



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

SEP 16 2003

UIL: 415.01-00

T:EP:RA:T3

LEGEND:

System A:

Excess Plan:

State M:

County X:

This is in response to your request for a private letter ruling, dated August 22, 2002, which was superseded by a letter dated February 13, 2003, as supplemented by letters dated March 17, 2003 and April 10, 2003, concerning the applicability of section 415(m) of the Internal Revenue Code to the County X Excess Benefit Pension Plan (Excess Plan) and the tax consequences related thereto. You have submitted the following facts and representations in support of your request.

System A is a defined benefit plan maintained by County X and established under State M statute. System A is a governmental plan as described in Code section 414(d), and meets the requirements of Code section 401(a). It is funded by both employer and employee contributions. Local agencies other than County X may elect to participate in System A. Participation in System A by eligible employees of County X and other participating local agency employers is automatic and mandatory. Contribution rates are determined annually upon recommendation of System A's actuary. Benefits to some participants will exceed the applicable limits imposed by section 415(b) of the Code and cannot be provided under System A.

The Excess Plan was adopted by County X to provide participants in System A that part of the participant's annual benefit otherwise payable under System A that exceeds the applicable limit on benefits imposed by Code section 415(b). The Excess Plan is intended to be a "qualified governmental excess benefit arrangement" within the meaning of that term in Code section 415(m)(3).

Local governmental agencies, in addition to County X, may, with the approval of County X, elect by agreement to participate in the Excess Plan for the benefit of their eligible current and former employees.

Participation in the Excess Plan is mandatory and automatic for all eligible employees of employers who participate in the Excess Plan on or after the employer commences participation in the Excess Plan except for employees who are represented by a collective bargaining representative and whose participation in the Excess Plan is subject to negotiation under applicable State M law. Such individuals will not be permitted to participate in the Excess Plan until their collective bargaining representative has negotiated their participation in the Excess Plan with their employer.

A retired employee who is a participant in System A, who has commenced the payment of benefits under System A at the time payment is reduced by the applicable limits on benefits imposed by Code section 415(b), and whose former employer (service for which qualifies the retired employee to receive a pension benefit under System A) elects and continues to participate in the Excess Plan, is automatically eligible for benefits under the Excess Plan. Such individual will not be permitted to waive participation or benefits under System A or the Excess Plan. The Excess Plan is and shall be maintained separately from System A. The Excess Plan shall not accept contributions or transfers from System A and shall not pay any System A benefits. Benefits under the Excess Plan will not be paid or funded from the qualified trust assets of System A or another tax-qualified plan of County X.

A participant under the Excess Plan receives a benefit from the Excess Plan that is equal to the amount of the annual pension benefit he or she would have received under System A but for the application of the applicable annual benefit limits under section 415(b) of the Code. Section 3.3 of the Excess Plan provides that the Deferred Compensation Administrator shall have the authority and discretion to direct the payment of the benefit to a participant or beneficiary in monthly installments or in an annual payment, provided that the payment of such benefits to a participant or beneficiary for a particular calendar year shall not be deferred to a subsequent calendar year. Participation in the Excess Plan and the payment of benefits under the Excess Plan automatically cease once the participant's annual benefit under System A is no longer reduced by the applicable limits on benefits imposed by Code section 415(b). Eligibility to participate in, and receive benefits under, the Excess Plan resume if a former participant's annual benefit under System A is once again limited by the applicable limitation on benefits imposed by Code section 415(b). Article IV(b) of the Excess Plan provides that, no employee or participant shall be provided the right at any time (directly or indirectly) to defer compensation under the Excess Plan. No employee contributions will be made to the Excess Plan.

To the extent assets remain in the Excess Plan they shall be held in the Excess Plan Trust (Trust), established solely for the purpose of providing benefits to participants or their beneficiaries and defraying reasonable expenses of the administration of the Excess Plan and the Trust. Each participating employer has a separate sub-trust established under the Trust solely to hold assets contributed to the Trust by such participating employer and solely from which payment of benefits under the Excess Plan for the participants of such participating employer are paid. The Trust is separate from the qualified plan trust of System A.

The Trust is revocable and is intended to be a grantor trust, of which each participating employer is the grantor with respect to its sub-trust, within the meaning of the term in Code sections 672 through 677. It is a grantor trust under state law. All assets held in the Trust, all property rights and beneficial interests acquired through the use of the Excess Plan's assets will

remain the general, unpledged, unrestricted assets of the Trust. The interests of participants and their beneficiaries in the Trust are not senior to the claims of unsecured creditors of County X and the other participating employers.

If the assets of the Trust are not sufficient to pay excess benefits under the Excess Plan, each participating employer, not System A, will pay such required amounts to the Trust to provide benefits with respect to its employees. Contributions to the Trust to provide benefits under the Excess Plan for a particular participating employer's covered current and former employees and to defray a portion of the reasonable expenses of the administration of the Excess Plan and Trust will come from such participating employer. By agreement, a participating employer is not required to and shall not be permitted to pre-fund the benefits under the Excess Plan and may contribute only such amounts for a plan year as are necessary to provide benefits under the Excess Plan for such year only plus the administrative expenses of the Excess Plan.

