Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:
PLR-113909-99 : CC:EBEO:2
Date:
February 16, 2000

In Re:

Company =

Plan =

Investment Options =

Plan Administrators =

Dear :

This responds to your letter dated August 11, 1999, requesting a ruling regarding the application of employment taxes to amounts deferred under the Plan.

FACTS:

The facts submitted provide that the Company is an investment management company that also provides fiduciary and banking services. The Company maintains the Plan for selected officers. The Plan provides eligible officers with the opportunity to defer certain portions of their compensation, at their election, in accordance with Plan provisions. A participant's interest in his or her account is fully vested and non-forfeitable. For bookkeeping purposes the Company maintains a separate account to reflect each participant's interest under the Plan. A participant's account balance is payable to the participant upon termination of employment for any reason. The normal form of benefit is a single lump sum cash payment.

On the last day of each calendar month, earnings attributable to each participant's account balance are credited by an amount determined by reference to the

applicable rate of return under the Investment Options chosen by the participant. The Investment Options may be any one of three currently offered by the Plan, which the Company represents are actual investments. Plan administrators may change the Investment Options available to participants prospectively with 45 days written notice. A participant may elect in advance to have any part or all of the balance of his or her account credited with earnings under any Investment Option available under the Plan at the time of election.

The Investment Option[s] elected by a participant remain in effect for the account until he or she notifies the Plan Administrators in writing on a specified form that a new election is being made. The new election takes place as of the first day of the calendar month following the date on which the Plan Administrators are notified, provided it is filed at least two days prior to such first day.

LAW AND ANALYSIS

Tax under the Federal Insurance Contributions Act (FICA) consists of an employee share under section 3101 and an employer share under section 3111. In general, the employer is required to withhold the employee share from wages when paid and to pay the employer share with respect to wages when paid. FICA taxes include two components: old-age, survivors and disability insurance (“OASDI”) under sections 3101(a) and 3111(a) and hospital insurance (“Medicare”) under sections 3101(b) and 3111(b).

Section 3121(v)(2) of the Code provides a special timing rule governing FICA taxation of nonqualified deferred compensation. Section 3121(v)(2)(A) provides that any amount deferred under such a plan shall be taken into account as wages for FICA purposes as of the later of when the services are performed or when there is no substantial risk of forfeiture of the rights to such amount. Under section 3121(v)(2)(B), any amount taken into account as wages (and the income attributable thereto) shall not thereafter be treated as FICA wages (the “non-duplication rule”). Section 3121(v)(2)(C) defines "nonqualified deferred compensation plan" as any plan or other arrangement for deferral of compensation other than a plan described in section 3121(a)(5). The Plan is not a plan described in section 3121(a)(5).

Regulations under section 31.3121(v)(2)-1 interpret section 3121(v)(2). Section 31.3121(v)(2)-1(g) provides that the regulations are generally effective January 1, 2000.

Section 31.3121(v)(2)-1(a)(1) describes the general timing rule that wages are taken into account for FICA purposes when actually or constructively paid. Section 31.3121(v)(2)-1(a)(2) describes the special FICA timing rule for wages under a nonqualified deferred compensation plan. Section 31.3121(v)(2)-1(c)(1)(ii) provides that an account balance plan is a nonqualified deferred compensation plan that credits

a principal amount to an individual account for an employee, credits (or debits) the income attributable to the principal amount to the individual account, and pays benefits to the employee based solely on the balance of that individual account. The Company's Plan is an account balance plan.

When applying the nonduplication rule to an account balance plan, the income attributable to the amount taken into account is not subject to FICA tax if it is attributable to an amount previously taken into account and it reflects either a rate of return that does not exceed the rate of return on a predetermined actual investment or a reasonable rate of interest. See section 31.3121(v)(2)-1(d).

For purposes of calculating the income attributable to the amount taken into account, section 31.3121(v)(2)-1(d)(2)(i)(B)(1) provides that the rate of return on a predetermined actual investment for any period means the rate of total return (including increases or decreases in fair market value) that would apply if the account balance were, during the applicable period, actually invested in one or more investments that are identified in accordance with the plan before the beginning of the period.

The plan assets need not actually be invested in the stated investment, nor does that investment need to be generally available to the public. For example, an account balance plan could provide that income on the account balance is determined based on an employee's prospective election among various investment alternatives that are available under the employer's section 401(k) plan, even if one of those investment alternatives is not generally available to the public.

There is no minimum period for which an investment must be set for it to be considered pre-determined if the election of that investment is truly prospective. An investment is pre-determined if it is elected prior to the beginning of the period during which it will earn interest and the plan participant may not change that investment once he learns what the return on that investment is.

Section 31.3121(v)(2)-1(d)(2)(i)(B)(2) provides that a rate of return will not be treated as the rate of return on a predetermined actual investment if the rate of return (to any extent or under any conditions) is based on the greater of the rate of return of two or more actual investments, is based on the greater of the rate of return on an actual investment and a rate of interest (whether or not the rate of interest would otherwise be reasonable under section 31.3121(v)(2)-1(d)(2)(i)(C)), or is based on the rate of return on an actual investment that is not predetermined.

Section 31.3121(v)(2)-1(d)(2)(iii)(A) provides that if an account balance plan credits income that is based on neither a predetermined actual investment, nor a rate of interest that is reasonable, the employer must calculate the amount that would be credited as income under a reasonable rate of interest, determine the excess (if any) of the amount credited under the plan over the income that would be credited using the

reasonable rate of interest, and take that excess into account as an additional amount deferred in the year the income is credited.

If the employer fails to calculate the amount that would be credited as income under a reasonable rate of interest and to take the excess into account as an additional amount deferred in the year the income is credited, or the employer otherwise fails to take the full amount deferred into account, then the excess of the income credited under the plan over the income that would be credited using AFR will be treated as an amount deferred in the year the income is credited. In addition, pursuant to section 31.3121(v)(2)-1(d)(1)(ii), the excess over the income that would result from the application of AFR and any income attributable to that excess are subject to the general timing rule of section 31.3121(v)(2)-1(a)(1).

Based upon the information submitted, the representations made, and the applicable law, we rule as follows:

(1) The Plan's provision that permits a participant to elect to have any part or all of the balance of his account credited with earnings under any Investment Option available under the plan at the time of his election, to the extent such Investment Options qualify as actual investments, complies with the requirement for the income attributable to the amount taken into account with respect to an account balance plan in section 31.3121(v)(2)-1(d)(2)(i)(B)(1) that the rate of return on a predetermined actual investment be based upon one or more investments.

(2) The Plan's provision that permits participants to change Investment Options to take effect prospectively with respect to his account balance as often as monthly, two or more days prior to the beginning of the period, to the extent such Investment Options qualify as actual investments, complies with the requirement for the income attributable to the amount taken into account with respect to an account balance plan in section 31.3121(v)(2)-1(d)(2)(i)(B)(1) that a predetermined actual investment be chosen prior to the beginning of the period.

This ruling offers no opinion as to whether the Plan's Investment Options qualify as actual investments. Whether the Plan's specific investments qualify as actual investments for purposes of section 31.3121(v)(2)-1(d)(2)(i)(B)(1) is a determination of fact on which we decline to rule under the provision set forth in section 7.01 of Rev. Proc. 2000-1, 2000-1 I.R.B. 21. We note that regulation section 31.3121(v)(2)-1(d)(2)(i)(B)(1) provides that an actual investment includes an investment identified by reference to any stock index with respect to which there are positions traded on a national securities exchange described in section 1256(g)(7)(A).

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

referenced in this letter.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. A copy of this letter must be attached to any income tax return to which it is relevant. In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

The rulings contained in this letter are 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.

Sincerely yours,
JERRY E .HOLMES
Chief, Branch 2
Office of the Associate Chief Counsel
(Employee Benefits and Exempt Organizations)

Enclosures:
Copy for section 6110 purposes

cc: