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Legend

Board =

EIN=

State X =

County Plan =

Fund =

This is in response to your letter dated September 28, 2000, on behalf of the Fund requesting a ruling on the proper treatment of certain employee contributions made to retirement programs operated by the Board under sections 414(h)(2) and 457 of the Internal Revenue Code. This ruling only addresses the deferred compensation program intended to meet the requirements of section 457(b) of the Code.

The Fund is a retirement fund established in 1994 to provide retirement benefits to employees of county governments located in State X. The Board governs the Fund. County employees elect nine board members. The governor of State X appoints the other two members.

Before January 1, 2000, all retirement benefits were provided through a defined benefit plan, a plan which is intended to be a tax-exempt retirement program under section 401(a) of the Code. However, in 1999, the State X Legislature amended the statute establishing the Fund to create a defined contribution plan, which also is intended to qualify as a tax-exempt retirement program under section 401(a). The new statute also authorized the Fund to sponsor a deferred compensation program intended to meet the requirements of section 457(b) of the Code ("County Plan"). The provisions of the defined benefit plan, defined contribution plan and the County Plan as of January

1, 2000, are set forth in proposed regulations under the State X Code of State Regulations.

Under the County Plan, an employee may elect to defer compensation that would have been received for services rendered to a participating county in any taxable year until death, separation from service from all the participating counties, attainment of age 70 ½, or the occurrence of an unforeseeable emergency (within the meaning of section 1.457-2(h)(4) of the Income Tax Regulations). The County Plan also includes a provision providing a voluntary in-service distribution of \$5,000.00 (or the dollar limit under section 411(a)(11) of the Code, if greater) 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 County Plan does not provide that a loan may be made from assets held by the County Plan to any participant or beneficiary under the County Plan.

The participant's election to defer compensation not yet earned under the County Plan must be filed prior to the beginning of the month in which his or her salary reduction agreement becomes effective. The County Plan provides for a maximum amount that may be deferred by a participant in any taxable year. The amounts that may be deferred under the annual maximum limitation are within the limitations of section 457 (including the section 457(c) coordinated deferral provision). A participant may also transfer his account in another eligible deferred compensation plan to the County Plan.

With certain limitations, a participant may elect to have his account distributed in a single lump sum, substantially nonincreasing installments paid at least annually over his or her life expectancy, a combination of a partial lump sum and such installments, or lifetime annuity payments. The election generally must be made at least 30 days prior to the date any such payment is to commence to the participant. If the participant fails to make a timely election, or if the participant dies, distribution of the participant's account will be made in a single lump sum.

The County Plan provides that the manner and time of benefit payout must meet the distribution requirements of sections 401(a)(9) and 457(d)(2) of the Code.

In order to carry out the purposes of the County Plan the Fund created and established a custodial account ("Custodial Account"). The Custodial Account is intended to satisfy the requirements of section 457(g)(3) of the Code, and to be treated as a trust solely for purposes of applicable tax laws under rules similar to the rules under section 401(f) as contemplated by that section. The County Plan provides that amounts of compensation deferred thereunder are held in the Custodial Account for the exclusive benefit of the participants and their beneficiaries. Also, all amounts deferred under the County Plan must be transferred to the custodial account within an administratively reasonable time period. The rights of any participant or beneficiary to payments pursuant to the County Plan are nonassignable and not subject to

attachment, garnishment, pledge, transfer, execution or other legal process.

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.

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 70-1/2, ii) when the participant is separated from service with the employer, or iii) when the participant is faced with an unforeseeable emergency as determined under Treasury regulations. However, section 401(a)(9)(C)(i) generally allows plans to postpone the required beginning date until April 1 of the calendar year following the later of the calendar year in which the employee retires or in which he attains age 70-1/2.

A basic requirement prescribed by section 457(b)(5) is that an eligible section 457 plan must meet the section 457(d) distribution requirements described above in order to retain its tax- deferred eligible status. A section 457 plan would violate these provisions of section 457(b)(5) and the regulations thereunder if the participant or anyone else received a distribution earlier than the earliest date established in section 457(d)(1)(A).

Section 457(e)(9)(A) provides that the total amount payable to a participant under the plan will not be treated as made available merely because the participant may elect to receive such amount (or the plan may distribute such amount without the participant's consent) if (i) such amount does not exceed \$5,000, and (ii) such amount may be distributed only if -- (I) no amount has been deferred under the plan with respect to such participant during the 2-year period ending on the date of the distribution, and (II) there has been no prior distribution under the plan to such participant under this option.

Section 1.457-2(h)(4) of the Income Tax Regulations defines an unforeseeable emergency as severe financial hardship to the participant resulting from a sudden and unexpected illness or accident of the participant or of a dependent, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

Section 457(g)(1) 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) provides that a trust described in section 457(g)(1) shall be treated as an organization exempt from tax under section 501(a). Section 457(g)(2)(B) provides that the amounts in the trust are treated as includible in the gross income of participants and beneficiaries only to the extent, and at the time, provided in section 457.

Section 457(g)(3) provides that for purposes of section 457(g), custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

Under the terms of the County Plan and Custodial Agreement, the custodian must hold all of the section 457(b) plan assets for the exclusive benefit of the participants and their beneficiaries, and all amounts deferred under the Plan must be transferred to a custodial account meeting the requirements of section 457(g)(3) of the Code within an administratively reasonable time period.

Based upon the provisions of the County Plan summarized above, the documents presented and the representations made, we conclude as follows:

1. The County Plan established by State X is an eligible deferred compensation plan as defined in section 457(b) of the Code.
2. Amounts of compensation deferred in accordance with the County Plan, including any income attributable to the deferred compensation, will be includible in the recipient's gross income for the taxable year or years in which amounts are paid or otherwise made available to a participant or beneficiary in accordance with the terms of the County Plan.
3. Any custodial accounts established pursuant to the Plan and the Custodial Agreement, which are described in section 401(f) of the Code, will be treated as trusts under rules similar to the rules under section 401(f) of the Code.

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than County Plan described above. In addition, this ruling applies only to deferrals made after the date this ruling was issued. If the County Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to Fund and the participants in the County Plan and applies only to the County Plan and Custodial Agreement submitted. Section 6110(k)(3) of the Internal Revenue 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. 2001-1, 2001-1 I.R.B. 1, 46. However, when the criteria in section 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

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

Sincerely,
Robert D. Patchell
Assistant Chief, Qualified Plans Branch 2
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt and Government Entities)