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Department of the Treasury
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Date:
February 11, 2005

In Re:

Legend

Employer =

Board =

Y =

Plan A =

Trust =

State X =

Dear :

This is in reply to your letter of July 9, 2004, on behalf of State X and Y, requesting a ruling concerning the proposed amended and restated deferred compensation plan ("Plan A") which State X 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). Employers participating in Plan A are represented to be eligible employers within the meaning of section 457(e)(1)(A).

The Board is the statutory body responsible under State X law for the establishment of nonqualified retirement plans. The Board has delegated the authority to administer any nonqualified retirement plans to Y. The employee benefits division of Y administrates and handles matters relating to the State X deferred compensation plans. It is represented that Y is an instrumentality of State X.

Effective July 25, 1979, the Board established Plan A pursuant to State X statutes. Plan A was amended and restated by Board on October 25, 2001. Plan A was last amended by the Board on February 28, 2002.

In PLR-105902-99, the Internal Revenue Service ruled that Plan A is an eligible deferred compensation as defined in section 457(b) of the Code. Plan A has been amended since the ruling to include a number of revisions taking into account statutory changes under section 457 and the revised Income Tax Regulations under section 457 promulgated by the Treasury Department on July 10, 2003.

Under Plan A, the amounts of compensation that may be deferred under the annual maximum limitation are within the limitations of section 457, including catch-up computation for amounts deferred for one or more of the participant's last three taxable years ending before he or she attains normal retirement age. The participant's election to defer compensation must be filed prior to the beginning of the month in which his or her participation agreement becomes effective.

With certain limitations, a participant may elect the manner in which his or her deferred amounts will be distributed. The election must be made prior to the date any amounts become payable to the participant under Plan A. If the participant fails to make a timely election, distribution will commence at the time and in the manner set forth in Plan A. Under Plan A, no amounts will be made available to the participant or beneficiary earlier than the calendar year the participant attains age 70-1/2, when the participant is separated from service, or when the participant is faced with an unforeseeable emergency as defined under Plan A in accordance with the requirements of section 457. The manner and time of benefit payout must meet the distribution requirements of sections 401(a)(9) and 457(d)(2) of the Code.

However, Plan A does permit one exception to the above distribution requirements. Plan A, in accordance with section 457(e)(9)(A), includes a provision permitting an in-service distribution of \$ 5,000.00 or less from a participant's account within the requirements of that section.

Plan A further provides that all amounts of compensation deferred pursuant to Plan A, all property and rights purchased with such amounts and all income attributable to such amounts, property, or rights shall be held in trust for the exclusive benefit of participants and beneficiaries under Plan A for the exclusive benefit of the participants and beneficiaries of Plan A. The trust under Plan A is established pursuant to a writing that is represented to be a valid trust under state law.

The rights of any participant or beneficiary to payments pursuant to Plan A are generally nonassignable and not subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, attachment, or garnishment by creditors of the participant or the participant's beneficiary.

The terms of Trust make it impossible prior to the satisfaction of all liabilities with respect to plan participants and their beneficiaries for any part of the assets and income of the trusts to be used for, or diverted to, purposes other than the exclusive benefit of plan participants and their beneficiaries.

Plan A permits a participant to transfer amounts from his or her account by way of a trustee-to-trustee transfer to any defined benefit governmental plan (as defined in section 414(d) of the Code) where the transfer is used to purchase permissive service credits under a defined benefit governmental plan.

In order to comply with the trust requirements set forth in section 457(g), the Trust was established effective January 1, 1999. It has been represented that the Trust was established pursuant to a writing that constitutes a valid trust under the laws of State X and is currently a valid trust under State X law.

Section 457 of the Code provides rules for the deferral of compensation by an individual participant 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.

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(d)(1)(A) of the Code 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 has a severance from employment 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.

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 1.457-6(c)(2) of the Income Tax Regulations defines an unforeseeable emergency as a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse, or the participant's or beneficiary's dependent (as defined in section 152(a)); loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, e.g., as a result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary.

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

Section 457(e)(10) provides that a participant shall not be required to include in gross income any portion of the entire amount payable to such participant solely by reason of the transfer of such portion from one eligible deferred compensation plan to another eligible deferred compensation plan.

Section 457(e)(17) provides that no amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined governmental plan (as defined in section 414(d)) if such transfer is (A) for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan or (B) a repayment to which section 415 does not apply by reason of subsection (k)(3) thereof.

Section 1.457-10(b)(1) of the Regulations provides that an eligible governmental plan may provide for the transfer of amounts deferred by a participant or beneficiary to another eligible governmental plan if the conditions in paragraphs (b)(2), (3), or (4) of section 1.457-10(b)(1) are met and such transfer of assets is not between an eligible governmental plan and a tax-exempt entity's eligible plan.

Section 1.457-10(b)(6) of the Regulations further provides that upon the transfer of any amount between eligible plans under paragraphs (b)(1) through (b)(4) of section

1.457-10(b)(1) , if the participant is performing services for the entity maintaining the receiving plan, such amount is subject to the restrictions of section 1.457-6 (relating to when distributions are permitted to be made to a participant under an eligible plan) in the receiving plan in the same manner as if the transferred amount had originally been deferred under the receiving plan.

Based upon the facts summarized above, we conclude as follows:

1. Plan A, when adopted by participating employers as described above, is an eligible deferred compensation plan as defined in section 457(b) of the Code.
2. The Trust will be treated under section 457(g) as an organization exempt from taxation under section 501(a) of the Code.
3. Plan A assets designed to provide a fixed annuity or other guaranteed return that are acquired under the provisions of Appendices C and D to Plan A and that are held in a custodial account, an annuity contract or other contract issued by an insurance company and described in section 401(f) will be treated as a trust under rules similar to the rules under section 401(f) of the Code.
4. Amounts of compensation deferred by an employee in accordance with the terms of Plan A are excluded from the gross income of the employee in the taxable year such amounts are deferred.
5. Amounts of compensation deferred in accordance with the terms of Plan A, including any income attributable to such deferred compensation, will be includible in the gross income of the employee in the taxable year or years in which such amounts are paid to the employee in accordance with the terms of Plan A. For these purposes, amounts are not considered to be paid (and taxable) to the employee in the event of a direct rollover described in section 401(a)(31) of the Code, a payment to a spouse or former spouse pursuant to a qualified domestic relation order as defined in section 414(p) (as addressed in section 1.457-10(c) of the regulations) and/or a transfer for the purchase of permissive service credit (as described in section 415(n)(3)).

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 Plan A. If the proposed amended and restated Plan A is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to

Plan A. Section 6110(k)(3) of the Code provides that this ruling may not be used or cited as precedent.

Sincerely,

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

Enclosure (1)

cc: