

**INTERNAL REVENUE SERVICE**

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July 31, 2001

State Agency A =

State S =

Program P =

Dear

This responds to your letter of January 12, 2001 and subsequent correspondence, on behalf of State Agency A, requesting a ruling concerning the proposed deferred compensation plan (the "Plan") which Agency A intends to be an eligible deferred compensation plan under section 457(b) of the Internal Revenue Code of 1986. A is represented to be a state rehabilitation agency which is a governmental entity described in section 457(e)(1)(A) of the Code.

Agency A has established the Plan for the benefit of a number of blind vendors who are participating in A's rehabilitation Program P. Pursuant to the terms of the federal Randolph-Sheppard Act, 20 U.S.C. 107b-e and a comparable State S statute for rehabilitating blind individuals, certain individuals with vision impairments, commonly known as the "blind vendors", who participate in Program P, are trained by A so they have the ability to operate certain vending facilities on either federally-owned, state owned or local government owned property. A and P are obligated to place these vendors in these government facilities. A is the state licensing agency for these facilities which provides opportunities for blind persons to operate its vending facilities.

Pursuant to this mission, A facilitates the establishment and operation of a vending facility by one of the blind vendors through negotiations with the federal, State, or local government agency that maintains the space where the facility is to be located. A enters into a standard agreement with the building manager at the government facility authorizing such vending location. In this agreement, among other things, A agrees to place a vendor in charge of the facility, to provide the facility's equipment and to jointly oversee the vending facility along with the building manager.

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A's standard agreement with the blind vendors grants them the right to operate the facility, and requires them to be responsible for managing and operating the facility. However, A generally provides and owns the equipment used at these facilities.

Once the vendor's facility has been established, the vendor pays a percentage of his/her proceeds into a fund maintained by A and used for various purposes such as the purchase, maintenance and replacement of the vending facilities' equipments. A also assists the vendors by administering workers' compensation and liability insurance and by providing management consultation regarding the facility's operation.

Many government buildings in State S have vending machines provided by A although no vendor actually operates a vending facility in the building. According to section 107d-3(a) of the Randolph-Sheppard Act, income from such vending machines will be used by the state for the following (among other) purposes:

*All vending machine income which accrues to a State licensing agency pursuant to subsection (a) of this section shall be used to establish retirement or pension plans, for health insurance contributions, and for provision of paid sick leave and vacation time for blind licensees in such State, subject to a vote of blind licensees . . . .*

State S has a similar statutory provision applicable to Agency A. After following the legally required procedures, A is establishing the Plan under section 457(b) to provide deferred compensation to the blind vendors pursuant to the above-mentioned federal and state statutes. Each vendor in Program P automatically participates in the Plan. For each plan year (which is a calendar year), deferred compensation contributions will be made to each vendor's account from the vending machine trust fund in accordance with the federal Randolph-Sheppard Act and comparable State S law. The amounts to be allocated to each vendor's account will be determined pursuant to the Plan's provisions. Amounts deferred for a calendar year will be deposited to the annuity contract within a reasonable time after the determination of such amount has been made. The vendors do not have a choice of receiving these amounts in cash instead of having them contributed to the Plan. However, if the deferred compensation for a vendor for a year exceeds the deferral limitations of section 457(b), the excess amount is paid directly to the vendor from this trust fund as soon as administratively feasible after the determination of such excess amount.

A's plan defers certain compensation described relating to services under Program P in any taxable year until death, separation from service as defined under the Plan, attainment of age 70½, or until the occurrence of an unforeseeable emergency.

The Plan provides for a maximum amount that may be deferred to a participant's account in any taxable year and also provides for a catch-up computation for amounts deferred for one or more of the participant's last three taxable years ending before he attains normal retirement age under the plan. The amounts that may be deferred under

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the annual maximum limitation and the catch-up provision are within the limitations of section 457 including the section 457(c) coordinated deferral provision. The Plan also provides that its participants may choose among various investment options offered under the Plan for investing the amounts in their Plan accounts.

With certain limitations, a participant may elect the manner in which his deferred amounts will be distributed. The election generally must be made prior to the date any such payment commences to the participant. If the participant fails to make a timely election, distribution will commence at the time and in the manner set forth in the Plan. The Plan also includes a provision permitting a one-time election by a participant to change the time and manner of his distributions under the Plan after the first permissible payout date if distribution from his account had not already commenced. The Plan provides that the manner and time of benefit payout must meet the distribution requirements of sections 401(a)(9) and 457(d)(2) of the Code.

The Plan provides that amounts of compensation deferred thereunder are to be transferred to and invested in a trust described in section 457(g) or in one or more annuity contracts for the exclusive benefit of the participants and their beneficiaries. The annuity contract is represented to be an annuity contract described in section 401(f) and thus eligible for treatment as a trust pursuant to section 457(g)(3). The rights of any participant or beneficiary to payments under the Plan are nonassignable and not subject to pledge, encumbrance, transfer or alienation.

The Plan generally provides that distribution to an alternate payee pursuant to a domestic relations order may occur or commence only when authorized under section 457(d)(1)(A) governing when distributions under the Plan may begin. If an alternate payee receives rights to amounts in a participant's account under a domestic relations order, the Plan may establish and maintain a separate account for that alternate payee pursuant to its provisions governing such accounts.

Section 457 of the Code provides rules for the deferral of compensation by an individual participating in an eligible deferred compensation plan as defined in section 457(b).

Section 457(a) of the Code provides that in the case of a participant in an eligible deferred compensation plan, any amount of compensation deferred under the plan and any income attributable to the amounts so deferred shall be includible in gross income only for the taxable year in which such compensation or other income is paid or otherwise made available to the participant or beneficiary.

Section 457(b)(1) provides that only individuals who perform service for the eligible employer may be participants in an eligible plan. Section 457(e)(1)(A) defines an eligible employer as including a state, a political subdivision of a state and any agency or instrumentality of a state or political subdivision of a state. Section 457(e)(2) defines the performance of service as including performance of service as an

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independent contractor, and it treats the governmental unit for whom such services are performed as the employer.

Section 1.457-1(b)(1) of the Income Tax Regulations provides that amounts deferred (including amounts previously deferred) under an eligible plan will not be considered made available to the participant solely because the participant is permitted to choose among various investment modes under the plan for the investment of such amounts whether before or after payments have commenced under the plan.

Section 457(g) provides that a plan maintained by an eligible governmental employer shall not be treated as an eligible deferred compensation plan unless all assets and rights purchased with such deferred compensation amounts and all income attributable to such amounts, property, or rights of the plan are held in trust for the exclusive benefit of participants and their beneficiaries. Section 457(g)(3) states that custodial accounts and annuity contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

Based upon the provisions of the Plan summarized above, and the documents presented, we conclude as follows:

1. The Plan established by Agency A for the blind vendors in Program P is an eligible deferred compensation plan as defined in section 457(b) of the Internal Revenue Code of 1986.
2. Amounts of compensation deferred in accordance with the Plan, including any income attributable to the deferred compensation, will be includible in the recipient's gross income for the taxable year or years in which amounts are paid or otherwise made available to a participant or beneficiary in accordance with the terms of the Plan. Excess deferred compensation from the vending machine trust fund exceeding the section 457(b) deferral limitations that is paid to the vendors pursuant to the Plan will be includible in the recipient's gross income in the year when it is paid or made available.
3. The annuity contract associated with A's section 457(b) Plan is treated under section 457(g) as a trust which is treated as an organization exempt from taxation under section 501(a).
4. The right of the Plan's participants to choose among various investment options under the plan for the investment of the amounts in their accounts does not adversely affect the Plan's status as an eligible deferred compensation plan described in section 457(b). Section 1.457-1(b)(1) of the Income Tax Regulations.

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No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than A's Plan described above. In addition, this ruling applies only to deferrals made after the date this ruling is issued. This ruling is directed only to Agency A and applies only to the Plan submitted on January 12, 2001, as revised by the amendments submitted on July 24, 2001 and to the annuity contract submitted on January 12, 2001. In addition, no opinion is expressed regarding the recently submitted Plan amendments which are intended to reflect the statutory revisions to section 457 enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001. If the Plan is significantly modified, this ruling will not necessarily remain applicable. Section 6110(k)(3) of the Internal Revenue Code provides that this ruling may not be used or cited as precedent.

Temporary or final regulations pertaining to one or more of the issues addressed in this ruling have not yet been adopted. Therefore, this ruling may be modified or revoked if the adopted temporary or final regulations are inconsistent with any conclusion in the ruling. See section 12.04 of Rev. Proc. 2001-1, 2001-1 I.R.B. 1, 46. However, when the criteria in section 12.05 of Rev. Proc. 2001-1 are satisfied, a ruling is not revoked or modified retroactively except in rare or unusual circumstances.

Sincerely yours,  
ROBERT D. PATCHELL  
Acting Chief, Qualified Plans Branch 2  
Office of the Associate Chief Counsel  
(Tax Exempt and Government Entities)

Enclosure:

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