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Person To Contact:
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Telephone Number:

Refer Reply To:
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PLR-125188-04

Date:
January 26, 2005

Employer =
EIN =
Plan =

Dear :

This is in response to your letter dated April 30, 2004, and subsequent correspondence on behalf of the above–referenced Employer requesting a ruling on the federal income tax consequences of Employer's Deferred Compensation Plan.

Employer is part of an integrated health care system, which owns and operates hospitals and related entities and provides related services. The Plan was adopted effective January 1, 2002.

An eligible employee may become a participant by executing a salary reduction agreement with Employer. After an election 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 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.

Employer represents that it is a tax-exempt organization under section 501(c)(3) of the Internal Revenue code of 1986 (the Code). The Plan will be offered to a select group of management and highly compensated employees who have materially contributed to the success of the employer, effective January 1, 2002. The purpose of the Plan is to allow certain employees to defer current compensation to enhance the accumulation of retirement income.

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 state 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 participants or beneficiary to payments pursuant to the Plan and the trust agreement are non-assignable, 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 state 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 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 receipt 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, 1972-1 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 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)(1)(B) of the Code provides that in the case of a participant in an eligible deferred compensation plan of a tax-exempt employer, any amounts 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(b)(5) prescribes that an eligible deferred compensation plan must meet the distribution requirements of section 457(d).

Section 457(b)(6) requires an eligible plan of a tax-exempt employer to provide that i) all amounts of compensation deferred under the plan, ii) all property and rights purchased with such amounts, and iii) all income attributable to such amounts , property, or rights must remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors.

Section 457(d)(1)(A) provides that for a section 457 plan to be an eligible plan, the plan must have distributions requirements providing that under the plan amounts will not be made available to participants or beneficiaries earlier than i) the calendar year in which participant attains 70 ½ , ii) the calendar year when the participant has a severance from employment with the employer, or iii) when the participant is faced with an unforeseeable emergency as determined under Treasury regulations.

Treas. Reg. Sec. 1.457-7(c)(10) states that amounts deferred (including amounts previously deferred) under an eligible plan will not be considered made available to the participant solely because the participant is permitted to choose among various investment modes under the Plan for the investment of such amounts whether before or after any payments have commenced under the 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 responsibilities for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and therefore, are not associates in 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 1, 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 an adverse 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 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 Security 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 upon 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 of participants or beneficiaries for purposes of section 83 or Treasury Regulations section 1.83-3(e).

5. Neither the adoption of the Plan nor the creation of the Trust nor employer's contribution 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 to the plan as submitted by a transmittal letter dated April 30, 2004, as revised by amendments submitted on December 14, 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

cc:

Copy of letter
Copy of letter for section 6110 purposes