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Department of the Treasury
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Date:
March 17, 2005

LEGEND:

State X:

The Plan:

County:

EIN:

State X Act:

Dear :

This responds to your letter requesting a ruling concerning the Plan. It is represented that County is a political subdivision of State X and an eligible employer within the meaning of section 457(e)(1)(A) of the Internal Revenue Code of 1986 (the Code). The Plan is intended to be an eligible deferred compensation plan under section 457(b) and a retirement system under section 3121(b)(7)(F) of the Code. The Plan is a collectively bargained plan, and it is codified under the County code as adopted by the relevant authority.

As a condition of employment, an eligible employee becomes a participant under the Plan by agreeing to defer four and a half percent of the employee's annual compensation (the basic contribution) which the County credits to an investment account maintained on behalf of the participant. With respect to the basic contributions, the agreement to defer compensation applies to compensation for services provided on or after the first day the employee becomes a participant. Beyond the basic contribution, the participant may elect to defer an additional amount of the participant's

compensation (the supplemental contribution) subject to certain limits. With respect to supplemental contributions, the deferral agreement applies to compensation for services on or after the first day of the month following the execution of the agreement. In addition to these amounts, the County credits each participant's account with an amount (the matching contribution) equal to three percent of the participant's annual compensation. All amounts credited to a participant's account, including any gains or losses that result from investment, are fully vested and nonforfeitable at all times. The Plan defines compensation as the amount of an employee's wages as defined for purposes of Code section 3121, including employee contributions to the Plan, but not including any compensation exceeding the contribution and benefit base as determined under section 230 of the Social Security Act.

The Plan provides for a maximum amount that may be deferred by a participant in any taxable year and also provides for a catch-up contribution for amounts deferred for one or more of the participant's last three taxable years ending before he or she attains normal retirement age under the Plan. The normal retirement age is age seventy and a half unless the participant designates an earlier normal retirement age which cannot be less than age sixty-five. The amounts that may be deferred under the annual maximum limitation and the catch-up provisions are within the limitations of section 457(c).

As a general matter, entitlement to a distribution of benefits occurs only after severance from employment, retirement, or death. Consistent with section 401(a)(31)(B), the Plan provides that a participant's entire account balance will be distributed to the participant when a participant severs from employment with an account balance of $1000.00 or less. Further, the Plan provides that notwithstanding any Plan provision to the contrary, the commencement and duration of any form of benefit payment shall be in accordance with sections 401(a)(9) and 457(d) and the regulations thereunder.

If a participant has a severance from employment in order to accept employment with another eligible governmental employer which sponsors an eligible deferred compensation plan, the participant may elect to transfer the participant's account to the eligible deferred compensation plan. In certain circumstances a participant may elect or the plan administrator may, in its discretion, transfer a participant's account to another eligible deferred compensation plan sponsored by the County. Further, the Plan provides for distribution of eligible rollover amounts directly to the trustee of an eligible retirement plan, if certain conditions are met.

The term "spouse" is not separately defined under the Plan. The plan provides that a "certified domestic relations order "(CDRO) is a domestic relations order that the Plan administrator has determined satisfies the requirements of a qualified domestic relations order as defined in section 414(p). For Plan purposes, an alternate payee is a spouse or former spouse of a participant who is recognized under a CDRO as having a right to receive all, or a portion of, the benefits payable under the Plan with respect to the participant.

Several Plan provisions (the Spouse Provisions), involve a participant's spouse, former spouse or surviving spouse. Specific Spouse Provisions involve the applicable distribution period, the appropriate life expectancy tables, and the required beginning date for distribution. These Spouse Provisions relate to the application of Income Tax Regulation sections 1.401(a)(9)-3, 1.401(a)(9)-5, and 1.401(a)(9)-9.

Other Spouse Provisions relate to whether a surviving spouse may roll over distributions into an eligible retirement plan in the same manner as if the spouse were the participant; the treatment of an early distribution a spouse or former spouse receives pursuant to a domestic relations order; and whether a spouse or former spouse may, pursuant to a domestic relations order, roll over distributions into any eligible retirement plan in the same manner as if the spouse were the participant. These Spouse Provisions involve the application of Income Tax Regulation section 1.402(c)-2 and the definition of "alternate payee" under Section 414(p)(8) of the Code.

State X Act provides that registered domestic partners have the same rights, protections and benefits and are subject to the obligations and duties "under law" as granted to and imposed on spouses. Likewise, former registered domestic partners and registered surviving domestic partners have the same rights, protections and benefits and are subject to the obligations and duties under law as granted to and imposed on former spouses and surviving spouses. To the extent that provisions of State X law adopt, refer to, or rely upon, provisions of federal law in a way that otherwise would cause registered domestic partners to be treated differently than spouses, registered domestic partners are to be treated under State X law as if federal law recognized a domestic partnership in the same manner as State X law. Accordingly, if applicable with respect to the Spouse Provisions, State X Act requires that a domestic partner be treated in the same manner as a spouse under the Plan. However, the Act expressly provides that it does not amend, or modify federal law or the benefits, protections and responsibilities provided by federal law.

The Plan provides that amounts of compensation deferred thereunder are to be transferred to and invested in a trust as described in section 457(g)(1) or a custodial account as described in sections 457(g)(3) and 401(f) for the exclusive benefit of the participants and their beneficiaries. All amounts deferred under the Plan must be transferred to the trust or custodial account within an administratively reasonable time period, but in no event, later than the fifteenth business day of the month following the month in which the amount deferred would have been payable to the participant in cash. The rights of any participant or beneficiary to payments pursuant to Plan A are not subject to alienation, transfer, assignment, pledge, attachment, or encumbrance of any kind.

We note that the Internal Revenue Service recently published Revenue Procedure 2004-56, 2004-35 I.R.B. 376. Rev. Proc. 2004-56, which contains model amendments (the Model Amendment) designed for use by eligible governmental employers maintaining eligible section 457(b) defined contribution plans that permit employees to

elect to defer compensation, that are maintained on the basis of the calendar year, and that provide for the use of one or more trusts to satisfy the requirements of section 457(g) of the Code. If an eligible governmental employer adopts one or more of the Model Amendments for a plan that is intended to be an eligible section 457(b) governmental plan, the plan will be treated as meeting the plan requirements for eligibility under section 457(b) with respect to the adopted provisions. The Plan has adopted several Model Amendment provisions on a word-for-word basis or in a manner that is substantially similar in all material respects.

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)(1)(A) of the Code provides that in the case of a participant in an eligible governmental 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 to the participant or beneficiary. Section 457(b) provides that the term "eligible deferred compensation plan" means a plan established and maintained by an eligible employer in which only individuals who perform service for the employer may be participants and which meets the deferral limitations described in section 457(c); which meets the distribution requirements described in section 457(d); which provides for deferral elections described in section 457(b)(4); and, in the case of a governmental plan, which requires the plan assets and income to be held in trust for the exclusive benefit of participants and beneficiaries as described in section 457(g).

Section 457(e)(1) of the Code defines the term "eligible employer" to mean a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State, and any other organization (other than a governmental unit) exempt from federal income tax.

Section 457(b)(4) of the Code provides that compensation will be deferred for any calendar month only if an agreement providing for such deferral has been entered into before the beginning of such month. However, a new employee may defer compensation payable in the calendar month during which the participant first becomes an employee if an agreement providing for the deferral is entered into on or before the first day on which the participant performs services for the eligible employer. An eligible plan may provide that if a participant enters into an agreement providing for deferral by salary reduction under the plan, the agreement will remain in effect until the participant revokes or alters the terms of the agreement. Nonelective employer contributions are treated as being made under an agreement entered into before the first day of the calendar month.