No contributions may be made to the Trust by any current or former employees.

Based on the above facts and representations, you have requested the following rulings:

1. That the Excess Plan and Trust as amended effective January 1, 2003, for the eligible employees of County X and the other participating employers meet the legal requirements of Code section 415(m) for a qualified governmental excess benefit arrangement; and
2. The benefit payments from the Excess Plan will be taxed to the participants as income only as they are actually paid or made available.

Code section 415(m) sets forth the treatment of qualified governmental excess benefit arrangements. Code section 415(m)(1) provides in part that, in determining whether a governmental plan (as defined in section 414(d)) meets the requirements of section 415, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account.

Section 415(m)(3) defines such an arrangement as a portion of a governmental plan which meets the following three requirements: (A) such portion is maintained solely for the purpose of providing to participants in the plan that part of the participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 ("excess benefits"); (B) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation; and (C) excess benefits are not paid from a trust forming a part of such governmental plan unless such trust is maintained solely for the purpose of providing such benefits.

With respect to your first requested ruling, the Excess Plan is a portion of System A, which your authorized representative has stated is a governmental plan as described in Code section 414(d). It is represented that the only purpose of the Excess Plan is to provide participants in System A that portion of a participant's benefits that would otherwise be payable under the terms of System A except for the limitations on benefits imposed by Code section 415. The Excess Plan does not allow participants to defer compensation. The Excess Plan limits participation to System A participants for whom contributions would exceed the Code section 415 limits. Therefore, we have determined that the Arrangement is a portion of a governmental plan which is maintained solely for the purpose of providing to System A participants that part of the participant's annual benefit otherwise payable under the terms of System A that exceeds the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A).

Your authorized representative has stated that participation in the Excess Plan is automatic and mandatory for System A participants for whom contributions are limited by Code section 415 and that there are no employee contributions to the Excess Plan. Thus, we have determined that no direct or indirect election is provided at any time to participants to defer compensation, and, accordingly, the requirements of section 415(m)(3)(B) are met.

Code section 415(m)(3)(C) requires that the trust from which excess benefits are paid must not form a part of the governmental plan (in this case, System A) which contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. In the present case, the Trust is part of System A, but it is maintained separately. Contributions to the Trust consist only of the amount required to pay the excess benefits for the plan year and the amount required to pay administrative expenses. Funds are not accumulated to pay benefits in future plan years. Therefore, we have determined that the requirements of section 415(m)(3)(C) are met.

Since the Excess Plan and Trust satisfy all of the requirements of section 415(m)(3), we conclude with respect to your first ruling request that the Excess Plan and Trust being implemented for the eligible employees of County X and the other participating employers meet the legal requirements of Code section 415(m) for a qualified governmental excess benefit arrangement.

With respect to the second requested ruling, section 415(m)(2) provides that "for purposes of this chapter, (A) the taxable year or years for which amounts in respect of a qualified governmental excess benefit arrangement are includible in gross income by a participant, and (B), the treatment of such amounts when so includible by the participant, shall be determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401."

Ruling 1 has already determined that the Excess Plan meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements. Accordingly, the tax treatment of the amounts distributed under the Excess Plan to the participants is determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation which is maintained by a corporation not exempt from tax under this chapter and which does not meet the requirements for qualification under section 401. It has been represented that the Trust is a grantor trust within the meaning of Code sections 672 through 677 and under state law.

Section 83(a) of the 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 transferable 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 an employer to an employee's 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 employee's 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, an employer's 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 451(a) of the Code and section 1.451-1(a) of the regulations provide that an item of gross income is includible in gross income for the taxable year in which actually or constructively received by a taxpayer using the cash receipts and disbursements method of accounting. Under section 1.451-2(a) of the regulations, income is constructively received in the taxable year during which it is credited to a taxpayer's account, set apart or otherwise made available so that the taxpayer may draw on 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.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situations 1-3, 1960-1 C.B. 174, holds that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income within the meaning of the cash receipts and disbursements method of accounting. See also Rev. Rul. 69-650, 1969-2 C.B. 106, and Rev. Rul. 69-649, 1969-2 C.B. 106.

Under the economic benefit doctrine, an employee has currently includible income from an economic or financial benefit received as compensation, though not in cash form. Economic benefit applies when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952), Rev. Rul. 60-31, Situation 4. In Rev. Rul. 72-25, 1972-1 C.B. 127, and Rev. Rul. 68-99, 1968-1 C.B. 193, an employee does not receive income as a result of the employer's purchase of an insurance contract to provide a source of funds for deferred compensation because the insurance contract is the employer's asset, subject to claims of the employer's creditors.

Accordingly, with respect to the second ruling request it is concluded that the benefit payments from the Excess Plan will be taxed to the participants as income only as they are actually paid or made available.

This ruling letter is based on the assumption that System A is a governmental plan as described in Code section 414(d) and that it meets all of the applicable requirements under Code section 401(a).

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

A copy of this letter has been sent to your authorized representative in accordance with the power of attorney on file in this office.

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If you have any questions about this letter, please contact
Please refer to SE:T:EP:RA:SE:T3.

at

Sincerely yours,

15/
Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures
Notice 437
Deleted copy of ruling letter