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July 9, 1999

Plan A =

Plan B =

X =

Y =

This is in response to your request for a ruling on behalf of X and Y, concerning the federal income tax consequences of the establishment of Plan B and a trust to assist X in providing benefits to certain participants in Plan A whose benefits have been limited by § 415 of the Internal Revenue Code.

Under the terms of a collective bargaining agreement, X, a trust exempt from tax under § 501(a) of the Code, has established Plan B, which is intended to provide benefits to certain participants whose benefits from Plan A, a plan qualified under § 401(a), have been limited by § 415. Under the terms of Plan B, X will receive amounts from Y, and other participating employers, on a monthly basis and will make monthly contributions to accounts in the trust maintained for each eligible participant in Plan B. The contributions will be made pursuant to a formula that takes into account the monthly benefit that would have been paid to Plan A participants in pay status whose benefits have been reduced due to § 415 (the “Excess Amount”). In addition, X will contribute an amount every month to be allocated to each participant's account equal to the employees’ portion of the employment taxes payable with respect to the Excess Amount (the “Gross Up Amount”). Amounts necessary to pay Y’s portion of applicable employment taxes and administrative expenses will also be paid or reimbursed by Y each month. Under the terms of the trust, all contributions to the trust are irrevocable and are held for the exclusive benefit of Plan B participants in pay status. Plan

B provides that the terms of the trust are incorporated into Plan B and the trust provides that the terms of Plan B are incorporated into the trust.

X and Y have represented that each month, as required by the collective bargaining agreement, Y will contribute the amounts necessary to Plan B to pay Plan B benefits, Y's portion of applicable employment taxes, and to reimburse Plan B administrative expenses. X and Y have represented that these amounts will be disbursed immediately (within the same business day) by Plan B to eligible Plan B participants, taxing authorities, and administrative service providers. Thus, there are no accumulated earnings and Plan B and the trust serve only as conduits through which collectively bargained contributions are identified and allocated to the individual accounts of Plan B participants in pay status.

The administrative expenses include, for example, attorney fees, fees of Plan B's third party administrator and accounting fees. The administrative expenses are described in the Plan B Agreement and Declaration of Trust as "[t]he reasonable and necessary expenses incurred in the collection of Contributions and in the administration and operation of the Trust." X and Y have represented that "[b]ecause no Plan B assets will be held for investment, Plan B will not incur any fees for brokerage commissions, investment management services or similar investment related activities that have been ruled to be deductible only under Code Section 404."

Section 3(36) of the Employee Retirement Income Security Act of 1974 (ERISA) defines an excess benefit plan as one maintained soley for the purpose of providing benefits for certain plan participants in excess of the limitations imposed by § 415 of the Code, without regard to whether the plan is funded.

Section 83(a) of the Internal Revenue 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 § 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 162 of the Code allows a deduction for the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 401(a)(16) of the Code provides that a trust shall not constitute a qualified trust if the plan of which the trust is a part provides for benefits or contributions which exceed the limitations of section 415.

Section 402(b) of the Code provides that contributions made by an employer to an employees' trust that is not exempt from tax under § 501(a) are included in the employee's gross income in accordance with § 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 § 83. Under § 1.402(b)-1(a)(1) of the regulations, employer 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 § 83.

Section 1.402(b)-1(c)(1) of the regulations provides that any amount actually distributed or made available to any distributee by an employees’ trust in a taxable year in which it is not exempt under § 501(a) shall be taxable under § 72 (relating to annuities) to the distributee in the taxable year in which it is so distributed or made available.

Section 404(a) of the Code provides the general deduction timing rules applicable to a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan or arrangement for deferring compensation, regardless of the Code section under which the amounts might otherwise be deductible. Pursuant to section 404(a)(5), contributions or compensation deferred under a nonqualified plan or arrangement are deductible in the taxable year in which an amount attributable to the contribution are includible in the gross income of the employees participating in the plan, but in the case of a plan in which more than one employee participates, only if separate accounts are maintained for each employee. See also § 1.404(a)-12(b)(3) of the regulations.

Section 1.404(a)-12(b)(1) of the regulations provides that a deduction is allowable for contributions paid only in the taxable year in which or with which ends the taxable year of an employee in which an amount attributable to such contribution is includible in his or her income as compensation, and then only to the extent allowable under section 404(a).

Section 412 of the Code provides minimum funding requirements that must be satisfied in qualified pension plans.

Section 1.414(1)-1(b)(1) of the regulations states that a plan is a "single plan" if and only if, on an ongoing basis, all of the plan assets are available to pay benefits to plan participants. Under this definition, Plan A and Plan B, taken together, do not constitute a single plan, because there is no possibility of transfer of assets from either one to pay benefits provided by the other. Since Plan B is a nonqualified and unfunded plan operating separately from Plan A, the existence of Plan B does not affect the qualified status of Plan A.

Section 415(b) of the Code sets out limitations on benefits payable from a qualified defined benefit plan.

Section 3101 of the Code imposes Federal Insurance Contributions Act ("FICA") tax on the income of every individual equal to a percentage of the wages received by the individual.

Section 3102(a) of the Code requires the employer to collect the FICA tax by deducting the amount of the tax from wages when paid. Section 3102(b) provides that the employer required to deduct the tax is liable for the payment of the tax.

Section 3301 of the Code, in general, imposes Federal Unemployment Tax Act ("FUTA") tax on employers equal to a percentage of the wages paid by the employer.

Section 3402 of the Code requires an employer making payment of wages to deduct and withhold from such wages the appropriate amount of tax.

Section 3403 of the Code provides that the employer is liable for the payment of the tax required to be deducted and withheld under § 3402.

An employer's payment of taxes assessable against an employee constitutes additional taxable income to such employee. Old Colony Trust Co. v. Commissioner, 179 U.S. 716 (1929), VIII-2 C.B. 222 (1929). Section 31.3401(a)-1(b)(6) of the Employment Tax Regulations provides generally that the term "wages" includes the payment by an employer of an employee's tax liability, including the taxes imposed by § 3101.

Rev. Proc. 81-48, 1981-2 C.B. 623 and Rev. Rul. 86-14, 1986-1 C.B. 304, set forth the methods of calculating and reporting an employee's FICA tax when such amount is not deducted from the employee's pay.

Because employees who participate in Plan B are fully vested in their Plan B benefits when Y's contributions are made and separate accounts are maintained for each participating Y employee, Y is entitled to a deduction under section 404(a)(5) of the Code in an amount equal to the amount included in income by the respective Y employee, assuming all other requirements for deductibility are met. The deduction is allowable in the taxable year in which or with which ends the taxable year of the employee in which the amount is includible in the employee's income as compensation.

Rev. Rul. 86-142, 1986-2 C.B. 61, considered the deductibility of broker's commissions charged in connection with the purchase and sale of securities for a qualified employees' trust or an individual retirement arrangement (IRA). It notes that brokers' fees are not recurring administrative or overhead expenses incurred in connection with the maintenance of the trust or IRA. Instead, brokers' commissions are intrinsic to the value of the trust's or account's assets; buying commissions are part of the cost of the securities purchased and selling commissions are an offset against sales price. Based on this analysis, Rev. Rul. 86-142 holds that employer contributions to the trust of a qualified plan, or direct payments by the employer to a broker, to pay brokers' commissions cannot be separately deducted under § 162 or 212 of the Code.

Unlike the brokers' fees at issue in Rev. Rul. 86-142, the administrative expenses described in this case are recurring administrative or overhead expenses incurred in connection with the maintenance of Plan B. The administrative expenses include attorney fees, fees of Plan B's third party administrator, accounting fees, etc, and are limited by the terms of the Plan B Agreement and Declaration of Trust to the "reasonable and necessary expenses incurred in the collection of Contributions and in the administration and operation of the Trust."

Under §§ 3102, 3301 and 3402 of the Code, the employer is liable for the payment of FICA and FUTA income tax required to be deducted and withheld from the employee's wages. The FICA and FUTA income tax required to be paid by the employer is a direct consequence of employer's obligation to pay the underlying wages and, as such, are deductible by the employer as ordinary and necessary business expenses under § 162.

Based on the information submitted and representations made, we conclude that:

1. The establishment and operation of Plan B will not cause Plan A or X to lose their respective tax-qualified and tax-exempt statuses.

2. The method of funding Plan B will not cause Plan A or X to lose their respective tax-qualified and tax-exempt statuses.

3. Plan B and the trust together constitute an employees' trust within the meaning of § 402(b).

4. Plan B participants and beneficiaries are taxable on contributions, including the Gross Up Amounts made on their behalf to the trust at the time the contributions to the trust are made.

5. Plan B is not taxable on contributions that are disbursed to Plan B participants on a monthly basis.

6. Assuming the requirements for deductibility are met, employer contributions are fully deductible by Y in the taxable year in which or with which ends the taxable year of the employees in which the amounts are includible in the employees' gross incomes.

7. Y's payments to Plan B of Y's portions of applicable employment taxes are deductible under § 162 in the taxable year in which Plan B disburses such payments to the applicable taxing authorities.

8. Y's payments to Plan B to reimburse Plan B's administrative expenses are deductible under § 162 in the taxable year in which Plan B disburses such payments to the administrative service providers.

Except as specifically ruled on above, no opinion is expressed as to the federal tax consequences of the above transaction under any other provision of the Code. Specifically, no opinion is expressed as to the application of § 3121(v) of the Code to this transaction.

This ruling is directed only to the taxpayers who requested it and applies only to the Plan and trust submitted as of the date of this ruling. If Plan B or the trust are amended, this ruling may not necessarily remain in effect. Section 6110(j)(3) of the Code provides that this ruling may not be used or cited as precedent.

Sincerely yours,

CHARLES T. DELIEE
Chief, Branch 1
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure:
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