

Department of the Treasury
Internal Revenue Service

200904033

OCT 28 2008

Uniform Issue List: 415.00-00

T, EP, RA:TB

Attention:

Legend:

City M =

Employer N =

System X =

Excess Plan X =

State S =

Dear :

This is in response to correspondence dated November 3, 2006, as supplemented by correspondence dated November 15 and 16, 2007, and March 21 and September 4, 2008, submitted on behalf of System X by its authorized representatives, in which a request for a letter ruling was submitted with respect to the applicability of section 415(m) of the Internal Revenue Code (Code) to the City M Excess Benefit Savings Plans (Excess Plan X) and the tax consequences related thereto.

The following facts and representations have been submitted under penalty of perjury in support of the rulings requested:

City M, a city in State S, established System X as a multiple employer contributory defined benefit retirement plan. System X is maintained in accordance with the State S constitution. Subject to the approval by the City M Council, a public agency of City M may participate in System X. Three employers currently participate in System X, including Employer N. System X consists of three pension groups, corresponding to the three participating employers, each covered by certain benefit provisions. Your authorized representatives have represented that System X is a governmental plan as described in section 414(d) of the Code and is intended to meet the qualification requirements of section 401(a).

Contributions to System X are mandatory for participating employees of Employer N. These contributions are made by payroll deductions equal to a percentage of each participant's regular compensation.

System X is administered by a Board of Administration. The City M Municipal Code authorizes the Board of Administration to establish a qualified excess benefit arrangement within the meaning of section 415(m) of the Code. Pursuant to this authority, the Board of Administration adopted Excess Plan X as a part of System X for the benefit of affected employees of Employer N. Excess Plan X will operate in accordance with section 415(m) of the Code as a qualified governmental excess benefit arrangement. Employer N employees who participate in System X will become eligible for benefits from Excess Plan X if their benefits calculated under the benefit formula are limited by section 415(b) of the Code as that section applies to governmental plans. Participation in Excess Plan X is mandatory and automatic for all eligible employees of Employer N.

Section 4.01 of Excess Plan X provides that a participant will receive a benefit equal to the amount of retirement income that would have been payable to, or with respect to, a participant by System X that could not be paid because of the application of the limitations on his retirement income under section 415(b) of the Code. An "excess benefit" under Excess Plan X will be paid only if and to the extent the participant is receiving retirement benefits from the retirement fund.

Excess Plan X will be administered by System X's Board of Administration, which has established a separate trust fund for segregation of the assets related to Excess Plan X. This trust fund has been established solely for the purpose of holding employer contributions intended to pay excess benefits to affected System X participants. The trust fund is designed as a grantor trust for state law and federal income tax purposes. You have represented that the participants receive no property right or interest in the trust assets, and that the trust assets are available to discharge the legal obligations of the adopting employers. The trustees of this separate trust fund will be System X's Board of Administration.

Excess Plan X is funded on a pay-as-you-go basis. Excess Plan X's trust fund will not accumulate assets from year to year for the purpose of advanced funding of Excess Plan X's liabilities. System X's Board of Administration will determine the amount necessary to pay the excess benefits under Excess Plan X for each plan year. The required contribution will be the aggregate of the excess benefits payable to all affected participants for such plan year and an amount determined by the Board to be a necessary and reasonable expense of administering Excess Plan X. The amount so determined will be paid by Employer N and deposited into the trust fund. Under no circumstances will Employer N's contributions to fund the excess benefits under Excess Plan X be credited to the trust established to fund System X. Excess Plan X will not accept contributions or transfers from System X. Any contributions not used to pay the excess benefits for a current plan year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administration expenses will be used to fund administrative expenses or benefits of participants in future years.

Benefits under Excess Plan X will be paid only if the participant is receiving benefits from System X. Participation in Excess Plan X will cease for any portion of a plan year in which the participant's benefit does not exceed the requisite limitations of section 415(b) of the Code under System X. The form of the benefits paid to a participant from Excess Plan X will be the same as otherwise selected by the participant and payable under System X. A participant in Excess Plan X will be paid the amount of the benefit that would otherwise have been payable to the participant under System X except for the limitations of section 415(b). The excess benefit to which a participant is entitled under Excess Plan X will be paid commencing during or with the month in which all monthly payments of retirement benefits under System X are paid, and the excess benefits will then be paid at the same time and in the same manner as retirement benefits under System X. Under no circumstances will the participant be given any election to defer compensation under Excess Plan X, either directly or indirectly. In addition, there will be no employee contributions to Excess Plan X.

Although Excess Plan X is a part of System X, no assets of System X will be used to pay any benefits under Excess Plan X. Excess Plan X is intended to grant a participant no more than a mere contractual right to payment of benefits under Excess Plan X. Employer contributions made to provide benefits under Excess Plan X may not be commingled with assets from its related trusts, nor may Excess Plan X receive any transfers from System X.

Based upon the facts and representations stated above, the following rulings are requested:

1. Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.
2. The benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.
3. Income accruing to Excess Plan X is exempt from federal income tax under Code sections 115 and 415(m)(1) as income derived from the exercise of an essential governmental function.

Pursuant to correspondence dated September 4, 2008, your authorized representatives withdrew a previously requested fourth ruling.

Section 415(b) of the Code sets forth the limitations on benefits for participants in defined benefit plans.

Section 415(m) of the Code sets forth the treatment of qualified governmental excess benefit arrangements. 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) of the Code 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, Excess Plan X was adopted and implemented by System X's Board of Administration as a part of System X. It has been represented that System X is a governmental plan as described in section 414(d) of the Code. It has also been represented that the only purpose of Excess Plan X is to provide affected employees of Employer N who participate in System X that portion of their benefits that would otherwise be payable under the terms of System X except for the limitations on benefits imposed by section 415(b) of the Code, as applicable to governmental plans. The terms of Excess Plan X limits participation to participants in System X for whom benefits would exceed the limits of section 415 of the Code. Therefore, we have determined that Excess Plan X is a governmental plan which is maintained solely for the purpose of providing to Employer N employees who participate in System X that part of the participants' benefits otherwise payable under the terms of the System X that exceed the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A).

Your authorized representatives have stated that participation in Excess Plan X is mandatory and automatic, and that there are no employee contributions to Excess Plan X. Your representatives also assert that no direct or indirect election to defer compensation is provided to any participant in Excess Plan X. 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.

Section 415(m)(3)(C) of the Code requires that the trust from which the excess benefits are paid must not form a part of the governmental plan which contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. In this case, Excess Plan X will be funded on a pay-as-you-go basis. System X's Board of Administration established a separate trust fund for segregation of the assets related to Excess Plan X. This trust fund has been established solely for the purpose of holding employer contributions intended to pay excess benefits to affected System X participants. Contributions to the trust fund consist only of the amounts required to pay the excess benefits and administrative expenses for the plan year. Any contributions not used to pay the excess benefits for a current plan year, together with any income accruing to the trust fund, will be used to pay the administrative expenses of Excess Plan X for the plan year. Any contributions not so used that remain after the payment of administration expenses will be used to fund administrative expenses or benefits of participants in future years. Therefore, we have determined that the requirements of section 415(m)(3)(C) are met.

Since Excess Plan X satisfies all of the requirements of section 415(m)(3) of the Code, we conclude with respect to your first ruling request that Excess Plan X is a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code.

With respect to the second requested ruling, section 415(m)(2) of the Code 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 Excess Plan X 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 Excess Plan X to the participants is determined as if such qualified governmental excess benefit arrangement was 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.

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 (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, we conclude that the benefits payable under Excess Plan X will be includible in gross income for the taxable year or years in which such benefits are paid or otherwise made available to a participant or a participant's beneficiary in accordance with the terms of Excess Plan X.

With respect to your third requested ruling, Code section 415(m)(1) provides that income accruing to a governmental plan (or to a trust that is maintained solely for the purpose of providing benefits under a qualified governmental excess benefit arrangement) in respect of a qualified governmental excess benefit arrangement will constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) will be exempt from tax under section 115. Ruling 1 has already determined that Excess Plan X meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements.

Accordingly, with respect to your third requested ruling, we conclude that income accruing to Excess Plan X is exempt from federal income tax under Code sections 115 and 415(m)(1) as income derived from the exercise of an essential governmental function.

No opinion is expressed as to the tax treatment of the transactions described herein under the provisions of any other section of either the Code or regulations which may be applicable thereto.

This letter assumes that System X is and was a governmental plan as described in section 414(d) of the Code, is and was qualified under section 401, and its related trust is and was exempt from tax under section 501(a) at all times relevant thereto.

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

Pursuant to a power of attorney on file with this office, a copy of this ruling letter is being sent to your authorized representatives. If you wish to inquire about this ruling, please contact _____, I.D. # _____, at _____. Please address all correspondence to _____.

Sincerely yours,


_____, Manager
Employee Plans Technical Group

Enclosures:

Deleted copy of letter ruling
Notice of Intention to Disclose