Internal Revenue Service

Department of the Treasury
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Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:EC – PLR-132353-03

Date:
April 19, 2004

Church =

Plan =

Trust =

Dear :

This responds to the March 31, 2003, letter and subsequent correspondence you submitted on behalf of Church requesting various rulings concerning the income tax consequences of the Plan and Trust.

Church represents that it is an organization described in section 501(c)(3) of the Internal Revenue Code ("Code"), and that it is a church for purposes of section 170(b)(1)(A)(i). Church established the Plan on January 1, 2001, for the purpose of providing supplemental, non-elective, nonqualified deferred compensation benefits to certain eligible employees ("participants").

Church established the Trust on January 31, 2003, to provide it with a source of funds to pay its obligations under the Plan. The Trust is revocable. Church represents that the Trust conforms to the model trust contained in Revenue Procedure 92-64, 1992-2 C.B. 422, and that the Trust document does not contain any language

that is inconsistent with the language of the model trust agreement. Church also represents that the Trust is a valid trust under state law and that all of the material terms and provisions of the Trust, including the creditors' rights clause, are enforceable under appropriate state laws. Church further represents that the trustee of the Trust is an independent third party that may be granted corporate trustee powers under state law.

Church designates the employees who are eligible to participate in the Plan. The Plan allocates benefits to participant accounts using a formulary computation. Participants forfeit their benefits under the Plan if their employment relationship with Church is terminated for cause, as defined in the Plan. Participants also forfeit their benefits under the Plan if they terminate their employment with Church without Church's consent.

The Plan provides that participants have the status of general, unsecured creditors of Church, and that the Plan constitutes a mere unfunded and unsecured promise by Church to pay benefits in the future. The Plan also provides that a participant's rights to benefits 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 further provides that it is the intention of Church that the Plan is unfunded for tax purposes and for purposes of Title I of the Employee Retirement Income Security Act of 1974 ("ERISA").

The Plan does not provide for any in service distributions. Under the Plan, participants receive the balance of their accounts in a single sum within 90 days after the Plan year during which they separate from service with Church.

Under the terms of the Trust, Trust assets will be used to provide Plan benefits to participants. However, the trustee is obligated to hold the Trust assets and income for the benefit of Church's general creditors in the event of Church's insolvency. The Trust further provides that participants receive no beneficial ownership interest in, or preferred claim on, the Trust assets.

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 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 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 fair market value of the property in applying section 83. Section 1.402(b)-1(a)(1) of the regulations provides that employer contributions to a nonexempt employees' trust are included as compensation in an 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 the regulations under section 83.

Section 451(a) of the Code and §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 §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 upon 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, Situation 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 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.

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 Internal Revenue Service ("Service") will determine whether the doctrine of constructive receipt is applicable on a case by case basis. The Service ordinarily will 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(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.

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 457 of the Code provides the rules governing the deferral of compensation by an individual participating in a deferred compensation plan of an eligible employer. Under section 457(e)(1)(B), a tax-exempt organization is an eligible employer covered by section 457. However, section 457(e)(13) provides that the term eligible employer does not include a church (as defined in section 3121(w)(3)(A)) or qualified church-controlled organization (as defined in section 3121(w)(3)(B)).

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 Plan to be other than "unfunded" for purposes of Title I of ERISA, and (ii) that the Trust provisions requiring Trust assets to be used to satisfy claims of Church's general creditors in the event of Church's insolvency are enforceable under federal and state law, we conclude that:

1. The Trust will be classified as a trust within the meaning of § 301.7701-4(a) of the Procedure and Administration Regulations. Because the principal and income of the Trust may be applied in discharge of legal obligations of Church, under section 677 of the Code, Church will be treated as the owner of the Trust. Accordingly, under section 677, there shall be included in computing Church's taxable income and credits, those items of income, deductions, and credits against tax of the Trust, subject to the provisions of the Code applicable to section 501(c)(3) organizations.

2. Neither the creation of the Trust, nor the contribution of assets to the Trust, will cause any amount to be includable in the taxable income of cash basis participants or beneficiaries under section 451 of the Code, the economic benefit doctrine, or section 457.

3. Neither the creation of the Trust, nor the contribution of assets to the Trust, nor the crediting of earnings on the Trust assets will constitute a transfer of property to any participant for purposes of section 83 of the Code or §1.83-3(e) of the regulations

4. Neither the creation of the Trust, nor the contribution of assets to the Trust, nor the crediting of earnings on the Trust assets will constitute a contribution to an employees' trust under section 402(b) of the Code.

This ruling applies only to participation in the Plan and contributions to the Trust that occur on or after the date of this ruling. No opinion is expressed or implied concerning the federal income tax consequences relating to participation in the Plan or contributions to the Trust that occurred prior to the date of this ruling. In accordance with section 3 of Rev. Proc. 92-64, this ruling expresses no opinion as to the consequences of the arrangement under Title I of ERISA.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it 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 the Plan or Trust is amended, this ruling may not remain in effect.

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

Sincerely,

CATHERINE FERNANDEZ
Chief, Executive Compensation Branch
Office of the Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government Entities)

Enclosure:
Copy for section 6110 purposes