

INTERNAL REVENUE SERVICE

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Date: May 5, 1999

Plan =

Trust =

State X =

Dear:

This responds to your letter of October 5, 1998 and subsequent correspondence, on behalf of State X, requesting a ruling concerning the proposed deferred compensation plan ("Plan") which State X intends to be an eligible deferred compensation plan under section 457 of the Internal Revenue Code of 1986 ("Code"). State X is an eligible employer as described in section 457(e)(1)(A).

Under the Plan, the amounts of compensation that may be deferred under the annual maximum limitation are within the limitations of section 457, including the section 457(c) coordinated deferral provision and the catch-up computation for amounts deferred for one or more of the participant's last three taxable years ending before he or she attains normal retirement age. The participant's election to defer compensation must be filed prior to the beginning of the month in which his or her salary reduction agreement becomes effective. The Plan does not provide that a loan may be made from assets held by the Plan to any participant or beneficiary under the Plan.

With certain limitations, a participant may elect the manner in which his or her deferred amounts will be distributed. The election must be made prior to the date any amounts become payable to the participant under the Plan. If the participant fails to make a timely election, distribution will commence at the time and in the manner set forth in the Plan. Under the Plan, no amounts will be made available to the participant or beneficiary earlier than the calendar year the participant attains age 70 ½, when the participant is separated from service with State X, or when the participant is faced with an unforeseeable emergency as defined under the Plan in accordance with the requirements of section 457. The manner and time of benefit payout must meet the distribution requirements of sections 401(a)(9) and 457(d)(2) of the Code.

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However, the Plan does permit one exception to the above distribution requirements. The Plan, in accordance with section 457(e)(9)(A), 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 has elected to receive the distribution.

The Plan further provides that all amounts of compensation deferred pursuant to Plan, all property and rights purchased with such amounts and all income attributable to such amounts, property, or rights shall be held (a) in trust for the exclusive benefit of participants and beneficiaries under the Plan, or (b) in one or more annuity contracts, as defined in section 401(g) of the Code, issued by an insurance company qualified to do business in the state where the contract was issued, for the exclusive benefit of the participants and beneficiaries of the Plan. For this purpose, the term "annuity contract" does not include a life, health or accident, property, casualty, or liability insurance contract. Any trust under the Plan will be established pursuant to a written agreement that constitutes a valid trust under the laws of State X. 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 in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment, or garnishment by creditors of the participant or the participant's beneficiary.

The terms of Trust and the insurance contracts make it impossible prior to the satisfaction of all liabilities with respect to plan participants and their beneficiaries for any part of the assets and income of Trust or the insurance contracts to be used for, or diverted to, purposes other than the exclusive benefit of plan participants and their beneficiaries.

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.

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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 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 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.

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Section 457(g)(2) 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)(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 for purposes of section 457(g), custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

Under the terms of the Plan and Trust and the insurance contracts, the trustee must hold all of the section 457(b) plan assets for the exclusive benefit of the participants and their beneficiaries, and all amounts deferred under the Plan must be transferred to a trust meeting the requirements of section 457(g) of the Code within an administratively reasonable time period.

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

1. The Deferred Compensation Plan established by State X 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 trust for the exclusive benefit of participants and their beneficiaries.
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. Trust established with respect to State X's Plan under section 457(b), is treated under section 457(g) as an organization exempt from taxation under section 501(a). An annuity contract entered into by State X, which is described in section 401(f) will be treated as a trust under rules similar to the rules under section 401(f).

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than State X's Plan described above. In addition, this ruling applies only to deferrals made after the date

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this ruling was issued. If the Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to State X and the participants of State X's Plan and applies only to the Plan and Trust submitted on October 29, 1998 and revised in accordance with the amendments submitted on March 2, 1999. 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. 99-1, 1999-1 I.R.B. 6, 47. However, when the criteria in section 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely yours,

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Office of the Associate  
Chief Counsel  
(Employee Benefits and  
Exempt Organizations)

Enclosure:

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