

INTERNAL REVENUE SERVICE

Number: **200039008**

Release Date: 9/29/2000

Index No.: 457.01-00 457.05-00

CC:TEGE:ET1:PLR-103846-00

June 22, 2000

Employer =

City X =

Plan =

Dear

This is in response to your letter dated February 15, 2000, on behalf of the Employer requesting a ruling on the federal tax consequences of the Plan. Employer intends the Plan to be an eligible deferred compensation plan under section 457 of the Internal Revenue Code of 1986 (the "Code"). Employer is represented to be an agency of City X and a state or local governmental entity as described in section 457(e)(1)(A). Employer established the Plan for the benefit of eligible employees and independent contractors of the Employer.

Under the Plan an employee or independent contractor (the "participant") may elect to defer compensation he or she would have received for services rendered to the Employer in any taxable year. The deferral extends until the participant reaches age 70 1/2, separates from service, or has an unforeseeable emergency. An election to defer compensation for any calendar month must be made before the beginning of such month. The Plan provides for a maximum amount that may be deferred by a participant in any taxable year and for a catch-up computation for amounts deferred for one or more of the participant's last three taxable years ending before normal retirement age under the Plan. The amounts that may be deferred under the annual maximum limitation and the catch-up provision are within the limitations set out in section 457 of the Code.

Distributions to a participant begin no later than 60 days following the end of the calendar year during which his or her separation. No later than sixty days following the date of the participant's separation from service, the participant may elect a deferred commencement date for all or a portion of the participant's account balance. If a participant has elected, in accordance with the Plan, to defer the commencement of distributions beyond the first permissible payout date, then the participant may make one additional election to further defer the commencement of distributions. The manner and time of benefits must meet the distribution requirements of section

401(a)(9) and 457(d)(2) of the Code.

The Plan permits an in-service distribution of \$5,000.00 or less from a participant's account provided that 1) the total amount payable to the participant under the Plan does not exceed the dollar limit under section 411(a)(11) (currently \$5,000), 2) the participant had not previously received an in-service distribution of the total payable to him or her under the Plan, and 3) no amount had been deferred under the Plan for the participant during the two-year period ending on the date of such in-service distribution. The Plan also permits distribution when it is determined that the participant has an unforeseeable emergency.

The Plan further provides that all amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts and all income attributable to such amounts, property, or rights shall be held in trust for the exclusive benefit of participants and beneficiaries under the Plan. The group annuity contract under the Plan was established pursuant to a written agreement that is represented to be a valid trust under the laws of the state where City X is located.

The rights of any participant or beneficiary to payments pursuant to the Plan are not subject in any manner to alienation by anticipation, sale, transfer, assignment, bankruptcy, pledge, attachment, charge, or encumbrance of any kind.

The terms of the group annuity contract make it impossible prior to the satisfaction of all liabilities with respect to participants and their beneficiaries for any part of the assets and income of the trust to be used for, or diverted to, purposes other than the exclusive benefit of participants and their beneficiaries.

Section 457 of the Code provides rules for the deferral of compensation by an individual participant in an eligible deferred compensation plan (as defined in section 457(b)).

Section 457(a) provides that in the case of a participant in an eligible deferred compensation plan, any amount of compensation deferred under the plan and any income attributable to the amounts so deferred shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or beneficiary.

Section 457(b)(5) prescribes that an eligible deferred compensation plan must meet the distribution requirements of section 457(d).

Section 457(d)(1)(A) provides that for a section 457 plan to be an eligible plan, the plan must have distribution requirements providing that under the plan amounts will not be made available to participants or beneficiaries earlier than i) the calendar year in which the participant attains age 70 ½, ii) when the participant is separated from service with the employer, or iii) when the participant is faced with an unforeseeable emergency

as determined under Treasury regulations. However, section 401(a)(9)(C)(i) generally allows plans to postpone the required beginning date until April 1 of the calendar year following the later of the calendar year in which the employee retires or in which he attains age 70 ½.

A basic requirement prescribed by section 457(b)(5) is that an eligible section 457 plan must meet the section 457(d) distribution requirements described above in order to retain its tax-deferred eligible status. A section 457 plan would violate these provisions of section 457(b)(5) and the regulations thereunder if the participant or anyone else received a distribution earlier than the earliest date established in section 457(d)(1)(A).

Section 457(e)(9)(A) provides that the total amount payable to a participant under the plan will not be treated as made available merely because the participant may elect to receive such amount (or the plan may distribute such amount without the participant's consent) if (i) such amount does not exceed \$5,000, and (ii) such amount may be distributed only if--(I) no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and (II) there has been no prior distribution under the plan to such participant under this option.

Section 1.457-2(h)(4) of the Income Tax Regulations defines an unforeseeable emergency as severe financial hardship to the participant resulting from a sudden and unexpected illness or accident of the participant or of a dependent, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

Section 457(g)(1) provides that a plan maintained by an eligible governmental employer shall not be treated as an eligible deferred compensation plan unless all assets and rights purchased with such deferred compensation amounts and all income attributable to such amounts, property, or rights of the plan are held in trust for the exclusive benefit of participants and their beneficiaries.

Section 457(g)(2) provides that a trust described in section 457(g)(1) shall be treated as an organization exempt from tax under section 501(a). Section 457(g)(2)(B) provides that the amounts in the trust are treated as includible in the gross income of participants and beneficiaries only to the extent, and at the time, provided in section 457. Section 457(g)(3) states that for purposes of section 457(g), custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

Under the terms of the Plan and group annuity contract, the administrator must hold all of the section 457(b) plan assets for the exclusive benefit of the participants and their beneficiaries, and all amounts deferred under the Plan must be transferred to the group annuity contract meeting the requirements of section 457(g) of the Code within an

administratively reasonable time period.

Based upon the provisions of the revised Plan summarized above, we conclude as follows:

1. The Plan established by Employer is an eligible deferred compensation plan as defined in section 457(b) of the Internal Revenue Code of 1986. All assets and income of the Plan described in section 457(b)(6) will be held in trust for the exclusive benefit of participants and their beneficiaries.
2. Amounts of compensation deferred in accordance with the Plan, including any income attributable to the deferred compensation, will be includible in the recipient's gross income for the taxable year or years in which amounts are paid or otherwise made available to a participant or beneficiary in accordance with the terms of the Plan.

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. In addition, no opinion is expressed concerning the effect the adoption of the trust has on the rights of employers under the Plan. This ruling applies only to deferrals made after the date this ruling is issued. If the Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to Employer and the participants of the Plan and applies only to the Plan submitted on February 15, 2000. Section 6110(k)(3) of the Internal Revenue 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 12.04 of Rev. Proc. 2000-1, 2000-1 I.R.B. 4, 46. However, when the criteria in section 12.05 of Rev. Proc. 2000-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely yours,
ROBERT D. PATCHELL
Assistant Chief, Qualified Plans Branch 1
Office of the Division Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosure:

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