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DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

200835034

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

JUN - 2 2008

SE:EP:RA:T3

LEGEND:

System A:

State M:

County(ies):

Dear

This is in response to a request submitted by your authorized representatives on your behalf for a private letter ruling, dated June 19, 2003, as supplemented by letters dated September 16, 2003, November 4, 2003, December 1, 2003, March 10, 2005, April 11, 2005, July 12, 2007, December 31, 2007, and January 24, 2008, concerning the application of section 415(m) of the Internal Revenue Code to an excess plan and the tax consequences of certain related transactions. Your authorized representatives have submitted the following facts and representations in support of your request.

System A is comprised of three defined benefit plans ("Plan X", "Plan Y", and "Plan Z", hereafter referred to either individually by those designations or in the aggregate as System A) created by the State M legislature and set forth in the State M statute. System A is a governmental plan as described in Code section 414(d), and meets the requirements of Code section 401(a). System A provides retirement benefits to certain employees of the Counties of State M. The Counties are political subdivisions of State M and are the employers referenced in this ruling letter. System A includes mandatory employee and employer contributions.

State M has enacted legislation which establishes within System A a qualified governmental excess benefit arrangement ("Arrangement") within the meaning of Code section 415(m) and authorizes System A to maintain it. The legislation also authorizes System A to create a rabbi trust ("Rabbi Trust").

Section 11.2022(2) of the State M Revised Statutes ("State M Statute") states in part that "excess benefit participant" means any member of System A whose retirement benefit as determined on the basis of all qualified plans of the employer without regard to the limitations of Code section 415 would exceed the maximum benefit permitted under Code section 415.

Section 11.2022(5) of the State M Statute states that "the actuary" means the actuary for System A.

Section 11.2024(1) of the State M Statute states in part that this excess benefit plan shall remain unfunded with respect to any member until the actuary makes a determination that the member will be an excess benefit participant during retirement.

Section 11.2024(2) of the State M Statute states in part that upon a determination that a member will be an excess benefit participant during retirement, the actuary shall redirect employer contributions made under this Chapter into the Rabbi Trust, in an amount necessary to actuarially fund the excess benefit to the excess benefit participant, plus an amount to compensate for expected administrative expenses of the Excess Benefit Plan. This section further states in part that such employer contributions shall be redirected so that they are not deposited into any fund of the retirement system, but shall be redirected into the Rabbi Trust, the funding vehicle, for this Excess Benefit Plan as provided for in paragraph (3) of this section.

Section 11.2042(3) of the State M Statute states in part that the funds directed into the Rabbi Trust shall be utilized to pay the excess benefit participant his or her excess benefits.

The Arrangement states that it is established to supplement the benefits provided to System A participants to the extent benefits payable from System A are reduced by the limitations on benefits imposed by Code section 415. Under the Arrangement, shortly before or soon after a System A participant's retirement date, the System A actuary shall determine if such participant will receive a retirement benefit from System A that will exceed the limitations imposed by Code section 415 ("excess benefit"). If the actuary determines that the participant will receive an excess benefit, the actuary will determine the amount necessary to actuarially fund the participant's excess benefit during retirement, plus expected administrative expenses of System A.

The amount necessary to fund the expected excess benefit is to be obtained from current employer contributions and there will be no employee contributions to the Arrangement. At the time when employer contributions will be made to System A, the funds shall be placed into a temporary clearing account ("Clearing Account") for final forwarding of funds into two other separate and distinct accounts. After the actuary appointed by System A determines how much, if any, of the funds in the Clearing Account will be needed to fund participants' excess benefits, the actuary will make a recommendation to System A to transfer a certain amount of the funds from the Clearing Account into another account which will be separately owned by the Rabbi Trust ("Rabbi Trust Account"), from which participants will receive their excess benefits. When System A accepts the actuary's recommendations, System A will authorize this transfer. The remaining funds in the Clearing Account will be transferred into a separate and distinct account for System A ("System A Account") from which participants will receive their System A retirement benefit. No funds will be transferred between the Retirement System Account and the Rabbi Trust Account. No funds placed in the Rabbi Trust Account shall be remitted to System A, except in the event that the Arrangement is terminated.

To assist in providing assets from which to pay the benefit obligations to the participants, System A has established the Rabbi Trust, intended to be a grantor trust pursuant to state law and for Federal income tax purposes. The Rabbi Trust provides that the principal of the trust, and any earnings thereon, will be held separate and apart from other funds of the employers and shall be used exclusively for the uses and purposes of participants in the Arrangement and general creditors. Participants in the Arrangement and their beneficiaries shall have no preferred claim on, or any beneficial ownership interest in, any assets of the Rabbi Trust. Any rights created under the Arrangement and the Rabbi Trust agreement shall be mere unsecured contractual rights of participants in the Arrangement and their beneficiaries. As provided in the Rabbi Trust agreement, any assets held by the Rabbi Trust will be subject to the claim of the employer's general creditors under federal and state law in the event of insolvency.

System A represents that the Rabbi Trust conforms to the model trust 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. System A represents that the Rabbi Trust language contains no language that conflicts with the model trust language. System A represents that the Rabbi Trust is a valid trust under state law and that all of the material terms and provisions of the Rabbi Trust, including the creditors' rights clause, are enforceable under the appropriate state law. System A further represents that the trustee is an independent third party that has been granted corporate trustee powers under the appropriate state law.

At all times, the Rabbi Trust assets will be subject to the claims of employer's general creditors under federal and state law if employer becomes insolvent, as provided in the Rabbi Trust agreement. Upon receipt of notice or other written allegations of the employer's insolvency, the trustee will suspend the payment of benefits with respect to participants and any beneficiaries. If the trustee determines that the employer is not insolvent or is no longer insolvent, the trustee will resume the payment of benefits. If the employer is insolvent, the trustee shall hold the assets of the Rabbi Trust for the benefit of such employer's general creditors.

Under the Arrangement, a retired participant, or that participant's beneficiary, will be paid that part of a retirement benefit that would otherwise have been payable by System A except for the limitations of Code section 415. A participant in the Arrangement shall receive a monthly benefit equal to the difference between the participant's monthly retirement benefit otherwise payable from System A prior to any reduction or limitation because of Code section 415 and the actual monthly retirement benefit payable from System A as limited by Code section 415. System A shall compute and pay the excess benefit in the same form, at the same time, and to the same person(s) as such benefits would have otherwise been paid as a monthly pension under System A except for Code section 415 limitations. Under no circumstances will a participant be given any election to defer compensation under the Arrangement, whether directly or indirectly.

The Rabbi Trust shall not accept contributions or transfers from System A, shall not have or invest System A assets, and shall not pay System A benefits. Employer contributions made to provide excess benefits will not be commingled with the System A trust fund.

All participants, retired participants and beneficiaries of System A will automatically participate in the Arrangement if their benefits under System A would exceed the limitation imposed by Code section 415. Participation in the Arrangement is determined for each plan year, and participation in the Arrangement will cease for any plan year in which the retirement benefit of a participant or beneficiary of System A is not limited by Code section 415.

Based on the above facts and representations, your authorized representatives have requested the following rulings on your behalf:

1. The Arrangement is a qualified governmental excess benefit arrangement as defined in Code section 415(m)(3);

2. Income accruing to the Arrangement as a qualified governmental excess benefit arrangement established is income derived from the exercise of an essential governmental function upon which the Arrangement is exempt from tax under Code sections 115 and 415(m)(1);

3. System A participants and their beneficiaries shall not be taxed on funds contributed to the Arrangement and Rabbi Trust by their employers on their behalf, in the year contributed under Code section 83 and the Income Tax Regulations thereunder;

4. System A participants and their beneficiaries shall not be taxed on funds contributed to the Arrangement and Rabbi Trust by their employers on their behalf, in the year contributed under Code section 451 and the Income Tax Regulations thereunder;

5. System A participants and their beneficiaries shall include in gross income payments made to them under the Arrangement in the taxable year actually paid or made available to them under the Arrangement;

6. the Rabbi Trust conforms to the model rabbi trust language contained in section 5 of Revenue Procedure 92-64; and

7. a System A participant, including beneficiaries, will not be in constructive receipt of income or incur an economic benefit solely on account of the adoption or maintenance of the Rabbi Trust.

Code section 415(m) sets forth the treatment of qualified governmental excess benefit arrangements. Code 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) 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, the Arrangement is a portion of System A, which your authorized representatives have stated is a governmental plan as described in Code section 414(d). According to the terms of the Arrangement, its only stated purpose is to provide participants in System A that portion of a participant's benefits that would otherwise be payable under the terms of System A except for the limitations on benefits imposed by Code section 415. The Arrangement does not allow participants to defer compensation. The terms of the Arrangement limit participation to System A participants for whom contributions would exceed the Code section 415 limits. Therefore, we have determined that the Arrangement is a portion of a governmental plan which is maintained solely for the purpose of providing to System A participants that part of the participant's annual benefit otherwise payable under the terms of System A that exceeds the section 415 limits, and, as such, meets the requirements of section 415(m)(3)(A).

