

Internal Revenue Service

Department of the Treasury

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Date:

December 18, 2001

Plan =

State S =

Dear

This responds to your letter of June 6, 2001 and subsequent correspondence, on behalf of State S and its Plan, requesting a ruling concerning the proposed plan relating to State S's volunteer firefighters' and rescue squad workers' service award program (the "Plan") which State S intends to be a length of service award plan described in section 457(e)(11)(B) of the Internal Revenue Code of 1986. State S and its political subdivisions are represented to be eligible employers described in section 457(e)(1).

State S has established the program reflected in the Plan for the benefit of long-term bona-fide volunteers who perform firefighting or rescue squad services or other volunteers who perform essential services as defined in the Plan for such volunteer fire departments or rescue squads associated with political subdivisions of State S. The program is established to provide length of service awards in the amounts and at the time determined under the Plan to eligible volunteers (determined under the Plan) for the volunteer fire departments and rescue squads in recognition of long-term volunteer service. Contributions to the fund associated with the Plan by State S (which are paid into the General Fund), the local political subdivision, or the local volunteer firefighting or rescue squad services, which are deemed to be instrumentalities of the related political subdivisions under State S law, (which are paid into the Department and Squad Fund) are held and invested by the state retirement system board, but they remain segregated property of the contributing entity subject to the claims of its creditors until distributed in payment of service awards. The Plan provides for a \$3,000 combined limit on a volunteer's length of service award accruing with respect to a year of service credit.

Any eligible volunteer rescue squad member or volunteer fire department member, as defined in the Plan, who meets the requirements and criteria set forth in the Plan may join State S's length of service award program. The Plan provides that an eligible member may not receive compensation from the department or squad for performing firefighting and prevention services and emergency medical and ambulance

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services other than reimbursement for (or reasonable allowance for) reasonable expenses, incurred in the performance of such services, or reasonable benefits (including length of service awards) and nominal fees for such services, customarily paid by the departments or squads in connection with the performance of such services by volunteers.

State S, the local volunteer rescue squad or fire department, or the related local political subdivision may make contributions to the members' accounts in the General or Department and Squad Funds of the program in accordance with the Plan and State S law. The Plan provides that the total Department and Squad Fund contribution and General Fund contribution combined, made with respect to an individual member, may not exceed \$3,000 for any year of service credit.

Once an eligible member has attained the age set forth in the Plan with the required years of service for a volunteer rescue squad or fire department in State S, he or she would be entitled to a lump-sum distribution of the amounts in his or her account determined pursuant to the Plan's provisions. However if the eligible member so elects, the state retirement system would purchase and deliver to him or her an annuity contract in lieu of such lump sum payment. If an eligible member dies prior to attaining the required age and length of service, his or her beneficiary defined in the Plan and State S statute would receive a lump-sum distribution of the amount in the member's Plan account. The Plan also includes detailed provisions regarding the purchase of service credit for the member's years of service before the Plan's effective date and the reduced amounts a member generally would receive if he or she ceases his or her services in State S or membership in the program before attaining the age and year of service requirement.

The Plan provides that all amounts deferred under the plan in the Department and Squad Fund and the General Fund and all income attributable to such amounts will remain (until made available to the participant or beneficiary) solely the property and rights of the contributing entities, subject only to the claims of the entity's general creditors. The Plan also provides that a participant or beneficiary has only an unsecured right to benefits under the Program. The rights of any participant or beneficiary to payments under the Plan are nonassignable and nontransferable.

Section 83(a) of the Internal Revenue Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 403(c) of the Code states that premiums paid by an employer for a nonqualified annuity contract shall be included in the employee's gross income in accordance with section 83 except that the value of such contract shall be substituted for the fair market value of the property for purposes of applying section 83.

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Section 451(a) of the Code and section 1.451-1(a) of the regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 1.451-2(a) of the regulations, income is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart, or otherwise made available so that the taxpayer may draw on it at any time. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also, Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Section 457 of the Internal Revenue Code of 1986 governs the taxation of *eligible deferred compensation plans* of *eligible employers*. The term "eligible employer" is defined in section 457(e)(1) as a state, political subdivision of a state, and any agency or instrumentality of a state or political subdivision of a state, and any other organization (other than a governmental unit) exempt from tax under subtitle A of the Code. An "eligible deferred compensation plan" as defined in section 457(b) must, among other things, provide that the maximum amount which may be deferred under the plan for a taxable year shall not exceed the lesser of \$7,500 (as adjusted for cost-of-living under section 457(e)(15)) or 33 1/3 percent of the participant's includible compensation.

Section 457(f)(1)(A) provides that if a plan of an eligible employer providing for a deferral of compensation is not an eligible deferred compensation plan, compensation deferred under such plan shall be included in the participant's gross income for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation.

Section 457(e)(11)(A)(ii) provides that a plan paying solely length of service awards to bona fide volunteers or their beneficiaries on account of qualified service performed by such volunteers is treated as not providing for the deferral of compensation under section 457. Section 457(e)(11)(C) defines qualified services as fire fighting and prevention services, emergency medical services and ambulance services.

Section 457(e)(11)(B) provides special rules applicable to a length of service award plan (LOSAP). Section 457(e)(11)(B)(i) defines the term "bona fide volunteer" to include only persons whose only compensation received for performing the services are reimbursements for (or reasonable allowances for) reasonable expenses incurred in performing such services or reasonable benefits (including length of service awards)

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and nominal fees for such services, customarily paid by eligible employers in connection with the performance of such services by volunteers.

Section 457(e)(11)(B)(ii) provides that a LOSAP may not provide for an aggregate amount of length of service awards exceeding \$3,000 accruing with respect to any year of service by a volunteer.

Section 72(b)(1) provides that gross income does not include that part of any amount received as an annuity which bears the same ratio to such amount as the investment in the contract bears to the expected return under the contract. Section 1.72-1(a) of the Income Tax Regulations states that amounts subject to 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.

Section 3121(a)(5)(I) provides that any payment made to, or on behalf of, an employee or his beneficiary under a plan described in section 457(e)(11)(A)(ii) and maintained by an eligible employer as defined in section 457(e)(1) is not treated as "wages" for purposes of determining whether Federal Insurance Contribution Act (FICA) taxes apply to such payment.

In light of the documents presented, including the relevant State S statutory provisions, the revised Plan submitted on October 31, 2001 and the representations made, we conclude as follows:

1. State S's length of service award program reflected in the Plan pays solely length of service awards to bona fide volunteers providing firefighting and prevention services, emergency medical services or ambulance services, as described in section 457(e)(11)(A)(ii). This program is not subject to section 457.
2. Amounts paid to members from the funds pursuant to the Plan are not wages for purposes of FICA taxes, pursuant to section 3121(a)(5)(I).
3. Amounts paid or otherwise made available to eligible members pursuant to the Plan are includible in the recipient's gross income in accordance with sections 451 and 72 only in the taxable year in which such amounts are paid or otherwise made available. If an eligible member receives an annuity contract in lieu of a lump sum payment, the value of such contract will be includible in his or her taxable income in accordance with section 83(a) in the year when he or she receives such annuity contract.

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than the Plan described above. If the Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion in the ruling. See section 12.04 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1, 46. However, when the criteria in section 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely,
Robert D. Patchell
Acting Branch Chief
Office of Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosure (1)