Section 457(b)(2) of the Code provides the basic limits on the amount of eligible annual deferrals. However, a catch-up amount described in section 457(b)(3) may be added to this amount for participants that are within three years of the normal retirement age or,

for participants age 50 or older, a catch-up amount may be added as described in section 457(e)(18). A participant eligible for both catch-up provisions is entitled to use the higher limit of the two. The total annual eligible deferral amount is limited by section 457(c). Coordination of the basic limits and the catch-up limits is described in section 1.457-4(c) of the regulations.

Section 1.457-4(c)(v)(A) of the regulations provides that a plan may define the normal retirement age for purposes of the three-year catch-up provision as any age that is on or after the earlier of age sixty-five or the age at which participants have the right to retire and receive, under the basic defined benefit pension plan of the State or tax-exempt entity (or a money purchase pension plan in which the participant also participates if the participant is not eligible to participate in a defined benefit plan), immediate retirement benefits without actuarial or similar reduction because of retirement before some later specified age, and that is not later than age seventy and a half. Alternatively, a plan may provide that a participant is allowed to designate a normal retirement age within these ages. For purposes of the three-year catch-up provision an entity sponsoring more than one eligible plan may not permit a participant to have more than one normal retirement age under the eligible plans it sponsors.

Section 1.457-5 of the regulations provides that the section 457(c) eligible-deferral amount limitation is applied to all eligible plans in which a participant participates in a tax year and is determined on an aggregate basis. If a participant has annual deferrals under more than one eligible plan and the applicable catch-up amount is not the same for each such eligible plan for the taxable year, section 457(c) is applied using the catch-up amount under whichever plan has the largest catch-up amount applicable to the participant. To the extent that the combined annual deferral amount exceeds the maximum deferral limitation, the amount is treated as an excess deferral under section 1.457-4(e) of the regulations. For purposes of determining whether there is an excess deferral resulting from a failure of a plan to apply the deferral limitations, all plans under which an individual participates by virtue of his or her relationship with a single employer are treated as a single plan (without regard to any differences in funding).

Section 457(d)(2) of the Code requires a plan to meet the minimum distribution requirements of section 401(a)(9). These requirements are described in sections 1.401(a)(9)-1 through 1.401(a)(9)-9 of the regulations. Section 457(d)(1)(A) of the Code provides that amounts distributed under an eligible plan will not be made available to participants or beneficiaries earlier than (i) the calendar year in which the participant attains age 70 1/2, (ii) when the participant has a severance from employment with the employer, or (iii) when the participant is faced with an unforeseeable emergency.

Section 457(d)(1)(C) of the Code requires an eligible governmental plan to meet requirements similar to the requirements of section 401(a)(31). Section 401(a)(31)(B) requires that mandatory distributions of more than $1,000.00 from a plan qualified under section 401(a) be paid in a direct rollover to an individual retirement plan (i.e., an individual retirement account as described in section 408(a) or an individual retirement

annuity described in section 408(b)) of a designated trustee or issuer if the distributee does not make an affirmative election to have the amount paid in a direct rollover to an eligible retirement plan or to receive the distribution directly. Recently published guidance, Notice 2005-5, 2005-3 I.R.B. 337, provides that the automatic rollover provisions of section 401(a)(31)(B) apply to section 457(b) eligible governmental deferred compensation plans. However, governmental plans will not be treated as failing to satisfy the requirements of section 401(a)(31)(B) if the automatic rollover provisions are not applied to mandatory distributions from such plans that are made prior to the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after January 1, 2006.

Section 457(e)(10) provides that a participant shall not be required to include in gross income any portion of the entire amount payable to such participant solely by reason of the transfer of such portion from one eligible deferred compensation plan to another eligible deferred compensation plan. Section 1.457-10(b)(1) of the regulations provides that an eligible government plan may transfer amounts to, and receive amounts from, an eligible government plan if certain conditions are met. With regard to transfers from an eligible governmental plan to another eligible governmental plan of the same employer, section 1.457-10(b)(4) of the regulations provides that a transfer from an eligible governmental plan to another eligible governmental plan is permitted if the following conditions are met: (i) the transfer is from an eligible governmental plan to another eligible governmental plan of the same employer; (ii) the transferor plan provides for transfers; (iii) the receiving plan provides for the receipt of transfers; (iv) the participant or beneficiary whose amounts deferred are being transferred will have an amount deferred immediately after the transfer at least equal to the amount deferred with respect to that participant or beneficiary immediately before the transfer; and (v) the participant or beneficiary whose deferred amounts are being transferred is not eligible for additional annual deferrals in the receiving plan unless the participant or beneficiary is performing services for the entity maintaining the receiving plan.

