Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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415.00-00

Contact Person:

Telephone Number:

In Reference to:
OP:E:EP:T:3

Date:

MAR 16 1999

LEGEND:

System A:

Subsystem B:

Subsystem C:

State M:

Dear

This is in response to your request for a private letter ruling, dated January 22, 1998, concerning the applicability of section 415(m) of the Internal Revenue Code to an excess plan and the tax consequences of certain related transactions. Your request was supplemented by two letters, each dated February 11, 1999. You have submitted the following facts and representations in support of your request.

System A was created and charged under State M law with administering Subsystem B and Subsystem C (collectively, the "Subsystems"), which are defined benefit plans. The Subsystems are governmental plans as described in Code section 414(d), and meet the requirements of Code section 401(a).

State M has enacted legislation which authorizes each Subsystem to establish an excess benefit plan ("Excess Plan"), which is intended to comply with the requirements of Code section 415(m) to be a qualified governmental excess benefit arrangement. The Excess Plans will be administered by System A as part of the Subsystems. As designed, the Excess Plans will only provide benefits to participants that would otherwise exceed the section 415 limits as applicable to governmental

plans. Eligibility for Excess Plan benefits will be determined at retirement and annually for each limitation year thereafter under a qualified plan offset design.

Under this design, the excess benefit payable to a participant is the difference between (i) the annual amount equal to the benefit that would have been payable under the terms of the Subsystems without application of the section 415 limits, and (ii) an annual benefit equal to the benefit that is payable under the terms of the Subsystems determined with application of the section 415 limits. Benefits under the Excess Plans will be paid at the same time and in the same manner as the Subsystems' qualified plan benefits. Assets will not be accumulated in the Excess Plans' trusts from year to year for the purpose of advance funding of the Excess Plan liabilities; assets will remain from year to year only as may be incidental due to cash flow timing. State M has represented that the trusts established in connection with the Excess Plans are grantor trusts pursuant to State M law and for Federal tax purposes.

The Excess Plans will not permit any participant to elect any additional deferral of compensation. As necessary to provide funding for the actual cash flow needs of the Excess Plans, part of the employer contributions to the Subsystems will be paid to the trusts of the Excess Plans. These trusts will be separate from the Subsystems' qualified plan trust and are maintained solely for the purpose of providing excess benefits. Excess Plan benefits will not be paid or funded from the qualified trust assets of the Subsystems.

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

1. The Excess Plans being implemented for the Subsystems meet the legal requirements of Code section 415(m) for qualified governmental excess benefit arrangements;

2. The benefit payments from the Excess Plans will be taxed to the recipients as gross income only as actually paid;

3. The income of the trust funds established to hold assets of the Excess Plans will not be subject to income taxation;

4. The contributions, benefit accruals and the payments under the Excess Plans will not be subject to FICA taxation.

Code section 415(m) sets forth the treatment of qualified governmental excess benefit arrangements. Section 415(m)(3) provides that a qualified governmental excess benefit arrangement means a portion of a governmental plan (1) if 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"); (2) under such portion no election is provided at any time to the participant (directly or indirectly) to defer compensation; and (3) 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 Excess Plans and their related trusts will be part of the Subsystems, which are governmental plans as described in Code section 414(d). The Excess Plans only provide "excess benefits" and do not allow participants to defer compensation. Benefits provided under the Excess Plans are paid from separate trusts which have no other purpose. Accordingly, we conclude that the Excess Plans being implemented for the Subsystems meet the legal requirements of Code section 415(m) for qualified governmental excess benefit arrangements.

With respect to the second requested ruling, 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 Excess Plans being implemented for the Subsystems meet 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 Excess Plans 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 trusts established in connection with the Excess Plans are grantor trusts pursuant to State M law and for Federal 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.

Accordingly, the benefit payments from the Excess Plans will be taxed to the recipients as gross income only as actually paid or made available under the Excess Plans.

With respect to your third 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 Excess Plans being implemented for the Subsystems meet the legal requirements of section 415(m) of the Code for qualified governmental excess benefit arrangements.

Accordingly, we conclude that income accruing to the trust funds established to hold the assets of the Excess Plans will be exempt from tax under Code section 115.

With respect to your fourth requested ruling, Revenue Procedure 99-1 I.R.B. 6, section 5.14, provides that the Internal Revenue Service will not issue a letter ruling if the ruling request presents an issue that cannot be readily resolved before a regulation or any other published guidance is issued. After careful consideration of your request, we have concluded that the question of FICA tax treatment of a qualified governmental excess benefit arrangement under Code section 415(m) cannot readily be resolved before published guidance is issued. Consequently, we are unable to rule on that portion of the request.

This ruling letter is based on the assumption that the Subsystems are governmental plans as described in Code section 414(d) and that they meet all of the applicable requirements under Code section 401.

Sincerely yours,

Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures
Notice 437
Deleted copy of ruling letter