Internal Revenue Service

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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:
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Date:
June 22, 2010

TY: Calendar year

Legend

X =

Dear :

This responds to your letter, on behalf of X, requesting a ruling concerning the possible application of section 457 of the Internal Revenue Code of 1986 to a number of different nonqualified deferred compensation (NQDC) plans maintained by X. Although X is currently a taxable entity, X anticipates a favorable determination letter from the Internal Revenue Service concerning its tax exempt status under section 501(c)(4).

X, as a taxable entity, has in recent years established three different NQDC plans for its directors and a select group of highly compensated or key employees. Each of the NQDC plans specifies that the amounts in the participants' accounts are nonassignable and nontransferable. In addition, the NQDC plans all provide that the amounts in their participants' bookkeeping accounts are unfunded and unsecured promises to pay in the future the amounts provided pursuant to the plans.

X has requested this ruling to determine whether section 457 (which imposes a number of additional requirements upon NQDC arrangements of tax-exempt entities and state and local governmental entities) would, upon X becoming a tax-exempt entity, apply to the NQDC plans of X which previously have been subject to the provisions applicable to NQDC plans maintained by taxable entities. X represents that its board intends to adopt a corporate resolution that freezes and bars future deferrals to its three existing NQDC plans upon X receiving a favorable determination letter establishing its status as a tax-exempt organization described in section 501(c)(4). The amounts in the frozen plans (and the deemed earnings thereon) would be held and distributed in accordance with the provisions of the plans.

Section 457 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 that 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 the applicable dollar amount (as determined under sections 457(b)(2) and (e)(15), $ 16,500 in 2010) or 100 percent of the participant's includible compensation. None of X's NQDC plans currently conform to this or other limitations of section 457.

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(f)(3)(B) states that a person's rights to compensation are subject to a substantial risk of forfeiture if such person's rights are conditioned upon the future performance of substantial services by any individual.

The legislative history of section 457 must be examined to determine the appropriate tax impact upon X's NQDC plans, originally established during X's period as a taxable entity, when X becomes a tax-exempt organization. The House Ways and Means Committee Report concerning the 1978 enactment of section 457 states, "The committee believes that limitations should be imposed on the amounts of compensation that can be deferred under these arrangements and allowed to accumulate on a tax deferred basis. The committee realizes that the denial of a compensation deduction to a nontaxable entity until an amount is includible in the income of the person providing services does not act as a restraint on the amounts that nontaxable entities are willing to let employees defer as it does when a taxable entity is involved. Accordingly, the committee believes that a percentage-of-compensation limit on amounts that can be deferred, as well as an absolute dollar limitation to prevent excessive deferrals by highly-compensated employees, is necessary . . . [T]he denial of a compensation deduction until there is a corresponding income inclusion by a [corporate] plan participant places some natural restraints on the amounts of compensation that can be deferred under private plans." (H.R. Report No. 95-1445 at 53 and 59, 1978-3 CB 227 and 233).

This indicates that a significant Congressional concern when it enacted section 457 was limiting the revenue loss that occurs when employees defer compensation that their tax-exempt employer is unable to deduct since it pays no income tax, whereas in a corporate NQDC arrangement, the revenue loss attributable to executive NQDC deferrals is offset to a significant degree by the corporate employer's inability to currently deduct such amounts against its taxable corporate income.

In X's case, when unrestricted amounts were deferred into its NQDC arrangements due to its taxable status, X was subject to corporate income taxation upon the amounts deferred. However, allowing X to continue unlimited deferrals in these plans after its conversion into a tax-exempt entity would produce the type of revenue loss that Congress intended to limit when it enacted section 457 in 1978. Thus, to comply with this Congressional intent that X's plan not produce revenue losses in excess of those permitted under section 457, X would have to freeze deferrals under its existing NQDC plans upon its becoming a tax-exempt organization.

To comply with the above-discussed Congressional intent, X, after it becomes a tax-exempt organization, would be able to allow its employees to make income tax deferrals under a NQDC arrangement only in a plan that meets the requirements of section 457(b). X's board of directors will adopt a resolution freezing these three plans as of the date when X receives a favorable determination letter from the IRS approving its status as an exempt organization described in section 501(c)(3). Amounts credited to the NQDC plan accounts of its employees (and the earnings thereon) due to deferrals made after X becomes a tax exempt organization would be subject to section 457 and would have to comply with the requirements of section 457(b) and the regulations thereunder for such amounts to remain tax-deferred under section 457(a) until they are paid or made available.

In light of the documents presented and the representations made, we conclude as follows:

Provided that X adopts and implements its corporate resolution freezing and barring any additional deferrals to its three NQDC plans described in this letter after X receives a favorable determination letter establishing its status as a tax exempt organization, these three NQDC plans will not be subject to section 457.

If the plans are significantly modified other than as provided in the proposed corporate resolution, this ruling will not necessarily remain applicable. In addition, no opinion is expressed concerning whether any of X's three pre-existing NQDC plans constitute a non-qualified deferred compensation plan that complies with the NQDC provisions under sections 83, 409A, 451, or 457A or the regulations thereunder, or the application of these section to the plans.

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.

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 11.04 of Rev. Proc. 2010-1, 2010-1 I.R.B. 1, 49. However, when the criteria in section 11.06 of Rev. Proc. 2010-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

No opinion is expressed or implied concerning the tax consequences of the proposed transactions under any other provision of the Code or regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transactions that are not specifically covered by the above rulings. In particular, no opinion is expressed or implied concerning the application of section 409A to the proposed transactions. Section 409A has been designated as an area in which ruling letters will not be issued until the Service resolves the issues through publication of a Revenue Ruling, Revenue Procedure, Regulations or otherwise. See section 3.01(43) of Revenue Procedure 2010-3, 2010-1 I.R.B. 110, 113.

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.

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.

Sincerely,

/ Cheryl E. Press /

Cheryl E. Press
Senior Counsel, Qualified Plans 2 (Employee Benefits)
(Tax Exempt & Government Entities)