Internal Revenue Service Department of the Treasury

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Washington, DC 20224

199901009

Person to Contact:

Telephone Number:

Refer Reply to:
CC:EBEO:1 - PLR-109737-98

Date:
SEP 29 1998

X =

Plan =

Trust =

Dear

This is in response to your request for a ruling dated April 15, 1998, on behalf of X concerning a nonqualified deferred compensation agreement (the "Plan") and a trust agreement (the "Trust") established to provide benefits for a select group of management employees (the "Participants") of X.

X established the Plan to enable the Participants to elect to defer all or a portion of the Participant's salary and/or bonus he or she would otherwise have received for the following year. The Plan provides for payment of benefits upon termination of employment.

Neither the Participant nor his or her beneficiaries shall have the right to anticipate, alienate, sell, transfer, assign, pledge, or encumber his or her account, nor shall such account be subject to attachment or garnishment by creditors of the Participants or their beneficiaries.

X established the Trust to hold assets to provide X with a source of funds to assist it in paying its obligations to the Participants under the Plan. The Trust conforms to the model trust contained in Revenue Procedure 92-64, including the order in which the sections of the model trust language appear. The Trust does not contain any language that is inconsistent with, or conflicts with, the language of the model trust agreement.

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

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

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, 1972-1 C.B. 127, and Rev. Rul. 68-99, 1968-1 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, 1960-1 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 the Trust, 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 X's general creditors in the event of X'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 X's insolvency they are fully within reach of X's general creditors, as are any other assets of X.

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 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 the Trust requiring use of trust assets to satisfy claims of X's general creditors in the event of X's insolvency is enforceable by such creditors under federal and state law, and (iii) the Plan and Trust are amended as proposed in your letter of July 17, 1998, we conclude that:

1. The Trust 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 the Trust may be applied in discharge of legal obligations of X, X 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 X all items of income, deductions, and credits against tax of the Trust. Section 671.

2. Under the economic benefit and constructive receipt doctrines of sections 61 and 451 of the Code, neither the adoption of the Plan, the creation of the Trust, the contribution of assets to the Trust, nor the crediting of earnings on the trust assets will create taxable income for the Participants or their beneficiaries under the cash receipts and disbursements method of accounting.

3. Benefits payable under the Plan and out of the Trust 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.

4. Neither the adoption of the Plan, creation of the Trust, the contribution of assets by X to the Trust, 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.

5. Neither the adoption of the Plan by X, the creation of the Trust, the contribution of assets to the Trust 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.

Rulings 2 through 5 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 Plan 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