Internal Revenue Service

Number: **200127031**
Release Date: 7/6/2001
Index Number: 083.13-00 402.00-00
401.00-00 162.02-00

Department of the Treasury

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply To:
DC/ACC:TEGE:EB:EC-PLR-120432-00

Date:
March 26, 2001

Union X =
Y =
Plan A =
Plan B =

This is in response to your request for a ruling on behalf of Union X and Y, concerning the federal income tax consequences of the establishment of Plan B and a trust to provide excess benefits to certain participants of Plan.

Plan A is a multiemployer defined benefit plan qualified under section 401(a) of the Internal Revenue Code. Retirement benefit levels under Plan A reflect such factors as length of service, employee status, age at retirement, and form of annuity income selected. These features incorporate the terms of the underlying collective bargaining agreements negotiated by Union X with various employers, including Y, that are required under these agreements to contribute certain amounts to Plan A. Contribution levels by the various employers are stipulated in the respective collective agreements, and are intended to be adequate to fund the benefits called for under such agreements. The benefits themselves under Plan A are, in accordance with the applicable provisions of the written plan document, in all instances subject to the limitations of section 415 of the Code. The enrolled actuary to Plan A has advised that there are participants of Plan A whose qualified plan benefits have been limited by the application of section 415.

Under the terms of the collective bargaining agreements, Union X has established Plan B. Plan B is intended to provide benefits to participants whose benefits under Plan A have been limited by section 415. Under the terms of Plan B, the participating employers will make monthly pension contributions under the collective bargaining agreements. These contributions will be deposited in a holding account at a bank and distributed to Plan A and Plan B by a third-party administrator. The third-party administrator will determine each month how much will be contributed to Plan B. The contributions to Plan B will be made pursuant to a formula that takes into account the monthly benefit that would have been paid to Plan A participants in pay status but for the application of section 415 (the “Excess Amount”). In addition, the contribution to Plan B will include an amount every month to be allocated to each participant’s account equal to the employee’s portion of the employment taxes payable with respect to the Excess Amount (the “Gross Up Amount”). Amounts necessary to pay the employer’s portion of applicable employment taxes and administrative expenses of the trust will also be contributed to Plan B each month. The remaining pension contributions from the participating employers will be contributed to the trust associated with Plan A.

Union X and Y have represented that each month, as required by the collective bargaining agreement, Y will contribute the amounts necessary to Plan B to pay Y's portion of the Plan B benefits, applicable employment taxes, and the reimbursement of Plan B administrative expenses.

Amounts contributed to Plan B will be held in a non-interest bearing account. Under the terms of Plan B, all contributions to the trust are irrevocable and are held for the exclusive benefit of Plan B participants in pay status. Under the terms of Plans A and B, it is impossible for any funds ever paid to Plan B to revert or otherwise to be transferred to Plan A or to be transferred from Plan A to Plan B. Further, the moneys designated for and paid over to Plan B are immediately identified as being for the payment of benefits from Plan B and are promptly disbursed as such and thus could not be used for any other purpose.

Under the terms of Plan B, the Plan Administrator shall "assure that by the end of each taxable year that all assets accumulated during that tax year have been paid out for benefits, FICA and other payroll taxes, and/or administrative expenses." Thus, there are no accumulated earnings, and Plan B and the related non-interest bearing account serve only as conduits through which collectively bargained contributions are identified and allocated to the individual accounts of Plan B participants.

The administrative expenses include, for example, attorneys fees, fees of Plan B's third party administrator and accounting fees. The administrative expenses are described in Plan B as "the reasonable and necessary expenses incurred in the collection of contributions and in the administration and operation of the Plan." Plan B provides that "[p]lan assets will not be held for investment and the Plan Administrator will not incur fees for brokerage commissions, investment management service or similar investment related activities." You have represented that "[b]ecause Plan B will not hold assets for investment, Plan B will not incur any fees for brokerage commissions, investment management services or similar investment related activities that have been ruled to be deductible only under Code section 404."

