Internal Revenue Service

Number: **200418010**
Release Date: 4/30/04
Index Number: 457.00-00

Department of the Treasury
Washington, DC 20224

Person To Contact:
,
Telephone Number:

Refer Reply To:
CC:TEGE:EB:QP2 – PLR-139827-03
Date:
January 09, 2004

In Re:

Legend:

Employer =
EIN =
Plan =
E =
I =
Trust =

Dear :

This is in response to your letter dated June 25, 2003, and subsequent correspondence on behalf of the above-referenced Employer requesting a ruling on the federal income tax consequences of the Employer's deferred compensation plan.

Employer is a not-for profit corporation that is exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code and is a public charity. The Employer is not however, a church (as defined in section 3121(w)(3)(A)) a qualified church-controlled organization (as defined in section 3121(w)(3)(B)) or the Federal government or any agency or instrumentality thereof.

Employer's taxable year begins on January 1 and ends on December 31. The Plan is also maintained on a calendar year.

Employer is in the business of providing hospital care and other health related services.

Under the Plan, employees who are participants in the Employer's Executive Compensation Program, and employees who are employed as physicians and who are selected for participation in the Plan by the Plan Administrator are eligible to participate in the Plan. Until Employer receives a ruling from the Department of Labor that the Plan is exempt from Title I of ERISA, only employees who are members of a select group of management or highly compensated employees may be participants. Individuals employed at the employer's facility in E, however, are not eligible to participate in the Plan.

An eligible employee may become a participant by executing a salary reduction agreement with the Employer. After an election to defer has been made, the deferred compensation contribution shall take effect the first day of the calendar month next following the date the eligible employee enters into the salary reduction agreement.

The Plan allows a maximum amount to be deferred by a participant in any calendar year and also provides for a catchup contribution for amounts deferred for one or more of the participant's last three taxable years ending before the participant attains normal retirement age under the Plan. The amounts which may be deferred are within the limitations set forth in section 457 of the Code.

In general, a participant's account balance will be distributed after he or she has severed employment with the Employer. A participant may however, receive a distribution of all or any portion of a participant's deferred benefit, limited to an amount necessary to alleviate an unforeseeable emergency. A participant may also elect to receive an in-service distribution of $5,000 or less from his or her account in certain limited circumstances as set forth in the Plan and in accordance with section 457(e)(9)(A) of the Code.

A participant may request payment of his or her account balance as of the first day of the calendar quarter following his or her severance of employment provided that it is no sooner than 30 days following the date of the participant's severance. If the participant makes no election, payments will automatically commence as of the date that is 30 days following severance. In the alternative, a participant may make an initial election to defer distribution to a specific date in the future. This date may not be later than April 1 of the calendar year following the later of: (1) the date the participant retires, or (2) the date the participant attains age 70 ½. The participant's initial election must be made no later than 15 days following such participant's severance from employment. If the participant makes an initial election to defer distributions under the Plan to a specific date in the future, the participant may later make an additional election to defer distributions under the Plan to a new, later specific date in the future. Again, this new date may not be later than the April 1 of the calendar year following the later of :(1) the date the participant retires, or (2) the date the participant attains age 70 ½.

A participant may elect the method of payment under the Plan at any time prior to the time the deferred amounts will be distributed. If the participant fails to make a timely election concerning distribution of the deferred amounts, the entire amount balance will be distributed in a lump sum in accordance with the participant's initial or additional election, or, if the participant fails to make an initial or additional election, the default payment schedule. The methods of payment include: (1) annual installments over a fixed period of time, not exceeding ten years, with each installment being equal to the balance in the account divided by the number of installments not previously made, (2) a lump sum cash payment, or (3) partly in a lump sum and partly in annual installments. Annual installments may be paid over no more than ten years and also may not be paid over a term that exceeds the maximum term permissible under the Treasury regulations for determining required minimum distributions. The participant may elect to have his or her annual installments paid as of the first day of any calendar quarter.

If payments have not commenced prior to a participant's death, the participant's beneficiary may make the same election as to the commencement of benefits as the participant except that the beneficiary has 75 days following the date of the participant's death to make the initial election and payments to beneficiaries may not begin sooner than 90 days after the date of the participant's death. In addition, the participant's beneficiary may make the same election as to the method of payment as the participant.

The Plan may accept a transfer of compensation previously deferred under another eligible 457 plan of a tax exempt entity. A participant who separates from service with Employer and accepts employment with another tax exempt employer that maintains an eligible 457 plan may elect to transfer his or her compensation deferred under the Plan to that plan if the other plan accepts such transfers.

To assist it in providing assets from which to pay the benefit obligations to the participants, Employer has established an irrevocable grantor trust. The trustee of the trust is an independent unrelated third party that has corporate trustee powers under I law. At all times, the trust assets will be subject to the claims of Employer's creditors. Participants have only the status of general unsecured creditors of Employer. The rights of any participant or beneficiary to payments pursuant to the Plan and the trust agreement are nonassignable, and their interests in benefits under the Plan and the trust agreement are not subject to attachment, garnishment, pledge, encumbrance or other legal process.

The Trust conforms to the model language contained in section 5 of Rev. Proc. 92-64, 1992-2 C.B. 422, including the order in which the sections of the model trust language appear. Moreover, the Trust contains no language that conflicts with the model trust language contained in section 5 of Rev Proc. 92-64. It is represented that the trust is a valid trust under I law and all of the material terms and provisions of the Trust, including the creditors' rights clause, are enforceable under the appropriate state laws.

The Trustee has the duty to invest the trust assets in accordance with the terms of the trust agreement. At all times, the trust assets will be subject to the claims of Employer's general creditors if Employer becomes insolvent, as defined in the trust agreement. Employer's Chief Executive Officer and its Board of Directors have the duty to inform the Trustee of Employer's insolvency. Upon receipt of such notice or other written allegations of Employer's insolvency, the Trustee will suspend the payment of benefits with respect to participants and any beneficiaries in the Plan. If the Trustee determines in good faith that Employer is not insolvent or is no longer insolvent, the Trustee will resume the payment of benefits. If Employer is insolvent, the Trustee shall hold the trust corpus for the benefit of employer's general creditors.

The Plan and Trust provide that all amounts deferred under the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts , property, or rights will remain (until made available to the participants or other beneficiaries) solely the property and rights of Employer, subject only to the claims of Employer's general creditors. Participants have only Employer's unsecured promise to pay deferred compensation pursuant to the Plan. The rights of the participants or their beneficiaries to payments pursuant to the Plan and trust agreement are nonassignable, and the interests in benefits under the Plan and the trust agreement are not subject to attachment, pledge, garnishment, encumbrance or other legal process.

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 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 includes real and personal property other than money or an unfunded and unsecured promise 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 creditor, for example, in a trust or escrow account. .

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 a taxpayer's account or set apart or otherwise made available so that the taxpayer may draw upon it at any time. However, income is not constructively received if the taxpayer's control of its receipts is subject to substantial limitations or restrictions.

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 irrevocable 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- 1C.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.

Section 457 of the Code provides rules for the deferral of compensation by an individual participating in an eligible deferred compensation plan (as described 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 amount 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

Treas. Reg. sec. 1.457-7(c)(1) states that amounts deferred under an eligible plan of a tax exempt organization will not be considered made available to the participant solely because the participant is permitted to choose among various investments under the Plan.

Section 457(e)(10) states that a participant shall not be required to include in gross income any portion of the entire amount payable to such participant solely by reason of the transfer of such portion from one eligible deferred compensation plan to another eligible deferred compensation plan.

Section 301.7701-4(a) of the Treasury 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 is treated as an owner of any portion of a trust under subpart E, part I, subchapter J, chapter 1 of the Code, there shall be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust (to the extent that such items would be taken into account under chapter 1 in computing the 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 Treasury 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 may be placed in trust to be used to provide deferred compensation benefits to participants. However, the trustee has the obligation to hold the trust assets and income for the benefit of Employer's general creditors in the event of insolvency. The trust agreement further provides that an employee receives no beneficial ownership in or preferred claim on the Trust assets. Therefore, although the assets are held in trust, in the event of Employer's insolvency they are fully within reach of Employer's general creditors, as are any other general assets of Employer.

Provided, (i) that the creation of the Trust does not cause the Plan to be other than unfunded for purposes of Title I of the Employee Retirement income Retirement Act of 1974, and (ii) that the provisions of the Trust requiring use of the trust assets to satisfy the claims of Employer's general creditors in the event of Employer's insolvency is enforceable by the general creditors of Employer under federal and state law, and based on the information submitted and representations made, we conclude as follows:

1. The Plan constitutes an eligible deferred compensation plan as defined in section 457(b) of the Code.

2. Amounts of compensation deferred pursuant to the Plan, including any income attributable to the deferred compensation will be includible in the gross income of the recipient only for the taxable year or years in which such amounts are paid or otherwise made available to a participant or beneficiary under the Plan.

3. The Trust will be classified as a trust within the meaning of Treasury Regulations section 301.7701-4(a). Because the principal and income of the Trust may be applied in discharge of legal obligations of Employer, under section 677, Employer shall be treated as the owner of the Trust. Accordingly, under section

677, there shall be included in computing Employer's taxable income and credits, those items of income, deductions, and credits against tax of Trust, subject to the provisions of the Code applicable to section 501(c)(3) organizations.

4. Neither the adoption of the Plan nor the creation of the Trust, nor Employer's contributions of assets to the Trust will result in a transfer of property to participants or beneficiaries for purposes of section 83 of Treasury Regulations section 1.83-3(e).

5. Neither the adoption of the Plan nor the creation of the Trust nor Employer's contributions of assets to the Trust will cause any amount to be included in the gross income of a participant or his beneficiaries under the cash receipts and disbursements method of accounting, pursuant to either the constructive receipt doctrine of section 451 or the economic benefit doctrine.

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the Plan under any other provision of the Code. If the Plan is significantly modified, this ruling will not necessarily remain applicable.

This ruling is directed only to Employer and applies only to the Plan submitted by a transmittal letter dated June 25, 2003, as revised by amendments submitted on December 22, 2003 and January 8, 2004. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

ROBERT D. PATCHELL
Chief, Qualified Plans
Branch Two
Office of the Division Counsel/
Associate Chief Counsel
(Tax Exempt and
Government Entities)

Enclosure
Copy of letter
Copy for section 6110 purposes