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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

AUG 02 2006

SE:T:EP:RA:T1

UIL Numbers: 72.02-00, 72.20-00, 402.06-00, and 415.00-00

Legend:

Plan X

System Y

Tier 1

Tier 2

State M

Board N

Statute O

Statute P

Rules and Regulations

Dear :

This is in response to a request for rulings submitted on your behalf by your authorized representative dated May 19, 2004, as supplemented by correspondence dated September 21, 2004, November 11, 2004, December 2, 2004, July 11, 2005, June 23, 2006, and July 28, 2006, regarding rulings under sections 402(a), 72, and 415 of the Internal Revenue Code (the "Code"). The following facts and representations were submitted in connection with this request.

State M maintains Plan X, a money purchase pension plan, and System Y, a multiple-employer plan for police officers and firefighters throughout State M. System Y is comprised of the following: Tier 1, a defined benefit tier; Tier 2, which contains both a defined benefit plan component ("DB Component") and a money purchase pension plan component ("MP Component"); and a retiree medical benefits account under Code section 401(h) ("401(h) Account"). Tier 1 was originally established in 1980, received a favorable determination letter

dated May 7, 1999, and was recently amended to include Tier 2 and the 401(h) Account. Plan X and System Y are intended to be governmental plans under section 414(d) and qualified under section 401(a). System Y received a favorable determination letter on May 19, 2006, and Plan X received a favorable determination letter on December 19, 2003. The effective date for System Y is January 1, 2004, but the adoption dates will vary with respect to each employer. Board N administers Plan X and System Y.

In 2003, in order to provide fire and police employees and their employers with retirement benefit alternatives, including a more economical defined benefit option, State M amended Statute P to permit an employer that has established a local money purchase pension plan ("Local MP Plan") pursuant to Statute O or Statute P or an employer that participates in Plan X to apply to cover its employees under either Tier 1 or Tier 2 of System Y. Based on the authority delegated by State M under Statute P, Board N developed a plan document for System Y, which includes certain rules and regulations (the "Rules and Regulations"). Section 1.01(ee) of the Rules and Regulations generally defines a "Member" under System Y to mean a salaried employee of a municipality, fire protection district, fire authority or county improvement district. Section 1.01(s) of the Rules and Regulations defines "Employer" to have the meaning set forth in Statute P, and Statute P defines "Employer" to mean a municipality in State M offering police or fire protection service employing one or more Members and any special district, fire authority, or county improvement district in State M offering fire protection service employing one or more Members. Both Tier 1 and Tier 2 of System Y provide for Employer and Member contributions.

Board N prepared two model resolutions for purposes of electing coverage under Tier 1 or Tier 2 of System Y ("Resolutions"). An Employer with either a Local MP Plan or an Employer that participates in Plan X must adopt a Resolution and file the Resolution and an application ("Application") with Board N. An Employer's Members must also approve participation in System Y by a 65 percent vote. Existing Members in a Local MP Plan or Plan X have three options for participation in System Y: they can elect to participate in Tier 1, if permitted by the Employer; in both the DB and DC components of Tier 2; or in only the MP component of Tier 2. Members hired after the effective date of Employer participation in System Y are limited to the Employer's selection of Tier 1 or the DB and/or MP Component of Tier 2.

An existing Member's election to participate in one of the tiers of System Y is irrevocable and must be made prior to the Employer's effective date of participation in System Y. If no election is made, a Member is deemed to have elected to participate only in the MP Component of Tier 2. An Employer who is permitted by Board N to participate in System Y is not permitted to opt out of System Y or either tier at a later date.

For Employers that maintain a Local MP Plan, the Resolution for electing coverage under System Y must contain the following:

(1) a request for the effective date of coverage;

(2) a statement as to whether the Employer will offer Members hired before the effective date the option of participating in Tier 1;

(3) the Employer's election to cover Members hired after the effective date under Tier 1 or Tier 2;

(4) the Employer's choice of coverage of clerical and personnel support as well as part-time employees;

(5) its choice of a vesting schedule for Employer contributions;

(6) a statement of whether the Employer intends to transfer account balances of active, inactive and retired members in the Local MP Plan to the MP Component of Tier 2;

(7) vesting records; and

(8) an acknowledgement that coverage under System Y is irrevocable.

An Employer who administers a Local MP Plan must certify in its Application that:

(1) such plan is qualified under Code section 401(a);

(2) the Employer has frozen, or completely or partially terminated the Local MP Plan;

(3) any termination does not adversely affect the qualified status of the Local MP Plan;

(4) if the Local MP Plan is terminated, the benefits accrued to the date of termination are nonforfeitable;

(5) all active participants of the Local MP Plan will become Members of System Y as of the effective date; and

(6) no reduction in account balances will be incurred as a result of the transfer.

An Employer will certify that a Local MP Plan is qualified pursuant to (1) above by submitting a copy of its determination letter from the Service or an opinion of counsel. If an Employer partly or completely terminates its Local MP Plan, all assets of the Members who will participate in System Y must be transferred. If it

freezes its Local MP Plan, no transfer of assets will be made, however, Members may subsequently elect to transfer all or a portion of their assets from the Local MP Plan to System Y if permitted under the terms of the Local MP Plan.

Employers that participate in Plan X must include similar information in their Resolutions and Applications, except that these Employers must terminate participation in Plan X and all assets of affected Members are automatically transferred to System Y. Assets transferred from the Local MP Plans or Plan X may be transferred to the MP Component of Tier 2, or used to purchase past service credits under Tier 1 or the DB Component of Tier 2.

Based on the above facts and representations, you request the following rulings that:

(1) The trustee to trustee transfer of assets from a Member's Local MP Plan or Plan X to System Y shall not be deemed to be an actual distribution to the Member of the amounts transferred and as a result shall not be subject to taxation at the time of the transfer under Code sections 402(a) and 72(t).

(2) Except as provided below, amounts transferred from a Member's Local MP Plan or Plan X, including picked up contributions, shall retain their federal income tax status as employer and employee contributions for purposes of recovery of investment in the contract and rollovers. If partial account balances are transferred, any tax basis will be allocated pro rata between amounts transferred and amounts not transferred.

(3) The amounts transferred from a Member's predecessor Local MP Plan or Plan X shall not be treated, for purposes of the limits on benefits and contributions under Code sections 415(b) or 415(c), either as part of the annual benefits accrued or as annual additions for the year of the transfer, and further shall not be treated as employee contributions made to purchase permissive service credit that are subject to the requirements and limitations of section 415(n).

Regarding ruling request (1), Code section 402(a)(1) provides that the amount actually distributed to a distributee by an employee's trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the distributee, in the taxable year of the distributee in which distributed under section 72.

Under Code section 72(t), certain early distributions from a qualified plan are subject to an additional income tax equal to ten percent of the amount includible in gross income.

Revenue Ruling 67-213, 1967-2 C.B. 149, provides that if a participant elects to have his entire interest in a qualified plan transferred from the trust forming part

of that plan to the trust forming part of another qualified plan without being made available to the participant, no taxable income will be recognized by reason of such transfer.

You represent that Plan X and System Y are qualified plans under Code section 401(a). Each Employer, to be covered under System Y, must certify that its Local MP Plan is also a qualified plan. Sections 402(a) and 72(t) apply to distributions. In this case, assets will automatically be transferred from Plan X, or an Employer who maintains a Local MP Plan will elect to transfer all of the assets of Members who will participate in System Y. If the Employer does not elect a transfer, Members may elect that all or a portion of their account balances be transferred to System Y. Because assets will be transferred directly from one qualified plan, a Local MP Plan or Plan X, to another qualified plan, System Y, they are not includible in the Members' gross income by reason of such transfer under sections 402(a) and 72(t). Accordingly, we conclude with respect to ruling request (1) that the trustee to trustee transfer of assets from a Local MP Plan or Plan X to System Y is not an actual distribution to the Member of the amounts transferred and, consequently, will not be subject to taxation at the time of transfer under sections 402(a) and 72(t).

Regarding ruling request (2), Code section 72(e)(6) defines the term "investment in the contract" as of any date as the aggregate amount of premiums or other consideration paid for the contract before such date, minus the aggregate amount received under the contract before such date, to the extent that such amount was excludable from gross income under current or prior income tax laws.

Plan X and the Local MP Plans provided for after-tax employee contributions and pick-up contributions. As indicated above, an Employer that participates in Plan X must transfer all assets in electing coverage under System Y. An Employer with a Local MP Plan may adopt a Resolution electing to transfer all or none of the assets to System Y. If the Employer does not elect a transfer, a Member may elect to transfer all or a portion of his or her account balance from the Local MP Plan to System Y. Members' account balances will be transferred either to purchase past service credit under Tier 1 or the DB Component of Tier 2, or to the MP Component of Tier 2. Thus, we conclude with respect to ruling request (2) that to the extent entire account balances are transferred, the transferred amounts, including picked-up contributions, will retain their federal income tax status as employee and employer contributions for purposes of recovery of investment in the contract and rollovers. However, with respect to partial transfers, a Member's investment in the contract will be allocated pro rata between amounts transferred and amounts that remain in the Local MP Plan.

With respect to ruling request (3), Code section 415(b) limits the amount of annual benefits provided under a qualified defined benefit plan, and section

415(c) limits the amount of annual contributions and other additions to a participant's account in a defined contribution plan.

Code section 415(n)(1) generally provides that if an employee makes one or more contributions to a defined benefit governmental plan (within the meaning of section 414(d)) to purchase permissive service credit under such plan, then the requirements of section 415 shall be treated as met only if the limit in either section 415(b) or 415(c) is met.

Section 1.415-3(b)(1)(iv) of the federal Income Tax Regulations (the "regulations") provides that when there is a transfer of assets and liabilities from one qualified plan to another, the annual benefit attributable to the assets transferred does not have to be taken into account by the transferee plan in applying the limitations of Code section 415.

Section 1.415-6(b)(2)(iv) of the regulations provides that the transfer of funds from one qualified plan to another will not be considered an annual addition for the limitation year in which the transfer occurs.

As indicated above, Code section 415(n)(1) applies to contributions, not transfers. The regulations under section 415 provide that trustee-to-trustee transfers are not included as annual additions or as part of a participant's accrued annual benefit. Thus, we conclude with respect to ruling request (3) that the amounts transferred from a Local MP Plan or Plan X to System Y are neither treated as contributions or benefits subject to the limit in section 415(c) or 415(b), nor subject to the requirements and limitations of section 415(n), in the limitation year of the transfer.

Rulings (1) through (3) are based on Statutes O and P in effect on May 19, 2004; the Rules and Regulations as amended and proposed to be amended in connection with System Y's May 19, 2006, determination letter, excluding any cross-references to Statutes O and P to the extent they were amended after May 19, 2004; and the facts and representations as described in this letter.

The above rulings assume that System Y, Plan X and the Local MP Plans are governmental plans within the meaning of Code section 414(d) and that such plans are qualified under section 401(a) at all relevant times.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other sections of the Code that may be applicable thereto.

The above rulings are directed only to the taxpayer that requested them. Section 6110(k)(3) provides that they may not be used or cited by others as precedent.

A copy of this letter has been sent to your authorized representative in accordance with a power of attorney on file in this office. Should you have any questions or concerns, please contact .

Sincerely yours,

Carlton A. Watkins

Carlton A. Watkins, Manager
Employee Plans Technical Group 1

Enclosures:
Copy of deleted ruling
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