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Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply to:
CC:EBEO:1 - PLR-106625-98

Date: SEP 3 0 1998

X =

Y =

Plan =

Trust X =

Trust Y =

Dear

This is in response to your request for a ruling dated March 6, 1998, concerning a nor-qualified deferred compensation agreement (the "Plan") established by X and adopted by Y, and a trust ("Trust Y") established by Y.

X established the Plan to provide supplemental retirement benefits for a select group of management and highly compensated employees of X and its affiliates (the "Participants") and to restore certain retirement benefits under the qualified retirement plan established under section 401(k) (the "Qualified Plan") on behalf of the Participants that were decreased due to limitation imposed by the Internal Revenue Code of 1986. Y has become a participating affiliate and has adopted the Plan.

Four types of contributions may be made to the Plan. First, a Participant who elects to contribute to the Qualified Plan the lesser of (i) the maximum elective deferral permitted under section 402 (g)(1) of the Code or (ii) the maximum elective contribution permitted under the terms of the Qualified Plan, may irrevocably elect to defer to the Plan up to fifteen percent of his regular salary and cash bonuses (including bonuses earned during such year but payable during the following year.) The amount of the deferral under the Plan is reduced by the participant's elective deferrals under the Qualified Plan for such year. Second, the Plan requires a matching contribution to be made by X or any participating affiliate. Third, the Plan requires X or any participating affiliate to make a profit sharing contribution as of the last day of each calendar quarter to each participant who is employed by X or a participating affiliate on the last day of such calendar quarter. Fourth, a participant may elect to defer up to 75% of his regular salary payable during the year and up to 85% of his cash bonuses earned during such year, including bonuses which are payable during the following year.

The Plan provides for the payment of benefits upon termination of services. The Plan also provides for distributions in the event of an unforeseeable emergency.

No benefits payable under the Plan to any person are subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance or charge, and any attempt to anticipate, alienate, sell, transfer, assign, pledge, encumber, charge or otherwise dispose of the benefits will be void.

X established Trust X. Y established an identical trust, Trust Y, in order to assist in the payment of its obligations to the Participants under the Plan. Trust Y conforms to the model trust contained in Revenue Procedure 92-64, including the order in which the sections of the model trust language appear. Trust Y does not contain any language that is inconsistent with, or conflicts with, the language of the model trust agreement. Any other participating affiliate will, upon becoming a participating affiliate, establish a separate trust identical to Trust X to assist in the payment of benefits under the Plan by the participating affiliate.

Under the Plan and Trust Y, the interest of a participant (or beneficiary) in the trust estate shall be no greater than the interest of any general unsecured creditor of Y.

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 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 money1 transferred or set aside from claims of the transferor's creditors, for example, in a trust or escrow account.

Section 401(k) (4) (A) provides, in pertinent part, that a cash or deferred arrangement of any employer shall not be treated as a qualified cash or deferred arrangement any other benefit is conditioned (directly or indirectly) on the employee electing to have the employer make or not make contributions under the arrangement in lieu of receiving cash. The preceding sentence shall not apply to any matching contribution (as defined in section 401(m)) made by reason of such an election. A rule similar to the rule of section 401(k) (4) (A) is found in section 1.401(k)-1(e) (6) (I) of the regulations.

Section 1.401(k)-1(e) (6) (iv) of the regulations provides that participation in a nonqualified deferred compensation plan is treated as contingent only to the extent that an employee may receive additional deferred compensation under the nonqualified plan if that employee makes or does not make elective contributions. However, deferred compensation that is dependent on an employee's having made the maximum elective deferrals under section 402(g) of the Code or the maximum elective deferrals permitted under a cash or deferred arrangement that is qualified under section 401(k) is not treated as contingent.

Section 402(b) of the Code provides that contributions made by an employer to an employees' 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. Section 1.402(b)-1(a) (1) of the regulations provides that employer contributions to a nonexempt employees' trust are included as compensation in an 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 provides that the amount of any item of gross income shall be included in gross income for the taxable year in which the taxpayer receives it, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for in a different period. Section 1.451-1(a) of the regulations provides that under the cash receipts and disbursements method of accounting, amounts are included in gross income when actually or constructively received.

Section 1.451-2(a) of the regulations provides that income is constructively received in the taxable year during which it is credited to the taxpayer's account or set apart for him or otherwise made available so that he may draw upon it at any time, or so that he could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

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-l C.B. 127, and Rev. Rul. 68-99, 1968-l 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.

Various revenue rulings have considered the tax consequences of nonqualified deferred compensation arrangements. Rev. Rul. 60-31, Situation 1-3, 1960-I 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 terms of Trust Y, assets will be placed in trust to be used to provide deferred compensation benefits to the Participants. However, the trustee has the obligation to hold the trust assets and income for the benefit of Y's general creditors in the event of Y's insolvency. The Trust further provides that a Participant receives no beneficial ownership in or preferred claim on the trust assets. Therefore, although the assets are held in trust, in the event of Y's insolvency they are fully within reach of Y's general creditors, as are any other assets of Y.

Section 404(a)(5) of the Code provides the general deduction timing rules applicable to any plan or arrangement for the deferral of compensation, regardless of the Code section under which the amount might otherwise be deductible. Pursuant to section 404(a)(5) of the Code and section 1.404(a)-12(b)(2) of the regulations, and provided that they otherwise meet the requirements for deductibility, amounts of contributions or compensation deferred under a non-qualified plan or arrangement are deductible in the taxable year in which they are paid or made available, whichever is earlier.

Section 301.7701-4(a) of the Procedure and Administration Regulations provides that, generally, an arrangement will be treated as a trust if it can be shown that the purpose of the arrangement is to vest in trustees responsibility for the protection and conservation of property for beneficiaries who cannot share in the discharge of this responsibility and, therefore, are not associates in a joint enterprise for the conduct of business for profit.

Section 671 of the Code provides that where a grantor shall be treated as the owner of any portion of a trust under subpart E, part I, subchapter J, chapter 1 of the Code, there shall then be included in computing the taxable income and credits of the grantor those items of income, deductions, and credits against tax of the trust which are attributable to that portion of the trust to the extent that such items would be taken into account under chapter 1 in computing taxable income or credits against tax of an individual.

Section 677(a) (2) of the Code provides that the grantor shall be treated as the owner of any portion of a trust whose income without the approval or consent of any adverse party is, or, in the discretion of the grantor or a nonadverse party, or both, may be held or accumulated for future distribution to the grantor.

Section 1.677(a)-1(d) of the regulations provides that under section 677 of the Code, a grantor is, in general, treated as the owner of a portion of a trust whose income is, or in the discretion of the grantor or a nonadverse party, or both, may be applied in discharge of a legal obligation of the grantor.

Provided (i) that creation of Trust Y does not cause the Plan to be other than "unfunded" for purposes of Title I of the Employee Retirement Income Security Act of 1974, (ii) that the provision of Trust Y requiring use of trust assets to satisfy claims of Y's general creditors in the event of Y's insolvency is enforceable by such creditors under federal and state law, and (iii) the Plan and Trust Y are amended as proposed in your letter of August 28, 1998, we conclude that:

1. Trust Y will be classified as a trust within the meaning of section 301.7701-4(a) of the Procedure and Administration Regulations. Because the principal and income of Trust Y may be applied in discharge of legal obligations of Y, Y shall be treated as the owner of the entire trust under section 677 of the

Code. Accordingly, there shall be included in computing the taxable income and credits of Y all items of income, deductions, and credits against tax of Trust Y. Section 671.

2. Neither the adoption of the Plan by Y, the creation of Trust Y, the contribution of assets by Y to Trust Y, nor the crediting of earnings on the trust assets will result in a transfer of property for purposes of section 83 of the Code or section 1.83-3(e) of the regulations and will not result in the inclusion of any amounts in the gross incomes of the Participants or beneficiaries under the cash receipts and disbursements method of accounting.

3. Neither the adoption of the Plan by Y, the creation of Trust Y, the contribution of assets by Y to Trust Y, nor the crediting of earnings on the trust assets will constitute a contribution to a nonexempt employees' trust under section 402(b) of the Code and will not result in the inclusion of any amounts in the gross incomes of the Participants or beneficiaries under the cash receipts and disbursements method of accounting.

4. Under the economic benefit and constructive receipt doctrines of sections 61 and 451 of the Code, neither the adoption of or the creation of liabilities under the Plan, the creation of Trust Y, the contribution of assets by Y to Trust Y, nor the crediting of earnings on trust assets will create taxable income for the Participants or their beneficiaries under the cash receipts and disbursements method of accounting. Benefits payable under the Plan will be includible as compensation in the gross income of the Participants or their beneficiaries under the cash receipts and disbursements method of accounting only in the taxable year or years in which such amounts are actually distributed or otherwise made available, whichever is earlier.

5. Y is entitled to a deduction pursuant to section 404(a) (5) of the Code for the amounts paid or made available under the Plan in the taxable year in which such amounts are includible in the gross income of the Participants or their beneficiaries, provided such amounts otherwise meet the requirements for deductibility. However, section 280G of the Code may limit the amount that may be deducted.

6. The terms of the Plan require a potential Participant to contribute the maximum amount permissible under the Qualified Plan prior to commencing his or her elective deferrals under the Plan. It is concluded that elective deferrals into the Plan fall under the exception enunciated in section 1.401(k)-1(e) (6) (iv) of the regulations. It is further concluded that such contributions are not treated as "contingent" within the meaning of section 401(k) (4) (A) of the Code.

Rulings 2, 3, and 4 that relate to the Trust are based on the assumption that prior deferrals under the Plan did not result in constructive receipt of income or economic benefit. No opinion is expressed as to whether such deferrals were actually or constructively received in the prior years.

This ruling is directed only to the taxpayer who requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent. Except as specifically ruled on above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. Moreover, if the Plans or Trust are substantially amended, this ruling may not remain in effect.

Sincerely yours,

ROBERT D. PATCHELL
Assistant Chief, Branch One
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure:
Copy for section 6110 purposes