INTERNAL REVENUE SERVICE

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Dear :

This responds to a request for a ruling you submitted in a letter dated June 24, 1998, and subsequent correspondence on behalf of Company C. This private letter ruling request concerns the federal income tax consequences of establishing a trust to assist C in providing certain nonqualified deferred compensation benefits to Participant A pursuant to the nonqualified Deferred Compensation Plan ("the Plan") executed by Company C and A.

The Plan established for A provides for the payment of deferred compensation benefits to A or his beneficiary in the time, manner, and amounts determined as set forth in the Plan and commencing after the participant’s death, or separation from service with C.

In order to provide for the benefit obligations to A, C will establish a trust to which C would contribute funds and other property to assist it in providing for accrued deferred benefit payments. C has represented that it will have an independent third-party trustee administer this trust. The trustee (including any successor) will have the duty to invest the trust assets and funds in accordance with the terms of the trust agreement. All rights associated with the assets of the trust will be exercised by the trustee and will in no event be exercisable by or rest with the participant or his beneficiary. The trust agreement provides that in the event of C’s insolvency (as defined in such agreement), the trustee shall hold the assets for the benefit of C’s general creditors. The trust agreement also provides that C’s board of directors and its chief executive officer have the duty to give notice to the trustee if C becomes insolvent.

The Plan and the trust agreement provide that A and his beneficiary have only the rights of unsecured general creditors to benefits arising from the Plan and receive no security or preferred interest attributable to the Plan or trust agreement in C’s general funds or assets or trust assets. The Plan and the trust agreement also provide that the benefits payable pursuant to the plan may not be attached, alienated, or encumbered.

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 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" does not include an unfunded and unsecured promise to pay money or property in the future. However, the term "property" does include 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 employees’ 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 property’s fair market value in applying section 83. Section 1.402(b)-1(a)(1) of the regulations provides that employer contributions to a nonexempt employees’ trust shall be included as compensation in the 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 section 1.83-3(b).

Section 404(a) 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(d) of the Code, and provided that they otherwise meet the requirements for deductibility, amounts paid to independent contractors under a plan deferring the receipt of compensation are deductible by the payer for the taxable year in which an amount attributable to the contribution or compensation is includible in the gross income of the persons participating in the plan.

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) of the regulations, income is constructively received in the taxable year during which it is credited to the 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. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, 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. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

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, 194 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.

Under the terms of the trust agreement, assets will be placed in trust to provide nonqualified deferred compensation benefits for the participant and his beneficiary. However, the trustee has the obligation to hold the trust assets and income for the benefit of C's general creditors in the event of C's insolvency. The trust agreement also provides that the participant has no interest in the trust assets other than the right to receive payments of retirement benefits from such assets when C is not insolvent. Therefore, although the assets are held in trust, in the event of C’s insolvency they are fully within reach of C’s general creditors, as are any other assets of C.

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 purpose of the arrangement is to vest in trustees 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 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 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.

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

1. 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 Company C, C shall be treated as the owner of the entire trust under section 677 of the Code. Accordingly, there shall be included in computing the taxable income and credits of C, the grantor, all items of income, deductions, and credits against tax of the trust. Section 671.

2. Neither C's creation of the trust nor C's contribution of assets to the Trust will constitute the transfer of property to the participant for purposes of section 83 of the Code or section 1.83-3(e) of the regulations.

3. Neither C's creation of the trust nor C's contribution of assets to the Trust will constitute a contribution to a nonexempt employees' trust under section 402(b) of the Code.

4. Neither C's adoption of the Plan nor its contribution of assets to the Trust will cause any amount to be included in the gross income of A or his beneficiary under the cash receipts and disbursements method of accounting pursuant to either the constructive receipt doctrine of section 451 of the Code or the economic benefit doctrine.

5. Amounts distributed under the Plan and from the Trust will be included in the gross income of the recipient who is on the cash receipts and disbursements method of accounting, in the taxable year or years in which such amounts are actually paid or otherwise made available to the recipient, whichever is earlier.

6. Company C will be entitled to deduct the amounts paid or made available pursuant to the Plan under section 404(d) of the Code in the taxable year or years in which such amounts are includible in the gross income of the recipient, provided such amounts otherwise meet the requirements for deductibility under section 162.

This ruling is directed only to the taxpayer who requested it and applies only to the revised trust agreement submitted on September 11, 1998 and to the revised nonqualified Deferred Compensation Plan for Participant A submitted on September 11, 1998. 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 tax consequences of the transaction described above under any other provision of the Code. Moreover, if either the Plan or the trust agreement is significantly amended, this ruling may not necessarily remain in effect.

Sincerely yours,

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