Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:TEGE:EB:QP2
PLR-159315-04
Date:
March 17, 2005

LEGEND:

State X:

Plan A:

Plan B:

Plan C:

County:

EIN: 95-6000927

State X Act:

Retirement Law One:

Retirement Law Two:

Dear . :

This responds to your letter requesting a ruling concerning Plan A, which the County intends to be an eligible deferred compensation plan under section 457(b) of the Internal Revenue Code of 1986 (the Code). In addition to Plan A, the County sponsors at least two other deferred compensation plans, Plan B and Plan C. Plan B is intended to be a grandfathered 401(k) plan under section 1116(f)(2)(B)(i) of the Tax Reform Act of 1986, consistent with a determination letter the County received from the Internal

Revenue Service dated May 5, 2003. Plan B was adopted prior to May 6, 1986. Plan C is intended to be an eligible deferred compensation plan under section 457(b) and a retirement system for purposes of section 3121(b)(7)(F). Plan C is the subject matter of a separate ruling request. The ruling involved in this letter relates solely to Plan A.

Plan A is a collectively bargained plan that is codified under the County code and was adopted by the relevant authority. It is represented that the County is a political subdivision of State X and an eligible employer within the meaning of section 457(e)(1)(A).

Under Plan A, an eligible employee becomes a participant by executing an agreement which authorizes the County to reduce the employee's compensation by a percentage or by a specific amount and to contribute such an amount into an investment account established on behalf of the participant. No portion of the compensation of an employee shall be deferred for any calendar month unless the employee enters into the agreement to do so prior to the beginning of the month. In addition to the participant's elective contributions, the participant also receives a vested contribution from the County matching each dollar contributed by the participant up to four percent of the participant's compensation.

Plan A provides for a maximum amount that may be deferred by a participant in any taxable year. It also provides for a catch-up contribution for amounts deferred for one or more of the participant's last three taxable years ending before he or she attains normal retirement age under Plan A. The normal retirement age for purposes of the catch-up provisions may not be earlier than age sixty-five or, the earliest date at which the participant would be eligible to retire and receive a full pension benefit pursuant to Retirement Law One or Retirement Law Two, as applicable, and may not be later than age seventy and a half. A qualified firefighter or police officer as defined in section 415(b)(2(H)(ii)(I) may designate a retirement date not earlier than age forty. In addition, Plan A provides for age fifty-plus catch-up contributions described in section 457(e)(18). The amounts that may be deferred under the annual maximum limitation and the catch-up provisions are within the limitations of section 457(c).

Some Plan A participants also participate in Plan B and have elected to be subject to a "combined limit." The combined limit, as determined under Plan B, is $8,500.00 adjusted annually to reflect cost of living increases. Under the combined limit, the annual deferral limit includes the aggregate of the participant's tax-deferred contributions under Plan B, the participant's contributions under Plan A and the matching contributions under Plan A. A participant in Plan B is precluded from making any age fifty plus catch-up contributions.

Participants are permitted to choose among various investment options under Plan A. Subject to the form and manner prescribed by Plan A, participants are permitted to change their investment at their discretion. Plan A provides for acceptance of transfers of a participant's investment account from Plan C under certain conditions. It also

provides for transfers to and from another eligible deferred compensation plan as provided for in section 457(e)(10). Plan A provides for acceptance of (and distribution of) eligible rollover distributions and the creation and maintenance of any necessary subaccounts. Plan A provides for direct trustee-to-trustee transfers of all or a portion of a participant's account: (1) to a defined benefit government plan in State X if the transfer is for the purchase of permissive service credits under the defined benefit governmental plan, or (2) for a repayment of contributions and interest to a defined benefit governmental plan with respect to an amount previously refunded upon forfeiture of service credits to which section 415 does not apply by reason of section 415(k)(3).

With certain limitations, a participant may elect the manner in which his or her deferred amounts will be distributed. Benefits generally may be paid in the form of: (1) a lump-sum; (2) substantially equal payments provided monthly, quarterly, semi-annually or annually not extending over twenty years; (3) periodic payments for the life of a participant or the joint lives of the participant and the designated beneficiary; or (4) a combination of these methods. Plan A provides that the manner and time of benefit payout must meet the distribution requirements of sections 457(d) and 401(a)(1)(9) of the Code.

Plan A also provides for additional distributions. Plan A provides for loans to be made to current participants. Plan A requires loans to be evidenced by a promissory note which provides for a reasonable rate of interest and repayment in equal installments at least quarterly. Further, a loan must be repaid in five years, or fifteen years if the loan is for the acquisition of a primary residence. A loan is secured by a first lien on the participant's investment account. The amount of the loan is subject to limits provided in section 72(p)(2) of the Code. Plan A also provides for a distribution due to an unforeseeable emergency that is a severe financial hardship resulting from extraordinary and unforeseeable circumstances beyond the control of the participant. In addition, when an employee separates from service with an account balance of less than $1000.00, the account balance will automatically be distributed in a lump sum. Finally, Plan A provides for voluntary in-service distributions of an amount not in excess of the dollar limited provided in section 401(a)(11) (i.e., $5000.00 adjusted for inflation) if certain conditions are met.

The term "spouse" is not separately defined under Plan A. Plan A provides that a "certified domestic relations order" (CDRO) is a domestic relations order that the Plan A administrator has determined satisfies the requirements of a "qualified domestic relations order" as defined in section 414(p). Under Plan A, an alternate payee is a spouse or former spouse of a participant who is recognized under a CDRO as having a right to receive all, or a portion of, the benefits payable under Plan A with respect to the participant.

Several provisions under Plan A (the Spouse Provisions), involve a participant's spouse, former spouse or surviving spouse. Specific Spouse Provisions involve the applicable distribution period, the appropriate life expectancy tables, and the required

beginning date for distribution. These Spouse Provisions relate to the application of Income Tax Regulation sections 1.401(a)(9)-3, 1.401(a)(9)-5, and 1.401(a)(9)-9.

Other Spouse Provisions under Plan A relate to a spouse's right to make rollover contributions to Plan A; whether a surviving spouse may roll over distributions from Plan A into an eligible retirement plan in the same manner as if the spouse were the participant; the treatment of an early distribution a spouse or former spouse receives pursuant to a domestic relations order; and whether a spouse or former spouse may, pursuant to a domestic relations order, roll over distributions into any eligible retirement plan in the same manner as if the spouse were the participant. These Spouse Provisions involve the application of Income Tax Regulation section 1.402(c)-2, 1.457-10(e) and the definition of "alternate payee" under Section 414(p)(8) of the Code.

In addition, certain Spouse Provisions relate to whether a severe financial hardship that burdens a spouse, for example an illness or accident, can provide the proper basis for an unforeseeable emergency distribution. These Spouse Provisions involve the application of Income Tax Regulation section 1.457- (6)(c).

State X Act provides that registered domestic partners have the same rights, protections and benefits and are subject to the obligations and duties "under law" as granted to and imposed on spouses. Likewise, former registered domestic partners and registered surviving domestic partners have the same rights, protections and benefits and are subject to the obligations and duties under law as granted to and imposed on former spouses and surviving spouses. To the extent that provisions of State X law adopt, refer to, or rely upon, provisions of federal law in a way that otherwise would cause registered domestic partners to be treated differently than spouses, registered domestic partners are to be treated under State X law as if federal law recognized a domestic partnership in the same manner as State X law. Accordingly, if applicable with respect to the Spouse Provisions, State X Act requires that a domestic partner be treated in the same manner as a spouse under Plan A. However, State X Act expressly provides that it does not amend, or modify federal law or the benefits, protections and responsibilities provided by federal law.

Plan A provides that amounts of compensation deferred under Plan A are to be transferred to and invested in a trust as described in section 457(g)(1) or a custodial account as described in sections 457(g)(3) and 401(f) for the exclusive benefit of the participants and their beneficiaries. All amounts deferred under Plan A must be transferred to the trust or custodial account within an administratively reasonable time period, but in no event, later than the fifteenth business day of the month following the month in which the amount deferred would have been payable to the participant in cash. The rights of any participant or beneficiary to payments pursuant to Plan A are not subject to alienation, transfer, assignment, pledge, attachment, or encumbrance of any kind.

We note that the Internal Revenue Service recently published Revenue Procedure

2004-56, 2004-35 I.R.B. 376. Rev. Proc. 2004-56, which contains model amendments (the Model Amendment) designed for use by eligible governmental employers maintaining eligible section 457(b) defined contribution plans that permit employees to elect to defer compensation, that are maintained on the basis of the calendar year, and that provide for the use of one or more trusts to satisfy the requirements of section 457(g) of the Code. If an eligible governmental employer adopts one or more of the Model Amendments for its plan that is intended to be an eligible section 457(b) governmental plan, the plan will be treated as meeting the plan requirements for eligibility under section 457(b) with respect to the adopted provisions. Plan A has adopted several Model Amendment provisions on a word-for-word basis or in a manner that is substantially similar in all material respects.

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

Section 457(a)(1)(A) of the Code provides that in the case of a participant in an eligible governmental 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 to the participant or beneficiary. Section 457(b) provides that the term "eligible deferred compensation plan" means a plan established and maintained by an eligible employer in which only individuals who perform service for the employer may be participants and which meet the deferral limitations described in section 457(c); which meets the distribution requirements described in section 457(d); which provides for deferral elections described in section 457(b)(4); and, in the case of a governmental plan, which requires the plan assets and income to be held in trust for the exclusive benefit of participants and beneficiaries as described in section 457(g).

Section 457(e)(1) provides that the term "eligible employer" means 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 income tax.

Section 457(b)(4) of the Code provides that compensation will be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month. An eligible plan may provide that if a participant enters into an agreement providing for deferral by salary reduction under the plan, the agreement will remain in effect until the participant revokes or alters the terms of the agreement. Nonelective employer contributions are treated as being made under an agreement entered into before the first day of the calendar month.

Section 457(b)(2) of the Code provides the basic limits on the amount of eligible annual deferrals. However, a catch-up amount described in section 457(b)(3) may be added to this amount for participants that are within three years of the normal retirement age or, for participants age 50 or older, a catch-up amount may be added as described in

section 457(e)(18). A participant eligible for both catch-up provisions is entitled to use the higher limit of the two. The total annual eligible deferral amount is limited by section 457(c). Coordination of the basic limits and the catch-up limits is described in section 1.457-4(c) of the Income Tax Regulation (“regulations”).

Section 1.457-4(c)(v)(A) of the regulations provides that a plan may define the normal retirement age for purposes of the last-three-years catch-up provision as any age that is on or after the earlier of age 65 or the age at which participants have the right to retire and receive, under the basic defined benefit pension plan of the State or tax-exempt entity (or a money purchase pension plan in which the participant also participates if the participant is not eligible to participate in a defined benefit plan), immediate retirement benefits without actuarial or similar reduction because of retirement before some later specified age, and that is not later than age seventy and a half. Alternatively, a plan may provide that a participant is allowed to designate a normal retirement age within these ages. For purposes of the three-year catch-up provision an entity sponsoring more than one eligible plan may not permit a participant to have more than one normal retirement age under the eligible plans it sponsors. Section 1.457-4(c)(3)(v)(B) of the regulations provides a special exception for qualified police and firefighters to retire as early as age forty for purposes of the three-year catch-up provision.

Section 1.457-5 of the regulations provides that the section 457(c) eligible-deferral amount limitation is applied to all eligible plans in which a participant participates in a tax year and is determined on an aggregate basis. If a participant has annual deferrals under more than one eligible plan and the applicable catch-up amount is not the same for each such eligible plan for the taxable year, section 457(c) is applied using the catch-up amount under whichever plan has the largest catch-up amount applicable to the participant. To the extent that the combined annual deferral amount exceeds the maximum deferral limitation, the amount is treated as an excess deferral under section 1.457-4(e) of the regulations. For purposes of determining whether there is an excess deferral resulting from a failure of a plan to apply the deferral limitations, all plans under which an individual participates by virtue of his or her relationship with a single employer are treated as a single plan (without regard to any differences in funding).

Section 457(d)(1)(A) of the Code provides that amounts distributed under an eligible plan will not be made available to participants or beneficiaries earlier than (i) the calendar year in which the participant attains age 70 1/2, (ii) when the participant has a severance from employment with the employer, or (iii) when the participant is faced with an unforeseeable emergency.

Section 1.457-6(c)(2) of the regulations provides the requirements for a unforeseeable emergency distribution. An unforeseeable emergency must be defined in the plan as a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse, or the participant's or beneficiary's dependent; loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not

otherwise covered by homeowner's insurance, e.g., as a result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary. Whether a participant or beneficiary is faced with an unforeseeable emergency is determined based on the relevant facts and circumstances of each case. However, a distribution on account of unforeseeable emergency may not be made to the extent that such emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or by cessation of deferrals under the plan. Further, distributions because of an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need (which may include any amounts necessary to pay any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution).

Section 457(d)(1)(C) of the Code requires an eligible governmental plan to meet requirements similar to the requirements of section 401(a)(31). Section 401(a)(31)(B) requires that mandatory distributions of more than $1,000.00 from a plan qualified under section 401(a) be paid in a direct rollover to an individual retirement plan (i.e., an individual retirement account as described in section 408(a) or an individual retirement annuity described in section 408(b)) of a designated trustee or issuer if the distributee does not make an affirmative election to have the amount paid in a direct rollover to an eligible retirement plan or to receive the distribution directly. Recently published guidance, Notice 2005-5, 2005-3 I.R.B. 337, provides that the automatic rollover provisions of section 401(a)(31)(B) apply to section 457(b) governmental eligible deferred compensation plans. However, governmental plans will not be treated as failing to satisfy the requirements of section 401(a)(31)(B) if the automatic rollover provisions are not applied to mandatory distributions from such plans that are made prior to the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2006.

Section 457(d)(2) of the Code requires a plan to meet the minimum distribution requirements of section 401(a)(9). These requirements are described in Income Tax Regulation sections 1.401(a)(9)-1 through 1.401(a)(9)-9.

Section 457(d)(3) of the Code provides that a governmental plan will not fail to meet the distribution requirements if it provides for in-service distributions of a limited-dollar amount which meet the requirements of section 457(e)(9)(A) and section 1.457-6(e) of the regulations. Section 1.457-6(e) of the regulations is satisfied if the participant's total amount deferred (the participant's total account balance) which is not attributable to rollover contributions is not in excess of the dollar limit under section 411(a)(11)(A)(i.e., $5000 adjusted for inflation), no amount has been deferred under the plan by or for the participant during the two-year period ending on the date of the distribution, and there has been no prior distribution under the plan to the participant of this kind.

The determination of whether the availability of a loan, the making of a loan, or a failure

to repay a loan from an eligible governmental plan to a participant or beneficiary is treated as a distribution, and the determination of whether the availability of the loan, the making of the loan, or a failure to repay the loan is in any other respect a violation of the requirements of section 457(b), depends on the facts and circumstances. Among the facts and circumstances are whether the loan has a fixed repayment schedule and bears a reasonable rate of interest, and whether there are repayment safeguards to which a prudent lender would adhere. Any amount loaned from an eligible governmental plan to a participant or beneficiary is includible in the gross income of the participant or beneficiary for the taxable year in which the loan is made, except to the extent a loan satisfies section 72(p)(2).

Section 457(e)(10) of the Code provides that a participant shall not be required to include in gross income any portion of the entire amount payable to such participant solely by reason of the transfer of such portion from one eligible deferred compensation plan to another eligible deferred compensation plan. Section 1.457-10(b)(1) of the regulations provides that an eligible government plan may transfer amounts to, and receive amounts from, an eligible government plan if certain conditions are met.

With regard to transfers from an eligible governmental plan to another eligible governmental plan of the same employer, section 1.457-10(b)(4) of the regulations provides that a transfer from an eligible governmental plan to another eligible governmental plan is permitted if the following conditions are met: (i) The transfer is from an eligible governmental plan to another eligible governmental plan of the same employer; (ii) The transferor plan provides for transfers; (iii) The receiving plan provides for the receipt of transfers; (iv) The participant or beneficiary whose amounts deferred are being transferred will have an amount deferred immediately after the transfer at least equal to the amount deferred with respect to that participant or beneficiary immediately before the transfer; and (v) The participant or beneficiary whose deferred amounts are being transferred is not eligible for additional annual deferrals in the receiving plan unless the participant or beneficiary is performing services for the entity maintaining the receiving plan.

Section 457(e)(16) of the Code provides that, with regard to rollover distributions, for an eligible deferred compensation plan if (i) any portion of the balance to the credit of an employee in such plan is paid to such employee in an eligible rollover distribution (within the meaning of section 402(c)(4)),(ii) the employee transfers any portion of the property such employee receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and (iii) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed, then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid. Under section 1.457-10(e) of the regulations, an eligible governmental plan that permits eligible rollover distributions made from another eligible retirement plan to be paid into the eligible governmental plan is required to provide that it will separately account for any eligible rollover distributions it receives. Amounts contributed to an eligible governmental plan as eligible rollover distributions are not taken into account for

purposes of the annual limit on annual deferrals by a participant but are otherwise treated in the same manner as amounts deferred under the plan. Section 1.402(c)-2(b) of the regulations provides that a distributee other than the employee or the employee's surviving spouse (or a spouse or former spouse who is an alternate payee under a qualified domestic relations order) is not permitted to roll over distributions.

Consistent with section 414(p)(10) of the Code, section 1.457-10(c) of the regulations provides for distributions made pursuant to a quailed domestic relations order. If a distribution or payment is made from an eligible plan to an alternate payee pursuant to a qualified domestic relations order, rules similar to the rules of section 402(e)(1)(A) apply to the distribution. Section 414(p)(8) provides that the term "alternate payee" means any spouse, former spouse, child or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant.

Section 457(e)(17) of the Code provides that no amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan (as defined in section 414(d)) if such transfer is for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan, or a repayment to which section 415(k)(3) does not apply.

Section 457(g) of the Code 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)(A) 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)(3) states that custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

Rev. Rul. 58-66, 1958-1 C.B. 60, provides that the marital status of individuals as determined under state law is recognized in the administration of tax laws. However, Section 3 of the "Defense of Marriage Act", P.L. 104-199 (September 21, 1996), provides that, "in determining the meaning of any Act of Congress, or of any ruling, regulation or interpretation of the various administrative bureaus or agencies of the United States, the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife."

Based upon the information submitted and the representations made, we conclude as follows:

1. Plan A is an eligible deferred compensation plan as defined in section 457(b) of the Code.

2. Amounts of compensation deferred under Plan A, including any income attributable to the deferred compensation, will be includible under section 457(a)(1)(A) of the Code in the recipient's gross income for the taxable year or years in which amounts are paid to a participant or beneficiary in accordance with the terms of Plan A.

3. A registered domestic partner, a former registered domestic partner, or a surviving registered domestic partner as defined in State X Act is not a spouse, a former spouse or a surviving spouse for purposes of section 457. Accordingly, in the event that the Spouse Provisions are not interpreted and applied in a manner consistent with the Defense of Marriage Act, the operation of Plan A will not be in compliance with section 457(b).

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. If Plan A is significantly modified, this ruling will not necessarily remain applicable.

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, this ruling applies only to deferrals made after the date of this ruling.

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.

Sincerely,

Robert D. Patchell
Branch Chief, Qualified Plans Branch 2 (Employee Benefits)(Tax Exempt & Government Entities)

Enclosure (1)
For 6110 purposes

cc: