Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:EC – PLR-137108-03
Date:
December 22, 2003

Legend

Company =

Plan =

Amount X =
Amount Y =

Dear :

This responds to Company's May 29, 2003, letter and subsequent submissions on December 4, 2003, December 11, 2003, and December 16, 2003, requesting various rulings concerning the federal income tax consequences of participation in the Plan.

Company is in the business of supplying specialized service-providers to certain service-recipients throughout the United States on an as needed basis. It established the Plan to provide supplemental, nonqualified deferred compensation benefits to certain key employees.

Under the Plan, participants can elect to defer any portion of the salary, bonus, overtime pay, and commissions they earn during the Plan year, which is the calendar year. To effect a deferral, participants must submit an election form to the Plan's administrator prior to the beginning of the Plan year. Employees who become eligible to participate in the Plan during the Plan year may elect to participate and effect a deferral by submitting

an election form to the Plan's administrator within 30 days of becoming eligible to participate in the Plan.

Elections to defer amounts under the Plan must specify (1) the amount that is to be deferred; (2) whether benefit payments are to commence on the Plan's retirement date or on a fixed payment date; and (3) the manner in which benefits are to be paid. Elections under the Plan are irrevocable, both as to the amount deferred and as to the time and manner of payment. The Plan's retirement date is the earlier of the date the participant attains age 55 and has 10 years of service with Company, or when the participant's age added to his or her years of service with Company, equals 60. Amounts deferred under a fixed payment date election must be deferred for a minimum of 10 years.

In addition to paying benefits in accordance with the deferral period specified in a deferral election, the Plan pays benefits upon a participant's death, disability, or separation from service with Company. The Plan also provides for limited financial hardship withdrawals in the event of an unforeseeable emergency beyond the participant's control. The Plan defines the term "unforeseeable emergency" as an unanticipated emergency that is caused by an event beyond the control of the participant and that would result in severe financial hardship to the individual if early withdrawal were not permitted. The Plan limits participants to one hardship withdrawal per plan year, and it suspends a participant's deferrals for the duration of the plan year if a hardship withdrawal is made.

The manner in which benefits are paid under the Plan depends upon the balance of the participant's deferral account on the date benefit payments commence. If the balance is less than Amount X, the benefit will be paid in a single sum. If the balance exceeds Amount Y, the benefit will be paid monthly over 10 years. If the balance is greater than or equal to Amount X but less than or equal to Amount Y, benefits are paid monthly over a two, three, five or 10 year period, as selected by the participant on the deferral election form.

Amounts deferred under the Plan are credited to a notional account. The Plan allows participants to choose among a variety of Company-determined investment options for measuring the deemed rate of return on the deferred amounts.

The Plan specifically prohibits the creation of a trust for purposes of holding amounts deferred under the Plan or for purposes of assisting Company in satisfying its obligations under the Plan. The Plan permits Company to purchase insurance and annuity contracts in connection with its obligations under the Plan, but it provides that Company must be the sole owner and beneficiary of all such contracts.

The Plan permits Company to make discretionary contributions to participant accounts. Vesting of discretionary contributions, and earnings thereon, occurs according to a three-year, level vesting schedule. Discretionary contributions, and earnings thereon, are forfeited if a participant separates from service with Company for cause, as defined in the Plan.

The Plan provides that participants have the status of general, unsecured creditors of Company, and that the Plan constitutes a mere unfunded and unsecured promise by Company to pay benefits in the future. It also provides that a participant's rights to benefit payments under the Plan are 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 Plan also provides that it is the intention of Company that the Plan is unfunded for tax purposes and for purposes of Title 1 of the Employee Retirement Income Savings Act of 1974 ("ERISA").

Section 83(a) of the Internal Revenue Code ("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 ("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 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 it is 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. The economic benefit doctrine 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.

Section 3.01 of Rev. Proc. 92-65, 1992-2 C.B. 428 states that in each request for a ruling involving the deferral of compensation, the Service will determine whether the doctrine of constructive receipt is applicable on a case by case basis. The Service will ordinarily issue rulings regarding unfunded, deferred compensation arrangements only if the requirements of Rev. Proc. 71-19, 1971-1 C.B. 698, are met and, in addition, the arrangement meets the guidelines set forth in Rev. Proc. 92-65.

Section 3.01(a) of Rev. Proc. 92-65 restates the position of section 3.01 of Rev. Proc. 71-19 that if a plan provides for an election to defer payment of compensation, such election must be made before the beginning of the period of service, generally the cash-basis employee's taxable year. Section 3.01(a)(2) of Rev. Proc. 92-65 provides that in the first year in which a participant becomes eligible to participate in a non-qualified deferred compensation plan, the newly eligible participant may make an election to defer compensation for services to be performed subsequent to such election within 30 days after the date the employee becomes eligible.

Section 3.01(b) of Rev. Proc. 92-65 states that the plan must define the time and method for payment of deferred compensation for each event (such as termination of employment, regular retirement, disability retirement or death) that entitles a participant to receive benefits. The plan may specify the date of payment or provide that payments will begin within 30 days after the occurrence of a stated event.

Section 3.01(c) of Rev. Proc. 92-65 states that the plan may provide for payment of benefits in the case of an unforeseeable emergency. "Unforeseeable emergency" must be defined in the plan as an unanticipated emergency that is caused by an event beyond the control of the participant or beneficiary and that would result in severe financial hardship to the individual if early withdrawal were not permitted. The plan must

further provide that any early withdrawal approved by the employer is limited to the amount necessary to meet the emergency. Language similar to that described in section 1.457-2(h)(4) and (5) of the Income Tax Regulations may be used.

Section 3.01(d) of Rev. Proc. 92-65 states that the plan must provide that participants have the status of general unsecured creditors of the employer and that the plan constitutes a mere promise by the employer to make benefit payments in the future. The plan also must state that it is the intention of the parties that the arrangements be unfunded for tax purposes and for purposes of Title I of ERISA.

Section 3.01(e) of Rev. Proc. 92-65 states that the plan must provide that a participant's rights to benefit payments under the plan are 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.

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, and provided that they otherwise meet the requirements for deductibility, amounts of contributions or compensation deferred under a nonqualified plan or arrangement are deductible in the taxable year in which they are paid or made available, whichever is earlier. Section 404(d) provides virtually identical deduction timing rules for non-qualified plan participants who have no employer-employee relationship with the payor.

Provided the Plan does not become other than "unfunded" for purposes of Title I of ERISA, and based on the information submitted and representations made, we conclude that:

1. Neither amounts deferred under the Plan by Plan participants, nor deemed investment returns on those amounts, nor discretionary contributions made by Company pursuant to the Plan to a participant's notional account, nor earnings on those discretionary contributions cause current recognition of income by Plan participants who are on the cash receipts and disbursements method of accounting under the constructive receipt doctrine of section 451 of the Code;

2. Neither amounts deferred under the Plan by Plan participants, nor deemed investment returns on those amounts, nor discretionary contributions made by Company pursuant to the Plan to a participant's notional account, nor earnings on those discretionary contributions cause current recognition of income by Plan participants or their beneficiaries under section 83(a) of the Code.

This ruling is directed only to Company, and it applies only to the provisions of the Plan, as submitted on June 5, 2003, with the proposed revisions submitted on December 4, 2003, December 11, 2003, and December 16, 2003. If the Plan, as submitted, is modified, or if the Plan is not amended in accordance with the revisions submitted on December 4, 2003, December 11, 2003, and December 16, 2003, this letter will have no effect. This ruling does not apply to amounts deferred under the Plan prior to the date of this ruling. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

The rulings contained in this letter are based upon information and representations submitted by Company and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Sincerely,

Catherine Livingston Fernandez
Chief, Executive Compensation Branch
Office of Office of Division
Counsel/Associate Chief Counsel
(Tax Exempt and Government Entities)