

Internal Revenue Service

Department of the Treasury

Index Number:
457.00-00

Washington, DC 20224

Number: **199951013**
Release Date: 12/23/1999

Person to Contact:

Telephone Number:

Refer Reply To:

CC:EBEO:1 - PLR-104920-99

Date:

September 22, 1999.

X =

Plan =

Y =

This is in response to your letter of February 26, 1999, and subsequent correspondence requesting a ruling with respect to X's Deferred Compensation Plan, which X intends to be an eligible state deferred compensation plan under section 457 of the Internal Revenue Code of 1986 (the "Code").

X is established pursuant to state law. It is represented to be an agency or instrumentality of the State of Y.

X proposes to continue to enter into salary reduction agreements with its employees who desire and are qualified to participate in the Plan to provide a vehicle for employees to invest funds for retirement and to encourage investment by allowing a vehicle for retirement funding through payroll deduction.

X reduces the compensation of an employee by the amount stated in the Participation Agreement per pay period, beginning on the first of the month after the date of acceptance of the Participation Agreement by X.

The Plan provides for a maximum amount that may be deferred by a participant in any taxable year and also provides for a catch-up contribution for amounts deferred for one or more of the participant's last three years ending before he or she attains normal retirement age under the Plan. The amounts that may be deferred under the annual maximum limitation and the catch-up provision are within the limitations set out in section 457 of the Code.

Monies that represent participants' deferred compensation are invested by X in

investment products with approved institutions. Approved institutions are organizations that have been approved by X to provide services or investment products to X under the Plan. All amounts and all income attributable to such amounts are held in trust, either in the form of annuity contracts or custodial accounts that are treated as trusts pursuant to Code section 457(g) or held by the trustee named in the Plan. Any amounts held by the trustee will be held pursuant to a written trust agreement that will be a valid trust under the laws of Y. The participants' accounts are not subject to the claims of the creditors of X.

Payments of benefits to participants or beneficiaries begin no later than 90 days after the close of the plan year after the later of the participant's separation from service or the date the participant attains, or would have attained, normal retirement age. A participant may apply to the Committee appointed by X for an earlier withdrawal in the case of an unforeseeable emergency.

Prior to the time that amounts are to be paid to participants (or a beneficiary, as the case may be), they may specify the method for distributing their deferred compensation benefits. The manner and time of benefit payout must meet the distribution requirements of sections 401(a)(9) and 457(d) of the Code.

The Plan can accept a transfer of compensation previously deferred under another eligible plan of deferred compensation maintained by another employer as a Code section 457 plan. A participant who separates from service with X and accepts employment with another employer that maintains an eligible 457 plan may elect to transfer his or her compensation deferred under the Plan to that other plan, if the other plan can accept such transfers.

Under the Plan, participants and beneficiaries may not sell, assign, commute, pledge, transfer or otherwise convey or encumber the right to receive payments.

The Plan also includes a provision permitting a participant to elect an in-service distribution of \$5,000 or less from his or her account in certain limited circumstances set forth thereunder and in accordance with section 457(e)(9)(A).

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

Treas. Reg. sec. 1.457-1(b)(2) 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 payments have commenced under the plan.

Section 457(g)(1) states that a plan maintained by a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State shall not be treated as an eligible deferred compensation plan unless all assets and income of the plan are held in trust for the exclusive benefit of participants and their beneficiaries. In addition, section 457(g)(3) states that custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

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.

Based upon the provisions of the Plan summarized above, we conclude as follows:

1. The Plan constitutes an eligible state deferred compensation plan as defined in section 457(b) of the Code, as amended under sections 1447 and 1448 of the Small Business Job Protection Act of 1996.
2. Amounts withheld from the compensation of a participant pursuant to the Plan shall not be includible in gross income of the participant at the time the amounts are withheld from compensation, but shall be includible in the gross income of the participant only for the taxable year or years in which such compensation or earnings is paid or otherwise made available to the participant under the Plan.
3. Amounts earned on the Plan assets held in trust (including annuity contracts and custodial accounts) will not be taxable to the approved institution, the Trustee, or to X. Such amounts will not be taxable to the employee-participant until earnings are paid or otherwise made available to the employee-participant or his or her beneficiary.
4. Amounts contributed to the Plan which are directly transferred from that plan to a different eligible state deferred compensation plan without having been paid to the employee shall not be deemed to be paid or otherwise made available to the employee participating therein and shall not be includible in the income of the employee solely by reason of the transfer.
5. If an employee elects to direct the Deferred Compensation Committee to transfer funds held in the participant's name from one approved institution to another approved

institution in order to effect a change in the investment of amounts deferred, the transfer of said amounts shall not result in taxable income to the participant.

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 X. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion in the ruling. See section 12.04 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, 47. However, when the criteria of section 12.05 of Rev. Proc. 99-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely yours,

ROBERT D. PATCHELL
Assistant Chief, Branch One
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure

Copy of letter

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