Written Determination
Number: 8125016
Internal Revenue Service
March 24, 1981

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In a letter dated August 13, 1980, as supplemented by subsequent letters, your authorized representative requested rulings on your behalf concerning the federal income tax consequences to participating employees of the distribution options available to them in conjunction with the termination of Plan X.

The individuals who participate in Plan X are employees of the sponsoring employers: Corporations M, N and O. Plan X is a trusteed defined benefit pension plan established effective July 1, 1949, for employees of Corporations M, N and O. Effective July 1, 1976, Plan X was amended to comply with requirements of the Employee Retirement Income Security Act of 1974 (ERISA). A favorable determination of Plan X’s continued qualification as amended was issued by the appropriate District Director on February 25, 1977. Effective July 1, 1978, additional amendments were made to bring Plan X into compliance with final regulations. A request for determination of Plan X's continued qualification, as amended, was filed on June 25, 1979, with the appropriate District office under the Special Reliance Procedure. The application has been reviewed and greement has been reached with respect to additional amendments to be made, but the determination letter has not yet been issued.

On March 14, 1980, Corporations M, N and O acted to terminate Plan X. A Notice of Intent to Terminate was filed with the Pension Benefit Guaranty Corpotion (PBGC) on May 21, 1980. The PBGC tentatively established June 30, 1980, as the plan termination date. In a telephone conversation on September 12, 1980, between a member of this office and your authorized representative, we were told that the Notice of Sufficiency has been issued. A request for determination of the continued qualification of Plan X upon termination was filed with the appropriate District office on June 4, 1980. Additional information was requested by the reviewing office and has been provided. The determination letter on the Plan X termination has not yet been issued.

Effective July 1, 1980, Corporations M, N and O are adopting Plan Y, a multiple employer, defined benefit pension plan.

Plan X has been funded exclusively by the purchase of individual endowment and retirement income contracts satisfying the requirements of Internal Revenue Code section 412(i). Under the terms of Plan X, the accrued benefit of each participant at any date prior to normal retirement age is equal to the cash surrender value of the insurance contracts purchased on behalf of the participant for purposes of providing retirement benefits under Plan X. Plan X is funded by employer and mandatory employee contributions.

In conjunction with the Plan X termination, participants will be offered three options with respect to distribution of their vested accrued benefits:

(i) Single sum cash distributions,

(ii) Transfer of all or part of their accrued benefit to Plan Z, or

(iii) Assignment of insurance contracts to the participants.

The election is to be made in writing on a form provided by the Plan X administrator and will be irrevocable once made. No distribution is to be made to any participant until a Notice of Sufficiency has been issued by PBGC, a determination of Plan X's continued qualification has been issued by the District Director, and the participant has completed an election form and filed it with the Plan X administrator. Amounts transferred to Plan Z will be distributable at a future time (death, disability, retirement, other termination of employment, or withdrawal) under the distribution and withdrawal provisions of Plan Z.

Effective July 1, 1980, employers maintaining the terminated Plan X will adopt Plan Y, a master or prototype defined benefit pension plan. Effective July 1, 1980, participants in the terminating Plan X will be participants accruing benefits under Plan Y.

Participants in the terminating Plan X also participate in Plan Z, a thrift plan to which only employee contributions are made. Plan Z has been determined by the District Director to be a qualified plan. Determination letters were issued on the plan October 31, 1978, and April 10, 1979.

Plan X provides that dividends payable on insurance contracts are to be paid to the trustee to be held in a general fund and applied to reduce the subsequent year's premiums. Since Plan X has been terminated, no premiums will be payable next year. It is proposed that Plan X be amended to provide that dividends payable after the date of termination be allocated directly to each contract on which dividends are payable, thus increasing the cash surrender value and termination distributions payable to the participants.

All contracts that fund Plan X benefits carry special endorsements providing the contracts are nontransferable if they are distributed to a plan participant. All contracts contain a life insurance element in the form of a pre-retirement death benefit.

Many Plan X participants have satisfied the age and service requirements for early retirement under Plan X. Some of these participants are proposing to take their termination distributions by electing to have the retirement income and endowment policies purchased to fund their benefits under Plan X assigned to them for the purpose of electing immediate commencement of annuity payments under any one of the settlement options available under the contracts. Under the terms of the contracts, election of current payment under any one of the settlement options would terminate the life insurance protection provided in the form of a pre-retirement death benefit equal to the face amount of the contract. The amount payable under any of the settlement options is determined by the cash surrender value of the contracts and the annuity purchase reates specified in the contracts at the time payment commences.

Plan Z has been determined by the appropriate Key District to be a qualified plan under Code section 401(a). Determination letters were issued to sponsoring employers on October 31, 1978, and April 10, 1979. Corporation O, a sponsoring employer of the terminating Plan X, is also a sponsoring employer in Plan Z and received a determination letter issued April 10, 1978. Both Plan X and Plan Z are to be amended to permit participants to direct the trustee to transfer all or part of their interest in Plan X to Plan Z where it will be held in a separate account in the name of the participant.

In accordance with the foregoing, rulings are requested as follows:

1. Participants entitled to termination distributions will not be deemed in constructive receipt of their interests in Plan X merely because each participant is allowed to make an irrevocable election among several distribution options one of which is a single payment in cash.

2. Termination distributions made as single cash payments will be qualifying rollover distributions within the the meaning of Code section 402(a)(5)(D)(i)(I).

3. Under the aggregation rules of Code section 402(e)(4)(C), Plan Y and Plan X will be considered a single plan for purposes of determining whether termination

distributions are lump sum distributions within the meaning of Code section 402(e)(4)(A).

4. Under the aggregation rules of Code section 402(e)(4)(C), Plan Z and Plan X will not be considered a single plan for purposes of determining whether termination distributions are lump sum distributions within the meaning of Code section 402(e)(4)(A).

5. Allocation of dividends payable after Plan X terminates to the contracts on which the dividends are payable will not violate the requirement that plan benefits be definitely determinable and will satisfy the requirement of Income Tax Regulations section 1.401-6(a)(2) that a terminating plan provide for the allocation of any previously unallocated funds.

6. A participant electing to take his termination distributions in the form of assignment of the retirement income and endowment contracts purchased to fund his benefits under Plan X will be deemed to have converted such contracts into nontransferable annuity contracts under which no part of any proceeds payable on death would be excludable from income under Code section 101(a), if within 60 days of receiving the contracts he elects to begin receiving benefits under the contracts immediately under any of the settlement options available under the contracts.

7. P.S.-58 costs that were taxable as income to the participant will be considered employee contributions for purposes of applying the Code section 72 employee contribution recovery rules to payments made under the contracts to participants who elect to take termination distribution in the form of assignment of the endowment and retirement income contracts purchased to fund their Plan X benefits and elect to have the payment of benefits commence immediately under the settlement options available under such contracts.

8. If a participant makes an individual retirement account (IRA) rollover contribution or elects to transfer to Plan Z an amount less than his total interest in Plan X, the amount not rolled over or transferred and distributed to him in cash will be includible in taxable income only to the extent it exceeds the amount of the employee contributions made by the participant to Plan X.

9. For purposes of computing the amount of a termination distribution that is excludable from income as a return of employee contributions under Code section 72, retirement income or endowment contracts assigned to the participant may be deemed to be a return of employee contributions in the amount of their cash surrender value that is not in excess of the contributions made by the participant to Plan X.

10. For purposes of computing the portion of a termination distribution that is excludable as a return of employee contributions, the P.S.-58 costs the participant reported as income on any contract actually assigned to the participant will be considered recoverable employee contributions whether the participant elects an immediate payout under one of the settlement options, or takes assignment of contracts as a nontaxable return of employee contributions to the extent of their cash surrender value and holds the contracts until they mature.

11. Election by a participant to have all or part of his interest in Plan X transferred by the trustee to Plan Z will not cause the amounts transferred to be considered made available or distributed to the participant.

12. Employee as well as employer contributions may be transferred to Plan Z without regard to the 10 percent limit on voluntary employee contributions, and transferred amounts will be considered rollover amounts within the meaning of Code section 415(c)(2).

With regard to ruling request 1, section 402(a)(1) of the Code states, in part, that the amount actually distributed or made available to any distributee by an employees' trust described in section 401(a), which is exempt from tax under section 501(a), shall be taxable to him in the year in which so distributed or made available. Therefore, under section 402(a)(1) of the Code, in some circumstances a participant in a qualified plan will be subjected to tax on his interest in a trust in a year even if such interest is not actually distributed to him in that year, if his interest is made available to him.

Revenue Ruling 55-317, 1955-1 C.B. 329, defines the term "made available." Rev. Rul. 55-317 states, in part, that an amount which is credited to the account of or set apart for a taxpayer and which may be drawn upon by him at any time is subject to tax for the year during which so credited or set apart although not then actually reduced to possession. To be made available, the amount must be credited to or set apart for the taxpayer without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that it may be drawn at any time, and its receipt brought within his own control and disposition.

Rev. Rul. 55-423, 1955-1 C.B. 41, provides examples of two classes of substantial conditions on an amount payable to a plan participant. The two general classes are penalties for withdrawal and the requirement that a prior irrevocable election be made to defer distribution to a fixed or determinable future time.

In a deferment by prior election, if the trust indenture or the plan of which it is a part provides for an irrevocable election by the employee, prior to the time his interest becomes distributable to him, to have distribution of such interest deferred to a fixed or determinable future time (such as 10 years or upon his prior retirement, severance of employment, death, or disability), his interest is not made available prior to such time or occurrence of any of the events enumerated. So long as the employee's election to defer the actual receipt of a distribution is irrevocable, it is immaterial whether the exercise of the election is in the form of positive action or merely Inaction on the part of the employee.

In the instant case, Plan X participants have a right to receive a single sum distribution of their account balances if they make a prior irrevocable election pursuant to the amendment to Plan X and the election form. Participants who do not elect to receive a distribution of their account balances make a prior irrevocable election to either 1) transfer all or a portion of their account balances to Plan Z, and thereby defer distribution until death, disability, retirement, termination of employment, or withdrawal, or 2) have their insurance contracts transferred to them.

Therefore, with regard to ruling request 1, we conclude that participants entitled to termination distributions will not be deemed to have made available to them their interests in Plan X merely because each participant is allowed to make a prior irrevocable election, among several distribution options, to receive a single payment in cash or to defer payment to a future fixed or determinable time.

Section 4041 of ERISA provides rules with respect to which benefits are guaranteed by the PBGC upon the termination of a qualified plan.

Code section 401(a)(7) states that a trust shall not constitute a qualified trust unless the plan of which such trust is a part satisfies the requirements of Code section 411 (relating to minimum vesting standards).

Code section 411(d)(3) states that in order for a trust to satisfy the requirements of Code section 401, the plan of which such trust forms a part must expressly provide that, upon the termination or partial termination of the plan or, in the case of a plan to Which Code section 412 does not apply, upon the complete discontinuance of contributions under the plan, the rights of each affected employee to benefits accrued to the date of such termination, partial termination, or discontinuance, to the extent funded as of such date, or the amounts credited to the employee's account, must be nonforfeitable.

Income Tax Regulations section 1.411(d)-2(c) states that a plan which falls under the jurisdiction of the PBGC is considered terminated on a particular date if, as of that date, the plan is voluntarily terminated by the plan administrator under section 4041 of ERISA, or the PBGC terminates the plan under section 4042 of ERISA.

Thus, if there is a plan termination for PBGC purposes, there is also a plan termination for purposes of section 402 of the Code.

Section 402(a)(5) of the Code provides that if the balance to the credit of an employee in a qualified trust is paid to him in a qualifying rollover distribution, and the employee transfers any portion of the property he receives in such distribution, within 60 days of receipt by the employee, to an eligible retirement program, then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid. The term "qualifying rollover distribution" means one or more distributions within one taxable year of the employee, for example, on account of a termination of the plan of which the trust is a part.

The aggregation rule of Code section 402(e)(4)(C) and the five year minimum participation rule of Code section 402(e)(4)(H) do not apply for purposes of determining whether distributions made on account of plan termination are eligible to be rolled over.

Therefore, we conclude, with regard to ruling request 2, that termination distributions made as single cash payments will be qualifying rollover distributions, within the meaning of Code section 402(a)(5)(D)(i)(I).

Section 1.401-1(b)(1) of the Regulations describes the types of retirement plans. Section 1.401-1(b)(1)(ii) states, in part, that a profit-sharing plan is a plan established and maintained by an employer to provide for the participation in his profits by his employees. Section 1.401-1(b)(1)(iii) defines a stock bonus plan as a plan established and maintained by an employer to provide benefits similar to that of a profit-sharing plan, except that the contributions by the employer are not necessarily dependent upon profits and the benefits are distributable in stock of the employer company. Rev. Rul. 71-256, 1971-1 C.B. 118, further explains that in order for a plan to be a stock bonus plan, the entire distribution (except for the value of a fractional part of a share) must be in stock of the employer corporation.

Section 1.401-1(b)(1)(i) of the Regulations defines a pension plan as a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. A plan designed to provide benefits for employees or their beneficiaries to be paid upon retirement or over a period of years after retirement will, for the purposes of section 401(a) of the Code, be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits, or as in the case of money purchase pension plans, such contributions are fixed without being geared to profits.

The following revenue rulings describe the forms a pension plan can take. In Rev. Rul. 66-205, 1966-2 C.B. 119, an employer established a plan under which the only contributions permitted to be made to the trust were employee contributions deducted from each employee's wages by the employer at the rate of X cents an hour. It was held that the fact that contributions to an employees' trust are limited to those of employees will not, of itself, preclude the qualification of the trust under section 401(a) of the Code, so long as the trust forms part of a pension plan.

In Rev. Rul. 74-385, 1974-2 C.B. 130, a money purchase pension plan provided for employee contributions which could vary year by year depending on the rate at which participants elect to contribute. Employer contributions were geared to the employee contributions. It was held that so long as the contributions are not subject to the discretion of the employer, this pension plan meets the requirement of definitely determinable benefits of section 1.401-1(b)(1)(i) of the Regulations.

Section 4.1 of Plan Z provides that participants shall make plan contributions by payroll deduction. Each member designates the amount of his contribution, from 2 to 10 percent of his annual compensation. Section 4.4 states that participating employers are not allowed to make contributions to Plan Z. Therefore, Plan Z cannot be characterized as a profit-sharing plan or a stock bonus plan because no employer contributions can be made to the plan. A lack of employer contributions is not a bar to the characterization of Plan Z as a pension plan, pursuant to Rev. Rul. 66-205. Rev. Rul. 74-385 indicates that plan benefits are definitely determinable even though employee contributions may vary. Thus, Plan Z is a pension plan, as are Plans X and Y.

A lump sum distribution, within the meaning of section 402(e)(4)(A) of the Code, is given special tax treatment under several methods, whether received by the employee or his beneficiary.

The term "lump sum distribution" means the distribution or payment, within one taxable year of the recipient, of the balance to the credit of an employee which becomes payable to the recipient, for example, on account of the employee's separation from service or after the employee has attained age 59 1/2.

Section 402(e)(4)(C) of the Code states, in pertinent part, that for purposes of determining the balance to the credit of an employee under section 402(e)(4)(A), all pension plans maintained by the same employer shall be treated as a single plan, all profit-sharing plans maintained by the employer shall be treated as a single plan, and all stock bonus plans maintained by the employer shall be treated as a single plan.

In the case at hand, Plans X, Y and Z are pension plans. Therefore, with regard to ruling requests 3 and 4, we conclude that under the aggregation rules of Code section 402(e)(4)(C), Plans X, Y and Z will be considered a single plan for purposes of determining whether distributions are lump sum distributions within the meaning of Code section 402(e)(4)(A).

Section 3.01 of Revenue Procedure 80-24, 1980-26 I.R.B. 30, states that the National Office may issue rulings involving employee plans matters under section 401 through 415 of the Code, except as provided in section 3 of Rev. Proc. 80-30, 1980-26 I.R.B. 56. Section 3.01 of Rev. Proc. 80-30 provides that District Directors of key district offices shall issue determination letters involving the provisions of section 401 of the Code when there is a termination of a plan and trust. Therefore, we are unable to issue a ruling with regard to ruling request 5. However, we are providing you with the following general information.

Section 1.401-1(b)(1)(i) of the Regulations states that a qualified pension plan is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. Benefits are not definitely determinable if funds arising from forfeitures on termination of service, or any other reason, may be used to provide increased benefits for the remaining participants. The rules regarding forfeitures under a qualified pension plan are further explained in section 1.401-7 of the Regulations. This section provides that forfeitures arising from a severance of employment, death, or for any other reason, must not be applied to increase the benefits any employee would otherwise receive under the plan prior to the termination of the plan or the complete discontinuance of employer contributions.

Section 1.401-6(a)(2)(i) of the Regulations provides that a qualified plan must provide for the allocation of any previously unallocated funds to the employees covered by the plan upon the termination of the plan or the complete discontinuance of contributions under the plan.

Plan X has provided that dividends payable on insurance contracts are to be paid to the trustee to be held in a general fund and applied to reduce the subsequent year's premium payments by the employer. Since Plan X has been terminated, no premiums will be payable in the future. Therefore, it is proposed that Plan X be amended to provide that dividends payable after the date of termination be allocated directly to each contract on which dividends are payable, thus increasing the cash surrender value and termination distributions payable to the participants.

We note that dividends that are allocated to Plan X participants after the termination of Plan X are not derived from any participant's accrued benefits but, rather, stem from unallocated funds.

With regard to ruling request 6, section 1.402(a)-1(a)(2) of the Regulations provides that when a qualified trust distributes a retirement income, endowment, or other life insurance contract, the entire cash value of the contract at the time of distribution must be included in the distributee's income in accordance with Code section 402, except to the extent that, within 60 days after the distribution of such contract, all or any portion of such value is irrevocably converted into a contract under which no part of any proceeds payable on death at any time would be excludable under Code section 101(a) (relating to life insurance proceeds).

In Rev. Rul. 66-322, 1966-2 C.B. 123, retirement income contracts were received by a distributee from a qualified employees' pension trust. At the time the contracts were distributed by the trustee to the distributee, the cash surrender value or reserve payable as death benefits exceeded the stated face amount of the contracts. This Revenue Ruling went on to say that the mere fact that such a contract may contain provisions permitting the application or the conversion of its reserve (the cash value or the maturity value), to provide annuity benefits does not make such a contract an annuity contract, unless, and until, such conversion takes place. Rev. Rul. 66-322 held that the mere elimination of the risk factor, i.e., that the reserve exceeded the face amount of the contract, is not considered to be a conversion of the insurance contract into an annuity contract for purposes of section 1.402 (a)-1(a)(2) of the Regulations.

In the case at hand, the retirement income and endowment policies used to fund Plan X provide that pursuant to an election upon maturity and termination of the policy for its net cash value on any policy anniversary date, policy proceeds may be placed under any one of the several settlement options. These options provide for various types of installment payments. These insurance policies further state that, if the payee dies before receiving full payments under the settlement options which he has elected, a single sum payment shall be made to his executor. This payment shall be equal to the commuted value of any unpaid installments. Therefore, an election of current payment under the settlement options terminates the pre-retirement death benefit under the insurance contract. Rev. Rul. 66-322 is distinguishable because no attempt was made to apply the cash value of the retirement income contract to provide annuity benefits. Therefore, with regard to ruling request 6, we conclude that a participant electing to take his termination distributions in the form of assignment of the retirement income and endowment contracts purchased to fund his benefits under Plan X will be deemed to have converted such contracts into nontransferable annuity contracts under which no part of any proceeds payable on death would be excludable from income under Code section 101(a) if within 60 days of receiving the contracts he elects to begin receiving benefits under the contracts immediately under any of the settlement options available under the contract.

Section 72(f) of the Code provides that amounts contributed to an insurance contract by the employer but includible in the employee's gross income are to be considered the employee's contributions. In explaining Code section 72(f), Regulations section 1.72-8(a)(1) states that section 72(f) provides that, for purposes of sections 72(c), 72(d), and 72(e), amounts contributed by an employer for the benefit of an employee or his beneficiaries shall constitute consideration paid or contributed by the employee to the extent that such amounts are includible in the gross income of the employee. This applies to premiums paid by an employer or with trust assets for life insurance protection for an employee to the extent such premiums are includible in the gross income of the employee when paid.

Section **1.72-16** of the Regulations was promulgated under Code section 72(m)(3), relating to insurance contracts. Section **1.72-16**(b)(1) states, in general, that the rules found in section **1.72-16** apply to any life insurance contract purchased by a trust described in Code section 401(a), which is exempt from tax under Code section 501(a), if the proceeds of the contract are payable directly or indirectly to a participant in such trust. A payment of the proceeds of a life insurance contract to a participant will be considered an indirect payment where they are payable to the trustee but, under the terms of the plan, the trustee is required to pay over all of such proceeds to the participant.

Regulations section **1.72-16**(b)(2) states that if under a qualified plan or trust, amounts which were allowed as a deduction under section 404 are applied toward the purchase of a life insurance contract, the cost of the life insurance protection under such contract shall be included in the gross income of the participant for the taxable year or years in which such contributions are so applied.

However, section **1.72-16**(b)(4) of the Regulations provides that the amount includible in the gross income of the employee shall be considered as premiums or other consideration paid or contributed by the employee, but only with respect to any benefits attributable to the contract (within the meaning of section 1.72-2(a)(3) of the Regulations) providing the life insurance protection.

Although separately provided and funded retirement benefits and life insurance may be two separate programs of interrelated contributions and benefits under Regulations section 1.72-2(a)(3)(ii), retirement benefits and life insurance are considered part of a single separate program of interrelated contributions and benefits to the extent both are provided under one retirement income, endowment, or other contract providing life insurance protection.

In Rev. Rul. 67-336, 1967-2 C.B. 66, plan participants' lives were insured by life insurance policies purchased by the trustee. On or before a participant's retirement date, the trustee surrendered the life insurance policy on the participant's life for its cash value. Thereafter, the cash received upon the surrender of the insurance contract was used by the trustee to purchase for the participant an annuity contract. The Revenue Ruling held that the employee's consideration for the annuity contract does not include the portion of the premiums payable under the insurance policy and which were included in the employee's gross income.

In the case at hand, participants who elect to take assignment of the retirement income and endowment contracts and thereafter elect immediate payment under one of the contract settlement options will receive a distribution of the contract on which the P.S.-58 costs were paid. The form the distribution takes (the various settlement options) is immaterial as long as the distribution is attributable to the life insurance contract. Therefore, we conclude, with regard to ruling request 7, that P.S.-58 costs that were taxable as income to the participant will be considered employee contributions for purposes of applying the Code section 72 employee contribution recovery rules to payments made under the contracts to participants who (1) elect to take termination distribution in the form of assignment of the endowment and retirement income contracts purchased to fund their plan benefits and (2) elect to have the payment of benefits commence immediately under any of the settlement options available under such contract.

Section 402(a)(5) of the Code provides that if the balance to the credit of an employee in a qualified trust is paid to him in a qualifying rollover distribution, such as on account of plan termination, and within 60 days after the date of distribution the employee transfers any portion of the property he receives in such distribution to an eligible retirement plan, such as an IRA or another qualified trust, then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

Section 402(a)(1) of the Code provides that the amount actually distributed or made available to any distributee by an employees' trust described in section 401(a) which is exempt from tax under section 501(a) shall be taxable to him, in the year in which so distributed or made available, under section 72 (relating to annuities).

Section 1.72-1(a) of the Regulations provides, in general, that amounts subject to the provisions of section 72 are includible in the gross income of the recipient except to the extent that they are considered to represent a reduction or return of premiums or other consideration paid.

Further, section 1.72-1(b) provides that for the purpose of determining the extent to which amounts received represent a reduction or return of premiums or other consideration paid, the provisions of section 72 distinguish between "amounts received as an annuity" and "amounts not received as an annuity." In general, "amounts received as an annuity" are amounts which are payable at regular intervals over a period of more than one full year from the date on which they are deemed to begin, provided the total of the amounts so payable or the period for which they are to be paid can be determined as of that date. Any other amounts to which the provisions of section 72 apply, are considered to be "amounts not received as an annuity."

Section 1.72-11(b) of the Regulations, promulgated under section 72(e)(1)(B) of the Code, provides that if payments in the nature of a return of premiums or other consideration are received before the annuity starting date or before the date on which an amount is first received as an annuity, whichever is later, such payments are includible in the gross income of the recipient, but only to the extent that they, when taken together with all previous payments received under the contract which were excludable from the gross income of the recipient under the applicable income tax law, exceed the aggregate of premiums or other consideration paid or deemed to have been paid by the recipient. Such payments shall be subtracted from the consideration paid (or deemed paid) for the purpose of determining the tax consequences of subsequent distributions under the plan.

