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Department of the Treasury
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Person To Contact:
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Refer Reply To:
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PLR-135812-15

Date:
April 26, 2016

Legend

Retirement =

Systems

Boards =

Excess Plans =

City C =

State S =

Dear :

This letter is in response to your ruling request, submitted by your authorized representative, dated October 1, 2015, with respect to the applicability of section 415(m) of the Internal Revenue Code ("Code") to the excess benefit plans ("Excess Plans") and the related federal tax consequences.

The following facts and representations have been submitted under penalties of perjury in support of your request:

The Retirement Systems were established by City C (the "Employer") located in State S. The Retirement Systems provide retirement plans and other funds that provide medical, death, disability and retirement benefits on behalf of active and former state employees, teachers, police, firefighters, judges, and volunteer firefighters.

The Retirement Systems were adopted by the Employer for benefit of eligible employees and are administered by the respective Boards and the Employer. Your authorized representatives have represented that the Retirement Systems are defined benefit plans and governmental plans (qualified plans as described in section 414(d) of the Code) and are intended to meet the qualification requirements of section 401(a). Each Retirement System has established its own trust fund ("Retirement Funds") which are administered and invested by the respective Boards.

The Employer adopted the excess benefit plans ("Excess Plans") for the Retirement Systems. The Excess Plans are intended to be "qualified excess benefit arrangements" within the meaning of section 415(m)(3) of the Code and will operate in accordance with that section. Under the Excess Plans, a Participant means a member, retiree, or beneficiary of the Retirement System who is entitled to benefits under the Excess Plans. The Participants will be paid the amount of retirement income that would otherwise have been payable to such Participant by the Retirement System, but could not be paid from the Retirement System because of the limitations of section 415(b). The retirement income benefits provided under the Excess Plans are hereinafter referred to as "Excess Benefits."

Employer contributions under the Excess Plans will be held in separate trusts (collectively, "Excess Plan Trusts"). Employer will compute and pay the Excess Benefits under the Excess Plans in the same form, at the same time, and to the same persons as such benefits would have otherwise been paid as a monthly pension under the Retirement Systems, except for the limitations of section 415 of the Code. Under the Retirement Systems, and therefore under the Excess Plans, retirement benefits are only payable to the Participants upon the occurrence of certain events permitting a distribution under the Retirement Systems (i.e., retirement, death, disability, or other termination of employment).

Participants in the Excess Plans may elect a form of benefit under one or more of the Retirement Systems, which dictates the form of payment under the Excess Plans. However, under the terms of the Excess Plans, participants are not provided an election to defer compensation under the plan, either directly or indirectly. The Excess Plans also provides that a participant's interests under the Excess Plans prior to distribution

may not be subject to execution, attachment, or garnishment or otherwise subject to any other process whatsoever.

The Excess Plan Trusts are separate and apart from the Retirement Fund and will be established solely for the purpose of holding Employer contributions intended to pay Excess Benefits under the Excess Plans. Your authorized representative has represented that the Excess Plan Trusts will be grantor trusts under state law and for federal income tax purposes. Employer is the grantor of the Excess Plan Trusts, within the meaning of sections 671 through 679 of the Code. Accordingly, the assets of the Excess Plan Trusts, which are held for benefits under the Excess Plans, are subject to the claims of the Employer's general creditors under federal and state law in the event of the insolvency of the Employer.

The Excess Plan Trusts will be funded on a "pay-as-you-go" basis and begin paying benefits as necessary to ensure compliance with the applicable limitations of section 415 of the Code. All assets held in Excess Plan Trustsand all property rights and beneficial interests acquired through the use of the Excess Plans assets will be held separate and apart from other funds of the Employer. Under the terms of the Excess Plans, participants in the Excess Plans receive no property rights, legal or beneficial, in any of the assets held in Excess Plan Trusts. The provisions of the Excess Plans explicitly provide that contributions to Excess Plan Trusts will be held separate and apart from the funds comprising the Retirement Fund and will not be commingled with assets of the Retirement Fund, and must be accounted for separately.

The Employer will determine the amount necessary to pay the Excess Benefits for each calendar plan year ("Plan Year"). The required contribution for the Employer will be the aggregate of the excess benefits payable under the Excess Plans to all Participants for the Plan Year and an amount determined by Employer to be a necessary and reasonable expense of administering the Excess Plans and the Excess Benefit Trusts. No employee contributions are permitted under the Excess Plans.

Contributions to the Excess Plans will not be calculated in a manner designed to pay future Excess Benefits. Any contributions not used to pay the Excess Benefit for a current Plan Year, together with any income accruing to Excess Benefit Trusts will be used to pay the administrative expenses of the Excess Plans for the Plan Year. However, any contributions not used to pay Excess Benefits for the current Plan Year that remain after paying administrative expenses of the Excess Plans for the Plan Year will be used to fund administrative expenses or Excess Benefits in future Plan Years.

Participants will automatically participate in the Excess Plans for a Plan Year if their retirement benefits from the Qualified Plan for the Plan Year would exceed the limitations imposed by section 415(b) of the Code. Participation in the Excess Plans ends for any Plan Year in which the retirement benefit of a Participant is not limited by section 415(b) and when all benefit obligations under the Excess Plans to the

Participant for that Plan Year have been satisfied. Neither the trustees of the Excess Benefit Trusts nor the Employer is responsible for paying Excess Benefits other than from contributions from the Employer.

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

1. That the Excess Plans establish a qualified governmental excess benefit arrangement within the meaning of section 415(m) of the Code;

2. That the benefits payable under the Excess Plans 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 the Excess Plans; and

3. That income accruing to the Excess Plans is exempt from federal income tax under sections 115 and 415(m)(1) of the Code as income derived from the exercise of an essential governmental function.

Section 415(b) of the Code and section 1.415(b)-1 of the Income Tax Regulations ("regulations") set forth the limitations on annual benefits for participants in defined benefit plans.

Section 1.415(b)-1(b)(1)(ii) of the regulations provides in part that the annual benefit does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16)) of the Code, determined pursuant to the rules of paragraph (b)(2) of this section. This section further states that the treatment of transferred benefits is determined under the rules of paragraph (b)(3) of this section.

Section 1.415(b)-1(b)(3)(ii) of the regulations addresses elective transfer of distributable benefits and states in part that the annual benefit provided by the transferee defined benefit plan does not include the annual benefit attributable to the amount transferred.

Section 415(m)(1) of the Code provides that, in determining whether a governmental plan (as defined in section 414(d)) meets the benefit limitations of section 415, benefits provided under a qualified governmental excess benefit arrangement shall not be taken into account. Section 415(m)(1) also states 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) shall constitute income derived from the exercise of an essential governmental function upon which such governmental plan (or trust) shall be exempt from tax under section 115.

Section 415(m)(2) of the Code describes the tax treatment of benefits payable under a qualified governmental excess benefit arrangement. Under section 415(m)(2), the

taxable year or years for which amounts in respect of a qualified excess benefit arrangement are includible in gross income by a participant, and the treatment of such amounts when so includible by the participant, are determined as if such qualified governmental excess benefit arrangement were treated as a plan for the deferral of compensation that is maintained by a corporation not exempt from tax and which does not meet the requirements for qualification under section 401.

Section 415(m)(3) of the Code defines a qualified governmental excess benefit arrangement as a portion of a governmental plan that meets the following three requirements:

(A) Such portion is maintained solely for the purpose of providing to participants in the plan that part of each participant's annual benefit otherwise payable under the terms of the plan that exceeds the limitations on benefits imposed by section 415 of the Code;
(B) Under such portion, no election is provided at any time to the participant (directly or indirectly) to defer compensation; and
(C) Such benefits in excess of the limitations under section 415 of the Code 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, according to the represented facts, the Qualified Plans are governmental plans as described in section 414(d) of the Code. Furthermore, under the represented facts, the only purpose of the Excess Plans is to provide affected employees of City C of State S and its qualifying governmental units who participate in the Qualified Plans that portion of their retirement benefits that would otherwise be payable under the terms of the Qualified Plans except for the limitations on benefits imposed by section 415(b), as applicable to governmental plans. Participation in the Excess Plans is limited to Participants receiving benefits under the Qualified Plans that would otherwise exceed the limits of section 415.

Consequently, we find that the Excess Plans are portions of the Retirement Systems, which are governmental plans, and are maintained solely for the purpose of providing employees of City and its qualifying governmental units who participate in the Retirement Systems that part of their benefits otherwise payable under the terms of the Retirement Systems that exceed the benefit limitations of section 415 of the Code. Accordingly, we conclude that the Excess Plans meet the requirements of section 415(m)(3)(A).

Your authorized representatives have stated that participation in the Excess Plans is mandatory and automatic, and that there are no employee contributions to the Excess Plans. Your representatives also assert that, while participants may elect a form of benefit under the Retirement Systems, which dictates the form of payment under the Excess Plans, no direct or indirect election to defer compensation is provided to any

participant in the Excess Plans. Therefore, because no direct or indirect election is provided at any time to Participants to defer compensation under the Excess Plans, the requirements of section 415(m)(3)(B) of the Code are met.

Section 415(m)(3)(C) of the Code requires that the trust from which the excess benefits of a qualified governmental excess benefit arrangement are paid not form a part of the governmental plan that contains the excess benefit arrangement, unless such trust is maintained solely for the purpose of providing such benefits. Under the facts of this case, the Excess Plans will be funded on a "pay-as-you-go" basis. The Excess Plan Trusts will be established solely for the purpose of holding employer contributions intended to pay excess benefits to Participants. The represented facts further state that contributions to the Excess Benefit Trusts will consist only of the amounts required to pay the excess benefits and related administrative expenses. The provisions of the Excess Plans explicitly provide that contributions to the Excess Benefit Trusts will be held separate and apart from the funds comprising the Retirement Fund and will not be commingled with assets of the Retirement Fund, and must be accounted for separately. Based on these representations and the provisions of the Excess Plans, we have determined that the requirements of section 415(m)(3)(C) are met.

With respect to your first requested ruling, since the Excess Plans satisfy the requirements of sections 415(m)(3)(A), (B) and (C) of the Code, we conclude that the Excess Plans are qualified governmental excess benefit arrangement within the meaning of section 415(m).

Your second ruling request asks whether the benefits payable under the Excess Plans 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 in accordance with the terms of the Excess Plans. In response to your first ruling request, we concluded that the Excess Plans meets the legal requirements of Code section 415(m) of the Code and, therefore, constitutes qualified governmental excess benefit arrangements. Accordingly, under section 415(m)(2), the tax treatment of benefits payable under the Excess Plans is determined as if the Excess Plans were plans for the deferral of compensation that is maintained by a corporation not exempt from tax and that does not meet the requirements for qualification under section 401.

Section 83(a) of the Code provides the rules for inclusion in gross income of the value of property transferred to an employee as compensation for his or her services. The excess of the fair market value of property so transferred over the amount paid for the property is includible in the gross income of the person who performed 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 regulations defines "property" as including real and personal property other than money or an unfunded and unsecured promise to pay money or

property in the future. Under section 1.83-3(e), property also includes a beneficial interest in assets (including money) transferred or set aside from claims of the transferor's creditors 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 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), 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, section 1.451-2(a) further provides that income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

The Service has also addressed the issue of constructive receipt as it applies to nonqualified plans of deferred compensation, including excess benefit plans, in various revenue rulings. In Rev. Rul. 60-31, Situations 1 – 3, the Service held that a mere promise to pay, not represented by notes or secured in any way, does not constitute receipt of income by a cash basis taxpayer. Rev. Rul. 60-31, 1960-1 C.B. 174, as modified by Rev. Rul. 64-279, 1964-2 C.B. 121, and Rev. Rul. 70-435, 1970-2 C.B. 100; see also Rev. Rul. 69-650, 1969-2 C.B. 106, Rev. Rul. 69-649, 1969-2 C.B. 106; and Rev. Rul. 71-419, 1971-2 C.B. 220.

Under the economic benefit doctrine, an employee is taxable in a year in which any economic or financial benefit is conferred upon the employee as compensation. Sproull v. Commissioner, 16 T.C. 244 (1951), aff'd per curiam, 194 F.2d 541 (6th Cir. 1952). An economic benefit is conferred on an employee when assets are unconditionally and irrevocably paid into a fund or trust to be used for the employee's sole benefit. 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 the claims of the employer's creditors.

Based on the foregoing, with respect to the second ruling request, we conclude that the benefits payable under the Excess Plans 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 the Excess Plans.

With respect to your third requested ruling, section 415(m)(1) of the Code 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 of the Code. We have determined, in connection with your first ruling request, that the Excess Plans meets the legal requirements of section 415(m) for qualified governmental excess benefit arrangements. Therefore, under section 415(m)(1), with respect to your third requested ruling, we conclude that income accruing to the Excess Plans is exempt from federal income tax under sections 115 and 415(m)(1) as income derived from the exercise of an essential government function.

The ruling contained in this letter is 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.

This letter ruling 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. Temporary or final regulations pertaining to one or more of the issues addressed in this letter ruling have not yet been adopted. Therefore, this letter ruling will be modified or revoked by the adoption of temporary or final regulations to the extent the regulations are inconsistent with any conclusion in the letter ruling. See section 11.04 of Rev. Proc. 2016-1, 2016-1 IRB 1, 59. If the taxpayer can demonstrate that the criteria in section 11.06 of Rev. Proc. 2016-1 I.R.B. 1, 60, are satisfied, the revocation or modification of a letter ruling is generally not applied retroactively.

This ruling is based on the assumption that the Retirement Systems will be governmental plans as described in section 414(d) of the Code, and qualified under section 401(a), and that the related Retirement Fund will be exempt from tax under section 501(a) at all times relevant to this ruling.

This ruling letter is based on the assumption that the after-tax contributions, rollovers and trustee-to-trustee transfers described above are excluded from the determination of annual benefit within the meaning of section 1.415(b)-1(b)(1)(ii) of the regulations.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or

referenced in this letter. If the Excess Plan is significantly modified, this ruling will not necessarily remain applicable.

For purposes of this letter ruling, it is assumed that the Excess Plan Trusts established by the Excess Plans constitute valid trusts under state law, and that all of the material provisions of the Excess Plan Trusts, including the creditors' right clause, are enforceable under appropriate state laws.

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than the plan described above. In addition, this ruling applies only to deferrals made after the date of this ruling.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representatives.

Sincerely,

Cheryl E. Press
Senior Counsel, Qualified Plans
Branch 4 (Employee Benefits)
(Tax Exempt Government Entities)

Enclosures:
Deleted copy of ruling letter