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The Split Personalities of 457(b) Nonqualified Plans

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The same section of the Internal Revenue Code (Code) governs, but very different rules apply to 457(b) plans of tax-exempt organizations and governmental entities. No wonder there is often confusion about these nonqualified deferred compensation plans. Changes made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) made 457(b) plans more attractive as a retirement savings vehicle for eligible employers. This article provides a detailed overview of the similarities and differences between 457(b) plans of state and local governments and those of tax-exempt organizations (other than governments).

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BACKGROUND ON CODE SECTION 457(B)

Code § 457 describes "eligible" and "ineligible" nonqualified plans for "eligible employers," *i.e.*, state and local government employers and other (nongovernmental) employers exempt from federal income taxation (tax-exempt employers).[1] Code § 457(b) defines the requirements to be an "eligible" nonqualified plan. A deferred compensation plan of an eligible employer that does not satisfy the requirements of 457(b) is not an eligible plan and is an "ineligible" plan under Code § 457(f), unless the plan is either a qualified plan under Code § 401(a), a 403(b) plan, a qualified governmental excess benefit plan under Code § 415(m), the portion of any plan that consists of a transfer of property under Code § 83, the portion of any plan that consists of a nonexempt trust under Code § 402(b), an applicable employment retention plan under Code § 457(f)(4), or certain other arrangements described in regulations.[2]

There are at least two advantages of a 457(b) plan over a 457(f) plan. First, a 457(b) plan is not subject to Code § 409A, while a 457(f) plan is.[3] Second, the amounts deferred under a 457(b) plan, whether due to salary reductions or nonelective employer contributions, generally are not taxable until paid to the participant or beneficiary, in the case of a governmental plan, or until paid or otherwise made available to the participant or beneficiary, in the case of a plan of a tax-exempt employer.[4] Amounts deferred under a 457(f) plan must be included in income of a participant or beneficiary for the first taxable year in which there is no substantial risk of forfeiture of rights to the deferred compensation.[5] The right of a person to compensation is subject to a substantial risk of forfeiture if the person's right to such compensation is conditioned on the future performance of substantial services by any individual.[6]

Many of the rules for 457(b) plans are the same for both governmental and tax-exempt employers, but many are different. For example, a 457(b) plan for a tax-exempt organization is an unfunded "top hat" plan under the Employee Retirement Income Security Act of 1974 (ERISA),[7] while a governmental 457(b) plan must be funded by a trust,[8] even though both are nonqualified plans. As will become apparent in this article, governmental 457(b) plans are more like qualified plans than 457(b) plans of tax-exempt employers.

THE IMPACT OF EGTRRA ON 457(B) PLANS

Prior to EGTRRA and subsequent legislation, 457(b) plans of tax-exempt organizations and governmental entities were more similar than they are today. EGTRRA made 457(b) plans more attractive for both types of eligible employers, but also increased the differences between governmental and tax-exempt employer 457(b) plans. Generally, EGTRRA changes were effective beginning in 2002.[9]

For example, prior to EGTRRA, amounts deferred under a 403(b) or 401(k) plan, a simplified employee pension plan (SEP) under Code § 408(k), a SIMPLE retirement account under Code § 408(p), and contribution amounts deductible under a plan described in Code § 501(c)(18) during a tax year reduced, dollar for dollar, amounts that could be deferred under a 457(b) plan for that tax year.[10] EGTRRA eliminated this coordination and established a separate, and increased, limit for amounts deferred under a 457(b) plan.[11] The basic annual limit on 457(b) compensation deferrals was increased to the lesser of 100 percent of compensation (as defined under Code § 415(c)(3)) or a dollar amount that is the same as the annual dollar limit on elective deferrals to a 403(b) or 401(k) plan.[12] EGTRRA also eliminated special minimum required distribution requirements applicable to 457 plans[13] and eliminated the "same desk rule," thereafter allowing distributions of elective deferrals following a severance from employment, for 457(b) plans as well as for 403(b) and 401(k) plans.[14]

EGTRRA extended the direct rollover and withholding rules to distributions from governmental 457(b) plans, including requiring the rollover notice for eligible rollover distributions.[15] EGTRRA also changed when amounts deferred under a governmental plan become includible in income to when "paid" rather than when "paid or otherwise made available." Amounts deferred under a plan of a tax-exempt employer continue to become includible in income when "paid or otherwise made available."

These changes made 457(b) plans more attractive for deferring compensation and increased the differences between the plans of governmental employers and tax-exempt employers. For tax-exempt employers, the repeal of the coordination with 401(k) and 403(b) deferrals and increased 457(b) deferral limits meant more could be deferred under a 457(b) plan, without the taxation upon the first taxable year in which there is no substantial risk of forfeiture of rights to the deferred compensation that would exist under a 457(f) plan. With the exception of certain grandfathered governmental 401(k) plans (adopted by a governmental entity before May 6, 1986),[16] state and local governments cannot sponsor a 401(k) plan,[17] but state and local public schools (including public colleges and universities) can maintain 403(b) plans,[18] so the repeal of the coordination with 401(k) and 403(b) deferrals still made 457(b) plans more attractive for many public entities, particularly public schools, colleges, and universities. The added ability to make eligible rollover distributions to and from a governmental 457(b) plan and EGTRRA limiting taxation of amounts deferred to when paid further increased the attractiveness of 457(b) plans to many governmental entities.

ELEMENTS COMMON TO 457(B) PLANS OF TAX-EXEMPT AND GOVERNMENTAL EMPLOYERS

A number of required and permissive provisions of 457(b) apply to all eligible employers, whether they are tax-exempt organizations or state and local governments.

Written Plan Document Required

A 457(b) plan must be established and maintained by an eligible employer pursuant to a written plan document containing all the material terms and conditions for benefits under the plan.[19] Although no prototype plan documents approved by the U.S. Department of Treasury (Treasury) and the Internal Revenue Service (IRS) are available, the Treasury and IRS issued model governmental 457(b) plan language in 2004.[20] However, such model language has not been updated to reflect final 415 regulations issued in 2007 or to reflect subsequent legislative changes affecting 457(b) plans.[21]

Salary Reduction Contributions Permitted

Amounts can be deferred under a 457(b) plan through salary reduction contributions for any calendar month only if an agreement providing for the deferral is entered into before the first day of the month in which the compensation is paid or made available or, in the case of a new employee, before the first day in the calendar month on which the employee performs services for the eligible employer. The plan may provide that the agreement will remain in effect until the participant revokes or alters the terms of the agreement.[22]

Although the regulations under Code § 457 do not expressly require that salary reduction contributions are immediately vested, IRS examination guidelines for 457(b) plans and certain other guidance from the IRS indicate that salary reduction contributions should be immediately vested.[23]

Nonelective Employer Contributions Permitted

Employer contributions other than on behalf of a participant under a salary reduction agreement (*i.e.*, nonelective employer contributions with respect to which the participant does not have the choice to instead receive the contribution amount in cash or property) are permitted under a 457(b) plan. A nonelective employer contribution to a 457(b) plan includes employer contributions to the plan that are matching contributions on a participant's salary reduction contributions to the 457(b) plan.[24] However, contributions to a 457(b) plan that are matching contributions on a participant's elective contributions to a 401(k) or 403(b) plan are not permitted, because of the anti-conditioning (contingent benefit) rules of 401(k) and 403(b).[25]

Annual Deferral

The amount of compensation deferred under a 457(b) plan for a taxable year, whether by salary reduction or by nonelective employer contribution, is the annual deferral amount for purposes of the limits under 457(b) and otherwise. The amount of compensation deferred under a 457(b) plan is taken into account as an annual deferral in the taxable year of the participant in which deferred or, if later, the year in which the amount of compensation deferred is no longer subject to a substantial risk of forfeiture.[26]

If the amount of compensation deferred under the plan during a taxable year is not subject to a substantial risk of forfeiture, the amount taken into account as an annual deferral is not adjusted to reflect gain or loss allocable to the compensation deferred. If, however, the amount of compensation deferred under the plan during the taxable year is subject to a substantial risk of forfeiture, the amount of compensation deferred must be adjusted to reflect gain or loss allocable to that amount until there is no longer a substantial risk of forfeiture, at which time the amount deferred, as adjusted, is taken into account as an annual deferral in the taxable year in which the substantial risk of forfeiture lapses.[27]

Basic Contribution Limit Applies to Salary Reduction and Employer Contributions Combined

Compensation deferred under a 457(b) plan, whether due to salary reduction contributions or nonelective employer contributions or both, are subject to a basic annual limit.[28] This basic annual limit is the lesser of—

- An indexed dollar amount ($17,500 for 2013); and

- 100 percent of the participant's compensation as defined under Code § 415(c)(3).[29]

The indexed dollar limit is the same amount as the dollar limit on elective deferrals to 401(k) and 403(b) plans under Code § 402(g), but the 457(b) basic dollar limit is separate and independent of the 402(g) limit, which does not apply to 457(b) plans.[30] Contributions to a 457(b) plan are not included in applying the limitation on annual additions under Code § 415(c)(1), but are included in determining an employee's 415(c)(3) compensation.[31]

Special Catch-Up Contribution During Last Three Years Prior to Normal Retirement Age

A 457(b) plan may provide that, for one or more of a participant's last three taxable years ending before the participant attains normal retirement age, the annual contribution limit is increased[32] to the lesser of—

- Twice the indexed dollar limit (*e.g.*, $35,000 for 2013); or

- The participant's "underutilized limitation."

Underutilized Limitation

A participant's underutilized limitation[33] is the sum of—

- The basic limit for the taxable year, that is, the lesser of 100 percent of the participant's compensation for the taxable year or the indexed dollar amount for the taxable year ($17,500 for 2013); plus

- The excess of the basic limit over the amount of the annual deferrals on behalf of the participant under the plan for any prior taxable year or years (disregarding any age-50 catch-up contributions, available only under governmental 457(b) plans).

Thus, if a participant met the basic contribution limit in all prior years, the participant would have no underutilized limitation, and the participant's special catch-up contribution would be limited to the basic limit for the current taxable year.

For purposes of determining the underutilized limitation for years prior to 2002, a participant remains subject to the rules in effect prior to the EGTRRA repeal of the coordination of amounts deferred under a 457(b) plan with amounts deferred under a 403(b) or 401(k) plan, a simplified employee pension plan (SEP) under Code § 408(k), a SIMPLE retirement account under Code § 408(p), and contribution amounts deductible under a plan described in Code § 501(c)(18). Treasury Regulations explain the application of special rules for purposes of determining the underutilized limitation for years prior to 2002.[34]

Normal Retirement Age

The plan must specify the normal retirement age for purposes of the special catch-up, which can be any age, not later than age 70½, on or after the earlier of: (1) age 65 (age 40, in the case of qualified police or firefighters as defined under Code § 415(b)(2)(H)(ii)(I)) or (2) the age at which a participant has the right to retire under the basic defined benefit plan of the governmental or tax-exempt entity (in which the participant also participates) and receive an unreduced benefit under the defined benefit plan.[35] If a participant is not eligible to participate in a defined benefit plan, but participates in a money purchase pension plan of the governmental or tax-exempt entity, then the age at which a participant has the right to retire and receive an unreduced benefit under the money purchase pension plan applies instead. Alternatively, the plan may permit the participant to designate a normal retirement age within the age ranges stated above. A participant cannot have more than one normal retirement age for purposes of the special catch-up, even if the employer sponsors more than one 457(b) plan.

Distributions due to Severance from Employment

Generally, amounts deferred under an eligible plan may not be paid to a participant or beneficiary before the participant has a severance from employment with the eligible employer or when the participant attains age 70½, if earlier. Exceptions to the general rule include distributions on account of an unforeseeable emergency, certain distributions of small accounts, distributions relating to domestic relations orders, and corrective distributions of excess deferrals.[36]

Severance from Employment

An employee has a severance from employment with the eligible employer if the employee dies, retires, or otherwise has a severance from employment with the eligible employer. An employee has a severance from employment when the employee ceases to be an employee of the employer maintaining the plan. An employee does not have a severance from employment if, in connection with a change of employment, the employee's new employer maintains the plan with respect to the employee.[37]

Independent Contractors

An independent contractor has a severance from employment with an eligible employer upon the expiration of the contract (or in the case of more than one contract, all contracts) under which services are performed for the employer, if the expiration constitutes a good-faith and complete termination of the contractual relationship.[38] If the employer anticipates a renewal of a contractual relationship or the independent contractor becoming an employee, the expiration does not constitute a good faith and complete termination of the contractual relationship. An employer is considered to anticipate the renewal if the employer intends to contract again for the services provided under the expired contract, and neither the employer nor the independent contractor has eliminated the independent contractor as a possible provider of services under any such new contract. An eligible employer also is considered to intend to contract again for the services provided under an expired contract if the employer's recontracting is conditioned only upon incurring a need for the services, the availability of funds, or both.

A 457(b) plan is considered to satisfy the requirement that no amounts deferred under the plan be paid or made available to a participant who is an independent contractor before the participant has a severance from employment with the eligible employer if, with respect to amounts payable to the participant, the plan provides that—

- No amount will be paid to the independent contractor before a date at least 12 months after the day on which the contract expires under which services are performed for the eligible employer (or, in the case of more than one contract, all such contracts expire); and

- No amount payable to the independent contractor on that date will be paid to the independent contractor if, after the expiration of the contract (or contracts) and before that date, the independent contractor performs services for the eligible employer as an independent contractor or an employee.[39]

Required Minimum Distributions

EGTRRA removed the special minimum distribution requirements applicable to 457(b) plans and made them subject to the minimum distribution requirements of Code § 401(a)(9) for distributions after December 31, 2001.[40] A governmental 457(b) plan is treated as having complied with Code § 401(a)(9), if the plan complies with a reasonable and good faith interpretation of Code § 401(a)(9).[41]

