Revenue Ruling **81-135**
Internal Revenue Service
1981-1 C.B. 203

26 CFR 1.402(a)-1: Taxability of *beneficiary under a trust which meets the requirements* of *section 401(a).*
(Also Section 401; 1.401-4.)

Lump sum distribution; termination; plan not in effect ten years; guaranteed repayment. A lump sum distribution paid to one of the 25 highest paid employees participating under a qualified pension plan before the plan has been in existence for ten years is entitled to special lump sum tax treatment where an agreement between the participant and the trustee guarantees repayment should the plan terminate within the first ten years or if the full current costs of the plan are not met at any time during this period. Rev. Rul. 61-10 superseded.

Rev. Rul. 81-135

The purpose of this revenue ruling is to restate the position of Rev. Rul. 61-10, 1961-1 C.B. 143, in view of the amendment of section 402 of the Internal Revenue Code by the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

Rev. Rul. 61-10 involved the questions of whether a distribution constitutes a lump sum distribution under a comparable provision to section 402 (e) (4) (A) of the Code under the circumstances described below, and second, whether the described distribution will satisfy the early termination requirements of section 1.401-4(c) of the Income Tax Regulations.

An employer established a pension plan for the benefit of its employees. The plan contained language requiring that certain limitations be placed on employer contributions used for the benefit of any of the 25 highest paid employees during the first ten years after establishment of the plan, to meet the requirements of section 1.401-4(c) of the regulations.

An employee who was one of the 25 highest paid employee participants in the plan, separated from service with the employer, before the plan had been in existence for ten years. The employee who was 100 percent vested, but for the high-25 restrictions, received a distribution the day after separation from service of the total accrued benefit of the employee. Prior to separation from service, the employee entered into an agreement with the plan administrator to the effect that in the event the

plan terminates within the first ten years of its establishment, or a default occurs in the payment of the full current costs of the plan for any year ending within the first ten years after establishment of the plan, the distributee (or, in the case of the distributee's death, the distributee's estate) would repay to the plan a sum equal to the actuarial value of the amounts by which the distributee's monthly retirement income benefits under the plan would have been decreased during the distributee's then remaining lifetime pursuant to the provisions of the plan which give effect to the principles of section 1.401-4(c) (2) of the regulations.

In order to guarantee the repayment of any amount required to be repaid under the agreement, the distributee agreed that promptly after the distribution the distributee would deposit with an acceptable depositary property having a fair market value equal to 125 percent of the amount which would be repayable if the plan had terminated on the date of distribution. The distributee further agreed that, if the market value of the property held by the depositary falls below 110 percent of the amount which would be repayable if the plan were then to terminate, additional property necessary to bring the value of the property held by the depositary up to 125 percent of such amount would be deposited.

The distributee has the right to receive any income from the property placed on deposit subject to the obligations to maintain the value of the property as described.

The depositary may not redeliver any property held under the agreement to the distributee (or the estate) except upon receipt of a certification by the plan administrator that the distributee (or the estate) is no longer obligated to repay any amount under the agreement.

Section 402 (e) (4) (A) of the Code generally defines a lump sum distribution as payment within one taxable year of the recipient of the balance to the credit of an employee on account of the employee's separation from service or death, or after the employee has become disabled or attained age 59 1/2, from a plan described in sections 401 (a) or 403(a) of the Code.

In this situation, the employee's accrued benefit was paid on one day on account of the employee's separation from service. The accrued benefit equals the balance to the credit of the employee. The fact that certain amounts may have to be repaid at a future date does not affect this conclusion.

Accordingly, the distribution will be considered a lump-sum distribution, within the meaning of section 402(e) (4) (A) of the Code.

With respect to the second issue, section 1.401-4(c) (1) of the regulations provides that a pension plan qualified under section 401 (a) of the Code must expressly incorporate provisions which comply with section 1.401-4 (c) (2) of the regulations at the time the plan is established, unless such provisions are not necessary to prevent the prohibited discrimination that may occur in the event of any early termination of the plan or a default in payment of the full current cost of the plan within the first ten years after its establishment.

Section 1.401-4 (c) (2) of the regulations requires that certain limitations be placed on employer contributions used for the benefit of any of the 25 highest paid employees, at the time the plan is established, during the first ten years after the plan's establishment.

In this case, it is apparent that adequate precautions have been taken to secure the repayment to the plan of any amounts distributed in excess of the restrictions contained in section 1.401-4(c) (2) of the regulations should termination or default in payment of the full current cost of the plan occur.

Accordingly, this distribution from the plan does not violate the requirements of section 1.401-4(c) of the regulations.

Rev. Rul. 61-10 is superseded because the position stated therein is restated under current law in this revenue ruling.