

## Part I

### Section 401. – Qualified Pension, Profit-sharing, and Stock Bonus Plans

#### Paid Time Off Contributions at Termination of Employment

#### Rev. Rul. 2009-32

#### ISSUES

- (1) Do the amendments described below to an existing qualified profit-sharing plan requiring or permitting certain contributions to the plan of the dollar equivalent of unused paid time off at a participant's termination of employment cause the plan to fail to meet the requirements of § 401(a) and, if applicable, § 401(k) of the Internal Revenue Code (Code)?
- (2) When is a participant required to recognize gross income with respect to the contributions to the qualified profit-sharing plan and payments to the participant as described below?

#### FACTS

For purposes of each situation below, it is assumed that the employer is a corporation to which subchapter C of Chapter 1, Subtitle A of the Code applies; that each participant is an individual who accounts for gross income under the cash receipts and disbursements method of accounting and has a calendar year taxable year; that all employees of the employer are eligible to participate in the paid time off plan (the PTO plan) on substantially the same terms and conditions; that prior to its amendment, the PTO plan qualifies as a bona fide sick and vacation leave plan for purposes of § 409A and § 1.409A-1(a)(5) of the Income Tax Regulations; that payments under the PTO plan for unused paid time off constitute payment for unused accrued bona fide sick, vacation, or other leave for purposes of § 1.415(c)-2(e)(3)(iii)(A); that all payments for paid time off (whether paid for used or unused time off) are made from the general assets of the employer; and that the employer has two-week pay periods. For this purpose, a paid time off plan refers to a sick and vacation pay or leave plan under which a participant may take paid leave without regard to whether the leave is due to illness or incapacity.

#### Situation 1

Company X maintains the Company X PTO Plan (X PTO Plan), under which all participants are granted up to 240 hours of paid time off each January 1 (prorated for new hires commencing employment during the calendar year), with

the number of hours depending solely on the participant's number of years of service. For this purpose, salaried employees are treated as working 8 hours per work day. Under the X PTO Plan, a participant at the end of the year may carry over to the following year an amount of unused paid time off not to exceed a specified number of hours (the carryover limit), and any hours of unused paid time off in excess of the carryover limit are forfeited. If a participant terminates employment, the dollar equivalent of any hours of unused paid time off remaining at the termination of employment are paid to the terminated participant within 60 days after the termination of employment, with the dollar equivalent determined as the number of hours of unused paid time off multiplied by the terminated participant's hourly rate of compensation for the pay period during which the participant terminates employment (determined for salaried employees by treating the employee as working 8 hours per work day).

Company X also maintains the Company X Profit Sharing Plan (X Profit Sharing Plan), which is a profit-sharing plan that, without regard to the amendment described in this Situation 1, meets the requirements of § 401(a). The X Profit Sharing Plan includes a qualified cash or deferred arrangement under § 401(k) that provides for elective contributions and that does not provide for catch-up contributions under § 414(v). The X Profit Sharing Plan has a calendar year plan year and limitation year. The X Profit Sharing Plan provides that amounts for unused paid time off paid by the later of 2½ months after termination of employment with Company X or the end of the limitation year that includes the date of the severance from employment are treated as compensation under the plan for purposes of § 415, to the extent permissible under § 415. The X Profit Sharing Plan provides that § 415 compensation is determined using only amounts actually paid during the limitation year.

In December 2008, Company X amended the X Profit Sharing Plan and the X PTO Plan, effective January 1, 2009, to provide that the dollar equivalent of any unused paid time off at the time of a participant's termination of employment is forfeited under the X PTO Plan and is contributed to the X Profit Sharing Plan and allocated to the participant's account as of the first day of the second pay period beginning immediately after the participant's termination of employment, to the extent the contribution (in combination with prior annual additions) does not exceed the applicable limitations under § 415(c). Under the X Profit Sharing Plan, contributions of the dollar equivalent of paid time off are in addition to other contributions under the plan and are treated as nonelective contributions. Under the terms of the X PTO Plan, the dollar equivalent of any unused paid time off that is not contributed to the X Profit Sharing Plan is paid to the terminated participant within 60 days after the termination of employment. For these purposes, the dollar equivalent of the unused paid time off is determined as the number of hours of unused paid time off multiplied by the terminated participant's hourly rate of compensation for the pay period during which the participant terminates employment (determined for salaried employees by treating the employee as working 8 hours per work day).

C is an employee of Company X who participates in the X PTO Plan and the X Profit Sharing Plan. C's employment terminates on October 1, 2009. As of the close of business on October 1, 2009, C has 12x hours of unused paid time off, and earns \$25 per hour, and so has unused paid time off with a dollar equivalent of \$300x. 12x hours does not exceed the sum of the hours in the remaining work days for 2009 plus the carryover limit.

A contribution of \$300x to the X Profit Sharing Plan on behalf of C, in combination with prior annual additions, would not cause C's total contributions and annual additions to exceed the limitations under § 415(c) for the 2009 limitation year. Company X contributes \$300x to the X Profit Sharing Plan on October 19, 2009, and allocates this amount to C's account under the X Profit Sharing Plan, effective as of October 19, 2009.

### Situation 2

The facts are the same as in Situation 1, except that C's employment terminates on December 28, 2009, and any payment for unused paid time off on account of termination will be paid to C in 2010 and will be the only payment of compensation that C will receive from Company X in 2010. C has 12x hours of unused paid time off and earns \$25 per hour, and therefore, has unused paid time off with a dollar equivalent of \$300x. The 12x hours of unused paid time off does not exceed the sum of the hours in the remaining work days for 2009 plus the carryover limit. The \$300x does not exceed the § 415(c) applicable dollar limit for 2010. Company X contributes \$150x to the X Profit Sharing Plan on January 18, 2010, and allocates the amount to C's account under the X Profit Sharing Plan as of January 18, 2010. This contribution is not treated as a contribution to the X Profit Sharing Plan for 2009. Company X pays the remaining \$150x to C on January 18, 2010.

### Situation 3

Company W maintains the Company W PTO Plan (W PTO Plan), under which participants ratably accrue up to 240 hours of paid time off each calendar year on a pay-period basis beginning on January 1. For this purpose, salaried employees are treated as working 8 hours per work day. Under the W PTO Plan, a specified number of unused paid time off hours remaining as of the close of business on December 31 may be carried over to the following year, and any hours of unused paid time off in excess of the carryover limit are forfeited. If a participant terminates employment, the dollar equivalent of any hours of unused paid time off remaining at the termination of employment are paid to the terminated participant within 60 days after the termination of employment, with the dollar equivalent determined as the number of hours of unused paid time off multiplied by the terminated participant's hourly rate of compensation for the pay

period during which the participant terminates employment (determined for salaried employees by treating the employee as working 8 hours per work day).

Company W also maintains the Company W Section 401(k) Plan (W 401(k) Plan), which is a profit-sharing plan that, without regard to the amendment described in this Situation 3, meets the requirements of § 401(a). The W 401(k) Plan includes a qualified cash or deferred arrangement under § 401(k) that does not provide for catch-up contributions under § 414(v). The W 401(k) Plan has a calendar year plan year and limitation year. The W 401(k) Plan provides that for purposes of §§ 401(k) and 415(c), amounts contributed to the plan are taken into account for the year in which falls the date the amounts are allocated to the participant's account under the plan. The W 401(k) Plan also provides that amounts for unused paid time off paid by the later of 2½ months after termination of employment with Company W or the end of the limitation year that includes the date of the severance from employment, are treated as compensation under the plan for purposes of § 415, to the extent permissible under § 415(c). The W 401(k) Plan provides that, for purposes of § 415, compensation is determined by including only amounts actually paid during the limitation year.

In December 2008, Company W amended the W 401(k) Plan and the W PTO Plan, effective January 1, 2009, to provide that a participant may elect to reduce all or part of the dollar equivalent of any unused paid time off at the time of a participant's termination of employment and have that amount contributed by Company W and allocated to the participant's account under the W 401(k) Plan as of the first day of the second pay period beginning immediately after the participant's termination of employment, to the extent that the contribution (in combination with prior annual additions) does not exceed the applicable limitations under § 415(c) and to the extent the contributions (in combination with prior elective deferrals) do not exceed the applicable limitation under § 401(a)(30). Under the terms of the W 401(k) Plan, contributions of the dollar equivalent of paid time off are in addition to other contributions and treated as elective contributions. Under the terms of the W PTO Plan, the dollar equivalent of any unused paid time off that is not contributed to the W 401(k) Plan is paid to the employee on the first day of the second pay period beginning immediately after the participant's termination of employment. For these purposes, the dollar equivalent of the unused paid time off is determined as the number of hours of unused paid time off multiplied by the terminated participant's hourly rate of compensation for the pay period during which the participant terminates employment (determined for salaried employees by treating the employee as working 8 hours per work day).

D is an employee of Company W who participates in the W PTO Plan and the W 401(k) Plan. D terminates employment on October 1, 2009. As of the close of business on October 1, 2009, D has 15x hours of unused paid time off, and earns \$20 per hour, and so has unused paid time off with a dollar equivalent

of \$300x. 15x hours does not exceed the sum of the hours in the remaining work days for 2009 plus the carryover limit.

D has a valid and timely election in effect to have 70% of the dollar equivalent of the unused paid time off contributed to the W 401(k) Plan. The contribution of \$210x (70% of \$300x) would not exceed the applicable limitations under §§ 401(a)(30) and 415(c). Company W contributes \$210x to the W 401(k) Plan on October 19, 2009, and allocates that amount to D's account under the W 401(k) Plan as of October 19, 2009. Company W pays the remaining \$90x to D on October 19, 2009.

#### Situation 4

The facts are the same as in Situation 3, except that D's employment terminates on December 28, 2009, and any payment for unused paid time off on account of termination will be paid to D in 2010 and will be the only payment of compensation that D will receive from Company W in 2010. As of the close of business on December 28, 2009, D has 15x hours of unused paid time off, and earns \$20 per hour, and so has unused paid time off with a dollar equivalent of \$300x. 15x hours does not exceed the sum of the hours in the remaining work days for 2009 plus the carryover limit.

D has a valid and timely election in effect to have 70% of the dollar equivalent of the unused paid time off contributed to the W 401(k) Plan. The contribution of \$210x (70% of \$300x) would not exceed the applicable limitations under §§ 401(a)(30) and 415(c). Company W contributes \$210x to the W 401(k) Plan on January 18, 2010 and allocates that amount to D's account under the W 401(k) Plan as of January 18, 2010. Company W pays the remaining \$90x to D on January 18, 2010.

#### LAW

Section 401(a) provides that a trust created or organized in the United States and forming part of a stock bonus, pension, or profit-sharing plan of an employer for the exclusive benefit of its employees or their beneficiaries constitutes a qualified trust under that section if a series of conditions is met. Section 401(a)(4) provides as one of those conditions that the contributions or benefits provided under the plan do not discriminate in favor of highly compensated employees (within the meaning of § 414(q)). A plan maintained pursuant to a collective bargaining agreement is deemed to satisfy the nondiscrimination requirements. In other cases, under the regulations under § 401(a)(4), the amount of nonelective contributions under a profit-sharing plan must satisfy either a design-based safe harbor or a test based on the contributions made for individual participants.

Section 401(a)(30) of the Code provides that in the case of a trust which is part of a plan under which elective deferrals (within the meaning of § 402(g)(3)) may be made with respect to any individual during a calendar year, such trust does not constitute a qualified trust unless the plan provides that the amount of such deferrals under such plan and all other plans, contracts, or arrangements of an employer maintaining such plan may not exceed the amount of the limitation in effect under § 402(g)(1)(A) for taxable years beginning in such calendar year. Under § 402(g)(3), elective contributions under a qualified cash or deferred arrangement are included in the definition of elective deferrals.

Section 401(k)(2)(A) provides, in pertinent part, that a qualified cash or deferred arrangement is any arrangement which is part of a profit sharing plan or stock bonus plan, a pre-ERISA money purchase plan, or a rural cooperative plan, which meets the requirements of § 401(a), and under which a covered employee may elect to have the employer make payments as contributions to a trust under the plan on behalf of the employee, or to the employee directly in cash.

Section 1.401(k)-1(a)(3)(i) provides that a cash or deferred election is any election by an employee to have the employer either: (A) provide an amount to the employee in the form of cash or some other taxable benefit that is not currently available or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation.

Section 1.401(k)-6 defines nonelective contributions as employer contributions (other than matching contributions) with respect to which the employee may not elect to have the contributions paid to the employee in cash or other benefits instead of being contributed to the plan. Section 1.401(k)-6 defines elective contributions as contributions made pursuant to a cash or deferred election under a cash or deferred arrangement (whether or not qualified).

Under § 401(k)(3)(A)(ii), elective contributions under a qualified cash or deferred arrangement generally must satisfy the actual deferral percentage test. Section 1.401(k)-2(a)(4)(i) provides generally that for purposes of the actual deferral percentage test, elective contributions are taken into account for a year if the elective contribution is allocated to the participant's account under the plan as of a date within that year, and certain other requirements are satisfied.

Section 402(a) provides that any amount actually distributed to any distributee by an employees' trust described in § 401(a) which is exempt from tax under § 501(a) is taxable to the distributee in the taxable year of the distributee in which distributed, under § 72. Section 72(t) provides, in pertinent part, that the income tax applicable to any amount a participant receives from a qualified plan generally is increased by an amount equal to 10 percent of the portion of the amount includible in gross income unless such amounts are distributed on or

after the date on which the participant attains age 59½ or after the participant's separation from service after attainment of age 55.

Section 402(e)(3) provides, in pertinent part, that contributions made by an employer on behalf of an employee to a trust which is part of a qualified cash or deferred arrangement (as defined in § 401(k)(2)) are not treated as distributed or made available to the employee nor as contributions made to the trust by the employee merely because the arrangement includes provisions under which the employee has an election whether the contribution will be made to the trust or received by the employee in cash.

Section 415(a)(1)(B) provides that a trust which is part of a pension, profit-sharing, or stock bonus plan does not constitute a qualified trust under § 401(a) if in the case of a defined contribution plan, contributions and other additions under the plan with respect to any participant for any taxable year exceed the limitation of § 415(c). Section 415(c)(1) provides that contributions and other additions with respect to a participant exceed the limitation of § 415 if, when expressed as an annual addition to the participant's account, the annual addition is greater than the lesser of \$40,000 or 100 percent of the participant's compensation. Section 415(d)(1)(C) provides that the Secretary shall adjust annually the \$40,000 amount for increases in the cost-of-living in accordance with regulations prescribed by the Secretary.

Section 1.415(c)-1(b)(1)(i) generally defines the term "annual addition" as the sum, credited to a participant's account for any limitation year, of (A) employer contributions; (B) employee contributions; and (C) forfeitures. Under § 1.415(c)-1(b)(6), an annual addition generally is treated as credited to the account of a participant for a particular limitation year if it is allocated to the participant's account under the terms of the plan as of any date within that limitation year.

Section 415(c)(3)(A) provides that in general, the term "participant's compensation" means the compensation of the participant from the employer for the year. Section 1.415(c)-2(b)(1) provides that, for purposes of § 415, compensation includes amounts received for personal services actually rendered in the course of employment with the employer maintaining the plan, to the extent that the amounts are includible in gross income (or to the extent the amounts would have been received and includible in gross income but for certain elections, including an election described in § 402(e)(3)). However, under § 1.415(c)-2(b)(2), contributions by an employer to a plan of deferred compensation (other than certain elective contributions, including contributions described in § 402(e)(3)) are not included in compensation for purposes of § 415.

Section 1.415(c)-2(e)(1)(i) states in pertinent part that, in order to be taken into account for a limitation year, compensation within the meaning of section 415(c)(3) must be actually paid or made available to an employee (or, if

earlier, includible in the gross income of the employee) within the limitation year. Section 1.415(c)-2(e)(1)(ii) states in pertinent part that, except as otherwise provided in § 1.415(c)-2(e), in order to be taken into account for a limitation year, compensation within the meaning of section 415(c)(3) must be paid or treated as paid to the employee (in accordance with the rules of § 1.415(c)-2(e)(1)(i)) prior to the employee's severance from employment with the employer maintaining the plan.

Section 1.415(c)-2(e)(3) provides that a plan may provide that certain amounts are included in the participant's compensation (within the meaning of § 415(c)(3)) if those amounts are paid by the later of 2½ months after severance from employment with the employer maintaining the plan or the end of the limitation year that includes the date of severance from employment with the employer maintaining the plan, and those amounts would have been included in the definition of compensation had they been paid prior to the employee's severance from employment with the employer maintaining the plan. Section 1.415(c)-2(e)(3)(iii)(A) provides that an amount is described in § 1.415(c)-2(e)(3)(iii) (and therefore may be included in § 415(c) compensation subject to certain conditions) if the amount is payment for unused accrued bona fide sick, vacation, or other leave, but only if the employee would have been able to use the leave if employment had continued.

Section 451(a) and §1.451-1(a) provide that an item of gross income is includible in gross income in the taxable year in which it is actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under §1.451-2(a), income is constructively received in the taxable year during which it is credited to a 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.

Section 409A(a)(1)(A)(i) provides, in pertinent part, that if at any time during a taxable year a nonqualified deferred compensation plan fails to meet certain requirements set forth under § 409A(a), or is not operated in accordance with such requirements, all compensation deferred under the plan for the taxable year and all preceding taxable years shall be includible in gross income for the taxable year to the extent not subject to a substantial risk of forfeiture and not previously included in gross income. Section 409A(a)(1)(B) provides, in pertinent part, that any compensation required to be included in gross income under § 409A(a)(1)(A) for a taxable year shall be subject to the additional taxes set forth in § 409A(a)(1)(B).

Section 409A(d)(1) provides that the term "nonqualified deferred compensation plan" means any plan that provides for the deferral of compensation, other than: (A) a qualified employer plan and (B) any bona fide vacation leave, sick leave, compensatory time, disability pay, or death benefit



plan. Section 409A(d)(2) provides, in pertinent part, that the term “qualified employer plan” means any plan, contract, pension, account or trust described in § 219(g)(5)(A) or (B) (without regard to § 219(g)(5)(A)(iii)). Section 219(g)(5)(A)(i) refers to a plan described in § 401(a), which includes a trust exempt from tax under § 501(a).

## ANALYSIS

### Situation 1

The amendment to the X Profit Sharing Plan to require certain contributions of the dollar equivalent of unused paid time off to the X Profit Sharing Plan does not cause the X Profit Sharing Plan to fail to meet the requirements of § 401(a), provided that the contributions satisfy the requirements of § 401(a)(4) (in combination with other contributions and forfeitures allocated for the year). Because C is not provided a right to elect a payment of cash for unused paid time off in lieu of a plan contribution, Company X’s contribution of \$300x to the X Profit Sharing Plan is not an elective contribution that is made pursuant to a cash or deferred election within the meaning of § 401(k)(2)(A) and § 1.401(k)-1(a)(3)(i). Rather, Company X’s contribution to the X Profit Sharing Plan is a nonelective employer contribution within the meaning of § 1.401(k)-6.

The amount contributed and allocated for each participant will vary based on the amount of the participant’s unused paid time off. Thus, the contributions for unused paid time off are likely to preclude a plan from satisfying a design-based safe harbor under § 401(a)(4). Therefore, testing based on the contributions made for individual participants generally will be required.

The contributions made pursuant to the arrangement must also not exceed the limitations under § 415(c) (in combination with prior annual additions). Because the contribution of \$300x was allocated to C’s account as of October 12, 2009, and made on that date (before the end of the 30 day period following the deadline for Company X to file its income tax return), the contribution is subject to the limitations under § 415(c) applicable for the 2009 limitation year and is taken into account for § 401(a)(4) purposes for the 2009 plan year. Under the facts presented, the contribution of \$300x (in combination with prior annual additions) does not exceed the limitations of § 415(c) for 2009.

If the requirements of § 401(a)(4) are met, the amount contributed will be included in C’s gross income in accordance with § 402(a) only when the amount is distributed to C. Like any other distribution from the X Profit Sharing Plan, the distribution of amounts attributable to the dollar equivalent of unused paid time off is subject to an additional 10% income tax under § 72(t) unless the distribution satisfies one of the exceptions described in § 72(t), such as being made on or after the date on which the participant attains age 59½ or after the participant separates from service after attainment of age 55.

The amendment to the X PTO Plan and the operation of the plan in accordance with the terms of the amendment do not cause the X PTO Plan to fail to qualify as a bona fide sick and vacation leave plan for purposes of § 409A and § 1.409A-1(a)(5).

## Situation 2

The amendment to the X Profit Sharing Plan to require certain contributions of the dollar equivalent of unused paid time off to the X Profit Sharing Plan does not cause the X Profit Sharing Plan to fail to meet the requirements of § 401(a) of the Code, provided that the contributions made pursuant to the amendment satisfy the requirements of § 401(a)(4) (in combination with other contributions and forfeitures allocated for the year). Because C is not provided a right to elect a payment of cash for unused paid time off in lieu of a contribution to the X Profit Sharing Plan, Company X's contribution of \$150x to the X Profit Sharing Plan is not an elective contribution that is made pursuant to a cash or deferred election within the meaning of § 401(k)(2)(A) and § 1.401(k)-(1)(a)(3)(i). Rather, Company X's contribution to the X Profit Sharing Plan is a nonelective employer contribution within the meaning of § 1.401(k)-6.

The contributions made pursuant to the arrangement must also not exceed the limitations under § 415(c) (in combination with prior annual additions). Because the contribution is allocated to C's account on January 18, 2010, and made on that date (before the end of the 30 day period following the deadline for Company X to file its income tax return), the contribution is subject to the limitations under § 415 applicable for the 2010 limitation year and is taken into account for § 401(a)(4) purposes for the 2010 plan year. Under the facts, none of the \$300x exceeds the applicable § 415(c)(1)(A) dollar limit for 2010, so the \$150x contribution also would not exceed the applicable § 415(c)(1)(A) dollar limit. However, under § 415(c)(1)(B), the \$150x contribution must also not exceed 100 percent of compensation for the 2010 limitation year. Because the \$150x contribution is a nonelective contribution, it is not taken into account as compensation for purposes of § 415. However, because the paid time off could have been carried over and used in 2010 had C remained employed, the payment of the remaining \$150x to C on January 18 can be included as § 415 compensation for 2010. Accordingly, the allocation of \$150x to C's account will provide an allocation of 100 percent of compensation and will not exceed the § 415(c) limitations for the 2010 limitation year.

If the requirements of § 401(a)(4) are met, the amount contributed will be included in C's gross income in accordance with § 402(a) only when the amount is distributed to C. Like any other distribution from the X Profit Sharing Plan, the distribution of amounts attributable to the dollar equivalent of unused paid time off is subject to an additional 10% income tax under § 72(t) unless the distribution

satisfies one of the exceptions described in § 72(t), such as being made on or after the date on which the participant attains age 59½ or after the participant separates from service after attainment of age 55.

Under the facts of Situation 2, C terminates employment in 2009, but the contribution to the X Profit Sharing Plan and the cash payment to C occur in 2010. Under the X PTO Plan as amended, the dollar equivalent of unused paid time off is not paid, set apart, or otherwise made available so that C may draw on it either (i) during the 2009 calendar year or (ii) upon conversion in 2009 to a contribution to a qualified plan or cash payment in 2010. Therefore, such amount is not includible in C's gross income in 2009 under the doctrine of constructive receipt and § 451. In addition, the amendment to the X PTO Plan and the operation of the plan in accordance with the terms of the amendment do not cause the X PTO Plan to fail to qualify as a bona fide sick and vacation leave plan for purposes of § 409A and § 1.409A-1(a)(5). The \$150x payment is includible in C's gross income in 2010, the taxable year in which it is paid to C.

### Situation 3

The amendment to the W 401(k) Plan to permit certain contributions of the dollar equivalent of unused paid time off to the W 401(k) Plan does not cause the W 401(k) Plan to fail to meet the requirements of §§ 401(a) and 401(k), provided that the contributions (taking into account other contributions, prior deferrals, and prior annual additions, as applicable) satisfy the nondiscrimination requirements of § 401(k) and the applicable limitations of §§ 401(a)(30) and 415(c).

Because D is provided a right to elect either a payment of cash or a plan contribution for the dollar equivalent of unused paid time off that may not be carried over to the following year, Company W's contribution of \$210x to the W 401(k) Plan is an elective contribution. Because the contribution is allocated to D's account as of October 19, 2009, and is made on that date (before the end of the 30 day period following the deadline for Company W to file its income tax return), the contribution is subject to the limitations under § 415 applicable for the 2009 limitation year. The contribution is also subject to the limitations on elective deferrals under § 401(a)(30) applied for 2009 and the actual deferral percentage nondiscrimination testing under § 401(k)(3)(A)(ii) and § 1.401(k)-2 for the 2009 plan year.

Under the facts presented, the allocation of \$210x to D's account (in combination with prior annual additions) does not cause the plan to exceed the limitations of § 415(c). Although the dollar equivalent of the unused paid time off was made available to D in 2009, pursuant to § 402(e)(3) the \$210x is not treated as made available to D because the amount was contributed to the plan as part of a qualified cash or deferred arrangement. Accordingly, if the nondiscrimination requirements of § 401(k) and the limitations of § 401(a)(30) are met, the amount contributed will be included in D's gross income in accordance with § 402(a) only

when the amount is distributed to D. Like any other distributions from the W 401(k) Plan, the distribution of amounts attributable to the dollar equivalent of unused paid time off is subject to the additional 10% income tax under § 72(t) if the distribution does not meet one of the exceptions of § 72(t), such as being made on or after the date on which the participant attains age 59½ or after the participant separates from service after attainment of age 55.

In addition, the amendment to the W PTO Plan and the operation of the plan in accordance with the terms of the amendment do not cause the W PTO Plan to fail to qualify as a bona fide sick and vacation leave plan for purposes of § 409A and § 1.409A-1(a)(5). The \$90x payment is includible in D's gross income in 2009, the taxable year in which it is paid to D.

#### Situation 4

The amendment to the W 401(k) Plan to permit certain contributions of the dollar equivalent of unused paid time off to the W 401(k) Plan does not cause the W 401(k) Plan to fail to meet the requirements of §§ 401(a) and 401(k), provided that the contributions (taking into account other contributions, prior deferrals, and prior annual additions, as applicable) satisfy the nondiscrimination requirements of § 401(k) and the applicable limitations of §§ 401(a)(30) and 415(c).

Because D is provided a right to elect either a payment of cash or a plan contribution for the dollar equivalent of unused paid time off that may not be carried over to the following year, Company W's contribution of \$210x to the W 401(k) Plan is an elective contribution. Because the contribution is made on January 18, 2010, and is allocated as of that date (before the end of the 30 day period following the deadline for Company W to file its income tax return), the contribution is subject to the limitations under § 415 applicable for the 2010 limitation year. The contribution is also subject to the limitations on elective deferrals under § 401(a)(30) applied for 2010 and the actual deferral percentage nondiscrimination testing under § 401(k)(3)(A)(ii) and § 1.401(k)-2 for the 2010 plan year.

As an elective contribution, the \$210x may be treated as compensation for purposes of § 415, so that D's total 2010 compensation for purposes of § 415(c) is \$300x (the \$210x elective contribution plus the \$90x payment). Under the facts presented, the allocation of \$210x to D's account (in combination with prior annual additions) will not cause the plan to exceed the limitations of § 415(c). Although the dollar equivalent of the unused paid time off was made available to D in 2010, pursuant to § 402(e)(3) the \$210x will not be treated as made available to D because the amount was contributed to the plan as part of a qualified cash or deferred arrangement. Accordingly, if the nondiscrimination requirements of § 401(k) and the limitations of § 401(a)(30) are met, the amount contributed will be included in D's gross income in accordance with § 402(a) only when the amount is distributed to D. Like any other distributions from the

W 401(k) Plan, the distribution of amounts attributable to the dollar equivalent of unused paid time off is subject to the additional 10% income tax under § 72(t) if the distribution does not meet one of the exceptions of § 72(t), such as being made on or after the date on which the participant attains age 59½ or after the participant separates from service after attainment of age 55.

Under the facts of Situation 4, D terminates employment in 2009, but the contribution to the X Profit Sharing Plan and the cash payment to D occur in 2010. Under the X PTO Plan as amended, the dollar equivalent of unused paid time off is not paid, set apart, or otherwise made available so that D may draw on it either (i) during the 2009 calendar year or (ii) upon conversion in 2009 to a contribution to a qualified plan or cash payment in 2010. Therefore, such amount is not includible in D's gross income in 2009 under the doctrine of constructive receipt and § 451. In addition, the amendment to the W PTO Plan and the operation of the plan in accordance with the terms of the amendment do not cause the W PTO Plan to fail to qualify as a bona fide sick and vacation leave plan for purposes of § 409A and § 1.409A-1(a)(5). The \$90x payment is includible in D's gross income in 2010, the taxable year in which it is paid to D.

#### **HOLDING**

- (1) Under the facts presented, the amendments requiring or permitting certain contributions of the dollar equivalent of unused paid time off to a qualified profit-sharing plan do not cause the plan to fail to meet the qualification requirements of § 401(a), provided that the contributions satisfy the applicable requirements of §§ 401(a)(4) and 415(c) and, where applicable, §§ 401(k) and 401(a)(30).
- (2) Under the facts presented, assuming the applicable qualification requirements are satisfied, a participant does not include in gross income contributions of the dollar equivalent of unused paid time off to the profit-sharing plan in accordance with § 402(a) until distributions are made to the participant from the plan and does not include in gross income an amount paid for the dollar equivalent of unused paid time off that is not contributed to the profit-sharing plan until the taxable year in which the amount is paid to the participant.

#### **DRAFTING INFORMATION**

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