

Internal Revenue Service

Number: **200521012**

Release Date: 5/27/2005

Index Number: 933.00-00, 3405.00-00,
6041.00-00, 6041A.00-00,
6047.00-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:INTL:BO1
PLR-155233-04

Date:
February 23, 2005

TY:

LEGEND

Plan A =

Plan B =

Company C =

Company D =

State E =

State F =

Date 1 =

Dear :

This is in response to a letter dated October 12, 2004, as supplemented by a letter dated January 14, 2005, requesting rulings on behalf of Plan A, Plan B, and Company C and its subsidiaries, including Company D, under sections 933, 3405, 6041, 6041A, and 6047 of the Internal Revenue Code.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

FACTS

Company C is incorporated in State E. Company D is a wholly owned subsidiary of Company C that is incorporated in State F. Company D's principal place of business is located in Puerto Rico. Company D has made an election to report its income separately as a "possession corporation" under section 936.

Prior to Date 1, Company C maintained Plan A, a U.S. qualified retirement plan under section 401(a) that covered employees of Company C and Company D who are employed in the United States and Puerto Rico. Effective on Date 1, Company D established Plan B, a profit sharing plan containing a cash or deferred arrangement, in Puerto Rico for the benefit of its employees in Puerto Rico. Assets attributable to participants resident in Puerto Rico were transferred from Plan A to Plan B. Plan B covers solely Puerto Rico residents, as that term is defined in Treas. Reg. section 1.501(a)-1(e). In addition, all participants in Plan B are and will at all relevant times be bona fide residents of Puerto Rico for purposes of section 933. All services giving rise to contributions to Plan B, including contributions that were transferred to Plan B from Plan A, have been and will be performed in Puerto Rico.

It is intended that Plan B remain a qualified plan under section 1165(a) and (e) of the Puerto Rico Internal Revenue Code, with a trust located in and established under the laws of Puerto Rico. Under section 1022(i)(1) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), the trust will be treated for purposes of section 501(a) as if it were an organization described in section 401(a). No election will be made under section 1022(i)(2) of ERISA to have the provisions of Title II of ERISA apply.

Under the current practice, distributions from Plan B to participants and beneficiaries are divided into two components: (i) the portion attributable to employee and employer contributions to Plan B ("Contributions"); and (ii) the portion attributable to earnings and accretions with respect to employee and employer contributions ("Earnings and Accretions"). The Earnings and Accretions portion is further divided into two subcomponents: (a) Earnings and Accretions that accrued on account balances prior to the time they were transferred from Plan A to Plan B ("Pre-Transfer Earnings and Accretions"), and (b) Earnings and Accretions that accrued on account balances on or after the time they were transferred to Plan B from Plan A ("Post-Transfer Earnings and Accretions").

The Contributions portion of each distribution from Plan B is treated as income derived from sources without the United States because the underlying services are performed by Plan B participants entirely in Puerto Rico. The Post-Transfer Earnings and Accretions portion of each distribution is treated as income derived from sources outside the United States because the situs of the trust for Plan B is Puerto Rico. Consequently, there is no withholding under section 3405 on the Contributions or Post-Transfer Earnings and Accretions portions of the distribution. Similarly, the reporting requirements under sections 3405, 6041, 6041A, and 6047 do not apply to the Contributions and Post-Transfer Earnings and Accretions portions of the distribution.

The Pre-Transfer Earnings and Accretions portion of each distribution from Plan B currently is treated as income derived from sources within the United States that is subject to withholding under section 3405 and reporting under sections 6041, 6041A, and 6047. Company D and Plan B propose to change the treatment of the Pre-Transfer Earnings and Accretions portion of the distribution. They plan to treat the Pre-Transfer Earnings and Accretions portion of the distribution as income derived from sources outside the United States.

RULINGS REQUESTED

The following rulings are requested:

- (1) The Pre-Transfer Earnings and Accretion portion of a distribution from Plan B to a participant who is bona fide resident of Puerto Rico constitutes income derived from sources within Puerto Rico for purposes of section 933;
- (2) No portion of a distribution from Plan B to a participant who is a bona fide resident of Puerto Rico will be subject to withholding under section 3405; and
- (3) No information return made either on Form 1099-R or any other form will be required to be filed with the U.S. Internal Revenue Service and no related statement will be required to be furnished to any Plan B participant who is a bona fide resident of Puerto Rico, in connection with any distribution from Plan B, pursuant to sections 6041, 6041A, or 6047(d).

LAW AND ANALYSIS

First ruling request

Section 933(1) provides that, in the case of an individual who is a bona fide resident of Puerto Rico during the entire taxable year, income derived from sources within Puerto Rico (other than amounts received for services performed as an employee of the United States or an agency thereof) is excluded from gross income and is exempt from tax under subtitle A of the Code, except that the individual is not allowed as a deduction from gross income any deductions (other than the deduction available under section 151, relating to personal exemptions) or any credit properly allocable or chargeable against amounts excluded from gross income under section 933(1).

Section 1.863-6 of the Income Tax Regulations provides that the principles applied for determining income from sources within and without the United States shall generally be applied for purposes of determining income from sources within and without a possession of the United States. For tax years beginning after October 22, 2004, see also section 937(b).

Sections 861 through 864 contain rules for sourcing income for services performed within and without the United States, but those sections contain no specific provision regarding the source of income from pensions.

Section 861(a)(3) provides that compensation for labor or personal services performed within the United States shall be treated as income from sources within the United States, and section 862(a)(3) provides that compensation for labor or personal services performed without the United States shall be treated as income from sources without the United States. Under section 863(b), income from services rendered partly within and partly without the United States is treated as derived partly from sources within and partly from sources without the United States.

Revenue Ruling 79-388, 1979-2 C.B. 270, provides rules for determining the source of distributions from a private employer's qualified pension plan that is located in the United States and pays benefits to a retired nonresident alien individual who earned the right to the payments by performing services both within and without the United States. The revenue ruling provides that such pension distributions must be allocated between United States and foreign source income as follows: (i) the portion of each distribution attributable to employer contributions with respect to services performed within the United States is income from United States sources; (ii) the portion of each distribution attributable to employer contributions with respect to services performed without the United States is income from foreign sources; and (iii) the portion of each distribution attributable to earnings on or accretions to employer contributions is income from United States sources.

The Court of Federal Claims upheld the Rev. Rul. 79-388 rule for sourcing the earnings and accretions portion of a distribution from a United States plan in Clayton v. United States, 33 Fed. Cl. 628 (1995), aff'd without published opinion, 91 F.3d 170 (Fed. Cir.), cert. denied, 519 U.S. 1040 (1996).

Section 501(a) provides, in relevant part, that an organization described in section 401(a) generally is exempt from income taxation. Section 1022(i)(1) of ERISA provides that for purposes of section 501(a), any trust forming part of a pension, profit-sharing, or stock bonus plan all of the participants of which are residents of Puerto Rico is treated as an organization described in section 401(a) if the trust both forms part of a pension, profit-sharing, or stock bonus plan and is exempt from income tax under the laws of Puerto Rico.

The trust that forms part of Plan B will be treated as an organization described in section 401(a) for purposes of section 501(a), provided that all of the participants are and continue to be residents of Puerto Rico and that Plan B is and continues to be tax exempt under the laws of Puerto Rico. Thus, distributions from Plan B to participants who are bona fide residents of Puerto Rico will be distributions from a trust that is exempt from United States income tax on the income from its United States investments. Under these circumstances, it is appropriate to source the earnings and

accretions portion of each distribution based on the situs of the trust at the time of the distribution.

Therefore, with respect to your first ruling request, we conclude that the Pre-Transfer Earnings and Accretions portion of a distribution from Plan B to a bona fide resident of Puerto Rico constitutes income derived from sources within Puerto Rico for purposes of section 933.

Second ruling request

Section 3405 generally provides that the payor of a designated distribution shall withhold from such payment a stated portion of such distribution. In the case where such designated distribution is a periodic payment or a nonperiodic payment (other than an eligible rollover distribution), the distributee may elect out of such withholding. Section 3405(e)(13) provides, in effect, that such election is available for any periodic or nonperiodic distribution that is to be delivered within any possession of the United States. However, in the case of any designated distribution that is an eligible rollover distribution, no such election is available, and the payor of such distribution shall withhold an amount equal to 20 percent of such distribution (unless the distributee elects to have the distribution directly rolled over to an eligible retirement plan). See section 3405(c) and section 35.3405(c)-1, Q&A-1 and Q&A-2 of the Treasury Regulations.