Therefore, we conclude, with regard to ruling request 8, that if a participant makes an IRA rollover contribution or elects to transfer to Plan Z an amount less than his total interest in Plan X, the amount not rolled over or transferred and distributed to him in cash will be includible in taxable income only to the extent it exceeds the amount of the employee contributions made by the participant to Plan X.

We wish to point out, as indicated above, that the amount of the P.S.-58 costs previously taxed to a participant are considered employee contributions within the meaning of Code section 402(a)(5)(B) and, thus, cannot be rolled over.

With regard to ruling request 9, we conclude that for purposes of computing the amount of a termination distribution that is excludable from income as a return of employee contributions under Code section 72, retirement income or endowment contracts assigned to the participant may be deemed to be a return of employee contributions in the amount of their cash surrender value that is not in excess of the contributions made by the participant to Plan X.

We also conclude, with respect to ruling request 10, that for purposes of computing the portion of a termination distribution that is excludable as a return of employee contributions, the P.S.-58 costs the participant reported as income on any contract actually assigned to the participant will be considered recoverable employee contributions whether or not the participant elects an immediate payout under one of the settlement options.

Rev. Rul. 68-160, 1968-1 C.B. 67, provides that the transfer of funds from one qualified trust to another qualified trust through the trustees of the plans does not result in funds being distributed or made available.

In the present case, the Termination Distribution Election Form provides that an employee may transfer 1) his or her entire account to Plan Z, 2) his or her taxable amount to Plan Z, or 3) his or her taxable amount plus any portion of the employee contributions. The transfer will be accomplished through the trustees of Plans X and Z.

Based on the foregoing, we conclude, with regard to ruling request 11, that election by a participant to have all or part of his interest in Plan X transferred by the trustee to Plan Z will not cause the amounts transferred to be considered made available or distributed to the participant.

Rev. Rul. 59-185, 1959-1 C.B. 86, provides that a qualified plan may permit voluntary employee contributions of up to 10 percent of compensation where such employee contributions do not affect the allocation of employer contributions.

Assuming the contributions by employees to Plan X previously met the restrictions of Rev. Rul. 59-185 when they were contributed, the amounts of such employee contributions transferred from Plan X to Plan Z will not be taken into account for purposes of computing the 10 percent limitation on voluntary employee contributions for the year in which the transfer occurs.

Section 415(c) of the Code permits annual contributions and other annual additions to defined contribution plans provided that certain limitations are not exceeded.

Subsection (2) defines an annual addition as the sum of employer contributions, forfeitures, and the lesser of an employee's contributions in excess of six percent of his compensation or one-half of the employee contribution.

The flush language of section 415(c) and of section 4.02 of Revenue Ruling 75-481, 1975-2 C.B. 188, which contains guidelines on section 415(c) limitations, indicates that "employee contributions" are determined without regard to any rollover contributions. The rationale for permitting exclusion of rollover contributions is that since the rollover amount was previously subjected to the section 415(c) limitation under a prior plan, a mere rollover of that amount from one plan to another plan does not affect the computation of the limitations. The same rationale applies to a trustee to trustee transfer of amounts under a qualified plan.

Where employer and employee contributions are taken into account under section 415 of the Code for limitation years under one plan and are merely transferred to another plan, the amounts transferred will not be taken into account as part of the current year's annual addition to the transferee plan for purposes of section 415(c).

Based on the foregoing, we conclude, with regard to ruling request 12, that (a) employee and employer contributions may be transferred to Plan Z without affecting the 10 percent limit on voluntary employee contributions for the year of transfer, and (b) transferred amounts will not be considered annual additions, within the meaning of Code section 415(c)(2), for the year of such transfer.

In accordance with a letter from your authorized representative, ruling request 13 has been withdrawn.

The above rulings are based on the assumption that Plans X, Y and Z will be qualified under section 401(a) of the Code and their related trusts will be tax-exempt under section 501(a) at the time the above transactions take place.

A copy of this letter has been sent to your authorized representative pursuant to instructions contained in a power of attorney on file in this office.