

Part I

Section 4980.--Tax On Reversion Of Qualified Plan Assets To Employer.

Rev. Rul. 2003-85

ISSUE

If a defined benefit plan is terminated, and an amount in excess of 25 percent of the maximum amount otherwise available for reversion is transferred from the terminating defined benefit plan to a defined contribution plan, what is the tax treatment of the amount transferred to the defined contribution plan and of any reversion to the employer from the terminating defined benefit plan?

FACTS

Company M maintains Plan A, a defined benefit plan qualified under § 401(a) of the Internal Revenue Code. On March 1, 2002, the Board of Directors of Company M adopted resolutions to terminate Plan A, effective July 1, 2002, and to adopt Plan B, a defined contribution plan. Company M did not amend Plan A in connection with the termination of the plan to provide for any increases in the accrued benefits of the participants.

All employees of Company M are eligible to participate in Plan B upon attainment of age 21 and completion of 1 year of service. Of the 1,000 participants with accrued benefits under Plan A that remained as employees of Company M as of July 1, 2002 (the termination date of Plan A), 95 percent were participants in Plan B on that date.

After satisfaction of all liabilities of Plan A, Company M could have received a reversion of \$60X of surplus assets (determined without regard to § 4980(d)). After satisfaction of all the plan liabilities and before taking a reversion of the surplus assets under Plan A, Company M transferred \$20X to Plan B. Plan B provides for the receipt and immediate allocation of excess assets in the form of a direct transfer from the terminating Plan A. The allocation of the excess assets will satisfy the requirements of §§ 401(a)(4) and 415.

LAW

Section 61 defines gross income as all income from whatever source derived (subject to certain exceptions). Section 111(a) provides that gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of the tax imposed by sections 1 through 1400L.

Section 4980(a) provides for a 20 percent excise tax on the amount of any reversion from a qualified plan. Section 4980(d)(1) provides, in pertinent part, that the excise tax under § 4980(a) is increased to 50 percent with respect to any employer reversion from a qualified plan unless the employer establishes or maintains a qualified replacement plan or the plan provides pro rata benefit increases described in § 4980(d)(3).

Section 4980(c)(2) generally defines “employer reversion” as the amount of cash and the fair market value of other property received (directly or indirectly) by an employer from the qualified plan.

Under § 4980(d)(2), a plan is a “qualified replacement plan” if it is established or maintained by the employer in connection with a qualified plan termination (replacement plan) and certain additional requirements are met. Under § 4980(d)(2)(A), in order for the replacement plan to be a qualified replacement plan, at least 95 percent of the active participants in the terminated plan who remain as employees of the employer after the termination are active participants in the replacement plan. Section 4980(d)(2)(C) provides rules for the allocation of the amount transferred.

Under § 4980(d)(2)(B), in order for the replacement plan to be a qualified replacement plan, a direct transfer must be made from the terminated plan to the replacement plan before any employer reversion, and the transfer must be in an amount equal to the excess (if any) of (I) 25 percent of the maximum amount the employer could receive as an employer reversion (determined without regard to § 4980(d)) over (II) the present value of the aggregate increases in the accrued benefits under the terminated plan of any participants or beneficiaries under a plan amendment which is adopted within 60 days before the plan termination and which takes effect immediately upon plan termination.

Section 4980(d)(2)(B)(iii) provides that, in the case of any amount transferred under § 4980(d)(2)(B)(i) from a terminated plan to a qualified replacement plan, such amount (I) shall not be includible in the gross income of the employer, (II) no deduction shall be allowable with respect to such transfer, and (III) such transfer shall not be treated as an employer reversion for purposes of § 4980.

HOLDINGS

1. Plan B is a qualified replacement plan for purposes of § 4980(d).
2. In accordance with § 4980(d)(2)(B)(iii), the direct transfer from Plan A to Plan B of \$20X, an amount that is at least 25 percent of the maximum amount which the employer could receive as an employer reversion, is treated as follows:
 - (a) the amount transferred is not includible in the gross income of the employer,
 - (b) no deduction is allowable with respect to the amount transferred, and
 - (c) the amount transferred is not treated as an employer reversion for purposes of § 4980.

3. The \$40X that the employer receives is subject to the 20 percent excise tax under § 4980(a) and is includible in income under § 61.

DRAFTING INFORMATION

The principal drafters of this revenue ruling are Steven Linder of the Employee Plans, Tax Exempt and Government Entities Division and Vernon Carter of the Office of the Division Counsel/Associate Chief Counsel (TEGE). For further information regarding this revenue ruling, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number) between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday. Mr. Linder may be reached at (202) 283-9888; Mr. Carter may be reached at (202) 622-6060. The telephone numbers in the preceding sentence are not toll-free.