Internal Revenue Service

Number: **201211001**
Release Date: 3/16/2012

Index Number: 457.05-00, 457.01-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:TEGE:EB:QP2
PLR-120737-11

Date:
November 07, 2011

Legend

Employer =

Plan =

Trust =

Dear :

This is in response to your letter dated March 7, 2011, and subsequent correspondence and information provided, on behalf of the above-referenced Employer requesting a ruling on the federal income tax consequences of the Plan.

Employer represented that it is a tax-exempt organization under section 501(c)(3) of the Internal Revenue Code of 1986 (Code) and an eligible employer under section 457(e)(1)(B). Employer is in the business of operating a teaching hospital and medical clinics. Employer also represented that participation in the Plan is limited to a select group of management and highly compensated employees of Employer who materially contribute to its success. The purpose of the Plan is to allow certain employees to defer current compensation to enhance the accumulation of retirement income.

An eligible employee may become a participant through salary reduction by executing a deferred compensation agreement with Employer. Elections to defer compensation will become effective in the month following the month in which made.

The Plan limits the amount to be deferred by a participant in any calendar year and also provides for a catch-up contribution for amounts deferred for one or more of the participant's last three taxable years ending before the participant attains normal retirement age under the Plan. Also, the Plan allows contributions for returning veterans in accordance with the Uniformed Services Employment and Reemployment Rights Act of 1994. The amounts which may be deferred under the Plan are within the limitations set forth in section 457(b)(2).

Subject to the provisions of section 401(a)(9), and in the absence of an unforeseeable emergency which meets the requirements of §1.457-6(c) of the Income Tax Regulations, or a qualified domestic relations order which meets the requirements of §1.457-10(c), Plan benefits will only be paid after the participant’s severance from employment with the Employer and in accordance with the participant’s election.

To assist it in providing assets from which to pay the benefit obligations to the participants, Employer has established the Trust. Employer has represented that the trustee of the Trust is an independent unrelated third party that has corporate trustee powers under state law. The Trust provides that the principal of the Trust, and any earnings thereon, will be held separate and apart from other funds of Employer and will be used exclusively for the uses and purposes of Plan participants and general creditors of Employer. Plan participants and their beneficiaries shall have no preferred claim on, or any beneficial ownership interest in, any assets of the Trust. Employer has represented that any rights created under the Plan and Trust will be mere unsecured contractual rights of Plan participants and their beneficiaries against Employer as required by section 457(b)(6). Any assets held by the Trust will be subject to the claims of Employer's general creditors under federal and state law in the event of insolvency. Benefits payable to participants and their beneficiaries under the Trust may not be anticipated, assigned (either at law or in equity), alienated, pledged, encumbered or subjected to attachment, garnishment, levy, execution or other legal or equitable process.

Employer represented that the Trust conforms to the model language contained in section 5 of Rev. Proc. 92-64, 1992-2 C.B. 422, including the order in which the sections of the model trust language appear, and that the Trust contains no language that conflicts with such model language. Employer also represented that the Trust is a valid trust under state law and all of the material terms and provisions of the Trust, including the creditors' rights clause, are enforceable under the appropriate state laws.

The trustee has the duty to invest the Trust assets in accordance with the terms of the Trust. At all times, the Trust assets will be subject to the claims of Employer's general creditors if Employer becomes insolvent, as defined in the Trust. The board of directors and the chief executive officer of Employer have the duty to inform the trustee of Employer's insolvency. Upon receipt of such notice or other written allegations of Employer's insolvency, the trustee will suspend the payment of benefits with respect to participants and any beneficiaries in the Plan. If the trustee determines in good faith that Employer is not insolvent or is no longer insolvent, the trustee will resume the payment of benefits. If Employer is insolvent, the trustee shall hold the Trust corpus for the benefit of Employer's general creditors.

Section 83(a) 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 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) 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 creditor, for example, in a trust or escrow account.

Section 451(a) and §1.451-1(a) 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 §1.451-2(a), income is constructively received in the taxable year during which it is credited to a taxpayer's account or set apart or otherwise made available so that the taxpayer may draw upon 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.

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 irrevocable 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 employer's creditors.

Section 457 provides rules for the deferral of compensation by an individual participating in an eligible deferred compensation plan (as described in section 457(b)).

Section 457(a)(1)(B) provides that in the case of a participant in an eligible deferred compensation plan of a tax- exempt employer, any amounts 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.

Section 457(b)(5) prescribes that an eligible deferred compensation plan must meet the distribution requirements of section 457(d).

Section 457(b)(6) requires an eligible plan of a tax-exempt employer to provide that (i) all amounts of compensation deferred under the plan, (ii) all property and rights purchased with such amounts, and (iii) all income attributable to such amounts, property, or rights must remain (until made available to the participant or other beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors.

Under section 457(d)(1)(A), an eligible plan must provide that amounts will not generally be made available to participants or beneficiaries before: (i) the calendar year in which participant attains 70-1/2, (ii) the participant has a severance from employment with the employer, or (iii) the participant has an unforeseeable emergency which meets the requirements of §1.457-6(c).

Section 1.457-7(c)(10) states that amounts deferred under an eligible plan will not be considered made available to the participant solely because the participant is permitted to choose among various investment alternatives under a plan for the investment of such amounts whether before or after any payments have commenced under the plan.

Section 301.7701-4(a) provides that, generally, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest, in trustees, responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and therefore, are not associates in joint enterprise for the conduct of business for profit.

Section 671 provides that where a grantor is treated as an owner of any portion of a trust under subpart E, part 1, subchapter J, chapter 1 of the Code, there shall be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against tax of the trust that are attributable to that portion of the trust (to the extent that such items would be taken into account under chapter 1 in computing the taxable income or credits against the tax of an individual).

Section 677(a)(2) provides that the grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or in the discretion of the grantor or an adverse party or both may be held or accumulated for future distribution to the grantor.

Section 1.677(a)-1(d) provides that under section 677, a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party or both, may be applied in discharge of a legal obligation of the grantor.

Under the terms of the Trust, assets may be placed in trust to be used to provide deferred compensation benefits to participants. However, the trustee has the obligation to hold the trust assets and income for the benefit of Employer's general creditors in the event of insolvency. The Trust further provides that an employee receives no beneficial ownership or preferred claim on the Trust assets. Therefore, although the assets are held in trust, in the event of Employer's insolvency they are fully within reach of Employer's general creditors, as are any other general assets of Employer.

Provided that (i) the creation of the Trust would not cause the Plan to be other than unfunded under Title I of the Employee Retirement Income Security Act of 1974, and (ii) the provisions of the Trust requiring use of the Trust assets to satisfy the claims of Employer's general creditors in the event of Employer's insolvency are enforceable by the general creditors of Employer under federal and state law, based upon the information submitted and representations made, we conclude as follows:

1. The Plan constitutes an eligible deferred compensation plan as defined in section 457(b).

2. Amounts of compensation deferred pursuant to the Plan, including any income attributable to the deferred compensation, will be includible in the gross income of the participant or beneficiary only for the taxable year or years in which such amounts are paid or otherwise made available to a participant or beneficiary under the Plan.

3. Neither the adoption of the Plan nor the creation of the Trust nor Employer's contributions of assets to the Trust will result in a transfer of property of participants or beneficiaries for purposes of section 83 or §1.83-3(e).

4. Neither the adoption of the Plan nor the creation of the Trust nor Employer's contribution of assets to the Trust will cause any amount to be included in the gross income of a participant or his beneficiaries under the cash receipts and disbursements method of accounting, pursuant to either the constructive receipt doctrine of section 451 or the economic benefit doctrine.

5. The Trust will be classified as a trust within the meaning of §301.7701-4(a). Because the principal and income of the Trust may be applied in discharge of legal obligations of Employer, under section 677, Employer shall be treated as the owner of the Trust. Accordingly, under section 677, there shall be included in computing Employer's taxable income and credits, those items of income, deductions, and credits against tax of the Trust, subject to the provisions of the Code applicable to section 501(c)(3) organizations.

Except as specifically ruled upon above, no opinion is expressed as to the federal income tax consequences of the Plan under any other provision of the Code. The Service expresses no opinion as to the consequences of the arrangement under Title I of the Employee Retirement Income Security Act of 1974. If the Plan is modified, this ruling will not necessarily remain applicable.

This ruling is directed only to Employer and applies to the Plan as submitted by a transmittal letter dated March 7, 2011, and the provisions of the amended and restated version provided on October 26, 2011. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Cheryl Press
Senior Counsel (Employee Benefits)
(Tax Exempt & Government Entities)

Enclosure (1)