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October 4, 2002.

Employer =

Plan A =

Plan B =

Plan C =

Trust D =

State X =

Dear :

This is in reply to your request for a ruling on whether State X can properly sponsor a section 403(b) plan, as well as other rulings concerning the status of Trust D as a group trust under section 401(a)(24) of the Code and the proper treatment under section 3402 of the Code of elective contributions made on behalf of participants of Plan A.

Employer, State X, is an eligible employer within the meaning of section 457(e)(1)(A) of the Code.

State X's Merit System of Personnel Administration ("Merit System") is responsible for administering plans sponsored by State X and its political subdivisions. Responsibility for administering the retirement plans has been delegated to the Merit System by the Employee Benefit Plan Council ("Council") and the State Personnel Board ("Board'). The Council is a statutory body responsible for the establishment of qualified retirement plans enacted by State X's legislature. The Board is a statutory body in State X responsible for the establishment of nonqualified plans, such as section 457 deferred compensation plans.

The Council established Plan A effective on December 18, 1985. It is represented that Plan A is a defined contribution plan with a cash or deferred arrangement and meets the requirements of sections 401(a) and 401(k) of the Code. A favorable determination letter was issued regarding Plan A by the Internal Revenue Service on June 26, 1987. Plan A was subsequently amended and received its most recent favorable determination letter on September 4, 1998. Plan A allows certain employees of State X to make pre-tax contributions of up to fifteen percent of their compensation. In addition, Plan A provides for discretionary matching contributions and other employer contributions if appropriated by the legislature. Although state and local governments may not currently adopt section 401(k) plans, it is represented that Plan A was adopted prior to May 6, 1986, and that State X may therefore continue to maintain Plan A.

The Council and the trustees of Plan A established Trust A to hold the assets of Plan A for the exclusive benefit of Plan A participants and beneficiaries. It is represented that Trust A meets the requirements of section 401(a) of the Code and is exempt from tax under section 501(a) of the Code.

Effective July 25, 1979, the Board established Plan B. Plan B is meant to be an eligible deferred compensation plan under section 457(b) of the Code. A ruling was issued by the Internal Revenue Service on September 30, 1999, that determined that State X's 457 Plan is an eligible deferred compensation plan as defined under section 457(b) of the Code.

In order to comply with the trust requirements for section 457 plans under section 457(g), the Board and the trustees of Plan B established the State X Deferred Compensation Plan Trust Agreement, Trust B, effective January 1, 1999, to hold the assets of Plan B for the exclusive benefit of Plan B participants and beneficiaries.

Effective January 1, 1999, Trust D was established by appropriate governmental authorities to pool the assets of Trust A and the assets of Trust B to improve the overall investment return. On September 30, 1999, the Service approved the pooling of assets, ruling that Trust D met the definition of a group trust as stated in section 401(a)(24) of the Code and was exempt from tax under section 501(a) of the Code. The assets associated with Plan A and Plan B each have separate accounting and the assets are pooled in Trust D for investment purposes only.

The Merit System, as an instrumentality of State X, has the authority to administer various defined contribution retirement plans for the benefit of state employees. State X wants to sponsor a new, unified section 403(b) tax deferred annuity plan, Plan C, for the employees of the various State X technical schools that currently maintain separate section 403(b) plans. Only those employees of the various state technical schools currently eligible to participate in a Code section 403(b) plan or other state employees who otherwise meet the eligibility requirements specified in Code

section 403(b)(1)(A) will be
allowed to participate in Plan C. Upon creation of Plan C, the Merit System will combine all assets currently held by the various, separate 403(b) plans established by the various technical schools whose employees will be covered by the unified Plan C and hold all such assets in a unified 403(b) trust, Trust C. Subsequent contributions by these employees pursuant to the unified Plan C will also be held by Trust C.

The Merit System proposes to hold the assets associated with Plan C in Trust D and pool such assets with the assets associated with Plan A and Plan B in Trust D. The assets associated with Plan C will remain invested exclusively in group annuities or the stock of registered investment companies held within Trust C, as required by Code sections 403(b)(1) and 403(b)(7). The assets associated with Plan C, along with the assets from Plan A and Plan B will each have a separate accounting and the assets will be pooled in Trust D for investment purposes only. The assets of Plan C, along with Plan A and Plan B, will be held for the exclusive benefit of their respective participants and beneficiaries.

Based on the foregoing, you have asked us to respond to the following rulings, as they relate to section 403(b) of the code:

1. Assuming that (i) Plan A otherwise satisfies the requirements of sections 401(a) and 401(k) of the Code (ii) Plan B otherwise satisfies the requirements of section 457(b) of the Code; and (iii) Plan C otherwise satisfies the requirements of section 403(b) of the Code, the pooling of assets associated with each of these plans in Trust D will not cause Trust D nor any individual subcomponent plan or trust to lose its exemption from taxation under section 501(a) of the Code or Trust D to fail to meet the definition of a group trust under section 401(a)(24) of the Code.

2. Assuming that Plan B otherwise satisfies the requirements of section 457(b) of the Code and that the pooling of assets associated with Plan A, Plan B and Plan C in Trust D will not cause the 457 Trust B to lose its exemption from taxation under section 501(a) of the Code, the pooling of assets associated with Plan B with the assets associated with Plan A and Plan C in Trust D will not result in Plan B failing to satisfy the requirements of section 457(b) of the Code.

3. Assuming that Plan C otherwise satisfies the requirements of section 403(b) of the Code and that the pooling of assets associated with the Plan A, Plan B and Plan C in Trust D will not cause the 403(b) Trust C to lose its exemption from taxation under section 501(a) of the Code, the pooling of assets associated with Plan C with the assets associated with Plan A and Plan B in Trust D will not result in Plan C failing to satisfy the requirements of section 403(b) of the Code.

Section 401(k)(2) of the Code states, in part, that a qualified cash or deferred arrangement is any arrangement which is part of a profit-sharing or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan which meets the requirements of section 401(a) under which a covered employee 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. Such arrangements must meet special standards governing withdrawals, forfeitures, and discrimination in order to qualify for tax benefits.

The Tax Reform Act of 1986 (Public Law 99-514) added Section 401(k)(4)(B)(ii) which 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 political subdivision thereof, or any agency or instrumentality thereof. However, a transition rule included in section 1116(f)(2)(B) of the Tax Reform Act of 1986 states that Section 401(k)(4)(B)(ii) added above shall not apply to any cash or deferred arrangement adopted by a state or local government or political subdivision before May 6, 1986.

Section 402(e)(3) provides that contributions made by an employer on behalf of an employee to a trust which is a part of a qualified cash or deferred arrangement (as defined in section 401(k)(2)) shall not be treated as distributed or made available to the employee nor as contributions made to the trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contribution will be made to the trust or received by the employee in cash.

Section 1.401(k)-1(a)(2) of the Income Tax Regulations provides that generally, a cash or deferred arrangement is an arrangement under which an eligible employee may make a cash or deferred election with respect to contributions to, or accruals or other benefits under, a plan that is intended to satisfy the requirements of section 401(a) of the Code.

Section 1.401(k)-1(a)(3)(i) of the regulations provides that a cash or deferred election is any election (or modification of an earlier election) by an employee to have the employer either (A) provide an amount to the employee in the form of cash or some other taxable benefit that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation. A cash or deferred election includes a salary reduction agreement between an employee and employer under which a contribution is made under a plan only if the employee elects to reduce cash compensation or to forgo an increase in cash compensation.

Section 1.401(k)-1(a)(3)(ii) of the regulations provides that a cash or deferred election can only be made with respect to an amount that is not currently available to the employee on the date of the election. Further, a cash or deferred election can only be made with respect to an amount that would (but for the cash or deferred election)

become
currently available after the later of the date on which the employer adopts the cash or deferred arrangement or the date on which the arrangement first becomes effective.

Section 1.401(k)-1(a)(3)(iii) of the regulations provides that cash or another taxable amount is currently available to the employee if it has been paid to the employee or if the employee is able currently to receive the cash or other taxable amount at the employee's discretion. An amount is not currently available to an employee if there is a significant restriction or limitation on the employee's right to receive the amount before a particular time in the future. The determination of whether an amount is currently available to an employee does not depend on whether it has been constructively received by the employee for purposes of section 451.

Section 1.401(k)-1(a)(4)(i) of the regulations provides that a qualified cash or deferred arrangement is a cash or deferred arrangement that satisfies the requirements of paragraphs (b), (c), (d), and (e) of section 1.401(k)-1 and that is part of a plan that otherwise satisfies the requirements of section 401(a).

Section 1.401(k)-1(a)(4)(ii) of the regulations provides that, except as provided in section 1.401(k) of the Code, elective contributions under a qualified cash or deferred arrangement are treated as employer contributions.

Section 1.401 (k)-1(a)(4)(iii) of the regulations provides that except as provided in section 402(g) of the Code, and in section 1.401(k)-1(f), elective contributions under a quailed cash or deferred arrangement are neither includible in an employee's gross income at the time the cash or other taxable amounts would have been includible in the employee's gross income (but for the cash or deferred election), nor at the time the elective contributions are contributed to the plan.

Section 403(b)(1) of the Code provides, for years beginning after December 31, 2001, that certain amounts contributed by an employer to purchase an annuity contract for an employee shall be excluded from the gross income of the employee for the taxable year, to the extent the aggregate of such amount does not exceed the applicable limit under section 415 provided (1) the employee performs services for an employer which is exempt from tax under section 501(a) of the Code 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) of the Code) which is a state, a political subdivision of a state, or an agency or instrumentality of any one or more of the foregoing; (2) the annuity contract is not subject to section 403(a) of the Code; (3) the employee's rights under the contract are nonforfeitable, except for failure to pay future premiums; (4) such contract is purchased under a plan which meets the nondiscrimination requirements of paragraph (12), except in the case of a contract purchased by a church; and, (5) in the case of a contract purchased under a plan which provides a salary reduction agreement, the plan 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.

Revenue Ruling 81-100, 1981-1 C.B. 326 holds that trusts which are parts of qualified retirement plans and individual retirement accounts may pool their assets in a group trust without affecting the exempt status of the separate trusts.

Section 401(a)(24) of the Code provides that any group trust which otherwise meets the requirements of section 401(a) shall not be treated as not meeting such requirements on account of the participation or inclusion in such trust of the moneys of any plan or governmental unit described in section 818(a)(6)

Section 818(a)(6) of the Code states that the term “pension plan” includes (A) a governmental plan (within the meaning of section 414(d), or an eligible deferred compensation plan (within the meaning of section 457(b)); or (B) the Government of the United States, the government of any state or political subdivision thereof, or by any agency or instrumentality of the foregoing, or any organization (other than a governmental unit) exempt from tax under this subtitle, for use in satisfying an obligation of such government, political subdivision, agency or instrumentality, or organization to provide a benefit under a plan described in section 818(a)(6)(A)

The Committee Report pertaining to section 401(a)(24) of the Code contained in Rep. No. 760, 97th Cong., 2d Sess. 639 (1982), states that under the conference agreement, the tax-exempt status of a group trust will not be adversely affected merely because the trust accepts monies from (a) a retirement plan of a State or local government, whether or not the plan is a qualified plan and whether or not the assets are held in trust, (b) any state or local government monies intended for use in satisfying an obligation of such State or local government to provide a retirement benefit under a government plan.

Nothing in the Internal Revenue Code nor the Income Tax Regulations thereunder would prevent an arrangement such as described herein to result in an arrangement being one other than as described under section 403(b) or section 401(k) of the Code. The arrangement described herein is analogous to the facts presented in Rev. Rul. 81-100, wherein individual trusts were combined into a group trust.

Accordingly, with respect to your ruling requests, we conclude:

1. Assuming that (i) Plan A satisfies the requirements of sections 401(a) and 401(k) of the Code; (ii) Plan B otherwise satisfies the requirements of section 457(b) of the Code; and (iii) Plan C otherwise satisfies the requirements of section 403(b) of the Code, the pooling of assets associated with each of these plans in Trust D will not cause Trust D nor any individual subcomponent plan or trust to lose its exemption
from taxation under section 501(a) of the Code or Trust D to fail to meet the

definition of a group trust under section 401(a)(24) of the Code.

2. Assuming that Plan B otherwise satisfies the requirements of section 457(b) of the Code and that the pooling of assets associated with Plan A, Plan B and Plan C in Trust D will not cause the Trust B to lose its exemption from taxation under section 501(a) of the Code, the pooling of assets associated with Plan B, the 457 Plan, with the assets associated with Plan A and Plan C in Trust D will not result in Plan B failing to satisfy the requirements of section 457(b) of the Code.

3. Assuming that Plan C otherwise satisfies the requirements of section 403(b) of the Code and that the pooling of assets associated with Plan A and Plan B with Plan C in Trust D will not cause the 403(b) Trust C to lose its exemption from taxation under section 501(a) of the Code, the pooling of assets associated with Plan C with the assets associated with Plan A and Plan B in Trust D will not result in Plan C failing to satisfy the requirements of section 403(b) of the Code.

The final ruling requested is, assuming that Plan A otherwise satisfies the requirements of sections 401(a) and 401(k), that the elective contributions made by its participants in the manner represented will not constitute “wages” subject to income tax withholding under section 3402 of the Code.

Federal income tax withholding under section 3402(a) is imposed on “wages” as defined in section 3401(a). The term “wages” is defined generally as including all remuneration for services performed by an employee for his or her employer, with certain specified exceptions.

Section 3401(a)(12)(A) provides an exception from wages for income tax withholding purposes for remuneration paid to, or behalf of, an employee or the employee’s beneficiary, from or to a trust described in section 401(a) which is exempt from tax under section 501(a) at the time of such payment unless such payment is made to an employee of the trust as remuneration for services rendered as such employee and not as a beneficiary of the trust.

Section 31.3401(a)(12)-1(a) of the regulations provides that the term “wages” does not include any payment made (1) by an employer, on behalf of an employee or his beneficiary, into a trust, or (2) to, or on behalf of, an employee or his beneficiary from a trust, if at the time of such payment the trust is exempt from tax under section 501(a) as an organization described in section 401(a).

The exception provided by section 3401(a)(12)(A) does not apply to amounts that are treated as employee contributions under the Code and are includible in the income of the employee prior to contribution to the qualified trust. Here the elective contributions to
Plan a are treated as employer contributions and are not includible in the income of the employee at the time the contributions would have been includible but for the cash or deferred election under section 401(k), or at the time contributed to the fund.

Based on the information provided and the representations made, we conclude as follows:

4. The elective contributions made on behalf of an employee under Plan A will not constitute wages subject to income tax withholding under section 3402. This ruling is based on the assumption that Plan A will otherwise be qualified under sections 401(a) and 401(k).

The Federal Insurance Contributions Act (FICA) tax consists of (1) the old-age, survivors and disability insurance tax imposed by sections 3101(a) and 3111(a), which is referred to as “social security tax” in IRS publications and forms; and (2) the hospital insurance tax imposed by sections 3101(b) and 3111(b), which is referred to as Medicare tax.

FICA tax is imposed on wages, as that term is defined in section 3121(a). Section 3121(a) defines the term “wages” for FICA purposes as all remuneration for employment unless specifically excepted. The term “employment” is defined in section 3121(b).

Section 3121(b)(7) contains various rules that apply in determining whether services for state or local governmental entities are considered “employment” for purposes of the social security tax portion of the FICA. Section 3121(b)(7)(E) provides that if services are covered under an agreement between the State and the Social Security Administration under section 218 of the Social Security Act (“section 218 agreement”), the services are included in employment for purposes of the social security tax. If the services are not covered under a section 218 agreement, the services may nevertheless be employment for purposes of the social security tax depending upon the applicability of the various subparagraphs of section 3121(b)(7). If the services for the state or local governmental entity are included in employment for purposes of the social security tax, the services are also included in employment for purposes of the Medicare tax. If the services are excepted from employment by section 3121(b)(7) for social security tax purposes, section 3121(u) generally provides that such services are nevertheless employment for Medicare tax purposes unless the “continuing employment exception” applies.

Section 3121(v)(1)(A) of the Code provides that nothing in any paragraph of subsection (a) (other than paragraph (1)) shall exclude from the term “wages” any employer contribution under a qualified cash or deferred arrangement (as defined in section 401(k)) to the extent not included in gross income by reason of section 402(e)(3).

Based on the above, we also conclude as follows:

5. The elective contributions made on behalf of an employee to Plan A are subject to social security taxes unless the services of the employee are excepted from employment by section 3121(b)(7) or unless remuneration equal to the contribution and benefit base has been paid to the employee during the calendar year by that employer. The elective contributions to Plan B are subject to Medicare taxes unless the continuing employment exception provided under section 3121(u) is applicable to the services of the employee. If the services of the employee are covered under a section 218 agreement, the elective contributions to Plan B are subject to social security tax (unless wages equal to the contribution and benefit base have been paid to the employee during the calendar year) and Medicare tax.

This ruling letter is directed only to State X and the participants of State X's Plan and applies only to the Plans and Trusts originally submitted and revised, including the amended plans submitted. Section 6110(k)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion in the ruling. See section 12.04 of Rev. Proc. 2002-1, 2002-1 I.R.B.1, 50. However, when the criteria in section 12.05 of Rev. Proc. 2002-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely yours,

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Enclosure:
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