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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEC 18 2002

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UIL: 401.00-00
451.00-00
3121.00-00

Legend

Employer A:

State B:

City C:

Plan X:

This is in response to a letter dated February 13, 2002, submitted on your behalf by your authorized representative, in which you request a private letter ruling dealing with the taxability of Employer Vacation Pay Benefit Contributions made to Plan X.

The following facts and representations have been submitted:

Employer A is a State B local governmental entity with its principal place of business located in City C. Employer A sponsors Plan X, which is a defined contribution plan with profit sharing features. Plan X meets the qualification requirements of section 401(a) of the Internal Revenue Code (the Code).

Plan X provides for an Employer Vacation Pay Benefit Contribution that is defined as a Member's Permitted Unused Vacation Pay for the year that would otherwise be forfeited by the participant. Section XXX of the Plan, entitled "The Employer Vacation Pay Benefit Contribution" provides that:

> The Employer shall contribute for each Plan Year an amount which equals the value of the Member's Permitted Unused Vacation Pay for the Plan Year that the Member elects to have contributed to the Plan on his behalf.

Section XXX of the Plan defines "Member's Permitted Unused Vacation Pay " as:

> "Member's Permitted Unused Vacation Pay" means the paid vacation time that a Member will permanently forfeit during the Plan Year if such Member either does not actually take a paid vacation from the Employer during the Plan Year or have the Employer contribute on behalf of the Member an amount equal to the value of the paid vacation time that would otherwise be forfeited by the Member during the Plan Year.

Each employee accrues paid vacation time based on the employee's years of service with Employer A. Vacation time that is accrued and unused may not be carried over to the next year and results in forfeitable vacation pay. An employee that does not utilize his/her forfeitable vacation pay for the year, and does not elect to have the Employer Vacation Pay Benefit Contribution made to Plan X by Employer A on his behalf, will permanently forfeit his forfeitable vacation pay.

An employee does not have the option of receiving a cash payment in lieu of vacation time. An employee has three options with respect to forfeitable vacation pay: (1) the employee can forfeit the unused vacation time at the end of the year; (2) the employee can use all vacation time accrued; or (3) the employee may exercise the option to have an amount contributed on his or her behalf to the Plan that is equivalent to the employee's forfeitable vacation pay.

Plan X allows for distributions upon termination of employments, death, pursuant to a qualified domestic relations order under section 404(p) of the Code, or as required by section 401(a)(9) of the Code. Plan X does not allow for in service distributions or loans to participants.

Based upon the foregoing, the following ruling is requested:

> That Employer Vacation Pay Benefit Contributions made by Employer A to Plan X on behalf of employees are not cash or deferred elections as described in section 401(k) of the Code, and are not includible in the employees' gross income for federal income tax purposes, or in the employees' gross wages for purposes of FICA.

Section 1.401(k)-1(a)(3) of the Income Tax Regulations (the Regulations) states that a cash or deferred election is any election (or modification of an earlier election) by an employee to have the employer either provide an amount to the employee in the form of cash or some other taxable benefit that is not currently available, or contribute an amount to a trust, or provide an accrual or benefit, under a plan deferring the receipt of compensation.

Section 451 of the Code provides that the amount of any item of gross income shall be included in gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the Regulations provides that under the cash receipts and disbursements method of accounting, an amount is includible in gross income when actually or constructively received. Section1.451-2(a) of the Regulations further provides that income is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart for him, or otherwise made available so that he 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.

Section 3121(a)(5)(A) of the Code provides, in general, that a payment on behalf of an employee to a qualified trust is not included in wages for purposes of FICA. Section 3121(v)(1)(A) provides that an employer contribution under a qualified cash or deferred arrangement under section 401(k) is included in wages.

In this case, an employee's only options with respect to forfeitable vacation pay is to; (1) use the vacation time within the year for which it has been earned; (2) elect to have Employer A contribute the monetary value of the forfeitable vacation pay to Plan X; or (3) forfeit, permanently, the forfeitable vacation pay. The employee's cash compensation is not effected by his/her choice.

Because the employee does not have the option to receive cash or any other taxable benefit in lieu of the additional employer contribution to Plan X, the employee's choice among the above options is not a cash or deferred arrangement. The Employer Vacation Pay Benefit Contribution is a non-elective employer contribution to a qualified plan. Further, because an employee does not have the option to receive cash or any other taxable benefit in lieu of the Employer Vacation Pay Benefit Contribution, he/she is not in constructive receipt of income, and the Employer Vacation Pay Benefit Contribution is not includable in the employee's gross income until distributed from Plan X.

We have already determined that the Employer Vacation Pay Benefit Contribution is not part of a cash or deferred arrangement. Because it is, however, a non-elective employer contribution to a qualified trust, the general rule of section 3121(a)(5)(A) excludes it from wages for purposes of FICA.

Accordingly, based upon the information submitted, we conclude that Employer Vacation Pay Benefit Contributions made by Employer A to Plan X on behalf of employees are not cash or deferred elections as described in section 401(k) of the Code, and are not includible in the employees' gross income for federal income tax purposes, or in the employees' gross wages for purposes of FICA.

This ruling is based upon the assumption that Plan X is qualified under section 401(a) of the Code. No opinion is expressed concerning the application of any other section of the Code or the regulations thereunder.

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

A copy of this ruling is being sent to your authorized representative pursuant to a power of attorney on file in this office. Should you have any questions pertaining to this ruling, you may contact of this office at (

Sincerely yours,

Andrew E. Zuckerman
Manager, Employee Plans
Technical Branch 1