Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

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Date:
November 3, 1998

DO:

Legend

Employer =

Plan =

Trust =

Dear

This is in response to your request for a ruling submitted on behalf of the Employer regarding the federal income tax consequences under sections 83, 402, 404, 451, 671, and 677 of the Internal Revenue Code ("Code") with respect to the Employer's nonqualified deferred compensation Plan ("Plan") and the Plan's related Trust ("Trust").

The Employer has adopted the Plan to provide nonqualified deferred compensation benefits for certain eligible employees, creating an incentive for the employees' performance and their continued employment with the Employer. An employee becomes a participant in the Plan only after entering into a written agreement with the Employer specifying that the employee is a Participant and the effective date of the participation. The general administration of the Plan will be delegated to a Compensation Committee, the members of which will be appointed by the Company Executive Committee. Decisions of the Compensation Committee, which will consist of at least three individuals, will be determined by the majority vote of the Committee.

Within 120 days following the end of each Plan year, the Employer will credit to the account of each Participant an amount equal to 10 percent of that Participant’s annual salary if he or she was employed by the Employer on the last day of the Plan Year. In addition to the preceding nonelective contribution, the Compensation Committee may specify an elective contribution to be made to the Plan for each Participant employed on the last day of the Plan Year. While the Plan provides a target amount for elective contributions, the Compensation Committee may vary the amount of such contributions for any reason, including a reduction to reflect the earnings credited to the Participant’s account that are taxable to the Employer.

In order to help the Employer satisfy its obligation to its employees under the plan, the Employer has established a Trust. The contributions for each Participant will be paid to the Trustee, which will hold the contributions in separate accounts for each Participant. The Participant’s account will be invested by the Trustee as directed by the Compensation Committee. Every Plan Year, 50 percent of the net investment income and all investment losses will be credited or debited to each Participant's account. The remaining 50 percent of earnings attributable to all Participants' accounts will be distributed to the Employer as a reimbursement for the income tax liability incurred by the Employer on such earnings. Investment expenses attributable to each Participant's account will be charged against such account. Trustee fees will be allocated among the Participants at the end of each Plan Year in a ratio that each Participant's account balance bears to the total of all Participants' account balances held by the Trustee at the beginning of the Plan Year.

Each Participant will be entitled to receive benefits from his or her account beginning on the earliest of the Participant's death, Disability, or Normal Retirement Date. Disability is defined in the Plan as the permanent inability of a Participant to continue to perform his or her regular duties as an employee due to physical or mental impairment. Normal Retirement Date is defined as the later of the first day of the calendar month following the Participant's sixty-fifth birthday or termination of employment with the Employer.

The benefit may be in the form of a lump sum payment or in any form of annuity that is commercially available. The annuity will be paid in equal monthly installments with a value that is the actuarial equivalent to the Participant's account balance at the time the Participant is eligible to receive benefits or a combination of a partial lump sum and an annuity. The Participant will elect the form of benefit prior to participation in the plan. While the Participant may not change the form of benefit once such benefit is elected, he or she may elect different forms of benefit for death, Disability, or Normal Retirement.

A Participant who terminates employment with the Employer for any reason other than death or disability will be vested in his or her account balance in accordance with the graded vesting schedule provided in the Plan. However, a Participant will be fully vested in his or her account balance upon the occurrence of death or disability if such event occurred while employed by the Employer. Upon a Participant’s termination of employment prior to death, Disability, or Normal Retirement, all forfeited amounts will be distributed to the Employer. Concurrently, the Participant will be paid the vested portion of his or her account balance.

In accordance with the provisions of Revenue Procedure ("Rev. Proc.") 92-65, 1992-2 C.B. 428, the Plan states that it is intended to be unfunded for tax purposes and for purposes of Title I of ERISA. The Plan provides that the Participants do not have any ownership interest in their accounts and that they have the status of general unsecured creditors of the Employer with respect to the amounts deferred in their accounts. All amounts deferred remain the property of the Employer and may be attached or otherwise reached by the Employer's general creditors until such amounts are distributed to the Participants. The Plan constitutes no more than a mere promise by the Employer to make benefit payments in the future. Under the Plan, a Participant's right to benefit payments may not be anticipated, alienated, sold, transferred, assigned, pledged, encumbered, attached, or garnished by creditors of the Participant or the Participant's beneficiary.

By agreement with an unrelated third party ("Trustee"), the Employer has established the Trust in order to provide a source from which the Employer may pay its obligations to participants. The Employer has represented that the Trust conforms with the model provisions set forth in Rev. Proc. 92-64, 1992-2 C.B. 422. Additionally, the Employer has represented that the Trust does not contain any inconsistent language that conflicts with the model trust language. The Employer further represents that the Trust is a valid trust under state law, and that all material terms and provisions of the Trust, including the creditors' rights clause, are enforceable under the appropriate state law. The Employer also represents that the Trustee of the Trust is an independent third party granted corporate trustee powers under the appropriate state law.

Section 83(a) of the 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 includable in the gross income of the person who performed the services in 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 Income Tax Regulations ("Regulations") provides that for purposes of section 83, the term "property" includes real and personal property other than either money or an unfunded and unsecured promised 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)(1) of the Code provides that contributions made by an employer to an employees' trust that is not exempt from tax under section 501(a) of the Code are includable in the employees' gross income in accordance with section 83 of the Code, except that the value of the employees' interest in the trust will be substituted for the property's fair market value in applying section 83.

Section 404(a)(5) of the Code provides the general deduction timing rules applicable to any plan or arrangement for the deferral of compensation, regardless of the Code section under which the amounts might otherwise be deductible. Pursuant to section 404(a)(5) of the Code and section 1.404(a)-12(b)(2) of the Regulations, compensation deferred under a nonqualified plan or arrangements is deductible in the taxable year in which they are paid or made available to the employee, whichever is earlier, provided that they otherwise meet the requirements for deductibility.

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

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Revenue Ruling ("Rev. Rul.") 60-31, 1960-1 C.B. 174, Situations 1-3, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also Rev. Rul. 69-649, 1969-2 C.B. 106, and Rev. Rul. 69-650, 1969-2 C.B. 106. 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.

Under the economic benefit doctrine, an employee has current includable income from an economic or financial benefit received as compensation, even if the benefit is 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, 194 F.2d 541 (6th Cir. 1952). See also Rev. Rul. 60-31, Situation 4.

Section 301.7701-4(a) of the Regulations provides that an arrangement generally will be treated as a trust under the Code if it can be shown that the purpose 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 states that in situations where a grantor is treated as the owner of any portion of a trust under Subpart E, Part I, Subchapter J, Chapter 1, Subtitle A 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 such items would be taken into account under Chapter 1 of the Code in computing taxable income or credits against the 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 are placed in trust to provide deferred compensation benefits to Participants and their beneficiaries. However, in the event the Employer becomes insolvent, the Trustee will have the obligation to hold the Trust assets for the benefit of the Employer's general creditors. The Trust defines Insolvency for purposes of the Trust Agreement as the Employer being unable to pay its debts as they become due, or the Employer is subject to a pending proceeding as a debtor under the United States Bankruptcy Code. The Trust further provides that Participants and their beneficiaries may pursue their rights as general creditors of the Employer with respect to deferred compensation benefits to which they are due under the Plan. If the Participant's account is wholly or partially unavailable to provide benefits to the Participant, the Employer shall pay the Participant (as an unsecured general creditor) an amount equal to that which each Participant would have received if such insolvency, bankruptcy, or seizure did not take place.

Provided that (i) the creation of the Trust does not cause the Plan to be other than "unfunded" for purposes of Title I of ERISA, and (ii) the provision in the Trust requiring use of the Trust assets to satisfy the claims of general creditors in the event of insolvency is enforceable by the general creditors of the Employer under federal as well as state law, and based on the information submitted and representations made, we conclude that:

The Plan, in combination with the use of the Trust, effectively defers compensation to an employee for federal income tax purposes until the deferred compensation is actually made available to the employee and that the employee will not be in constructive receipt of income nor incur economic benefit on account of the adoption or maintenance of the Plan and Trust.

This ruling applies to the copies of the Plan and Trust submitted with your letter dated March 24, 1998, as amended in your letters dated June 29, 1998, July 21, 1998, and October 30, 1998. This ruling is contingent on the adoption of the Plan and the proposed amendments to the Plan and the Trust. If the Plan or the Trust is otherwise modified, this ruling may no longer apply.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent. Except as specifically ruled on above, no opinion is expressed as to the federal income tax consequences of the above transaction under any other provision of the Code.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

CHARLES T. DELIEE
Chief, Branch 1 Office of the Associate
Chief Counsel
(Employee Benefits and Exempt
Organizations)