TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

APR 0 8 2005

200526025

UIL: 415.01-00

SE:T:EP:RA:T3

Attention:

LEGEND:

Plan P:

Excess Plan X:

State S:

County C:

Dear

This is in response to your request for a private letter ruling, dated November 6, 2003, as supplemented by a letter dated February 17, 2005, concerning the applicability of section 415(m) of the Internal Revenue Code to the County C Excess Benefit Savings Plan (Excess Plan X) and the tax consequences related thereto. You have submitted the following facts and representations in support of your request.

Plan P is a defined contribution profit sharing plan maintained by County C. Plan P is a governmental plan as described in Code section 414(d) of the Code. It is intended to meet the requirements of Code section 401(a). It is funded by employer contributions. No employee contributions are made to Plan P. Plan P is made available to the employees of County C and the employees of other local agencies which elect by agreement to participate in Plan P. Participation in Plan P by eligible employees of a participating employer is automatic and mandatory except for employees who are represented by a collective bargaining representative and whose participation in Plan P is subject to mandatory negotiation under the applicable law of State S. Such individuals will not be permitted to participate in Plan P until their collective bargaining representative has negotiated their participation in Plan P with their employer. Contributions for some participants will exceed the applicable limits imposed by section 415(c) and cannot be provided under Plan P.

Excess Plan X was adopted effective January 1, 2003, by County C to provide participants in Plan P a benefit (not augmented by earnings or gains) equal to the part of the employer contribution that would otherwise have been contributed to participants' accounts in Plan P but

for the fact that it exceeded the applicable limits on contributions to such plan under section 415(c) of the Code. Excess Plan X is intended to be a "qualified governmental excess benefit arrangement" within the meaning of that term in Code section 415(m)(3). Participation in Excess Plan X and the payment of benefits under Excess Plan X automatically cease once the participant has received a complete distribution of his or her benefits under Excess Plan X. Eligibility to participate in and receive benefits under Excess Plan X will resume, upon reemployment, if a former participant's employer contributions under Plan P are once again limited by the applicable limitation on annual additions imposed by section 415(c). A participant receives a distribution of his or her benefits under Excess Plan X in a lump sum within sixty days of his or her termination of employment.

Local governmental agencies, in addition to County X, may, with the approval of County X, elect by agreement to participate in Excess Plan X for the benefit of their eligible current and former employees provided that they agree that (i) the local governmental agency cannot designate participation in Excess Plan X by employees or exclusion of employees from participation in Excess Plan X on an individual basis, and (ii) current and former employees will not be given the opportunity to elect directly or indirectly to defer income under Excess Plan X. No election is provided under Excess Plan X at any time (directly or indirectly) to defer compensation. No employee contributions will be made to Excess Plan X.

Participation in Excess Plan X is mandatory and automatic for all eligible employees of employers who participate in Excess Plan X except for employees who are represented by a collective bargaining representative and whose participation in Excess Plan X is subject to negotiation under applicable State M law. Such individuals will not be permitted to participate in Excess Plan X until their collective bargaining representative has negotiated their participation in Excess Plan X with their employer.

Excess Plan X will not accept contributions or transfers from Plan P and will not pay any Plan P benefits. The Excess Plan X trust is separate from the Plan P trusts and is maintained solely for the purpose of providing excess benefits. Benefits under Excess Plan X will not be paid or funded from the qualified trust assets of Plan P. To the extent there are excess assets in Excess Plan X they will be used to defray the expenses of administering Excess Plan X and its trust. Each participating employer has a separate sub-trust established under the Excess Plan X trust solely to hold assets contributed to the trust by such participating employer and solely from which the benefits under Excess Plan X for the participants of such participating employer are paid.

The Excess Plan X trust is a grantor trust under the applicable state law. The trust is revocable and for income tax purposes, is intended to be a grantor trust (of which each participating employer is the grantor with respect to its own sub-trust) within the meaning of the term in Code sections 672 through 677. All assets held in the trust, all property rights and beneficial interests acquired through the use of trust assets will remain the general, unpledged, unrestricted assets of the trust. The interests of participants and their beneficiaries in the trust are not senior to the claims of unsecured creditors of County C and the other participating employers.

If the assets of the Excess Plan X trust are not sufficient to pay the benefits under Excess Plan X, by agreement each participating employer (and not Plan P) will pay such required amounts to the trust to provide benefits with respect to its employees. Contributions to the trust to provide benefits under Excess Plan X for a particular participating employer's covered current and former employees and to defray a portion of the reasonable expenses for administration of Excess Plan X and its trust will come from such participating employer. By agreement, a

participating employer is not required to and shall not be permitted to pre-fund the benefits under Excess Plan X and may contribute only such amounts for a plan year as are necessary to provide benefits under Excess Plan X for such year only plus the administrative expenses.

Based on the above facts and representations, you have requested the following rulings:

1. That Excess Plan X and its trust as adopted effective [redacted] for the benefit of eligible employees of County C and the other participating employers meet the legal requirements of Code section 415(m) for a qualified governmental excess benefit arrangement; and

2. The benefit payments from Excess Plan X will be taxed to the participants as income only as they are actually paid or made available.

Code section 415(m) sets forth the treatment of qualified governmental excess benefit arrangements. Code section 415(m)(1) provides in part that, in determining whether a governmental plan (as defined in section 414(d)) meets the requirements of section 415, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account.

Section 415(m)(3) defines such an arrangement as a portion of a governmental plan which meets the following three requirements: (A) such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 ("excess benefits"); (B) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation; and (C) excess benefits are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

With respect to your first requested ruling, Excess Plan X is a portion of Plan P, which your authorized representative has stated is a governmental plan as described in Code section 414(d). It is represented that the only purpose of Excess Plan X is to provide participants in Plan P that portion of a participant's benefits that would otherwise be payable under the terms of Plan P except for the limitations on contributions imposed by Code section 415(c). The Excess Plan X limits participation to Plan P participants for whom contributions would exceed the Code section 415(c) limits. Therefore, we have determined that Excess Plan X is a portion of a governmental plan which is maintained solely for the purpose of providing to Plan P participants that part of the participant's benefit otherwise payable under the terms of Plan P that exceeds the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A).

Your authorized representative has stated that participation in Excess Plan X is automatic and mandatory for Plan P participants for whom contributions are limited by Code section 415 and that there are no employee contributions to Excess Plan X. Your representative also asserts that no direct or indirect election to defer compensation is provided to any participant in Excess Plan X. Thus, we have determined that no direct or indirect election is provided at any time to participants to defer compensation, and, accordingly, the requirements of section 415(m)(3)(B) are met.

Code section 415(m)(3)(C) requires that the trust from which excess benefits are paid must not form a part of the governmental plan (in this case, Plan P) which contains the excess benefit

arrangement, unless such trust is maintained solely for the purpose of providing such benefits. In the present case, the Excess Plan X trust is part of Plan P, but it is maintained separately. Contributions to the trust consist only of the amount required to pay the excess benefits for the plan year and the amount required to pay administrative expenses. Funds are not accumulated to pay benefits in future plan years. Therefore, we have determined that the requirements of section 415(m)(3)(C) are met.

Since Excess Plan X and its trust satisfy all of the requirements of section 415(m)(3), we conclude with respect to your first ruling request that Excess Plan X and its trust being implemented for the eligible employees of County C and the other participating employers meet the legal requirements of Code section 415(m) for a qualified governmental excess benefit arrangement.

With respect to the second requested ruling, section 415(m)(2) provides that "for purposes of this chapter, (A) the taxable year or years for which amounts in respect of a qualified governmental excess benefit arrangement are includible in gross income by a participant, and (B), the treatment of such amounts when so includible by the participant, shall be determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401."

Ruling 1 has already determined that Excess Plan X meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements. Accordingly, the tax treatment of the amounts distributed under Excess Plan X to the participants is determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401. It has been represented that the Trust is a grantor trust within the meaning of Code sections 672 through 677 and under state law.

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 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 creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by an employer to an employee's 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. Under section 1.402(b)-1(a)(1) of the regulations, an employer's contributions to a nonexempt employee's trust are included as compensation in the 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 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, 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. Economic benefit 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.

Accordingly, with respect to the second ruling request it is concluded that the benefit payments from Excess Plan X will be taxed to the participants as income only as they are actually paid or made available.

This ruling letter is based on the assumption that Plan P is a governmental plan as described in Code section 414(d) and that it meets all of the applicable requirements under Code section 401(a).

This ruling letter is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

A copy of this letter has been sent to your authorized representative in accordance with the power of attorney on file in this office.

200526025

If you have any questions about this letter, please contact at
Please refer to SE:T:EP:RA:T3.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures
Notice 437
Deleted copy of ruling letter

Cc: