

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

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Refer Reply To:  
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Date:  
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In Re:

Legend

- = W
- = X
- = Y
- = Z
- = Retirement Make-up Plan
- = Thrift Make-up Plan
- = Industry
- = Date 1
- = Ruling A
- = Ruling B
- = Ruling C
- = Portion

Dear :

This is in reply to your request for a ruling concerning whether the nonqualified pension plans maintained for the benefit of employees of X and Z constitute “exempt governmental deferred compensation plans” for purposes of sections 3121(a)(5)(E) and 3121(v)(3) of the Internal Revenue Code (“the Code”).

FACTS

X and Z are each an integral part of W. Y is included in Z. X and Z are exempt from federal income tax under section 501(c)(1) of the Code as “corporation[s] organized under Act of Congress which [are] instrumentalit[ies] of the United States...” X and Z jointly sponsor the following employee retirement plans for the benefit of their employees:

- The Retirement Plan for Employees of W (the “Retirement Plan”)
- The Thrift Plan for Employees of W (the “Thrift Plan”)
- The Retirement Make-up Plan for Employees of W (the “Retirement Make-up Plan”)
- The Thrift Make-up Plan for Employees of W (the “Thrift Make-up Plan”)

### Retirement Make-up Plan

The Retirement Plan is a tax-qualified defined benefit pension plan. The Retirement Make-up Plan is an unfunded nonqualified defined benefit pension plan established by X and Z for the benefit of their employees whose benefits under the Retirement Plan are limited by the application of Sections 401(a)(17) and/or 415 of the Code.<sup>1</sup>

Generally, the Retirement Make-up Plan provides eligible participants and their beneficiaries with supplemental retirement and ancillary death benefits equal to the difference between the benefits they are entitled to under the Retirement Plan and the benefits they would have been entitled to under the Retirement Plan if not for the application of Sections 401(a)(17) and 415 of the Code.

Benefits under the Retirement Make-up Plan accrue and vest at the same time as the corresponding benefits under the Retirement Plan. Benefits under the Retirement Make-up Plan are not payable to a participant or his or her beneficiary prior to such participant's retirement under the Retirement Plan or death, if earlier.

### Thrift Make-up Plan

The Thrift Plan is a tax-qualified defined contribution plan. The Thrift Make-up Plan is an unfunded nonqualified defined contribution plan established by X and Z for the benefit of their employees whose matching contributions under the Thrift Plan are limited by application of section 401(a)(17) of the Code. Generally, the Thrift Make-up Plan provides that a book account will be established for each Thrift Plan participant whose employer matching contribution under the Thrift Plan is limited by application of section 401(a)(17) of the Code. A participant's Thrift Make-up Plan account will be credited each month with an amount equal to the difference between the employer matching contribution such participant is credited with under the Thrift Plan for that month and the employer matching contribution such participant would have been credited with under the Thrift Plan for that month if not for the application of section 401(a)(17) of the Code. The participant's Thrift Make-up Plan account is thereafter credited with earnings at a rate of return equal to the rate of return for the Thrift Plan investments elected by the participant with respect to such participant's employer matching contribution account for the same period.

Amounts credited to a participant's Thrift Make-up Plan account vest at the same time as the corresponding employer matching contributions under the Thrift Plan. A participant's Thrift Make-up Plan account balance is not payable to a participant until after the participant terminates employment.

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<sup>1</sup> Section 401(a)(17) of the Code provides limitations on compensation that may be taken into account under a qualified plan. Section 415 of the Code provides dollar limitations on benefits and contributions under a qualified plan.

Your request for a ruling concerns only the Retirement Make-up Plan and the Thrift Make-up Plan. Specifically, you have requested a ruling that the Retirement Make-up Plan and Thrift Make-up Plan are “exempt governmental deferred compensation plans” within the meaning of section 3121(v)(3) of the Code and, accordingly, payments to, or on behalf of, a participant under such plans are not “wages” for purposes of employment taxes under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA).

#### LAW

Section 3121(a) of the Code provides, for purposes of FICA, that the term “wages” means all remuneration for employment, unless specifically excepted.

Section 3121(a)(5)(E) of the Code provides that the term wages does not include any payment made to, or on behalf of an employee or his beneficiary under or to an exempt governmental deferred compensation plan (as defined in section 3121(v)(3) of the Code).

Section 3121(v)(3) of the Code defines an exempt governmental deferred compensation plan as any plan providing for deferral of compensation established and maintained for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing. Such term shall not include - (1) any plan to which Code sections 83, 402(b), 403(c), 457(a), or 457(f)(1) applies; (2) any annuity contract described in Code section 403(b); and (3) the Thrift Savings Fund (within the meaning of subchapter III of chapter 84 of title 5, United States Code).

None of the following Code sections apply to the Retirement Make-up Plan and the Thrift Make-up Plan: section 83, 402(b), 403(c), 457(a), 457(f)(1) or 403(b). Neither plan is the Thrift Savings Fund within the meaning of subchapter III of chapter 84 of title 5, United States Code.<sup>2</sup>

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<sup>2</sup> Code sections 457(a) and 457(f) apply only to deferred compensation plans of an “eligible employer.” Code section 457(e)(1) includes within the definition of “eligible employer” 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 tax under this subtitle. Because X and Z are governmental units, but not of a State or political subdivision of a State, they are not eligible employers and neither § 457(a) nor § 457(f) applies. In addition, neither the Retirement Make-up Plan nor the Thrift Make-up Plan is a qualified governmental excess benefit arrangement described in section 415(m) of the Code. Therefore, this ruling should not be interpreted to suggest any answer on the issue of whether a plan under § 457(a), § 457(f) or § 415(m) maintained by a State or local government is subject to FICA.

Section 3121(v)(2) provides special timing rules for the application of FICA to nonqualified deferred compensation plans. However, § 3121(v)(2) does not apply to amounts that are excluded from wages for FICA purposes. See § 31.3121(v)(2)-1(a)(2)(v).

Section 31.3121(v)(2)-1(b)(3) of the Employment Tax Regulations states that a plan provides for the deferral of compensation with respect to an employee only if, under the terms of the plan and the relevant facts and circumstances, the employee has a legally binding right during a calendar year to compensation that has not been actually or constructively received and that, pursuant to the terms of the plan, is payable to (or on behalf of) the employee in a later year. An employee does not have a legally binding right to compensation if that compensation may be unilaterally reduced or eliminated by the employer after the service creating the right to the compensation has been performed. For this purpose, compensation is not considered subject to unilateral reduction or elimination merely because it may be reduced or eliminated by operation of the objective terms of the plan, and an employee does not fail to have a legally binding right to compensation merely because the amount of compensation is determined under a formula that provides for benefits to be reduced due to investment losses.

Section 3306(b) of the Code provides, for purposes of FUTA, that the term “wages” means all remuneration for employment, unless specifically excepted.

Section 3306(b)(5)(E) of the Code provides that the term wages does not include any payment made to, or on behalf of, an employee or his beneficiary under or to an exempt governmental deferred compensation plan (as defined in section 3121(v)(3) of the Code).

## DISCUSSION

In order for the Retirement Make-up Plan and the Thrift Make-up Plan to be deemed “exempt governmental deferred compensation plans” within the meaning of section 3121(v)(3) of the Code, they must be plans which provide for the deferral of compensation which are established and maintained by an agency or instrumentality of the United States.

### Deferral of Compensation

The Retirement Make-up Plan and Thrift Make-up Plan each provide for the deferral of compensation. Under each Make-up Plan, a participant has a legally binding right to benefits that accrue during a calendar year, but because each plan is unfunded, such benefits are not actually or constructively received when accrued. See Rev. Rul. 69-650, 1969-2 C.B. 106. Participants are not entitled to payment of their accrued benefits until either their retirement (in the case of the Retirement Make-up Plan) or termination of employment (in the case of the Thrift Make-up Plan).

Participants also have a “legally binding right” to their plan benefits upon accrual. Under the Make-up Plans, a participant’s accrued benefit cannot be unilaterally reduced or eliminated by an employer, except that the objective terms of each of the Make-up plans provide that unvested benefits are forfeited upon termination of employment. Additionally, benefits under the Thrift Make-up Plan can be reduced to reflect investment losses. For purposes of determining whether a plan provides for a deferral of compensation, benefit forfeitures or reductions pursuant to objective plan vesting provisions and account reductions due to investment losses are expressly permitted under the Employment Tax Regulations without causing a participant to fail to have a legally binding right to those benefits. See § 31.3121(v)(2)-1(b)(3). Thus, both the Retirement Make-up Plan and Thrift Make-up Plan provide for the deferral of compensation for employment tax purposes.

#### United States Agency or Instrumentality

In order to be classified as exempt governmental deferred compensation plans, the Retirement Make-up Plan and Thrift Make-up Plan must be established and maintained by an agency or instrumentality of the United States for the benefit of such agency’s or instrumentality’s employees. The Retirement Make-up Plan and Thrift Make-up Plan were established by X and Z and are maintained jointly for the benefit of their respective employees.

The Service utilizes certain factors in determining whether an entity is a government agency or instrumentality. See e.g., Rev. Rul. 57-128, 1957-1 C.B. 311 (providing factors to be considered in determining whether an organization is an instrumentality of a state or political subdivision for purposes of Code section 3121(b)(7)); and Rev. Rul. 89-49, 1989-1 C.B. 117 (providing factors to be considered in determining whether an organization is an agency or instrumentality of a government for purposes of Code section 414(d)). These factors include whether the government exercises control and supervision over the organization, whether there is specific legislation creating the organization, and the source of operating funds of the organization.

The Service has consistently ruled that the components of Z are instrumentalities of the United States. See e.g., Ruling A, Ruling B and Ruling C. Additionally, on Date 1, the Service ruled that W is an instrumentality of the United States, and the Retirement Plan and Thrift Plan maintained for employees of W are governmental plans for purposes of section 414(d) of the Code. Section 414(d) of the Code defines a governmental plan as “a plan established and maintained for its employees by the Government of the United States, by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.”

X was created by an Act of Congress to perform governmental functions. Its members are appointed by the President with the advice and consent of the Senate, and it must regularly report to and consult with the full Congress. Further, Congress has delegated to X broad powers that are inherently governmental in nature, including the power to

promulgate and enforce certain federal industry regulations and assess civil penalties that are payable to the United States. X is required to submit reports to Congress, including an annual report of its operations and weekly reports indicating the condition of Z. In addition, the financial accounts of X are subject to audit by the General Accounting Office. Although X is not funded through Congressionally appropriated funds, it is funded through profits of Z, which, after payment of statutory dividends to members of Z, are otherwise earmarked for the United States Treasury.

The components of Z were established under an act of Congress as separate corporate entities. Z performs governmental functions such as performing industry services for the federal government and conducting examinations and inspections of certain industry institutions. Z is subject to the oversight of X. X appoints the portion of the directors of Z and approves the compensation of all directors, officers and employees of Z.

Based on the foregoing, we conclude that X and Z (including Y) are instrumentalities of the United States for purposes of section 3121(v)(3) of the Code. Accordingly, the Retirement Make-up Plan and the Thrift Make-up Plan are “exempt governmental deferred compensation plans” within the meaning of section 3121(v)(3) of the Code, and payments to, or on behalf of, the participants in such plans are not wages for purposes of FICA and FUTA. In addition, section 3121(v)(2) does not apply to amounts deferred under the Retirement Make-up Plan or the Thrift Make-up Plan.

This ruling is directed only to Y, the taxpayer requesting it, and may not be relied upon by any other taxpayers. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,  
Patricia M. McDermott  
Senior Technician Reviewer, Branch 2  
Office of the Associate Chief Counsel  
(Employee Benefits & Exempt Organizations)

cc: