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Date:
September 16, 2003

Entity E

Year 1 =

Year 2 =

Dear

This responds to your representative's letter of February 6, 2003 and subsequent correspondence, on behalf of Entity E, requesting a ruling concerning the application of the constructive receipt of income doctrine and section 457(e)(11) of the Internal Revenue Code (the "Code") to the revised paid-time-off (PTO) plan and policy (the "Plan") that E intends to implement for its eligible employees in the near future. E is represented to be a tax exempt entity that is an eligible employer described in section 457(e)(1)(B) of the Code.

E has pre-existing vacation, sick and other personal leave policies providing eligible staff members with paid time off for vacations, holidays, sick days and other days off. Effective on July 1 of Year 1, E is consolidating these leave policies into a combined, single paid time off (PTO) leave policy. Under that policy, prior to January 1 of Year 2, an eligible employee of E who meets the Plan's requirements may irrevocably elect to convert a limited number of PTO leave hours (up to a maximum set in the Plan) to be earned in the next calendar year (beginning in Year 2) into compensation to be paid ratably during the next calendar year. Although an employee may carry over PTO leave hours accrued in one year to the subsequent calendar year, the taxpayer has represented that the election will apply only to PTO leave hours earned in the

subsequent calendar year, and not to employees who fail to submit a timely election. The Plan provides that such leave conversion will occur only for employees who submit a timely election. It is represented that neither the revised PTO policy nor the Plan will provide E's employees any additional hours of PTO that they were not already entitled to under the previous leave policies which had not included this election.

Section 457 of the Code provides rules regarding the taxation of deferred compensation plans of eligible employers. For this purpose, the term "eligible employer" is defined in section 457(e)(1) as a state, political subdivision of a state, and any agency or instrumentality of a state or political subdivision of a state, or any other organization (other than a governmental unit) exempt from tax under subtitle A of Title 1 of the Code. E is represented to be an eligible employer within the meaning of section 457(e)(1)(B).

Under section 457(e)(11)(A)(i), a bona fide sick or vacation leave plan is treated as not providing for the deferral of compensation for purposes of section 457. In the present case, it is represented that the primary function of E's current (and revised PTO) policies for the crediting and use of sick, vacation and other leave is to provide employees with paid time off from work when appropriate because of sickness or for other personal reasons. Thus, the revised PTO Plan (assuming the current leave policies constitute bona-fide leave plans described in section 457(e)(11)(A)(i)) is part of a bona fide sick or vacation leave plan within the meaning of section 457(e)(11)(A)(i). Accordingly, the rules of section 457 will not apply to the revised PTO Plan.

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 the 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 proposed Plan, the employee's election to take part or all of the PTO hours set out in the Plan either as cash compensation in the following calendar year or as paid time off after the current calendar year is made before the beginning of the period of service for which the compensation is payable. No amount is constructively

received by an employee when the employee makes an irrevocable election in December, selecting either of the available options concerning a limited number of PTO hours to be earned in the next calendar year, because once the employee earns the PTO hours, the employee cannot elect to receive any amount in cash in lieu of paid leave.

Based upon the provisions of the Plan summarized above, and the document and information presented, we conclude as follows:

1. The right of an employee to make an irrevocable election under the Plan, or the employee's election, made under the Plan before the deadline set thereunder, to take part or all of the permitted PTO hours available as cash compensation in the following calendar year or as paid time off in or after the following calendar year will not cause inclusion of such amounts in the employee's taxable income under either the doctrine of constructive receipt of income, section 451 of the Code or section 457 of the Code for the year in which this election is made.

2. Assuming Entity E's previous vacation, sick or other leave policies constitute bona-fide sick and vacation leave plans described in section 457(e)(11)(A), the revised combined PTO Plan will also constitute a bona-fide vacation or sick leave plan described in section 457(e)(11)(A). Thus, the Plan and the benefits elected thereunder will not be subject to section 457. Instead, compensation paid pursuant to the Plan, either in the form of cash compensation or in the form of paid time off will be taxed pursuant to the general principles of section 451 and the regulations thereunder.

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred or payable under any plan other than E's revised Plan described above. If the Plan is significantly modified, this ruling will not necessarily remain applicable. This ruling is directed only to Entity E and applies only to the Plan submitted on February 6, 2003. Section 6110(k)(3) of the Internal Revenue Code provides that this ruling may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion in the ruling. See section 12.04 of Rev. Proc. 2003-1, 2003-1 I.R.B. 1, 44. However, when the criteria in section 12.06 of Rev. Proc. 2003-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely yours,

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Enclosure:

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