

200410023



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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEC 12 2003

UICs: 402.01-01
402.07-00
72.20-00
72.20-01

T:EP:RA:T3

LEGEND:

Taxpayer A:

Company B:

Plan X:

State W:

Date 1:

Date 2:

Quantity C:

Value E:

Value F:

Value H:

Value I:

Dear Mr.

This is in response to the _____, letter submitted on your behalf by your authorized representative, as supplemented by correspondence dated _____, and in which you request several letter rulings under sections 402(e)(4)(B) and 72(t)(2)(A) of the Internal Revenue Code. The following facts and representations support your ruling request.

Taxpayer A, a resident of State W, whose date of birth was Date 1, 1941, has attained age 59 %. Taxpayer A is currently employed by Company B as its President and Chief Executive Officer. Taxpayer A does not intend to terminate employment with Company B.

Company B sponsors Plan X, a profit sharing plan which your authorized representative is qualified within the meaning of Code section 401(a). Your authorized representative has also

asserted that Plan X's trust is tax exempt under Code section 501(a). Plan X is authorized to hold employer securities. The provisions of Plan X provide that a plan participant who has attained age 59 ½ may elect to receive a distribution of up to his entire Plan X account balance without electing to terminate employment with Company B. The provisions of Plan X also provide for the direct rollover of Plan X distributions into one or more "eligible retirement plans".

As of Date 2,2002, Taxpayer A held Quantity C shares of Company B common stock in Plan X. His shares of Company B stock were valued at Value E per share as of that date. The total value of Taxpayer A's shares of Company B stock was Value F of which Value H represented his total cost basis as calculated under section 1.402(a)-1(b)(2)(ii) of the income Tax Regulations. In addition to his Company B common stock, Taxpayer A's investment in Plan X consists of cash and other securities with a value as of Date 2,2002 of Value I.

Taxpayer A is a participant in Plan X and intends to receive a single sum distribution of the full amount standing to his credit under Plan X no later than December 31, 2004.

Taxpayer A intends to directly transfer into an individual retirement arrangement set up and maintained in his name, by means of a trustee to trustee transaction, the portion of his Plan X distribution that consists of cash and non Company B stock. None of his Company B stock will be transferred into his IRA.

Based on the above facts and representations, you, through your authorized representative, request the following letter rulings:

1. The Net Unrealized Appreciation (NUA), within the meaning of Code section 402(e)(4)(B), is the difference between the cost basis and the fair market value of the non-rollover shares of Company B stock as of the Distribution Date. Taxpayer A will not, therefore, under Code section 402(e)(4)(B), recognize ordinary income on the non-rollover portion of his Plan X distribution which represents the NUA;
2. Any taxable gain on the subsequent sale of the non-rollover shares will be treated as capital gain income on the sale of a capital asset held in excess of 12 months to the extent of the original NUA regardless of the time period between the sale date and the Distribution Date. Post-distribution gain in excess of the amount of NUA will be taxed at the applicable capital gain rate based on the holding period of the stock from the Distribution Date to the sale date; and
3. No portion of the Plan X distribution will be subject to the 10 percent additional income tax imposed on early distributions in accordance will Code section 72(t)(1) because Taxpayer A meets the exception under Code section 72(t)(2)(A)(i) for distributions made to an individual after attaining age 59 ½.

With respect to your initial ruling request, Code section 402(a) provides that an amount actually distributed to a taxpayer by a trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to the taxpayer in the year of distribution except as otherwise provided in section 402.

Code section 402(e)(4)(D) provides, in pertinent **part**, that the term "lump sum distribution" means the distribution or payment, within one taxable year of the recipient, of the balance to the credit of the employee which becomes payable (II) after the employee attains age 59 ½ or (III) on account of the employee's separation from service, from a trust which forms part of a plan described in Code section 401(a) and which is exempt from tax under Code section 501(a).

Code section 402(c)(1), in general, provides rules governing a qualified plan distribution's exclusion from income if it is properly rolled over into an eligible retirement plan.

Code section 402(c)(4) provides that the term "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified trust except the following distributions:

- (A) any distribution which is one of a series of substantially equal periodic payments (not less frequently than annually) made-
 - (i) **for** the life (or life expectancy) **of** the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or
 - (ii) for a period of 10 years or more,
- (B) any distribution to the extent the distribution is required under section 401(a)(9), and
- (C) any distribution which is made upon hardship of an employee.

Section 402(c)(8)(B) of the Code, in part, defines eligible retirement plan as (i) an individual retirement account described in section 408(a), (ii) an individual retirement annuity described in section 408(b) (other than **an** endowment contract), (iii) a section 401(a) of the Code qualified retirement plan, and (iv) an annuity plan described in section 403(a).

Section 402(c)(3) of the Code provides, generally, that section 402(c)(1) shall not apply to any transfer of a distribution made after the 60th day following the day on which the distributee received the property distributed.

Section 401(a)(31)(A) of the Code provides that a trust shall constitute a section 401(a) qualified trust only if the plan of which such trust is a part provides that if the distributee of any eligible rollover distribution-

(i) elects to have such distribution paid directly to an eligible retirement plan, and

(ii) specifies such eligible retirement plan to which such distribution is to be paid (in such form and at such time as the plan administrator may prescribe),

such distribution shall be in the form of a direct trustee-to-trustee transfer to the eligible retirement plan so specified.

Section 401(a)(31)(B) provides rules governing certain mandatory direct transfers to individual retirement plans.

Section 401(a)(31)(C) of the Code provides that subparagraphs (A) and (B) shall apply only to the extent that the eligible rollover distribution would be includible in gross income if not transferred as provided in subparagraph (A) (determined without regard to sections 402(c), 403(a)(4), 403(b)(8) and 457(e)(16)). However, the preceding sentence does not apply if the transferee plan is an eligible retirement plan described in either clause (i) or clause (ii) of section 402(c)(8)(B).

The term "eligible rollover distribution" when used in section 401(a)(31) of the Code has the same meaning as when used in section 402(c) of the Code.

The term "eligible retirement plan" when used in section 401(a)(31) of the Code includes IRAs defined in sections 408(a) and 408(b) of the Code.

Generally, a direct trustee-to-trustee transfer described in section 401(a)(31) of the Code constitutes a "direct rollover" of an "eligible rollover distribution" and is entitled to tax-deferred treatment pursuant to section 402(c) of the Code.

Section 1.401(a)(31)-1 of the Income Tax Regulations, Question and Answer 5, provides that an eligible rollover distribution that is paid to an eligible retirement plan in a direct rollover is not currently includible in the distributee's gross income under Code section 402(c).

Section 1.401(a)(31)-1 of the Income Tax Regulations, Question and Answer 14, provides, in pertinent part, that a direct rollover is a distribution and rollover of the eligible rollover distribution and not a transfer of assets and liabilities.

With respect to your ruling requests, Code section 402(e)(4)(B) provides that, for purposes of Code section 402(a), in the case of any lump sum distribution which includes securities of the employer corporation, there shall be excluded from *gross* income the net unrealized appreciation (NUA) attributable to that part of the distribution which consists of securities of the employer corporation.

Code section 402(e)(4)(C) provides that, for purposes of subparagraph (B), net unrealized appreciation and the resulting adjustments to basis shall be determined in accordance with regulations prescribed by the Secretary.

Section 1.402(a)-1(b)(2)(i) of the regulations provides that the amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust.

With respect to NUA, section 1.402(a)-1(b)(1)(i)(B) of the regulations provides, in pertinent part, that, in the case of a total distribution, the amount of NUA which is not included in the basis of securities in the hands of the distributee at the time of distribution shall be considered gain from the sale or exchange of a capital asset held for more than six months to the extent that such appreciation is realized in a subsequent taxable transaction. However, if the net gain realized by the distributee in a subsequent taxable transaction exceeds the amount of the NUA, such excess shall constitute a long-term or short-term capital gain depending upon the holding period in the hands of the distributee.

Notice 98-24, 1998-17 I.R.B. 5, provides, in relevant part, that the amount of NUA which is not included in the basis of the securities in the hands of the distributee at the time of distribution is considered a gain from the sale or exchange of a capital asset held for more than 18 months to the extent that such appreciation is realized in a subsequent taxable transaction. However, with respect to any further appreciation in the employer securities after distribution from the plan, the actual holding period in the hands of the distributee determines the capital gains rate that applies.

With respect to long-term capital gains treatment, Code section 1222(3) currently provides that the term "long-term capital gain" means gain from the sale or exchange of a capital asset held for more than 1 year.

In this case, Taxpayer A, who has not attained age 70 1/2, but who has attained age 59 1/2, intends to receive a single sum distribution of the full amount standing to his credit under Plan X in accordance with the provisions of Plan X. Taxpayer A's distribution will consist, in part, of securities of Company B.

Taxpayer A's distribution will be a "lump sum distribution" as that term is defined in Code section 402(e)(4)(D). Furthermore, neither the Code nor the regulations promulgated thereunder preclude a distribution from being treated as a lump sum distribution under Code section 402(e)(4)(D) even if a portion of the distribution is either rolled over or directly transferred into an IRA.

As noted above, the portion of Taxpayer A's Plan X distribution that consists of cash and non Company B stock will be directly transferred, by means of a trustee to trustee transfer, into an IRA set up and maintained in his name. Since the transfer will constitute a mechanism to defer taxation on the portion transferred, said transferred portion does not constitute an amount taxed to Taxpayer A in the year of distribution from Plan X. Taxpayer A will retain the Company B securities portion of his Plan X distribution.

The authorities cited above indicate that a distributee who receives a lump sum distribution from a qualified plan which includes securities of the sponsoring employer may exclude from immediate taxation the **full** amount of the net unrealized appreciation attributable to said securities,

Thus, with respect to your first and second ruling requests, we conclude as follows:

1. The Net Unrealized Appreciation (NUA), within the meaning of Code section 402(e)(4)(B) is the difference between the cost basis and the fair market value **of** the non-rollover shares of Company B as of the Distribution Date. Taxpayer **A** will not, therefore, under Code section 402(e)(4)(B), recognize ordinary income on the non-rollover portion of his Plan X distribution which represents the NUA;
2. Any taxable gain on the subsequent sale of the non-rollover shares will be treated as long term capital gain income on the sale of a capital asset held in excess of the long-term holding period (currently 1 year) to the extent of the original NUA regardless of the time period between the sale date and the Distribution Date. Post-distribution gain in excess of the amount of NUA will be taxed at the applicable capital gain rate based on the holding period of the stock from the Distribution Date to the sale date.

With respect to your third ruling request, Code section 72(t)(1) provides, in summary, that if any taxpayer receives any amount from a retirement plan qualified within the meaning of Code § 401(a), then the taxpayer's tax under this chapter for the taxable year in which such amount is received shall be increased by an amount equal to 10 percent of the portion **of** such amount which is included in gross income.

Code section 72(t)(2) provides several exceptions to the additional 10 percent income tax imposed by Code section 72(t)(1). One exception is found at subparagraph(A)(i) of section

72(t)(2) which provides that the tax will not be imposed on a distribution made on or after the date on which the employee-recipient attains age 59 ½.

In this case, Taxpayer A attained age 59 ½ during calendar year 2000. He will receive a single sum distribution of his Plan X account balance no later than December 31, 2004.

Based on the above facts and representations, we conclude with respect to your third ruling request as follows:

3. No portion of the Plan X distribution will be subject to the 10 percent additional income tax imposed on early distributions in accordance with Code section 72(t)(1) because Taxpayer A meets the exception under Code section 72(t)(2)(A)(i) for distributions made to an individual after attaining age 59 ½.

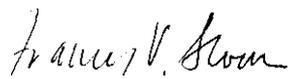
This letter ruling assumes that Taxpayer A's Plan X distribution will be made in accordance with the terms of Plan X. It also assumes that Taxpayer A's IRA, referenced above, will meet the requirements of Code section 408(a).

Pursuant to a power of attorney on file with this office, the original of this letter is being sent to your authorized representative.

200410023

This letter is directed only to the taxpayer that requested it and is based solely on the representations made with respect thereto. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,



Frances V. Sloan
Manager, Employee Plans
Technical Group 3

Enclosures:

Deleted copy of letter ruling
Form 437