Section 3405(e)(10) and section 35.3405-1T, Qs&As D-1 through D-34, of the Temporary Employment Tax Regulations set forth various rules relating to the requirements and election procedures regarding elections out of withholding with which the payor must comply for periodic and nonperiodic payments as well as designated distributions generally.

Section 3405(e)(1)(A)(i) defines a "designated distribution" as any payment or distribution from or under an employer deferred compensation plan, an individual retirement plan, or a commercial annuity. Under section 3405(e)(1)(B)(ii), the term "designated distribution" does not include the portion of a distribution or payment that it is reasonable to believe is not includible in gross income. See section 35.3405-1T, Q&A A-2, of the Temporary Employment Tax Regulations.

Based upon the facts discussed above, it is reasonable to believe that no amount of any distribution from Plan B to a bona fide resident of Puerto Rico will be includible in gross income by reason of the application of section 933. Therefore, with respect to your second ruling request, we conclude that no portion of any distribution from Plan B to a bona fide resident of Puerto Rico will be subject to withholding under section 3405, without regard to whether such distribution is considered a periodic payment, a nonperiodic payment, or an eligible rollover distribution.

Third ruling request

Section 6041(a) provides, in relevant part, that all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary.

Section 6041(d) provides, in relevant part, that every person required to make a return under section 6041(a) shall furnish to each person with respect to whom such return is required a written statement showing the name, address, and phone number of the information contact of the person required to make such return, and the aggregate amount of payments to the person required to be shown on the return.

Section 6041A(a) provides, in relevant part, that if any service-recipient engaged in a trade or business pays in the course of such trade or business during any calendar year remuneration to any person for services performed by such person, and the aggregate of such remuneration paid to such person is \$600 or more, then the service-recipient shall make a return, according to the forms or regulations prescribed by the Secretary.

Section 1.6041-2(b)(1) of the Income Tax Regulations provides, in relevant part, that amounts which are distributed or made available to a beneficiary and to which section 402 (relating to employees' trusts) or section 403 (relating to employee annuity plans) applies shall be reported on Forms 1096 and 1099 to the extent such amounts are includible in the gross income of such beneficiary if the amounts so includible aggregate \$600 or more in any calendar year.

Section 1.6041-1(a)(2) of the Income Tax Regulations provides, in relevant part, that where a Form 1099 is required to be filed, a separate Form 1099 shall be furnished for each applicable person to whom payments are made.

Section 6047(d) provides, in relevant part, that the Secretary shall, by forms or regulations, require that an employer maintaining a plan from which designated distributions (as defined in section 3405(e)(1)) may be made, make returns and reports regarding such plan to the Secretary and to the participants and beneficiaries of such plan. No return or report may be required with respect to distributions to any person during any year unless such distributions aggregate \$10 or more.

Section 35.3405-1 of the Employment Tax Regulations, Q&A E-8, provides that compliance with the reporting requirements of section 6047(d) is required whenever there is a designated distribution to which section 3405 applies. Therefore, the "old law rule that distributions of less than \$600 per year do not require reporting" no longer applies. Section 35.3405-1 of the regulations, Q&A E-9, provides that the reporting requirements will be satisfied if Form 1099 is filed with respect to each payee in the

absence of other forms and regulations.

With respect to your third ruling request, we conclude that Trustee B will not be required to report payments from Plan B on Form 1099 or any other form required to be filed with the Internal Revenue Service and no related statement will be required to be furnished to any Puerto Rico participant in connection with any distribution from Plan B pursuant to either section 6041 or 6041A. We also conclude that because no portion of a distribution from Plan B to a bona fide resident of Puerto Rico is subject to the withholding rules of section 3405, no portion of such distribution is subject to the requirements of section 6047(d).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. In particular, no opinion is expressed or implied concerning whether the recipients of distributions from Plan B are bona fide residents of Puerto Rico for purposes of section 933.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant.

Sincerely,

M Grace Fleeman
Senior Counsel
Office of the Associate Chief Counsel
(International)