Section 3(36) of the Employee Retirement Income Security Act of 1974 (ERISA) defines an excess benefit plan as one maintained solely for the purpose of providing benefits for certain plan participants in excess of the limitations imposed by section 415 of the Code, without regard to whether the plan is funded. There is no corresponding section of the Code with respect to excess benefit plans.

Section 401(a)(16) of the Code provides that a trust shall not constitute a qualified trust if the plan of which the trust is a part provides for benefits or contributions which exceed the limitations of section 415.

Section 412 of the Code provides minimum funding requirements that must be satisfied in qualified pension plans.

Section 1.414(l)-1(b)(1) of the regulations state that a plan is a “single plan” if and only if, on an ongoing basis, all of the plan assets are available to pay benefits to plan participants.

Under this definition, Plan A and Plan B, taken together, do not constitute a single plan, because there is no possibility of transfer of assets from either one to pay benefits provided by the other. Since Plan B is a nonqualified and unfunded plan operating separately from Plan A, the existence of Plan B does not affect the qualified status of Plan A.

Section 415(b) of the Code sets out limitations on benefits payable from a qualified defined benefit plan.

Section 83(a) of the Internal Revenue Code provides that the excess (if any) of the fair market value of property transferred in connection with the performance of services over the amount paid (if any) for the property is includible in the gross income of the person who performed the services for the first taxable year in which the property becomes transferrable or is not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Income Tax Regulations provides that for purposes of section 83, the term “property” includes real and personal property other than money or an unfunded and unsecured promise to pay money or property in the future. Property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor’s creditors, for example, in a trust or escrow account.

Section 402(b) of the Code provides that contributions made by any employer to an employees’ trust that is not exempt from tax under section 501(a) are included in the employee’s gross income in accordance with section 83, except that the value of the employees’ interest in the trust will be substituted for the fair market value of the property in applying section 83. Under section 1.402(b)-1(a)(1) of the regulations, employer contributions to a nonexempt employee’s trust are included as compensation in the employee’s gross income for the taxable year in which the contribution is made, but only to the extent that the employee’s interest in such contribution is substantially vested, as defined in the regulations under section 83.

Section 1.402(b)-1(c)(1) of the regulations provides that any amount actually distributed or made available to any distributee by an employees’ trust in a taxable year in which it is not exempt under section 501(a) shall be taxable under section 72 (relating to annuities) to the distributee in the taxable year in which it is so distributed or made available.

Section 404(a) of the Code provides the general deduction timing rules applicable to a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan or arrangement for deferring compensation, regardless of the Code section under which the amounts might otherwise be deductible. Pursuant to section 404(a)(5), contributions or compensation deferred under a nonqualified plan or arrangement are deductible in the taxable year in which an amount attributable to the contribution are includible in the gross income of the employees participating in the plan, but in the case of a plan in which more than one employee participates, only if separate accounts are maintained for each employee. See also section 1.404(a)-12(b)(3) of the regulations.

Section 1.404(a)-12(b)(1) of the regulations provides a deduction is allowable for contributions paid only in the taxable year in which or with which ends the taxable year of an employee in which an amount attributable to such contribution is includible in his or her income as compensation, and then only to the extent allowable under section 404(a).

Section 162 of the Code allows a deduction for the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 3101 of the Code imposes Federal Insurance Contribution Act ("FICA") tax on the income of every individual equal to a percentage of the wages received by the individual.

Section 3102(a) of the Code requires the employer to collect the FICA tax by deducting the amount of the tax from wages when paid. Section 3102(b) provides that the employer required to deduct the tax is liable for the payment of the tax.

Section 3301 of the Code, in general, imposes Federal Unemployment Tax Act ("FUTA") tax on employers equal to a percentage of the wages paid by the employer.

Section 3402 of the Code requires an employer making payment of wages to deduct and withhold from such wages the appropriate amount of tax.

Section 3403 of the Code provides that the employer is liable for the payment of the tax required to be deducted and withheld under section 3402.

