

Internal Revenue Service

Department of the Treasury

Number: **200050008**
Release Date: 12/15/2000
Index Number: 457.01-00 457.05.00

Washington, DC 20224

Person to Contact:
R. Lisa Mojiri-Azad
Telephone Number:
(202) 622-6030
Refer Reply To:
CC:TEGE:EB - PLR 116265-99
Date:
August 28, 2000

Authority =
State X =
Plan =

This ruling is in response to your letter dated October 4, 1999, as supplemented by letters dated March 20, 2000 and June 5, 2000, on behalf of the Authority requesting a ruling on the federal tax consequences of the Plan. The Authority intends that the Plan qualify as an eligible deferred compensation plan under § 457 of the Internal Revenue Code of 1986 (the "Code"). The Plan, authorized by the legislature of State X, has been adopted by the Authority, a political subdivision of State X, effective as of October 5, 1977. You represent that the Plan has been amended and restated, effective as of September 25, 1998, to comply with the Small Business Job Protection Act.

Under the Plan an employee or independent contractor may elect to defer compensation he or she would have received for services rendered to the employer in any taxable year. The election to defer compensation must be made no later than the last day of the month preceding the first full payroll period of the month in which the compensation being deferred is earned. The deferral extends until the participant revokes his election or separates from service. 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. A participant may change the amount he or she elects to defer under the Plan only twice per calendar year, and revoke a prior election only once per calendar year.

With certain limitations, a participant or beneficiary may elect the manner in which his or her benefits will be distributed. The election must be made upon the participant's enrollment in the Plan and prior to the date any amounts become payable to the participant or beneficiary under the Plan. If a participant elects to have the distribution of his or her benefits commence upon his or her separation of service, payments will begin no later than 60 days after such participant's separation from service. A participant may elect, no later than 30 days after his or her separation from service, to have benefits commence on any later date, but not later than 60 days following the close of the plan year in which the participant attains his or her normal retirement age (as defined in the Plan). Effective as of January 1, 1997, a participant

may make one additional election to have benefits commence at a later date. The manner and time of all benefits distributed under the Plan must meet the distribution requirements of section 401(a)(9) and 457(d)(2) of the Code.

The Plan, however, permits an exception to the above distribution requirements. The Plan, in accordance with section 457(e)(9)(A) of the Code, includes a provision requiring an in-service distribution of \$5,000 or less from a participant's account prior to that participant's separation from service, 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 amount 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 rights of any participant or beneficiary to payments pursuant to the Plan are generally non assignable and are not subject in any manner to alienation by anticipation, sale, transfer, assignment, bankruptcy, pledge, attachment, charge, or encumbrance of any kind.

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 one or more custodial accounts for the exclusive benefit of participants and beneficiaries under the Plan. The custodial accounts under the Plan were established pursuant to a written agreement that is represented to be a valid custodial arrangement, as described in section 457(g)(3), and a trust solely for purposes of applicable tax laws under rules similar to the rules under section 401(f).

The terms of the custodial agreement 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. A section 457 plan would violate the 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)(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) provides that custodial accounts described in section 401(f) shall be treated as trusts exempt from tax under section 501(a).

Under the terms of the Plan and custodial agreement, the custodian must hold all of the Plan assets for the exclusive benefit of the participants and their beneficiaries, and all amounts deferred under the Plan must be transferred to the custodial account(s), meeting the requirements of 457(g)(3), within an administratively reasonable time period.

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

1. The Plan established by the Authority 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 custodial accounts, meeting the requirements of section 457(g), for the exclusive benefit of participants and their beneficiaries.
2. Amounts of compensation deferred under 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.
3. Any custodial accounts established pursuant to the Plan and the custodial agreement and which are described in section 401(f) of the Code, will be treated as trusts under rules similar to the rules under section 401(f) of the Code.

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. 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 the Authority and the participants of the Plan and applies only to the Plan submitted on March 20, 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, 6. ever, 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 Branch 2
CC:TEGE:EB:QP2

Enclosure:

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