

Under the Model Plan a participant may elect to defer compensation that would have been received for services rendered to a governmental employer within State S in any taxable year until death, severance from employment, attainment of age 70½, or until the occurrence of an unforeseeable emergency. The Model 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), as well as a provision permitting the employer or its plan administration committee to make a mandatory cash-out of such amounts in those circumstances.

The Model Plan also permits the adopting employer or its plan administration committee to establish a program which would allow participants to take loans from their plan accounts, subject to certain restrictions. Loans made under the Model 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 Model 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 Model 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 Model 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 employer's Plan minus the amount actually deferred in such years.

In addition, the Model Plan also provides for the age 50 plus catch-up contributions described in section 414(v). However, the Model 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 Model 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 Regulations require an eligible employer which adopts the Model Plan to establish a trust described in section 457(g) and to arrange for a trustee to hold the amounts deferred under the employer's Model Plan for the

exclusive benefit of its participants and beneficiaries. The Model Plan provides that amounts of compensation deferred thereunder must be transferred to and invested in a trust described in section 457(g)(1) for the exclusive benefit of the participants and their beneficiaries within an administratively reasonable time period. The rights of any participant or beneficiary to payments pursuant to the Model 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 Model 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 State Regulations, we conclude as follows:

1. The proposed amended and restated Model 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 Model 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. Provided that a loan from the eligible employer's Model Plan is made in accordance with the Plan's provisions, the making of the loan will not be 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 Model Plan. If the amended and restated Model Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to the Model Plan and applies only if the amended and restated Model Plan submitted on January 14, 2004 is revised in accordance with the proposed modifications submitted on September 23, 2004. In addition, this ruling applies to an adopting eligible employer only if it establishes a trust satisfying the requirements of the Model Plan and the State

Regulations. 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 Branch 2 (Employee
Benefits)
(Tax Exempt & Government Entities)

Enclosure (1)