

INTERNAL REVENUE SERVICE
Index No.: 457.01-00 457.05-00
Number: **199952045**
Release Date: 12/30/1999

CC:EBEO:Br1 - PLR104684-99

September 30, 1999.

Board =

State X =

State Plan =

This is in response to your letter dated February 25, 1999, on behalf of the Board requesting a ruling on the federal tax consequences of the State Plan. State X intends the State Plan to be an eligible deferred compensation plan under section 457 of the Internal Revenue Code of 1986 (the "Code"). The State Plan has been or will be adopted only by employers that are state or local governmental entities described in section 457(e)(1)(A). Pursuant to the laws of State X, the Board established the State Plan for the benefit of eligible employees of State X and of other public jurisdictions in State X that adopt the State Plan.

In 1996 the Internal Revenue Service (the "IRS") ruled that the State Plan as amended and restated at that time was an eligible state deferred compensation plan as defined in section 457. The State Plan has been amended and restated again to include several amendments effective in 1997 and 1998.

Under the State Plan an employee may elect to defer compensation he or she would have received for services rendered to an employer in any taxable year. The deferral extends until the participant reaches age 70 1/2, separates from service, or has an unforeseeable emergency. The election to defer compensation must be made by the 10th of the calendar month before any payroll date. The State Plan provides for a maximum amount that may be deferred by a participant in any taxable year and for a

catch-up computation for amounts deferred for one or more of the participant's last three taxable years ending before normal retirement age under the State Plan. The amounts that may be deferred under the annual maximum limitation and the catch-up provision are within the limitations set out in section 457 of the Code.

With certain limitations, a participant or beneficiary (or an alternate payee as described below) 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 or beneficiary under the State Plan. If the participant or beneficiary fails to make a timely election concerning distribution of the deferred amounts, distributions are made at the time and in the manner prescribed by the State Plan. Regardless of who makes the election, the manner and time of benefits must meet the distribution requirements of section 401(a)(9) and 457(d)(2) of the Code.

The State Plan allows segregation of accounts on behalf of and payments to an alternate payee pursuant to a Plan Certified Domestic Relations Order (a "PCDRO"). A PCDRO is defined in the State Plan as a domestic relations order determined by a specified agency to meet the requirements of a qualified domestic relations order within the meaning of Code section 414(p). The State Plan provides that no distribution may be made to an alternate payee before the amount distributed would otherwise be available to the participant, that the rights of an alternate payee may never be greater than those of the participant, and that an alternate payee may not receive a distribution for an unforeseeable emergency. An alternate payee may direct the investment of amounts segregated on his or her behalf.

However, the State Plan does permit one exception to the above distribution requirements. The State Plan, in accordance with section 457(e)(9)(A) of the Code, 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 State 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 payable to him or her under the State Plan, 3) no amount had been deferred under the State 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 State Plan further provides that all amounts of compensation deferred pursuant to the State Plan, all property and rights purchased with such amounts and all income attributable to such amounts, property, or rights shall be held in trust for the exclusive benefit of participants and beneficiaries under the State Plan. The trust under the State Plan was established pursuant to a written agreement that is represented to be a valid trust under the laws of State X.

The rights of any participant or beneficiary to payments pursuant to the State Plan are not subject in any manner to alienation by anticipation, sale, transfer, assignment, bankruptcy, pledge, attachment, charge, or encumbrance of any kind.

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

Section 457 of the Code provides rules for the deferral of compensation by an individual participant in an eligible deferred compensation plan (as defined in section 457(b)).

Section 457(a) 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(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.

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.

Under the terms of the State Plan and trust, 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 State 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 State Plan summarized above, we conclude as follows:

1. The State 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 State 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 State 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 a participant or beneficiary in accordance with the terms of the State Plan.

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than the State Plan described above. In addition, no opinion is expressed concerning the effect the adoption of the trust has on the rights of employers under the State Plan. This ruling applies only to deferrals made after the date this ruling is issued. If the State Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to State X and the participants of the State Plan and applies only to the State Plan submitted on February 25, 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,

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

Enclosure:

Copy for section 6110 purposes