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Department of the Treasury
Washington, DC 20224

Person To Contact:

Telephone Number:

Refer Reply To:
CC:TEGE:EB:EC – PLR-170696-03

Date:
February 10, 2005

In Re:

Legend

Company =

Plan =

Trust =

X =

Y =

Dear :

This is in reply to your letter dated October 28, 2003, and subsequent correspondence requesting rulings on behalf of the Company concerning certain federal income tax consequences of the Trust. The Company established the Trust to pay benefits under the Plan, which the Company sponsors for the benefit of certain of its current or former employees who qualify as “highly compensated employees” within the meaning of section 414(q) of the Internal Revenue Code (“Participants”).

Under the Plan, a Participant may defer receipt of (1) up to X percent of the Participant’s base salary on an after-tax basis; and/or (2) up to Y percent of the Participant’s bonus/incentive compensation on an after-tax basis. The Plan provides that the plan administrator of the Plan shall credit to each Participant’s after-tax salary deferral account under the Plan the after-tax deferral amount designated by the Participant on his or her salary deferral election and any subsequent earnings or losses thereon.

Amounts deferred under the Plan on an after-tax basis and earnings thereon are always 100 percent vested and nonforfeitable and are not subject to the claims of the Company's creditors. Participants have the right to direct the investment of their after-tax contributions and earnings thereon, which are held in the Trust. Subject to the right of the plan administrator to restrict the number of withdrawals in a plan year, a Participant may withdraw any after-tax salary deferrals and the earnings thereon at any time.

Section 451 of the Code states that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-2(a) of the Income Tax Regulations states that income, although not actually reduced to a taxpayer's possession, is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time, or so that the taxpayer 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.

Section 83 of the Code provides that the excess of the fair market value of property transferred in connection with the performance of services over the amount (if any) paid 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 Regulations provides that, for purposes of section 83 of the Code, the term "property" includes real or 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. However, to the extent a transfer to a trust is subject to section 402(b), section 83 applies to such a transfer only as provided for in section 402(b). See section 1.83-8(a).

Section 402(b)(1) of the Code provides, in general, that contributions to a nonexempt employees' trust made by an employer are includible in the gross income of the employee in accordance with section 83, with the value of the employee's interest in the trust substituted for the fair market value of the property for purposes of applying section 83. Section 402(b)(3) provides that the beneficiary of a nonexempt employee's trust described in section 402(b)(1) shall not be considered the owner of any portion of such trust under subpart E of part I of subchapter J. Section 1.402(b)-1(b)(6) of the Regulations provides, however, that where contributions by the employee to a trust are not incidental when compared to contributions by the employer, if the applicable requirements of such subpart E are satisfied, the employee is treated as the owner of the portion of the trust attributable to the employee's contributions. For this purpose, employee contributions are not incidental when compared to employer contributions if the total employee contributions as of any date exceed the employer contributions on behalf of the employee as of that date.

Section 402(b)(4)(A) of the Code provides that if one of the reasons a trust is not exempt from tax under section 501(a) is the failure of the plan of which it is a part to meet the requirements of section 401(a)(26) or section 410(b), then a highly compensated employee shall, in lieu of the amount determined under section 402(b)(1) or (2), include in gross income for the taxable year with or within which the taxable year of the trust ends an amount equal to the employee's vested accrued benefit (other than the employee's investment in the contract) as of the close of the taxable year of the trust. Since this amount is includible in income in lieu of the amount determined under section 402(b)(1) or (2), it is includible only in the case of a trust to which section 402(b)(1) would otherwise apply.

Section 671 of the Code provides the general rule that when the grantor or another person is regarded as the owner of any portion of a trust, there shall be included in computing his taxable income and credits, those items of income, deduction, and credits against tax of the trust that are attributable to that portion of the trust (to the extent that such items could be taken into account in computing the taxable income or credits against the tax of an individual).

Sections 673 through 677 of the Code specify the circumstances that cause a taxpayer to be regarded as the owner of a portion of a trust. Section 673(a) provides that the grantor shall be treated as the owner of any portion of a trust in which he has a reversionary interest in either the corpus or the income therefrom, if, as of the inception of that portion of the trust, the value of such interest exceeds 5 percent of the value of such portion.

Section 1.671-4 of the Regulations sets out requirements for the reporting of items of income, deduction, and credits when a taxpayer is regarded as the owner of a portion of a trust pursuant to section 671 of the Code.

A Participant is fully vested in and has a right to withdraw the amount deferred on an after-tax basis pursuant to the Plan at any time, subject only to a limitation the plan administrator may impose on the number of withdrawals that may be made during a plan year. A Participant who withdraws the amount of any after-tax deferred amount receives an amount equal in value to the amount the Participant would have received if the Participant had not withdrawn the after-tax deferred amount. Therefore, a Participant would not forego a valuable right by electing a cash withdrawal, and the amount the Company pays to the Trust on behalf of a Participant is made available to the Participant by the Company. Thus, the Participant's control over the receipt of the withdrawn amount is not subject to substantial limitations or restrictions. Accordingly, a

Participant is in constructive receipt of any contribution made by the Company to the Participant's account under the Trust.

Because the Participant is in constructive receipt of the after-tax deferred amount, any after-tax deferred amount contributed to the Trust is treated as having been paid to the Participant and then contributed by the Participant to the Trust. In this case, a Participant will be considered the owner of his portion in the Trust because, among other things, the Participant has a 100 percent reversionary interest in both the corpus and the income therefrom.

Therefore, the applicable requirements of subpart E, part I, subchapter J (sections 671-679) of the Code are satisfied. There are no employer contributions to the Trust and hence the employee contributions to the Trust are not incidental compared to those of the employer. Thus, the Trust is not an employee's trust subject to section 402(b)(1). It follows that section 402(b)(4) also does not apply to the Trust.

Accordingly, we rule as follows.

1. Each Participant will be treated as the owner of his or her subaccount in the Trust, such that the timing and character of all income items earned by each Participant's Trust subaccount will be passed through to the Participant in determining his or her annual federal income tax liability.

2. The Trust itself is not a taxpayer and the Company does not have any income tax obligations with respect to the Trust.

3. Each participant's share of the income of the Trust for a calendar year as determined from each participant's account in the Trust shall be reported to such participant using the appropriate Form 1099 or such other report as required by Section 1.671-4 of the Regulations.

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

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to the taxpayer.

Sincerely,

Robert B. Misner
Senior Technician Reviewer
Office of Division Counsel/Associate Chief Counsel
(Tax Exempt & Government Entities)

Enclosure:

Copy of letter for section 6110 purposes