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Date:

December 23, 2004

Legend

Board =

State S =

State Plan =

State Regulations =

Dear . :

This responds to your letter of January 14, 2004, and subsequent correspondence, on behalf of State S and its Board, requesting a ruling concerning the proposed amended and restated deferred compensation plan (the "State Plan") which S intends to be an updated eligible deferred compensation plan under section 457(b) of the Internal Revenue Code of 1986 (the "Code"), as amended under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). The State Plan has been or will be adopted only by State S or other employers which are state or local governmental entities within State S. The other governmental entities within State S which adopt the State Plan as a deferred compensation eligible plan are represented to be eligible employers described in section 457(e)(1)(A) of the Code.

On September 30, 1999, the Internal Revenue Service ruled, in PLR 199952045, that the State Plan, as amended and restated at that time, was an eligible state governmental deferred compensation plan as defined in section 457(b). The proposed State Plan has been amended and restated again to

include a number of revisions taking into account subsequent statutory changes under section 457 and the revised Income Tax Regulations under section 457 promulgated by the Treasury Department on July 10, 2003.

Under the State Plan a participant may elect to defer compensation that would have been received for services rendered to a governmental employer in State S in any taxable year until death, severance from employment, attainment of age 70½, or until the occurrence of an unforeseeable emergency. The State Plan also includes a provision allowing an elective in-service distribution of \$5,000.00 or less to be paid to a participant from his or her account in certain limited circumstances set forth thereunder and in section 457(e)(9)(A).

The State Plan also permits the Board to establish a program which would allow participants to take loans from their plan accounts, subject to certain restrictions. Loans made under the State Plan are subject to rules in the Plan and in § 1.457-6(f)(2) of the Income Tax Regulations, including provisions restricting the maximum amount and term of a plan loan.

The participant's election under the State Plan to defer compensation not yet paid must be filed prior to the beginning of the month in which his or her salary reduction agreement becomes effective. The State Plan provides for a maximum amount that may be deferred by a participant in any taxable year and also provides for a catch-up computation for amounts deferred for one or more of the participant's last three taxable years ending before he attains normal retirement age under the Plan. The State Plan clarifies that a participant electing the special catch-up may use the sum of the limitations for all plan years the participant was eligible to participate in the State Plan minus the amount actually deferred in such years.

In addition, the State Plan also provides for the age 50 plus catch-up contributions described in section 414(v). However, the State Plan provides that a participant can only utilize one of the two catch-up contribution provisions during a single year. The amounts that may be deferred under the annual maximum limitation and the catch-up provisions are within the limitations of section 457 including the section 457(c) coordinated deferral provision.

With certain limitations, a participant, beneficiary or alternate payee may elect the manner in which his/her deferred amounts will be distributed. The State Plan provides that the manner and time of benefit payout must meet the distribution requirements of sections 401(a)(9) and 457(d) of the Code.

The State Plan provides that amounts of compensation deferred thereunder are to be transferred to and held in a trust described in section 457(g)(1) for the exclusive benefit of the participants and their beneficiaries. All

amounts deferred under the State Plan must be transferred to the trust within an administratively reasonable time period. The trust under the State Plan was established pursuant to a written agreement which provides that the trust shall be operated in accordance with the State Regulations and section 457(g) of the Code. The trust also provides that amounts invested therein shall be held for the exclusive benefit of the State Plan's participants and their beneficiaries. The rights of any participant or beneficiary to payments pursuant to the State Plan are generally nonassignable and not subject to pledge, transfer or encumbrance.

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)(1)(A) of the Code provides that in the case of a participant in an eligible governmental 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 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(d)(1)(A) provides that for a section 457 plan to be an eligible plan, the plan must have distribution requirements providing that under the plan amounts will not be made available to participants or beneficiaries earlier than i) the calendar year in which the participant attains age 70½, ii) 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.

Section 457(e)(1)(A) defines an eligible employer to be a state, political subdivision of a state, any agency or instrumentality of a state or political subdivision of a state.

Section 457(g) provides that a plan maintained by an eligible governmental employer shall not be treated as an eligible deferred compensation plan unless all assets and rights purchased with such deferred compensation amounts and all income attributable to such amounts, property, or rights of the plan are held in trust for the exclusive benefit of participants and their beneficiaries. Section 457(g)(2)(A) provides that a trust described in section 457(g)(1) shall be treated as an organization exempt from tax under section 501(a).

Section 1.457-7(b)(3) of the Income Tax Regulations provides that, in accordance with section 72(p), the amount of any loan from an eligible governmental plan to a participant or beneficiary is generally treated as having been received as a plan distribution under section 72(p)(1) except to the extent set forth in section 72(p)(2), relating to loans that do not exceed a maximum amount and that are repayable in accordance with certain terms, and § 1.72(p)-1 of the Income Tax Regulations. Thus, except to the extent a loan from a governmental section 457(b) plan satisfies section 72(p)(2) and § 1.457-6(f)(2), any amount loaned from an eligible governmental plan to a participant or beneficiary is includible in the gross income of the borrower for the taxable year when the loan is made. If a loan made under the Plan meets the requirements established under the Plan, the loan would satisfy the requirements of section 72(p)(2) and § 1.457-6(f)(2), and thus would not be treated as a taxable distribution under section 72(p)(1) solely because the loan was made.

Based upon the provisions of the Plan summarized above and the documents presented, including the written trust agreement, we conclude as follows:

1. The proposed amended and restated State Plan constitutes an eligible deferred compensation plan as defined in section 457(b) of the Internal Revenue Code of 1986 as amended under EGTRRA.
2. Amounts of compensation deferred in accordance with the State Plan, including any income attributable to the deferred compensation, will be includible under section 457(a)(1)(A) in the recipient's gross income for the taxable year or years in which amounts are paid to a participant or beneficiary in accordance with the terms of the Plan.
3. Assuming that it is a valid trust under State S law, the trust associated with the State Plan is treated under section 457(g) as a trust that is treated as an organization exempt from taxation under section 501(a).
4. Provided that a loan from the State Plan is made in accordance with the Plan's provisions, the making of the loan is not treated as a distribution subject to current taxation under section 72(p)(1) of the Internal Revenue Code.

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than the above-described State Plan. If the amended and restated State Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to the State Plan and applies only if the amended and restated State Plan submitted on January 14, 2004 is revised in accordance with the proposed modifications submitted on September 23, 2004. In addition, this ruling applies only to the Trust Agreement submitted on

October 15, 2004. Section 6110(k)(3) of the Internal Revenue Code provides that this ruling may not be used or cited as precedent.

Sincerely,

Robert D. Patchell
Chief, Qualified Plans 2 (Employee Benefits)
(Tax Exempt & Government Entities)

Enclosure (1)