With regard to rollover distributions, section 457(e)(16) provides that for an eligible deferred compensation plan, if (i) any portion of the balance to the credit of an employee in such plan is paid to such employee in an eligible rollover distribution (within the meaning of section 402(c)(4)), (ii) the employee transfers any portion of the property such employee receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and (iii) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed, then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid. Income Tax Regulation section 1.402(c)-2(b) provides that a distributee other than the employee or the employee's surviving spouse (or a spouse or former spouse who is an alternate payee under a qualified domestic relations order) is not permitted to roll over distributions.

Consistent with section 414(p)(10), section 1.457-10(c) of the regulations provides for distributions made pursuant to a qualified domestic relations order. If a distribution or

payment is made from an eligible plan to an alternate payee pursuant to a qualified domestic relations order, rules similar to the rules of section 402(e)(1)(A) apply to the distribution. Code section 414(p)(8) provides that the term "alternate payee" means any spouse, former spouse, child or other dependent of a participant who is recognized by a domestic relations order as having a right to receive all, or a portion of, the benefits payable under a plan with respect to such participant.

Rev. Rul. 58-66, 1958-1 C.B. 60, provides that the marital status of individuals as determined under state law is recognized in the administration of tax laws. However, Section 3 of the "Defense of Marriage Act", P.L. 104-199 (September 21, 1996), provides that, "in determining the meaning of any Act of Congress, or of any ruling, regulation or interpretation of the various administrative bureaus or agencies of the United States, the word 'marriage' means only a legal union between one man and one woman as husband and wife, and the word 'spouse' refers only to a person of the opposite sex who is a husband or a wife."

Section 457(g) of the Code 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. Code section 457(g)(2)(A) provides that a trust described in section 457(g)(1) shall be treated as an organization exempt from tax under section 501(a). Code section 457(g)(3) states that custodial accounts and contracts described in section 401(f) shall be treated as trusts under rules similar to the rules under section 401(f).

The Federal Insurance Contribution Act (FICA) imposes a tax on wages paid by employers to employees with respect to "employment." The FICA tax is comprised of two separate taxes. Sections 3101(a) and 3111(a) of the Code impose Old-Age, Survivor's, and Disability Insurance (OASDI) taxes and sections 3101(b) and 3111(b) impose Hospital Insurance (HI) taxes on employees and employers, respectively.

Section 3121(b)(7)(F) of the Code generally expands the definition of employment for FICA purposes to include service performed after July 1, 1991, as an employee for a state or local government entity, unless the employee is a member of a retirement system of such entity.

Section 3121(u)(2)(A) of Code provides that, for purposes of the HI tax, sections 3101(b) and 3111(b) generally apply to state and local government employees and employees of instrumentalities without regard to the general exclusion in section 3121(b)(7).

Section 31.3121(b)(7)-2(b) of the Employment Tax Regulations provides that the rules under section 31.3121(b)(7)-2 generally treat an employee as a member of a retirement system if the employee (1) is a "qualified participant" in a system that provides

retirement benefits, and (2) has an accrued benefit or receives an allocation under the system that is comparable to the benefits the employee would have received under Social Security. In the case of part-time, seasonal and temporary employees, this minimum retirement benefit must be non-forfeitable.

Section 31.3121(b)(7)-2(d)(1)(ii) of the regulations provides, in general, that an employee is a “qualified participant” in a defined contribution system with respect to services performed on a given day if, on that day, the employee has satisfied all conditions (other than vesting) for receiving an allocation to the employee's account (exclusive of earnings) that meets the minimum-retirement-benefit requirement of section 31.3121(b)(7)-2(e)(2).

Section 31.3121(b)(7)-2(e)(1) of the regulations provides that the system must provide retirement-type benefits. For purposes of section 3121(b)(7)(F) of the Code, a retirement system includes any pension, annuity, retirement or similar fund or system within the meaning of section 218 of the Social Security Act that is maintained by the state or local government to provide retirement benefits to its employees who are participants. Thus, the legal form of the system is generally not relevant. For example, a retirement system may include a plan described in section 401(a), an annuity plan or contract under section 403 or a plan described in section 457(b) or (f). Accordingly, a plan need not be qualified under section 401(a) in order to be a retirement system for purposes of Code section 3121(b)(7)(F).

The general rule under section 31.3121(b)(7)-2(e)(2) of the regulations is that the system must provide a benefit that is comparable to the benefit provided under the OASDI portion of Social Security. Whether this requirement is met is generally determined on an individual basis. A defined contribution retirement system meets the minimum benefit requirement if allocations to the employee's account (not including earnings) are at least 7.5% of the employee's compensation. Employer matching contributions may be taken into account for this purpose. The plan must use a definition of compensation that is generally no less inclusive than the definition of the employee's base pay as designated by the employer or the retirement system.

Section 31.3121(b)(7)-2(e)(2)(C) of the regulations specifies that a defined contribution retirement system will not meet the minimum benefit requirement unless the employee's account is credited with interest at a rate that is reasonable under all the facts and circumstances, or employees' accounts are held in a separate trust that is subject to general fiduciary standards and are credited with actual earnings of the trust fund.

Additional rules apply for determining whether part-time, seasonal or temporary employees are qualified participants. Section 31.3121(b)(7)-2(d)(2) of the regulations provides that a part-time, seasonal or temporary employee is not a qualified participant on a given day unless any benefit relied upon to meet the requirements of section 31.3121(b)(7)-2(d)(1) is 100% non-forfeitable on that day.

Section 31.3121(b)(7)-2(d)(2)(ii) of the regulations provides that a part-time, seasonal or temporary employee's benefit is considered non-forfeitable within the meaning of section 31.3121(b)(7)-2(d)(2)(i) on any given day if, on that day, the employee is unconditionally entitled under the retirement system to a single sum distribution on account of death or separation from service of an amount that is at least equal to 7.5% of the participant's compensation for all periods of credited service taken into account in determining whether the employee's benefit under the retirement system meets the minimum-retirement-benefit requirement.

Based upon the information submitted and the representations made, we conclude as follows:

1. The Plan is an eligible deferred compensation plan as defined in section 457(b) of the Code.

2. Amounts of compensation deferred in accordance with the Plan, including any income attributable to the deferred compensation, will be includible under section 457(a)(1)(A) of the Code in the recipient's gross income for the taxable year or years in which amounts are paid to a participant or beneficiary in accordance with the terms of the Plan.

3. A registered domestic partner, a former registered domestic partner, or a surviving registered domestic partner as defined in state X Act is not a spouse, a former spouse or a surviving spouse for purposes of Code section 457. Accordingly, in the event that the Spouse Provisions are not interpreted and applied in a manner consistent with the Defense of Marriage Act, the operation of the Plan will not be in compliance with section 457(b).

4. The Plan qualifies as a retirement system within the meaning of Code section 3121(b)(7)(F) and the Plan’s participants are qualified participants within the meaning section 31.3121(b)(7)-2(d)(1) of the regulations.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter. If the Plan is significantly modified, this ruling will not necessarily remain applicable.

No opinion is expressed concerning the timing of the inclusion in income of amounts deferred under any deferred compensation plan other than the Plan described above. In addition, this ruling applies only to deferrals made after the date of this ruling.

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 your authorized representative.

Sincerely,

Robert D. Patchell
Branch Chief, Qualified Plans Branch 2 (Employee Benefits)(Tax Exempt & Government Entities)

Enclosure (1)
Copy for section 6110 purposes

cc: