

## Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Contact Person:

Telephone Number:

In Reference to:

CC:EBO:1 - PLR-116469-98

Date:  
DEC 19 1998

Entity E =

State S =

Dear

This responds to your letter of August 5, 1998 and subsequent correspondence, on behalf of Entity E, requesting a ruling concerning the proposed deferred compensation plan (the "Plan") which E intends to be an eligible deferred compensation plan under section 457 of the Internal Revenue Code of 1986. E is represented to be a State S governmental entity described in section 457(e)(1)(A). Provided that E receives a ruling regarding the Plan's eligible status from the Service, E plans to make the plan available for adoption by state or local governmental entities within a certain category specified in the Plan and which are located within State S.

Under the Plan an employee may elect to defer compensation that would have been received for services rendered to a governmental entity in State S that adopts E's plan in any taxable year until attainment of age 70 ½, death, separation from service with the employer, or until the occurrence of an unforeseeable emergency. The Plan also includes a provision permitting 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 amount payable to him or her under the Plan, 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, and 4) the participant had elected to receive the distribution.

The participant's election to defer compensation under the Plan must be filed prior to the beginning of the month in which his or her salary reduction agreement becomes effective. 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. The amounts that may be deferred under the annual maximum limitation and the catch-up provision are within the limitations of section 457 including the section 457(c) coordinated deferral provision.

PLR-116469-98

With certain limitations, a participant may elect the manner in which his deferred amounts will be distributed. The election must be made prior to the date any such payment must commence to the participant. If the participant fails to make a timely election, distribution will commence at the time and in the manner set forth in the Plan. The manner and time of benefit payout must meet the distribution requirements of sections 401(a)(9) and 457(d)(2) of the Code.

The Plan further provides that the trustee of its assets must hold all the section 457 plan's assets for the exclusive benefit of the participants and their beneficiaries, and that all amounts deferred under the Plan must be transferred to the trust within an administratively reasonable time period (i.e., within 15 business days after the end of the month in which such amounts were deferred). The trust is represented to be a valid trust under state law. The rights of any participant or beneficiary to payments pursuant to the Plan are generally nonassignable and not subject to attachment, garnishment, pledge or garnishment.

The plan provides that distribution to an alternate payee pursuant to a domestic relations order may occur or commence only when the participant himself becomes eligible to receive distributions under the Plan and under section 457(d). If such alternate payee receives rights to amounts in a participant's account under a domestic relations order, the Plan may maintain a bookkeeping account for such beneficiary. The plan administrator may make distributions from such account pursuant to the domestic relations order to the alternate payee at or after the time section 457(d) permits distributions from the participant's account.

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) of the Code 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

PLR-116469-98

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.

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(f) provides that if a section 457 plan is or becomes an ineligible plan then the deferred compensation shall be included in the gross income of the participant or beneficiary for the first taxable year in which there is no substantial risk of forfeiture of the rights to such compensation, and the tax treatment of any amount made available under such plan to a participant or beneficiary shall be determined under section 72 relating to annuities.

Section 457(g) 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.

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 3401(a) defines "wages as all remuneration for services performed by an employee for his employer subject to certain exceptions. Under § 31.3401(a)-1(a) of the Employment Tax Regulations, "wages" is defined, in pertinent part, as "all remuneration for services performed by an employee for his employer unless specifically excepted under section 3401(a)."

Section 3402(a) of the Code provides that, except as otherwise provided, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Employment Tax Regulations § 31.3402(a)-1(b) provides that wages are

PLR-116469-98

considered to be paid for federal income tax withholding purposes when actually or constructively paid. In order to constitute constructive payment, the wages must be credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available so that they may be drawn at any time, and their payment brought within the employee's own control and disposition.

Additionally, section 3405 of the Code provides special rules for pensions, annuities, and certain other deferred compensation. Temporary Employment Tax Regulations § 35.3405-1 A-23 provides that amounts paid from a plan described in section 457 are wages under section 3401(a) and that the general wage withholding rules, not the special rules of section 3405, apply to these payments.

Based upon the provisions of the revised plan summarized above, and the documents presented, we conclude as follows:

1. The Deferred Compensation Plan established by Entity E is an eligible deferred compensation plan as defined in section 457(b) of the Internal Revenue Code of 1986. Eligible employers within State S that adopt this Plan will have adopted an eligible deferred compensation plan as defined in section 457(b).
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 an employee or beneficiary in accordance with the terms of the Plan.
3. E's Plan will not become an ineligible plan described in section 457(f) solely because its administrator or trustee complies with a domestic relations order requiring the distribution of the benefits of a participant in pay status (currently eligible to receive distributions) under section 457(d)(1)(A) to the alternate payee named in the order (such as the participant's spouse or ex-spouse) to meet the participant's obligations with respect to alimony, support, or division of marital rights.
4. The trust established under E's section 457(b) plan is treated under section 457(g) as an organization exempt from taxation under section 501(a).

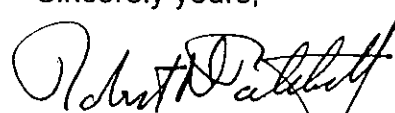
PLR-116469-98

5. Amounts deferred under section 457(b) are not subject to federal income tax withholding at the time of deferral. Rather, under section 3401(a), amounts deferred will be wages, subject to federal income tax withholding at the time paid or made available to the participant or beneficiary under the plan.

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than E's Plan described above. In addition, this ruling applies only to deferrals made after the date this ruling was issued. If the Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to Entity E and the employees of the governmental entities within State S that adopt E's plan and applies only to the Plan submitted on August 5, 1998 and revised in accordance with the amendments submitted on September 28, 1998. 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. 98-1, 1998-1 I.R.B. 7, 47. However, when the criteria in section 12.05 of Rev. Proc. 98-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely yours,



ROBERT D. PATCHELL  
Assistant Chief, Branch 1  
Office of the Associate  
Chief Counsel  
(Employee Benefits and  
Exempt Organizations)

Enclosure:

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