

Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:

CC:TEGE:EB:EC-PLR-116272-02

Date:

December 20, 2002

Legend

Entity =

State X =

Member =

Federal Government Agency =

State Commission A =

State Commission B =

Business Y =

Dear _____ :

This is in response to your letter of February 13, 2002, and subsequent correspondence, requesting rulings with respect to certain qualified and nonqualified deferred compensation arrangements.

The Entity was created by authorization of State X law, and chartered as a corporation under State X law. The Entity is the only entity, other than the federal government, permitted to conduct Business Y. A person meeting specific qualifications may be authorized to become a Member of the Entity. These qualifications are that a potential Member must obtain a license from the Federal Government Agency, complete an apprenticeship with the Entity, and be recommended by a State commission and by the governor of State X.

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The Entity assigns Members to provide the services related to Business Y in accordance with its own internal by-laws, rules and regulations. The volume of services is determined by market conditions and not by State regulation. Individual Members are subject to education and discipline by State Commission B. The Entity's receipts come from the rates charged to private clients by the Entity to provide services related to Business Y. The rates are regulated by a commission of industry representatives and State Commission B, and the Entity is required to file periodic reports with State Commission B.

The Entity is managed by a board of directors consisting of five Members or former Members elected by the current Members. State X has no control over the selection of the Entity's directors or officers. State X does not treat Members or employees of the Entity as State X employees. The Entity's charter provides that on liquidation, all of the Entity's assets must be distributed to its Members.

The Entity sponsors a plan intended to be qualified under Code section 401(a) that has a cash or deferred arrangement intended to be qualified under section 401(k). The Entity also sponsors certain other nonqualified arrangements intended to provide deferred compensation.

Section 401(k)(1) of the Internal Revenue Code provides that a profit sharing or stock bonus plan, a pre-ERISA money purchase plan or a rural cooperative plan shall not be considered as failing to satisfy the requirements for qualified plans under section 401(a) of the Code merely because the plan includes a qualified cash or deferred arrangement.

Section 401(k)(4)(B)(ii) provides that a cash or deferred arrangement is not a qualified cash or deferred arrangement if the arrangement is part of a plan maintained by a State or local government or political subdivision thereof, or any agency or instrumentality thereof.

Section 414(d) provides that for purposes of Part 1 (sections 401 through 424), the term governmental means a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Section 457 provides special rules governing deferred compensation plans of eligible employers. Section 457(e)(1) defines an eligible employer as a state, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State, and any other organization (other than a governmental unit) exempt from tax under this subtitle.

The Service considers several factors in determining whether an entity is an instrumentality of a State. See Rev. Rul. 89-49, 1989-1 C.B. 117 (factors to be

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considered in determining whether an organization is an instrumentality of a state or political subdivision for purposes of Code section 414(d)); see also Rev. Rul. 57-128, 1957-2 C.B. 311 (factors to be considered in determining whether an organization is an instrumentality of a state or political subdivision for purposes of Code section 3121(b)(7)).

Rev. Rul. 89-49, 1989-1 C.B. 117, provides that a plan will not be considered a governmental plan within the meaning of Code section 414(d) merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. Under Rev. Rul. 89-49, one of the most important facts to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision is the degree of control that a governmental entity or entities exercises over the organization's everyday operations. Other factors include: (1) whether there is specific legislation creating the organization, (2) the source of funds for the organization, (3) the manner in which the organization's trustees or operating boards are selected, and (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit. Rev. Rul. 89-49 clarifies that although all of the above factors are considered in determining whether an organization is an agency or instrumentality of a government, the mere satisfaction of one or all of the factors is not necessarily determinative.

In this case, the Entity is a creation of a State X statute, and there is some State X regulation of the Entity through State Commission B and the requirement that potential Members be recommended by State Commission A. However, all directors on the Entity's board of directors are elected by the Members. State X is not involved in the everyday operations of the Entity, and the Entity controls the assignment of Members to particular work in accordance with its internal rules. State X does not fund the Entity's operations, and the Entity's employees are not treated as employees of State X. Upon liquidation, the Entity's assets must be distributed to its Members.

Based on the information submitted and representations made, we conclude that:

1. the Entity is not an agency or instrumentality of a State within the meaning of section 457(e)(1)(A); and
2. the Entity is not an agency or instrumentality of a governmental entity under Code sections 401(k) and 414(d), and therefore is eligible to adopt a qualified plan with a qualified cash or deferred arrangement under section 401(k).

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. Specifically, no opinion is expressed or implied as to the proper classification of the the Entity as a partnership or corporation. Nor is any opinion expressed or

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implied as to the status of any retirement plan as a qualified plan under section 401(a) or any cash or deferred arrangement within that plan as a qualified cash or deferred arrangement under section 401(k). Furthermore, as was discussed with your taxpayer representative in a telephone conversation on November 25, 2002, we express no opinion regarding the tax consequences of the establishment of or participation in any nonqualified deferred compensation arrangement or related trust.

This ruling is directed only to the entity requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

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

The rulings contained in this letter are based upon information and representations submitted by the Entity and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination. Additionally, should the facts upon which this ruling is based change, this may affect the taxpayer's status and this ruling would no longer be effective.

Sincerely,

CATE LIVINGSTON FERNANDEZ
Chief, Executive Compensation Branch
Office of Division Counsel /
Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures:

Copy of Letter
Copy of Letter for section 6110 purposes