An employer's payment of taxes assessable against an employee constitutes additional taxable income to such employee. Old Colony Trust Co. v. Commissioner, 179 U.S. 716 (1929), VIII-2 C.B. 222 (1929). Section 31.3401(a)-1(b)(6) of the Employment Tax Regulations provides generally that the term "wages" includes the payment by an employer of an employee's tax liability, including the taxes imposed by section 3101. Rev. Proc. 81-48, 1981-2 C.B. 623 and Rev. Rul. 86-14, 1986-1 C.B. 304, set forth the methods of calculating and reporting an employee's FICA tax when such amount is not deducted from the employee's pay.

Because employees who participate in Plan B are fully vested in their Plan B benefits when Y's contributions are made and separate accounts are maintained for each participating Y employee, Y is entitled to a deduction under section 404(a)(5) of the Code in an amount equal to the amount included in income by the respective Y employee, assuming all other requirements for deductibility are met. The deduction is allowable in the taxable year in which or with which ends the taxable year of the employee in which the amount is includible in the employee's income as compensation.

Rev. Rul. 86-142, 1986-2 C.B. 61, considered the deductibility of brokers' commissions charged in connection with the purchase and sale of securities for a qualified employee's trust or an individual retirement arrangement (IRA). It notes that brokers' fees are not recurring administrative or overhead expenses incurred in connection with the maintenance of the trust or IRA. Instead, brokers' commissions are intrinsic to the value of the trust's or IRA's assets. Buying commissions are part of the cost of the securities purchased and selling commissions are an offset against sales price. Based on this analysis, Rev. Rul. 86-142 holds that employer contributions to the trust of a qualified plan, or direct payments by the employer to a broker, to pay brokers' commissions cannot be separately deducted under section 162 or 212 of the Code.

Unlike the brokers' fees at issue in Rev. Rul. 86-142, the administrative expenses described in this case are recurring administrative or overhead expenses incurred in connection with the maintenance of Plan B. The administrative expenses include attorneys' fees, fees of Plan B's third party administrator, accounting fees, etc., and are limited by the terms of Plan B to the "reasonable and necessary expenses incurred in the collection of contributions and in the administration and operation of the Trust."

Under sections 3102, 3301, and 3402 of the Code, the employer is liable for the payment of FICA and FUTA tax required to be deducted and withheld from the employee's wages. The FICA and FUTA tax required to be paid by the employer is a direct consequence of the employer's obligation to pay the underlying wages and, as such, are deductible by the employer as ordinary and necessary business expenses under section 162.

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

1. The establishment and operation of Plan B by the trustees of Plan A will not cause Plan A or the trust established thereunder to lose their respective tax-qualified and tax-exempt statuses.

2. The method of funding Plan B will not cause Plan A or the trust established thereunder to lose their respective tax-qualified and tax-exempt statuses.

3. Plan A and Plan B, taken together, do not constitute a single plan under section 1.414(l)-1(b)(1) of the Regulations because there is no possibility of transfer of assets from either plan to pay benefits provided by the other plan.

4. Plan B participants and beneficiaries are taxable on contributions, including the portions allocable to payroll taxes, made on their behalf to the Plan B trust at the time the contributions to the trust are made.

5. Plan B is not taxable on contributions that are disbursed to Plan B participants

on a monthly basis.

6. Assuming the requirements for deductibility are otherwise met, Y's contributions to pay the Excess Amount and the Gross Up Amounts are fully deductible by Y in the taxable year in which or with which ends the taxable year of the employees in which the amounts are includible in the employees' gross income.

7. Y's payments to Plan B of Y's portion of applicable employment taxes are deductible under section 162 in the taxable year in which Plan B disburses such payments to the applicable taxing authorities.

8. Y's payments to Plan B to reimburse Plan B's administrative expenses are deductible under section 162 in the taxable year in which Plan B disburses such payments to the administrative service providers.

Except as specifically ruled on above, no opinion is expressed as to the federal tax consequences of the above transaction under any other provision of the Code.

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

The rulings contained in this letter are based upon information and representations submitted by the taxpayer 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.

Sincerely,
Charles T. Deliee
Chief, Executive Compensation Branch
Office of the Division Counsel/Associate
Chief Counsel (Tax Exempt and
Government Entities)