 1, 1999, Employer C adopted Plan X. Plan X, together with amendments submitted on ********** ********** is intended to meet the applicable requirements of section 403(b)(7) of the Code.

Under section 3.1 each eligible employee shall be eligible to participate in Salary Deferral Contributions on the first payroll date on or after he or she has been employed. The employer shall give each eligible employee written notice of his or her eligibility to participate in the Plan when he or she is employed. A participant shall be eligible for matching contributions for plan years ending after completing an eligibility year of service and attaining age 21.

Article IV of Plan X provides for five types of contributions: (1) employee contributions pursuant to a salary reduction agreement, (2) voluntary employee contributions, (3) nonelective employer contributions, (4) discretionary employer matching contributions equal to 50 percent of the participant's salary deferral contributions and voluntary employee contributions, and (5) catch-up contributions. Only salary reduction contributions up to 8 percent of compensation are considered for purposes of matching contributions.

Section 6.1 of Plan X provides that salary deferral contributions are nonforfeitable and one hundred percent vested at all times.

Custodian M is named as the custodian in the salary reduction agreement. Under the representations submitted in this case Custodian M operates a trust department that is a regulated state-chartered trust company under the provisions of state statutes and is subject to examination and regulation by the State Commissioner of Banks.

Under the salary reduction agreement under Plan X, an eligible employee may reduce his or her eligible compensation

(subject to a minimum of $200 per plan year) by a dollar amount or by any full percentage of compensation between 1% and 13% each pay period, and the employer agrees to contribute this amount on the employee's behalf to the investment options selected by the employee. The employee may change the amount of the salary reduction or terminate the agreement by filing a written notice of such change or termination with the employer 30 days prior to the date the employee wishes the change to take effect.

Article IV of Plan X limits salary deferral contributions in accordance with section 402(g) of the Code including catch-up and increased contributions within the limitations under section 402(g)(1)(C) and 402(g)(7).

Section 4.14 of Plan X provides that salary deferral contributions accumulated through payroll deductions shall be paid to the Custodian as of the earliest date on which such contributions can reasonably be segregated from the employer's general assets, but in any event no later than the 15th business day of the month following the month in which the salary deferral contributions are received by the employer or the 15th business day of the month following the month in which amounts would otherwise have been payable to the participant in cash.

Section 4.11 of Plan X provides that the maximum annual additions credited to a participant's accounts under all plans of the employer for any limitation year shall not exceed the section 415 contribution limitation for such limitation year. Section 4.11B describes the alternate elections set forth in section 415(c)(4) of the Code.

Section 5.3 of Plan X describes the investment powers of Custodian M and provides that amounts paid by the employer to the fund shall be invested only in regulated investment company stock which shall be held by the fund.

Article VII of Plan X provides that no distribution shall be paid or made available to a participant before the participant dies, attains age 59 1/2, separates from service or becomes disabled (within the meaning of Code section 72(m)(7). Sections 7.6 and 7.19 of Plan X (concerning the

required beginning date for before-death distribution) provides that a participant's entire interest must commence to be distributed no later than April 1 of the calendar year following the year in which the participant (i) attains age 70 1/2 or (ii) terminates service, whichever is later, and the after-death distribution rules satisfy the requirements of section 401(a)(9)(B) of the Code. The life expectancy of a participant and a surviving spouse may be recalculated annually at the option of the participant and/or the spouse. Additionally, Plan X provides for distribution in the form of a joint and survivor annuity, preretirement survivor annuity, and a single life annuity.

Section 7.4 of the plan provides that if the value of a terminated participant's vested benefit derived from employer and employee contributions has never exceeded $5,000, the entire vested benefit to be paid to such participant in a single lump sum as soon as practicable.

Section 7.16 of Plan X provides for an optional direct trustee-to-trustee transfer of an eligible rollover distribution to an eligible retirement plan, as required by section 401(a)(31) of the Code.

Plan X is not intended to meet the requirements of section 403(a) of the Code.

Based on the foregoing facts and representations, the following rulings are requested:

1. That Plan X meets the requirements of sections 403(b) including section 403(b)(7) but excluding section 403(b)(12);

2. That the salary reduction agreement maintained under Plan X satisfies the requirements of Code section 401(a)(30);

3. That amounts contributed by Employer C to the custodial account of plan X shall be excluded from the gross income of the employee for the taxable year of the contributions to the extent that aggregate of such amounts does not exceed the limitations of section 415 for such year.

Section 403(b)(1) of the Code provides, in part, that amounts contributed by an employer to purchase an annuity contract for an employee are excludable form the gross income of the employee in the year contributed provided (1) the employee performs services for an employer which is exempt from tax under section 501(a) as an organization described in section 501(c)(3), or the employee performs services for an educational institution (as defined in section 170(b)(1)(A)(ii)) which is a state, a political subdivision of a state, or an agency or instrumentality of one or more of the foregoing; (2) such annuity contract is not subject to section 403(a); (3) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums; and (4) in the case of a contract purchased under a plan which provides a salary reduction agreement, the contract meets the requirements of section 401(a)(30).

Section 403(b)(1) of the Code provides further that the employee shall include in his gross income the amounts actually distributed under such contract in the year distributed as provided in section 72 of the Code. In addition, except as provided in section 403(b)(7)(B), a custodial account described in section 403(b)(7) is treated as an annuity contract for all purposes of the Code.

Section 403(b)(3) of the Code defines includible compensation to mean the amount of compensation received from the employer in the employee's most recent one-year period of service which is includible in the employee's gross income.

Section 403(b)(10) of the Code requires that arrangements pursuant to section 403(b) must satisfy requirements similar to those of section 401(a)(9) and similar to the incidental death benefit requirements of section 401(a). In addition, this section provides that any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of the transfer.

Section 401(a)(9) of the Code, in general, provides for a mandatory benefit commencement date of April 1 following the plan year in which the participant attains age 70 1/2 or retires, whichever is later, and specifies required minimum

distribution rules for the payment of benefits from qualified plans.

Section 403(b)(7) of the Code provides that the amounts paid by a qualifying employer to a custodial account shall be treated as amounts contributed by the employer for an annuity contract for his employee if the amounts are invested in regulated investment company stock to be held in that custodial account, and under the custodial account no such amounts may be paid or made available to any distributee before the employee dies, attains age 59 1/2, separates from service, becomes disabled (within the meaning of section 72(m)(7)).

Section 415(a)(2) of the Code provides, in pertinent part, that a plan will not be considered a plan described under section 403(b) unless amounts contributed under the plan satisfy the limitations of section 415.

Section 403(b)(1)(E) of the Code provides that in the case of a contract purchased under a salary reduction agreement, the contract meets the requirements of section 401(a)(30). Section 401(a)(30) of the Code (concerning limitations of elective deferrals) provides that in the case of a trust which is part of a plan (including section 403(b) plans)under which elective deferrals (within the meaning of section 402(g)(3) which includes salary reduction amounts) may be made with respect to any individual during a calendar year, such trust shall not constitute a qualified trust under this subsection unless the plan provides that the amount of such deferrals under such plan and all other plans, contracts, or arrangements of an employer maintaining such plan may not exceed the amount of the limitation in effect under section 402(g)(1) for the taxable year beginning in such calendar year.

Section 402(g) of the Code provides, generally, that the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals exceeds the applicable dollar amount. Section 402(g)(7) provides for certain increases in the dollar amount for employees who have completed 15 years of service with the employer. Section 402(g)(1)(C) provides that employees who will have attained

age 50 by the end of a taxable year may make additional elective deferrals during such plan year within certain specified amounts that will not be treated as exceeding the limitations of sections 402(g) and/or 415.

In this case, Employer C is an organization described in section 501(c)(3) which is exempt under section 501(a), which has established Plan X for the benefit of its employees. A participants salary reduction contributions (and earnings thereon) are fully non-forfeitable at all times.

The Program satisfies the requirement, under section 403(b)(7)(A) of the Code, that amounts held in custodial accounts shall be invested in regulated investment company stock held by Custodian C, and no such amounts shall be distributed before the participant's attainment of age 59 1/2, death, disability, or termination of employment.

The Program satisfies the distribution requirements of section 403(b)(10) of the Code because the minimum distribution and incidental death benefit requirements are satisfied.

The salary deferral agreement limits contributions in accordance with sections 402(g) and 415 of the Code. Plan X satisfies the applicable requirements of section 403(b)(7) of the Code.

Therefore, with respect to ruling request number one, we conclude that Plan X meets the requirements of section 403(b) of the Code, including 403(b)(7), but excluding section 403(b)(12). With respect to ruling request number two we conclude that the salary reduction agreement maintained under Plan X satisfies the requirements of Code section 401(a)(30).

The third ruling request concerns the exclusion of amounts contributed to Plan X. Section 403(b)(1) of the Code provides, in effect, that the amounts contributed to a custodial account described in section 403(b)(7) by an employer which is described in section 501(c)(3) which is exempt from tax under section 501(a) for an employee are excludable from the employee's gross income in the taxable year in which such amounts are contributed. The amounts contributed as salary reduction contributions on behalf of an

employee to a custodial account under Plan X are not in excess of the limitations under sections 415 and 402(g) and satisfy the requirements for exclusion from income. Therefore, concerning ruling request three, we conclude that amounts contributed by Employer C to Plan X custodial fund shall be excluded from the gross income to the employee for the taxable year of the contributions to the extent that aggregate of such amounts does not exceed the applicable limits under the Code for such taxable year.

This letter ruling is not effective unless the proposed amendments reflected in the letters dated May 11, 2001, August 10, 2001, September 12, 2002, November 4, 2002, and January 8,2003 are adopted by Plan X.

This ruling is limited to the form of Plan X and does not extend to any operational violations of sections 401, 403(b) or 415 of the Code by Plan X now or in the future. Finally, this letter is not a ruling as to whether the annuity contracts that may be used or distributed by Plan X will satisfy the requirements of section 403(b) of the Code.

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

Any questions concerning this ruling should be addressed to , at .

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

Sincerely yours,

Al Pipkin, Manager
Employee Plans Technical Group 4
Tax Exempt & Government Entities Division