

**Internal Revenue Service**

Number: **200703012**

Release Date: 1/19/2007

457.01-00, 457.05-03, 671.02-00, 83.13-00

Department of the Treasury

Washington, DC 20224

[Third Party Communication:

Date of Communication: Month DD, YYYY]

Person To Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EB:QP2

PLR-113804-06

Date:

September 28, 2006

Legend

Entity E =

Related Entities RE =

Dear \_\_\_\_\_ :

This responds to your authorized representative's letter of January 31, 2006 and subsequent correspondence, on behalf of Entity E and its Related Entities RE, requesting a ruling concerning the deferred compensation plan (the "Plan") which E intends to be an eligible deferred compensation plan under section 457(b) of the Internal Revenue Code of 1986 (the "Code"), as amended under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). In addition, your representative also requested rulings regarding the trust associated with the plan under sections 83, 451, 671 and 677 of the Code. Entities E and RE are represented to be

PLR-113804-06

tax-exempt organizations which are eligible employers described in section 457(e)(1)(B) of the Code. RE are represented to be in the same controlled group as their parent, E.

Under the Plan an eligible participant, a member of a select group of highly compensated employees determined as provided thereunder, may elect to defer compensation that would have been received for services rendered to his employer in any taxable year until death, or severance from employment with the employer. The RE have also adopted the Plan as their deferred compensation plan.

Under the Plan, the participant's election to defer compensation not yet paid or made available must be filed prior to the beginning of the month in which his or her salary reduction agreement becomes effective for such amounts. The Plan provides for a maximum amount that may be deferred by a participant in any taxable year and also provides for a catch-up computation for amounts deferred for one or more of the participant's last three taxable years ending before he attains normal retirement age under the Plan. Pursuant to the Plan the employer may make matching or other discretionary employer contributions to a participant's account up to a maximum amount determined thereunder. However, such employer contributions are included in determining whether a participant has reached the maximum annual deferral limitation under section 457(b) (2) or (3) of the Code. The amounts that may be deferred under the annual maximum limitation and the catch-up provisions are within the limitations of section 457.

The Plan provides that the deferred amounts will be distributed to the participant (or to the beneficiary after the participant's death) in a lump sum within a short period after the participant's severance from employment, thus meeting the distribution requirements of sections 401(a)(9) and 457(d)(1) of the Code.

The Plan provides that all amounts deferred under the Plan and all income attributable to such amounts will remain (until made available to the participants or beneficiaries) solely the property and rights of the participant's employer, subject only to the claims of the employer's general creditors. The Plan also provides that a participant or beneficiary has only an unsecured right to benefits thereunder, and no right or claim against the assets of his/her employer. The rights of any participant or beneficiary to payments pursuant to the Plan are generally non-assignable and not subject to pledge, alienation or encumbrance.

E has adopted a related trust to help it and the REs meet their obligations under the Plan. The trust conforms to the model language contained in Section 5 of Rev. Proc. 92-64, 1992-2 C.B. 11, that serves as a

PLR-113804-06

safe harbor against the constructive receipt of income and the realization of economic benefit. The trust contains no language that is inconsistent or conflicts with the model trust language. Under the trust, all trust assets of E or an RE remain subject to the claims of its general creditors in the event of that employer's insolvency. E represents that the trust is valid under the appropriate state law and that all material terms and provisions of the trust, including the creditors' rights clause, are enforceable under the appropriate state law. E further represents that the Trustee of the trust is an independent third party that may be granted corporate trustee powers under the appropriate state law.

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

Section 457(a)(1)(B) of the Code provides that in the case of a participant in an eligible deferred compensation plan of a tax-exempt employer, 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(b)(6) requires an eligible plan of a tax-exempt employer to provide that i) all amounts of compensation deferred under the plan, ii) all property and rights purchased with such amounts, and iii) all income attributable to such amounts, property, or rights must remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors.

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 has a severance from employment with the employer, or iii) when the participant is faced with an unforeseeable emergency as determined under Treasury regulations.

Section 83(a) of the Internal Revenue Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable

PLR-113804-06

year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Income Tax Regulations provides that for purposes of section 83 the term "property" includes real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future. Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by an employer to an employee's trust that is not exempt from tax under section 501(a) are included in the employee's gross income in accordance with section 83, except that the value of the employee's interest in the trust will be substituted for the fair market value of the property in applying section 83. Under section 1.402(b)-1(a)(1) of the regulations, an employer's contributions to a nonexempt employees' trust are included as compensation in an employee's gross income for the taxable year in which the contribution is made, but only to the extent that the employee's interest in such contribution is substantially vested, as defined in the regulations under section 83.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 195 F.2d 541 (6th Cir. 1952), Rev. Rul. 60-31, Situation 4. In Rev. Rul. 72-25, 1972-1 C.B. 127, and Rev. Rul. 68-99, 1968-1 C.B. 193, an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the insurance contract is the employer's asset, subject to claims of the employer's creditors.

Section 301.7701-4(a) of the Procedure and Administration Regulations provides that, generally, an arrangement will be treated as a trust if it can be shown that the purposes of the arrangement is to vest in trustees the responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of a business for profit.

Section 671 of the Code provides that where a grantor shall be treated as the owner of any portion of a trust under Subpart E, part I, subchapter J, chapter 1 of the Code, there shall then be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that

PLR-113804-06

such items would be taken into account under chapter 1 in computing taxable income or credits against tax of an individual.

Section 677(a)(2) of the Code provides that the grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be held or accumulated for future distribution to the grantor.

Section 1.677(a)-1(d) of the regulations provides that under section 677 of the Code, a grantor is, in general, treated as the owner of a portion of a trust whose income is, or, in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Under the terms of the trust, assets may be placed in trust to provide benefits to Plan participants and their beneficiaries. However, in the event that E or an RE becomes insolvent, the Trustee will have the obligation to hold the trust assets and income for the benefit of that employer's general creditors. The trust agreement further provides that a participant receives no beneficial ownership in or preferred claim on any trust assets. Therefore, contributed assets will be held in trust, and in the event of the insolvency of E or an RE, the employer's assets will be fully within reach of its creditors.

Provided (i) that the creation of the trust does not cause the Plan to be other than "unfunded" for purposes of Title I of the Employee Retirement Income Security Act of 1974, and (ii) that the provisions of the trust requiring use of the employer's trust assets to satisfy the claims of its general creditors in the event of its insolvency is enforceable by its creditors under federal and state law, and based on the information submitted and representations made, we conclude that:

Based upon the provisions of the Plan summarized above, the documents presented and representations made, we conclude as follows:

- 1 The Plan adopted by Entity E and its related entities RE is an eligible deferred compensation plan as defined in section 457(b) of the Internal Revenue Code of 1986 as amended under the EGTRRA
- 2 Amounts of compensation deferred in accordance with the Plan, including any income attributable to the deferred compensation, will be includible under section 457(a)(1)(B) in the recipient's gross income for the taxable year or years in which such amounts are paid or made available to a participant or beneficiary in accordance with the terms of the Plan.
- 3 Under the economic benefit and constructive receipt doctrines of sections 61 and 451 of the Code, neither the creation of the Plan or the

trust, nor the contribution of assets to the trust will create taxable income for participants or their beneficiaries under the cash receipts and disbursements method of accounting.

- 4 The trust will be classified as a trust within the meaning of the Procedure and Administration Regulations. Because the principal and income of the trust may be applied in discharge of legal obligations of R and each RE contributing to the trust, each such employer shall be treated as the owner of the trust to the extent of its proportionate contributions to the trust under section 677 of the Code, to the extent that amounts in the trust are attributable to services provided for E or that RE. Accordingly, there shall be included in computing the taxable income and credits of each such employer, the appropriate portion of items of income, deductions, and credits against tax of the trust, under section 671, subject to the provisions of the Code applicable to section 501(c)(3) organizations.
- 5 Neither the creation of the trust nor the contribution of assets by E or an RE to the trust will result in a transfer of property for purposes of section 83 of the Internal Revenue Code or section 1.83-3(e) of the regulations.

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 amounts deferred (including the earnings thereon) after the date this ruling is issued. The Service expresses no opinion as to the consequences of the arrangement under Title I of the Employee Retirement Income Security Act of 1974. If the Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to Entity E and its related tax-exempt affiliates, the REs, that have adopted the Plan. Also, this ruling applies only to the Plan submitted on January 31, 2006 and to the revised trust document submitted on August 1, 2006. Section 6110(k)(3) of the Internal Revenue Code provides that this ruling may not be used or cited as precedent.

Sincerely,

Robert D. Patchell  
Branch Chief, Qualified Plans Branch 2 (Employee  
Benefits)  
(Office of Division Counsel/Associate Counsel)

Enclosure (1)