Your authorized representative has stated in accordance with the terms of the Arrangement that participation is automatic and mandatory for System A participants for whom contributions are limited by Code section 415. 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.

Code section 415(m)(3)(C) requires that the trust from which excess benefits are paid must not form a part of the governmental plan (in this case, System A) which contains the excess benefit arrangement, with a certain exception for trusts maintained solely for the purpose of providing such benefits. In the present case, the Rabbi Trust is a grantor trust and it is maintained separately from System A. Contributions to the Rabbi Trust consist only of the amount required to pay excess benefits during retirement and the amount required to pay administrative expenses. Therefore, we have determined that the requirements of section 415(m)(3)(C) are met.

Since the Arrangement satisfies all of the requirements of Code section 415(m)(3), we conclude with respect to your first requested ruling that the Arrangement is a qualified governmental excess benefit arrangement as defined in Code section 415(m)(3).

With respect to your second requested ruling, Code section 415(m)(1) provides that "[I]ncome 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 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." Ruling 1 has already determined that the Arrangement meets the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements.

Accordingly, with respect to your second requested ruling, we conclude that income accruing to the Arrangement as a qualified governmental excess benefit arrangement established is income derived from the exercise of an essential governmental function upon which the Arrangement is exempt from tax under Code sections 115 and 415(m)(1).

With respect to your third, fourth, and fifth requested rulings, section 415(m)(2) provides that "for purposes of this chapter, (A) the taxable year or years for which amounts in respect to 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 the Arrangement 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 the Arrangement to the participants is 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. State M has represented that the trust established in connection with the Arrangement is a grantor trust pursuant to State M law and for Federal income tax purposes.
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 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.
Section 409A generally applies to nonqualified deferred compensation plans. However, section 409A(d)(1)(A) provides that for purposes of section 409A, the term "nonqualified deferred compensation plan" does not include a qualified employer plan. Section 409A(d)(2)(C) further provides that for purposes of section 409A, the term qualified employer plan does not include any plan described in section 415(m). Accordingly, section 409A is not applicable to a plan described in section 415(m).

Accordingly, with respect to your third, fourth, and fifth requested rulings, we conclude that System A participants and their beneficiaries shall not be taxed on funds contributed to the Arrangement and Rabbi Trust by their employers on their behalf, in the year contributed under Code section 83 and the Income Tax Regulations thereunder; System A participants and their beneficiaries shall not be taxed on funds contributed to the Arrangement and Rabbi Trust by their employers on their behalf, in the year contributed under Code section 451 and the Income Tax Regulations thereunder; and System A participants and their beneficiaries shall include in gross income payments made to them under the Arrangement in the taxable year actually paid or made available to them under the Arrangement.

Under the terms of the Rabbi Trust, assets may be placed in trust to provide benefits to Plan participants and their beneficiaries. However, in the event that a participant's employer becomes insolvent, the trustee will have the obligation to hold the trust assets and income for the benefit of that employer's general creditors. The trust agreement further provides that a participant receives no beneficial ownership in or preferred claim on any trust assets. Therefore, contributed assets will be held in trust, and in the event of the insolvency of a participant's employer, the assets will be fully within the reach of the employer's creditors.

With respect to your sixth and seventh requested rulings, provided that the provisions of the Rabbi Trust requiring use of the Rabbi Trust assets to satisfy the claims of general creditors of a participating employer in the event of the employer's insolvency is enforceable by the employer's creditors under federal and state law, and based on the information submitted and representations made, we conclude that the Rabbi Trust conforms to the model trust language contained in section 5 of Revenue Procedure 92-64, and that a participant in the Arrangement, including beneficiaries, will not be in constructive receipt of income or incur an economic benefit solely on account of the adoption or maintenance of the Rabbi Trust.

This ruling letter is based on the assumption that System A is a governmental plan as described in Code section 414(d) and that it meets all of the applicable requirements under Code section 401(a).

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

The original and a copy of this letter have been sent to your authorized representatives in accordance with the power of attorney on file in this office.

If you have any questions about this letter, please contact
Please refer to SE:T:EP:RA:T:3.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3

Enclosures
Notice 437
Deleted copy of ruling letter

Cc: