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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
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Date:
June 16, 2015

TY: Calendar year

Legend

System A =

Board B =

Trust O =

Excess Plans =

State N =

Statute S =

Dear :

This letter is in response to your ruling request, submitted by your authorized representative, dated November 8, 2012, as supplemented by correspondence dated July 9, 2014, April 17, 2015, May 7, 2015, May 11, 2015, and May 22, 2015 with respect to the applicability of section 415(m) of the Internal Revenue Code ("Code") to the excess benefit plans ("Excess Plans") and the related federal tax consequences.

The following facts and representations have been submitted under penalties of perjury in support of your request:

System A is a statewide system established under Statute S. Sponsored by State N, System A administers retirement plans and other funds that provide medical, death, disability and retirement benefits on behalf of active and former state employees, teachers, police, firefighters, judges, and volunteer firefighters.

System A has established qualified plans (Qualified Plans) which were adopted by employers for benefit of eligible employees and are administered by Board B and System A. Your authorized representatives have represented that the Qualified Plans are defined benefit plans and governmental plans as described in section 414(d) of the Code and are intended to meet the qualification requirements of section 401(a). The funding vehicle for the Qualified Plans is a master trust ("Retirement Fund"), which includes the trust funds of the Qualified Plans adopted by an employer.

Each of the employers has established an excess benefit plan. The Excess Plans are intended to be "qualified excess benefit arrangements" within the meaning of section 415(m)(3) of the Code, and will operate in accordance with that section. Under the Excess Plans, a participant who is receiving a retirement benefit from a Qualified Plan ("Retiree"), or an individual who is receiving a retirement allowance or other benefit under a Qualified Plan ("Beneficiary"), will be paid the amount of retirement income that would otherwise have been payable to such Retiree or Beneficiary by System A, but could not be paid from the Qualified Plan because of the limitations of section 415(b) of the Code. The retirement income benefits provided under the Excess Plans are hereinafter referred to as "Excess Benefits."

Employer contributions under the Excess Plans are held in Trust O. If and only to the extent the Employer makes sufficient contributions to Trust O, Board B will compute and pay the Excess Benefits under the Excess Plans in the same form, at the same time, and to the same persons as such benefits would have otherwise been paid as a monthly pension under the Qualified Plan, except for the limitations of section 415 of the Code. Under the Qualified Plans, and therefore under the Excess Plans, retirement benefits are only payable to Retirees and Beneficiaries upon the occurrence of certain events permitting a distribution under a Qualified Plan (i.e., retirement, death, disability, or other termination of employment).

Participants in the Excess Plans may elect a form of benefit under one or more of the Qualified Plans, which dictates the form of payment under the Excess Plans. However, under the terms of the Excess Plans, participants are not provided an election to defer compensation under the plan, either directly or indirectly. The Excess Plans also provides that a participant's interests under the Excess Plans prior to distribution may not be subject to execution, attachment, or garnishment or otherwise subject to any other process whatsoever.

Trust O, separate and apart from the Retirement Fund, has been established solely for the purpose of holding employer contributions intended to pay Excess Benefits under the Excess Plans. Your authorized representative has represented that the Trust O is a grantor trust under state law and for federal income tax purposes. Board B is the grantor of Trust O, within the meaning of sections 671 through 679 of the Code. Accordingly, the assets of Trust O, which are held for each employer under the Excess Plans, are subject to the claims of that employer's general creditors under federal and state law in the event of the insolvency of the employer.

Trust O will be funded on a "pay-as-you-go" basis and begin paying benefits as necessary to ensure compliance with the applicable limitations of section 415 of the Code. All assets held in Trust O and all property rights and beneficial interests acquired through the use of the Excess Plans assets will be held separate and apart from other funds of the employers. Under the terms of the Excess Plans, participants in the Excess Plans receive no property rights, legal or beneficial, in any of the assets held in Trust O. The provisions of the Excess Plans explicitly provide that contributions to Trust O will be held separate and apart from the funds comprising the Retirement Fund and will not be commingled with assets of the Retirement Fund, and must be accounted for separately. Board B members act as trustees with respect to Trust O.

Board B will determine the amount necessary to pay the Excess Benefit under the Excess Plans for each calendar plan year ("Plan Year"). The required contribution for each Employer will be the aggregate of the excess benefits payable under the Excess Plans to all Retirees and Beneficiaries of that Employer for the Plan Year and an amount determined by Board B to be a necessary and reasonable expense of administering the Excess Plans and Trust O. No employee contributions are permitted under the Excess Plans.

Contributions to the Excess Plans will not be calculated in a manner designed to pay future Excess Benefits. Any contributions not used to pay the Excess Benefit for a current Plan Year, together with any income accruing to Trust O, will be used, as determined by Board B, to pay the administrative expenses of the Excess Plans and Trust O for the Plan Year. However, any contributions not used to pay Excess Benefits for the current Plan Year that remain after paying administrative expenses of the Excess Plans and Trust O for the Plan Year will be used to fund administrative expenses or Excess Benefits in future Plan Years.

All Retirees and Beneficiaries will automatically participate in the Excess Plans for a Plan Year if their retirement benefits from the Qualified Plan for the Plan Year would exceed the limitations imposed by section 415(b) of the Code. The administrator will determine for each Plan Year which Retirees and Beneficiaries will participate in the Excess Plans (such Retirees and Beneficiaries who are entitled to a benefit under the Excess Plans are hereinafter referred to as a "Participants"). Participation in the Excess Plans ends for any Plan Year in which the retirement benefit of a Participant is not limited by section 415(b) and when all benefit obligations under the Excess Plans to the Participant for that Plan Year have been satisfied. Neither the trustees of Trust O nor System A is responsible for paying Excess Benefits other than from contributions from the Employers.

Based on the above facts and representations, you request the following rulings:

1. That the Excess Plans establishes a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code;
2. That the benefits payable under the Excess Plans will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a Participant or a Participant's Beneficiary in accordance with the terms of the Excess Plans; and
3. That income accruing to the Excess Plans is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

Section 415(b) of the Code and section 1.415(b)-1 of the Income Tax Regulations ("regulations") set forth the limitations on annual benefits for participants in defined benefit plans.

Section 1.415(b)-1(b)(1)(ii) of the regulations provides in part that the annual benefit does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) of the Code, determined pursuant to the rules of

paragraph (b)(2) of this section. This section further states that the treatment of transferred benefits is determined under the rules of paragraph (b)(3) of this section.

Section 1.415(b)-1(b)(3)(ii) of the regulations addresses elective transfer of distributable benefits and states in part that the annual benefit provided by the transferee defined benefit plan does not include the annual benefit attributable to the amount transferred.

Section 415(m)(1) of the Code provides that, in determining whether a governmental plan (as defined in section 414(d)) meets the benefit limitations of section 415, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Section 415(m)(1) also states that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115.

Section 415(m)(2) of the Code describes the tax treatment of benefits payable under a qualified governmental excess benefit arrangement. Under section 415(m)(2), the taxable year or years for which amounts in respect of a qualified excess benefit arrangement are includible in gross income by a participant, and the treatment of such amounts when so includible by the participant, are determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation that is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401.

Section 415(m)(3) of the Code defines a qualified governmental excess benefit arrangement as a portion of a governmental plan that meets the following three requirements:

- (A) Such portion is maintained solely for the purpose of providing to participants in the plan that part of each participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 of the Code;
- (B) Under such portion, no election is provided at any time to the participant (directly or indirectly) to defer compensation; and
- (C) Such benefits in excess of the limitations under section 415 of the Code are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

With respect to your first requested ruling, according to the represented facts, the Qualified Plans are governmental plans as described in section 414(d) of the Code. Furthermore, under the represented facts, the only purpose of the Excess Plans is to provide affected employees of State N and its qualifying governmental units who participate in the Qualified Plans that portion of their retirement benefits that would otherwise be payable under the terms of the Qualified Plans except for the limitations on

benefits imposed by section 415(b), as applicable to governmental plans. Participation in The Excess Plans is limited to Participants receiving benefits under the Qualified Plans that would otherwise exceed the limits of section 415.

Consequently, we find that the Excess Plans are portions of the Qualified Plans, which are governmental plans, and are maintained solely for the purpose of providing employees of State N and its qualifying governmental units who participate in the Qualified Plans that part of their benefits otherwise payable under the terms of the Qualified Plans that exceed the benefit limitations of section 415 of the Code. Accordingly, we conclude that the Excess Plans meets the requirements of section 415(m)(3)(A).

Your authorized representatives have stated that participation in the Excess Plans is mandatory and automatic, and that there are no employee contributions to the Excess Plans. Your representatives also assert that, while participants may elect a form of benefit under the Qualified Plans, which dictates the form of payment under the Excess Plans, no direct or indirect election to defer compensation is provided to any participant in the Excess Plans. Therefore, because no direct or indirect election is provided at any time to Participants to defer compensation under the Excess Plans, the requirements of section 415(m)(3)(B) of the Code are met.

Section 415(m)(3)(C) of the Code requires that the trust from which the excess benefits of a qualified governmental excess benefit arrangement are paid not form a part of the governmental plan that contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. Under the facts of this case, the Excess Plans will be funded on a "pay-as-you-go" basis. The represented facts indicate that a separate trust fund, Trust O, has been established for the segregation of the assets related to the Excess Plans. This trust fund has been established solely for the purpose of holding employer contributions intended to pay excess benefits to affected participants in the Qualified Plans. The represented facts further state that contributions to Trust O will consist only of the amounts required to pay the excess benefits and related administrative expenses. The provisions of the Excess Plans explicitly provide that contributions to Trust O will be held separate and apart from the funds comprising the Retirement Fund and will not be commingled with assets of the Retirement Fund, and must be accounted for separately. Based on these representations and the provisions of the Excess Plans, we have determined that the requirements of section 415(m)(3)(C) are met.

With respect to your first requested ruling, since the Excess Plans satisfy the requirements of sections 415(m)(3)(A), (B) and (C) of the Code, we conclude that the Excess Plans are qualified governmental excess benefit arrangement within the meaning of section 415(m).

Your second ruling request asks whether the benefits payable under the Excess Plans will be includible in gross income for the taxable year or years in which such benefits

are paid or otherwise made available to a Participant in accordance with the terms of the Excess Plans. In response to your first ruling request, we concluded that the Excess Plans meets the legal requirements of Code section 415(m) of the Code and, therefore, constitutes a qualified governmental excess benefit arrangement. Accordingly, under section 415(m)(2), the tax treatment of benefits payable under the Excess Plans is determined as if the Excess Plans were plans for the deferral of compensation that is maintained by a corporation not exempt from tax and that does not meet the requirements for qualification under section 401.

Section 83(a) of the Code provides the rules for inclusion in gross income of the value of property transferred to an employee as compensation for his or her services. The excess of the fair market value of property so transferred over the amount paid for the property is includible in the gross income of the person who performed services for the first taxable year in which the property becomes transferable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the regulations defines "property" as including real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future. Under section 1.83-3(e), property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors 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 employee's trust are included as compensation in the employee's gross income for the taxable year in which the contribution is made, but only to the extent the employee's interest in such contribution is substantially vested, as defined in the regulations under section 83.

Section 451(a) of the Code and section 1.451-1(a) of the regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 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, section 1.451-2(a) further provides that income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

The Service has also addressed the issue of constructive receipt as it applies to nonqualified plans of deferred compensation, including excess benefit plans, in various revenue rulings. In Rev. Rul. 60-31, Situations 1 – 3, the Service held that a mere promise to pay, not represented by notes or secured in any way, does not constitute

receipt of income by a cash basis taxpayer. Rev. Rul. 60-31, 1960-1 C.B. 174, as modified by Rev. Rul. 64-279, 1964-2 C.B. 121, and Rev. Rul. 70-435, 1970-2 C.B. 100; see also Rev. Rul. 69-650, 1969-2 C.B. 106, Rev. Rul. 69-649, 1969-2 C.B. 106; and Rev. Rul. 71-419, 1971-2 C.B. 220.

Under the economic benefit doctrine, an employee is taxable in a year in which any economic or financial benefit is conferred upon the employee as compensation. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952). An economic benefit is conferred on an employee when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. 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 the claims of the employer's creditors.

Based on the foregoing, with respect to the second ruling request, we conclude that the benefits payable under the Excess Plans will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a Participant or a Participant's Beneficiary in accordance with the terms of the Excess Plans.

With respect to your third requested ruling, section 415(m)(1) of the Code provides that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement), in respect of a qualified governmental excess benefit arrangement, will constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) will be exempt from tax under section 115 of the Code. We have determined, in connection with your first ruling request, that the Excess Plans meets the legal requirements of section 415(m) for qualified governmental excess benefit arrangements. Therefore, under section 415(m)(1), with respect to your third requested ruling, we conclude that income accruing to the Excess Plans is exempt from federal income tax under sections 115 and 415(m)(1) as income derived from the exercise of an essential government function.

The ruling contained in this letter is based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

This letter ruling is directed only to the taxpayer who requested it. 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 letter ruling have not yet been adopted. Therefore, this letter ruling will be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in the letter ruling. See section 11.04 of Rev. Proc.

2015-1, 2015-1 IRB 1, 59. If the taxpayer can demonstrate that the criteria in section 11.06, 60, of Rev. Proc. 2015-1 are satisfied, the revocation or modification of a letter ruling is generally not applied retroactively.

This ruling is based on the assumption that the Qualified Plans will be governmental plans as described in section 414(d) of the Code, and qualified under section 401(a), and that the related Trust O will be exempt from tax under section 501(a).

This ruling letter is based on the assumption that the after-tax contributions, rollovers and trustee-to-trustee transfers described above are excluded from the determination of annual benefit within the meaning of section 1.415(b)-1(b)(1)(ii) of the regulations.

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 the Plan 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.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representatives.

Sincerely,

Cheryl E. Press
Senior Counsel, Qualified Plans
Branch 4 (Employee Benefits)
(Tax Exempt Government Entities)

Enclosures:

Deleted copy of ruling letter
Notice of Intention to Disclose

cc: