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Letter Ruling 81-38: Deferred Compensation Plan

May 4, 1981

***** Bank offers a deferred compensation plan ("Plan") to municipalities and subdivisions of Massachusetts and to certain organizations which are tax exempt under Section 501(c)(3) of the Internal Revenue Code ("Code"). You request a ruling concerning the Massachusetts income tax status of deferred compensation of employees participating in the Plan.

Your Plan is intended to comply with Section 457 of the Code. Under this Section compensation deferred under an eligible state deferred compensation plan is includible in an employee's federal gross income only in the taxable year in which such compensation is paid or otherwise made available to the employee. An eligible state deferred compensation plan may be established and maintained by a State, by any political subdivision of a state, or by their respective agencies. An eligible state deferred compensation plan may also be established by a tax-exempt rural electric co-operative.

In order for a compensation plan to be eligible under Section 457, the plan must: (1) restrict participation to those individuals who perform service for the employer; (2) provide that the maximum that may be deferred under the plan for the taxable year not exceed the lesser of \$7500 or 33 1/3% of the participant's includible compensation (except that higher ceilings may also be provided to employees within three years of normal retirement age); (3) provide that compensation may be deferred for any calendar month only if an agreement providing for deferral has been entered into before the beginning of that calendar month; (4) not provide that amounts payable under the plan will be available to participants or other beneficiaries earlier than when the participant is separated from service with the employer or is faced with an unforeseeable emergency; and (5) provide that all amounts of compensation deferred under the plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property or rights remain solely the property and rights of the employer until made available to the participant or other beneficiary.

You use both a general form entitled "Plan and Agreement" and a different form for use by non-municipal employers, entitled "Deferred Compensation Plan and Agreement". The requirements on the Plan and Agreement form appear to be consistent with those in Section 457. The form for use by non-municipal employers lacks a provision indicating the maximum amount of compensation which a participant may annually defer. The Internal Revenue Service allows a plan until January 1, 1982 to satisfy the requirements of Section 457 but beginning after taxable year 1978, no participant may defer more than the maximum permitted under the Code.

You indicate that your Plan will be offered to certain non-profit 501(c)(3) corporations. Under Section 457, participation in a deferred compensation plan is limited to employees of state and local governments or their respective agencies and employees of tax-exempt rural electric co-operatives. Deferred compensation plans which are offered to employees of other 501(c)(3) corporations do not qualify for deferred compensation treatment under Section 457.

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Based on the foregoing it is ruled that

1. Amounts deferred under the Plan by employees of state and local governments or their respective agencies and by employees of tax-exempt rural electric co-operatives are not subject to Massachusetts income tax in the year deferred to the extent that such amounts are not taxable to the employees under Section 457 of the Code for federal income tax purposes.
2. Amounts deferred by said employees pursuant to Section 457, so long as such amounts are considered deferred for federal and Massachusetts income tax purposes, are not subject to withholding of Massachusetts income taxes at the time such amounts are deferred and are not included on the Form W-2 (Wages and Tax Statement) as wages or other compensation until the year in which the funds are made available to the employee.
3. Amounts deferred by said employees are includible in Massachusetts gross income and are subject to withholding of Massachusetts income taxes during the taxable year in which such amounts are paid or otherwise made available to the employees, their beneficiaries or estates through retirement, separation from service, death or unusual hardship.

Very truly yours

/s/L. Joyce Hampers

L. Joyce Hampers
Commissioner of Revenue

LJH:RSF:mf

LR 81-38