Distributions due to Unforeseeable Emergency

Hardship distributions from a 457(b) plan are not identical to hardship distributions from a 403(b) or 401(k) plan, but rather are distributions due to an unforeseeable emergency.[42] Whether a participant or beneficiary has an unforeseeable emergency that permits a distribution from a 457(b) plan must be determined under all the relevant facts and circumstances. There are no "safe harbor" reasons that are deemed to satisfy the 457(b) unforeseeable emergency rules, unlike the availability of safe harbor reasons for a hardship distribution under a 401(k) or 403(b) plan.[43] However, an unforeseeable emergency must be defined in a 457(b) plan document "as a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse, or the participant's or beneficiary's dependent (as defined in Section 152, and, for taxable years beginning on or after January 1, 2005, without regard to Section 152(b)(1), (b)(2), and (d)(1)(B)); loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, such as damage that is the result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary."[44]

The relevant regulations go on to state that the following may constitute an unforeseeable emergency:

- The imminent foreclosure of, or eviction from, the participant's or beneficiary's primary residence;

- The need to pay for medical expenses, including nonrefundable deductibles, as well as for the cost of prescription drug medication; and

- The need to pay for the funeral expenses of a spouse or a dependent (as defined in Code § 152, without regard to Code §§ 152(b)(1), 152(b)(2), and 152(d)(1)(B)) of a participant or beneficiary.

However, except as otherwise specifically provided above, the purchase of a home and the payment of college tuition are not unforeseeable emergencies.

A 457(b) plan is not required to permit distributions due to an unforeseeable emergency, nor is the plan required to include all events for which a distribution due to an unforeseeable emergency is permitted.[45]

Similar to hardship distributions under a 401(k) or 403(b) plan, a distribution from a 457(b) plan on account of unforeseeable emergency may not be made to the extent that such emergency is, or may be, relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets (to the extent the liquidation of such assets would not itself cause severe financial hardship), or by cessation of deferrals under the plan. Similar to hardship distributions under a 401(k) or 403(b) plan, a distribution because of an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need, which may include amounts necessary to pay for any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution. Unlike a hardship distribution from a 401(k) or 403(b) plan, there are no "safe harbor" requirements that would permit a distribution from a 457(b) plan to be deemed necessary to satisfy an emergency need.[46]

Distributions of Small Accounts

A 457(b) plan may, but is not required to, provide for a distribution of all or a portion of a participant's benefit if—

- The participant's total amount deferred (the participant's total account balance) not attributable to rollover contributions (as defined in Code § 411(a)(11)(D)) is not in excess of the dollar limit under Code § 411(a)(11)(A);
- No amount has been deferred under the plan by or for the participant during the two-year period ending on the date of the distribution; and
- There has been no prior small account distribution under the plan to the participant.

If the small account distribution requirements are met, the plan may provide that the total amount deferred for a participant or beneficiary will be distributed automatically to the participant or beneficiary or only if the participant or beneficiary so elects. The plan may substitute a specified dollar amount that is less than the total amount deferred. For example, a plan could provide for automatic distributions for up to $500, but allow a participant or beneficiary to elect a distribution if the total account balance is above $500.[47]

Distributions on Account of Qualified Domestic Relations Orders

A 457(b) plan does not become a 457(f) plan solely because its administrator or sponsor complies with a qualified domestic relations order (as defined in Code § 414(p)), including an order requiring the distribution of the benefits of a participant to an alternate payee earlier than otherwise permitted under the general rules for plan distributions. If a distribution or payment is made to an alternate payee pursuant to a qualified domestic relations order, rules similar to the rules of Code § 402(e)(1)(A) apply to the distribution or payment (*i.e.*, the alternate payee is treated as the distribute).[48]

Minimum Coverage and Nondiscrimination Testing Are Not Required

A 457(b) plan is a nonqualified plan and is not subject to the minimum coverage requirements of Code § 410(b), the nondiscrimination requirements of Code § 401(a)(4) and § 401(a)(5), nor the "universal availability" requirements of Code § 403(b)(12)(A)(ii). However, a 457(b) plan of a taxexempt employer must be limited to a select group of management or highly compensated employees, as defined under ERISA § 201(2), to satisfy the Code § 457(b)(6) requirement that a 457(b) plan be unfunded except in the case of a governmental plan.[49]

Plan Termination

A 457(b) plan may contain provisions that permit the plan to be terminated and amounts deferred to be distributed on plan termination. In order for the plan to be considered terminated, amounts deferred under the plan must be distributed to all plan participants and beneficiaries as soon as administratively practicable after termination of the plan.[50]

Plan termination is a permitted alternative to the tax consequences otherwise required for a 457(b) plan of an employer that ceases to be an employer eligible to maintain a 457(b) plan.[51] If the employer was a taxexempt organization and the plan is not terminated, the tax consequences to participants and beneficiaries in the plan are determined in accordance with Code § 451, if the employer becomes an entity other than a state or local government, or in accordance with Code § 457(f), if the employer becomes a governmental entity. In the case of a governmental plan, another alternative is to transfer the assets of the plan to a 457(b) plan of another governmental plan of another eligible employer in the same state. If the employer was a governmental employer and the plan is neither terminated nor transferred to another eligible plan within that same state, the tax consequences are determined in accordance with Code § 402(b), or Code § 403(c) for assets held in an annuity contract, and the governmental plan's trust is no longer to be treated as a trust that is exempt from tax under Code § 501(a).

Defined Contribution or Defined Benefit Plan

A 457(b) plan can be either a defined contribution plan or a defined benefit plan. Most 457(b) plans are defined contribution plans; defined benefit 457(b) plans are rare.[52] If the 457(b) plan is a defined benefit plan, the annual deferral for a taxable year is the present value of the increase during the year of the participant's accrued benefit that is not subject to a substantial risk of forfeiture (disregarding any such increase attributable to prior annual deferrals). Present value must be determined using reasonable actuarial assumptions and methods (both individually and in the aggregate), as determined by the IRS.[53]

Effect of Vesting Schedule on Federal Income Taxation

Including a vesting schedule in a 457(b) plan can produce adverse federal income tax consequences for a participant, because the amount of compensation deferred, whether by salary reduction or by nonelective employer contribution, is taken into account as an annual deferral in the taxable year of the participant in which deferred or, if later, the year in which the amount of compensation deferred is no longer subject to a substantial risk of forfeiture.[54] A vesting schedule can create excess deferrals that, unless corrected by a timely distribution (discussed in a subsequent section of this article), are taxed under the rules for a 457(f) plan.[55]

Example: An eligible employer maintains a 457(b) plan with a three-year cliff vesting schedule (*i.e.*, the participant becomes 100 percent vested after three years of service) that does not permit salary reduction contributions. An employee becomes a participant in the plan at the start of 2011. The employer contributes the maximum basic limit on behalf of the participant: $16,500 in 2011, $17,000 in 2012, and $17,500 in 2013, for a total of $51,000 in nonelective contributions. The participant's compensation exceeds the employer's nonelective contribution amount in each of those years and the participant is not eligible for any catch-up contributions. At the end of 2013, the participant's account balance is $55,000, which includes $4,000 in earnings. The participant fully vests at the end of 2013, when the annual deferral dollar limit is $17,500, so the amounts vesting greater than $17,500 are excess deferrals under 457(b). The excess of $37,500 ($55,000 account balance minus the $17,500 deferral limit for 2013) becomes subject to federal income taxation in 2013, whether distributed that year or not.

If the plan in the example above had immediately vested the participant in each year's nonelective contribution, there would be no excess deferrals. The annual limit would have been satisfied in each year separately and for the three years in the aggregate, and the earnings would have been disregarded for purposes of the annual 457(b) limit. When the amount of compensation deferred under the plan during a taxable year is not subject to a substantial risk of forfeiture, the amount taken into account as an annual deferral is not adjusted to reflect gain or loss allocable to the compensation deferred.

DIFFERENCES BETWEEN 457(B) PLANS OF TAX-EXEMPT AND GOVERNMENTAL EMPLOYERS

Despite the many rules in common, there are a number of significant differences between a 457(b) plan of a tax-exempt employer and that of a governmental employer. Many of the differences are what make governmental 457(b) plans more like qualified plans.

Eligible Employees

Common law employees may be participants in a 457(b) plan, but the plan can limit which employees may participate. Independent contractors providing services to the employer also may be permitted to participate.

Tax-Exempt Employer

A 457(b) plan of a taxexempt employer must be limited to a select group of management or highly compensated employees of the employer, as defined under ERISA § 201(2), to satisfy the Code § 457(b)(6) requirement that a 457(b) plan of a nongovernmental eligible employer be unfunded.

Governmental Employer

A 457(b) plan of a governmental employer may cover some or all common law employees of the employer, as there are no minimum coverage requirements.

Trust Requirement

A governmental 457(b) plan is subject to a trust requirement, while assets of a 457(b) of a tax-exempt employer must remain subject to the claims of the employer's creditors.

Tax-Exempt Employer

A 457(b) plan of a tax-exempt entity must be unfunded. Plan assets, regardless of whether or not the amounts were deferred pursuant to a salary reduction agreement, must not be set aside for participants or their beneficiaries. The plan must provide that all amounts deferred under the plan, all property and rights to property (including rights as a beneficiary of a contract providing life insurance protection) purchased with such amounts, and all income attributable to such amounts, property, or rights, must remain (until paid or made available to the participant or beneficiary) solely the property and rights of the employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the employer's general creditors. Any funding arrangement under an eligible plan of a tax-exempt entity that sets aside assets for the exclusive benefit of participants violates this requirement, and, generally, amounts deferred are immediately includible in the gross income of plan participants and beneficiaries. Nevertheless, participants and their beneficiaries may be permitted to elect among different investment options available under the plan.[56] A trust under which the assets remain subject to the claims of the employer's creditors (*e.g.*, a "rabbi" trust) can satisfy the requirement that the plan remain unfunded.[57]

Governmental Employer

All amounts deferred under a governmental 457(b) plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights, must be held in trust for the exclusive benefit of plan participants and their beneficiaries. If a trust and governmental plan satisfy the requirements of 457(b), the trust is treated as an organization exempt from tax under Code § 501(a), and a participant's or beneficiary's interest in amounts in the trust is includible in the gross income of the participants and beneficiaries only to the extent, and at the time, otherwise required for inclusion under a governmental 457(b) plan. The trust must be established pursuant to a written agreement that constitutes a valid trust under applicable state law. The terms of the trust must make it impossible, prior to the satisfaction of all liabilities with respect to participants and their beneficiaries, for any part of the assets and income of the trust to be used for, or diverted to, purposes other than for the exclusive benefit of participants and their beneficiaries. Custodial accounts and annuity contracts described in Code § 401(f) are treated as trusts, provided they satisfy certain regulatory requirements. The use of a custodial account or annuity contract as part of a governmental plan does not preclude the use of a trust or another custodial account or annuity contract as part of the same plan, provided that all such vehicles satisfy the requirements of Code § 457(g)(1) and Code § 457(g)(3) and corresponding regulations and that all assets and income of the plan are held in such vehicles.[58]

Roth Contributions

Roth contributions are not permitted in a 457(b) plan of a tax-exempt employer. The Small Business Jobs Act of 2010 (SBJA) provided that governmental 457(b) plans are permitted to include designated Roth accounts for taxable years beginning after 2010 such that a participant may elect to make designated Roth contributions *in lieu* of all or a portion of the elective deferrals that the participant otherwise would be eligible to make under the plan, provided that the requirements of Code § 402A are satisfied. The SBJA further provided that in-plan Roth rollovers of eligible rollover distributions from a governmental 457(b) plan may be permitted, if the plan so provides, but can only be made within a plan containing a qualified Roth contribution program from accounts other than designated Roth accounts, and only if the otherwise applicable rollover requirements of Code § 457(e)(16) are satisfied. Because distributions from a 457(b) plan generally are not permitted until the participant has a severance from employment, this meant that in-plan Roth rollovers generally were not possible until the participant had a severance from employment. However, the American Taxpayer Relief Act of 2012 amended Code § 402A(c)(4) such that a governmental 457(b) plan may provide for an individual to elect to have the plan transfer any amount not otherwise distributable under the plan to a designated Roth account maintained for the benefit of the individual after 2012. Such a transfer is treated as an in-plan Roth rollover of an eligible rollover distribution from the plan, which was then contributed in a qualified rollover contribution to the plan, and shall not be treated as violating Code § 457(d)(1)(A).[59]

Age-50 Catch-Up Contributions

Age-50 catch-up contributions under Code § 414(v) are not permitted in a 457(b) plan of a tax-exempt employer. A governmental 457(b) plan may provide for catch-up contributions for a participant aged 50 by the end of the year, in accordance with Code § 414(v) and the regulations thereunder, provided that such age-50 catch-up contributions do not exceed the catch-up limit under Code § 414(v)(2) for the taxable year. However, if a participant also is eligible for the special 457(b) catch-up in the final three years before normal retirement age, the participant is only eligible for the larger of the special 457(b) or age 50 catch-up, but not both.[60] Age-50 catch-up contributions made in accordance with Code § 414(v) are not counted against the annual basic limit.[61]

Rollover Contributions

Contributions of eligible rollover distributions from an eligible retirement plan under Code § 402(c) are not permitted to a 457(b) plan of a tax-exempt employer. A governmental 457(b) plan may accept contributions of eligible rollover distributions from an eligible retirement plan as defined under Code § 402(c), if the plan provides for such rollover contributions. Rollover contributions are not taken into account for purposes of the annual limit on annual deferrals. A governmental 457(b) plan that permits rollover contributions is required to provide that it will separately account for any eligible rollover distributions it receives. A plan may separately account for particular types of rollover contributions (*e.g.*, it can maintain a separate account for rollover contributions attributable to annual deferrals made under other governmental 457(b) plans and a separate account for amounts attributable to other rollover contributions), but any such separate account cannot include any amount not attributable to an eligible rollover distribution received by the plan.[62]

Deferrals in Excess of Limits

Any amount deferred under a 457(b) plan for the taxable year of a participant that exceeds the maximum deferral limitations, and any amount that exceeds the "individual limitation," constitutes an excess deferral that is taxable in accordance with Code § 457(f) for that taxable year. Excess deferrals, whether due to salary reduction or nonelective contributions, are subject to inclusion in income in the year deferred or, if later, the first year in which there is not substantial risk or forfeiture, whether made to a 457(b) plan of a taxexempt employer or a governmental employer.[63] However, the ability to correct excess deferrals is different between tax-exempt and governmental employers.

Individual Limitation

For purposes of determining the amount excluded from a participant's gross income in any taxable year (including the underutilized limitation), the participant's annual deferral under all 457(b) plans must be determined on an aggregate basis. The "individual limitation" equals the annual deferral limitation, applied by taking into account the combined annual deferral for a participant for any taxable year under all eligible plans. The individual limitation applies to eligible plans of all employers for whom a participant has performed services, including eligible plans of a governmental entity and eligible plans of a tax-exempt entity and including all eligible plans of the employer and other employers. To the extent that the combined annual deferral amount exceeds the maximum deferral limitation, the amount is treated as an excess deferral.

A 457(b) plan may provide that an excess deferral resulting solely from a failure to comply with the "individual limitation" for a taxable year may be distributed to the participant, with allocable net income, as soon as administratively practicable after the plan determines that the amount is an excess deferral. Although a plan will still maintain eligible status if excess deferrals due to the individual limitation are not distributed, a participant must include the excess amounts in income.[64]

Tax-Exempt Employer

A 457(b) plan of a tax-exempt employer that has excess deferrals will become subject to Code § 457(f) and the plan's benefits are taxed accordingly. However, a plan may distribute to a participant any excess deferrals (and any income allocable to such amount) not later than the first April 15th following the close of the taxable year of the excess deferrals. In such a case, the plan will continue to be treated as a 457(b) plan. However, any excess deferral must be included in the gross income of a participant for the taxable year of the excess deferral.

If the excess deferrals are not timely corrected by distribution, the plan is an ineligible plan under which benefits are taxable in accordance with Code § 457(f). For purposes of determining whether there is an excess deferral resulting from a failure of a plan to apply the limitations, all eligible plans under which an individual participates by virtue of his or her relationship with a single employer are treated as a single plan.[65]

Governmental Employer

A governmental 457(b) plan must provide that any excess deferral under the plan (computed without regard to the individual limitation) will be distributed to the participant, along with allocable net income, as soon as administratively practicable after the plan determines that the amount is an excess deferral. 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). If such excess deferrals are not timely corrected by distribution, the plan will be an ineligible plan under which benefits are taxable in accordance with Code § 457(f).[66]

Taxation of Distributions

When an amount deferred under a 457(b) plan is includible in the gross income of a participant or beneficiary depends on whether the plan is a governmental plan or a plan of a tax-exempt entity.

Governmental Employer

Amounts deferred under a governmental plan generally are includible in the gross income of a participant or beneficiary for the taxable year in which paid to the participant or beneficiary under the plan. As noted above, a spouse or former spouse is treated as the distributee with respect to payments to the spouse or former spouse pursuant to a qualified domestic relations order.[67] Eligible rollover distributions from a governmental 457(b) plan that are timely and effectively rolled over to an eligible retirement plan are not includible in the gross income of a participant or beneficiary (or alternate payee) for the taxable year in which the rollover distribution is made.[68]

Tax-Exempt Employer

Amounts deferred under a 457(b) plan of a tax-exempt employer are includible in gross income of a participant or beneficiary for the taxable year in which paid or otherwise made available to the participant or beneficiary under the plan. (Amounts are not considered made available merely because the participant or beneficiary is permitted to choose among various investments under the plan.) The amounts are includible in the year first made available under the terms of the plan, even if the amounts are not distributed.[69]

Made Available. Generally, amounts deferred under a 457(b) plan of a tax-exempt employer are considered made available at the earliest date, on or after severance from employment, on which the plan allows distributions to commence, but not later than the date on which required minimum distributions must begin under Code § 401(a)(9). For example, if a plan permits distribution to commence 60 days after the close of the plan year in which the participant has a severance from employment with the employer, amounts deferred are considered to be made available 60 days after the close of the plan year. However, distributions may be deferred through an initial election to defer and through one additional election to defer in accordance with rules described below, without being treated as made available merely because the plan allows such elections. In addition, no portion of a participant or beneficiary's account is treated as made available merely because the provisions of the plan permit the participant or beneficiary to elect to receive a distribution in the event of an unforeseeable emergency or for which the total amount deferred is not in excess of the dollar limit under Code § 411(a)(11)(A).[70]

Initial Election. An eligible plan of a tax-exempt entity may provide a period for making an initial election, during which the participant or beneficiary may elect to defer the payment of some or all of the amounts deferred to a fixed or determinable future time. The period for making this initial election must expire prior to the first time that any such amounts would be considered made available under the plan. A change in election made during the initial election period is still considered an initial election, rather than an additional election described below. If no initial election is made by a participant or beneficiary, then the amounts deferred generally are considered made available and taxable to the participant or beneficiary at the earliest time, on or after severance from employment, that distribution is permitted to commence under the terms of the plan, but not later than when distributions must begin pursuant to Code § 401(a)(9). The plan may provide for a default payment schedule that applies if no election is made, under which the amounts deferred are includible in the gross income of the participant or beneficiary in the year the amounts deferred are first made available under the terms of the default payment schedule.[71] Thus, if each payment is actually paid when first made available under the default schedule, each payment becomes taxable when actually paid.

Additional Election. The plan is permitted to provide that a participant or beneficiary who has made an initial election may make one additional election to defer, but not accelerate, commencement of distributions under the plan. This additional election is made after the initial election period ends and must be made before distributions have commenced in accordance with his or her initial deferral election. Amounts payable are not treated as made available merely because the plan allows such an additional election. A participant or beneficiary is not precluded from making an additional election merely because the participant or beneficiary previously has received a distribution due to an unforeseeable emergency, has received a small amount distribution, has made (and revoked) other deferral or method of payment elections within the initial election period, or is subject to a default payment schedule under which the commencement of benefits is deferred (*e.g.*, until age 65).[72]

Payment Method Election. The plan may provide that an election as to method of payment (such as a lump sum or installments) may be made at any time prior to the time the amounts are distributed in accordance with the participant or beneficiary's initial or additional election to defer commencement. If the payment method is timely elected, amounts are taxable when paid (unless taxable earlier for some other reason, such as a right granted under the payment method for the employee to accelerate payments at any time). If no method of payment is elected (or is not timely elected), the entire amount deferred will be includible in the gross income of the participant or beneficiary when the amounts first become made available in accordance with a participant's initial or additional elections to defer, unless the plan provides for a default method of payment, in which case amounts are considered made available and taxable when paid under the terms of the default payment schedule.[73]

Plan Transfers

Transfers between 457(b) plans are possible, but transfers between a governmental 457(b) plan and a 457(b) plan of a tax-exempt organization are not permitted. Following a transfer of any amount between plans, the transferred amount is subject to distribution restrictions in the receiving plan in the same manner as if the transferred amount had originally been deferred under the receiving plan, if the participant is performing services for the entity maintaining the receiving plan. If the transfer is between 457(b) plans of tax-exempt entities, the transferred amount is subject to the requirements as to when amounts are considered made available in the same manner as if the elections made by the participant or beneficiary under the transfering plan had been made under the receiving plan, except as may otherwise be determined by the IRS.[74]

Tax-Exempt Employer

A transfer from a 457(b) plan of a tax-exempt employer to another 457(b) plan of a tax-exempt employer is permitted if: (1) both plans provide for such transfers, (2) the participant or beneficiary will have an amount deferred immediately after the transfer at least equal to the amount deferred immediately before the transfer, and (3) if the transfer is for a participant, the participant has had a severance from employment with the transfering plan employer and is performing services for the entity maintaining the receiving plan.[75]

Governmental Employer

A transfer from a governmental 457(b) plan to another governmental 457(b) plan is permitted if: (1) both plans provide for such transfers, (2) the participant or beneficiary will have an amount deferred immediately after the transfer at least equal to the amount deferred immediately before the transfer, and (3) certain other requirements are satisfied, depending on whether the transfer is on account of a severance from employment, a transfer of all plan assets, or to another plan of the same employer, as follows:[76]

- The transfer is for a participant, the participant has had a severance from employment with the transferring employer, and the participant is performing services for the entity maintaining the receiving plan;

- The transfer is to another governmental 457(b) plan within the same state, all of the assets held by the transfering plan are transferred, and the participants or beneficiaries whose deferred amounts are being transferred are not eligible for additional annual deferrals in the receiving plan unless they are performing services for the entity maintaining the receiving plan; or

- The transfer is to another governmental 457(b) plan of the same employer (but the employer is not the same if the participant's compensation is paid by a different entity) and the participant or beneficiary whose deferred amounts are being transferred is not eligible for additional annual deferrals in the receiving plan unless he or she is performing services for the entity maintaining the receiving plan.

In addition, a governmental 457(b) plan maintained by a state may provide for the transfer of amounts deferred by a participant or beneficiary to a defined benefit governmental plan, as defined by Code § 414(d), that is qualified under Code § 401(a) and maintained by a state, but only if the transfer is either for the purchase of permissive service credit (as defined in Code § 415(n)(3)(A)) in the receiving governmental defined benefit plan or a repayment to which Code § 415 does not apply by reason of Code § 415(k)(3). However, a qualified plan may not transfer assets to a governmental 457(b) plan or to a 457(b) plan of a tax-exempt entity, and a governmental 457(b) plan or 457(b) plan of a tax-exempt entity may not accept such a transfer.[77]

Rollover Distributions

Eligible rollover distributions from an eligible retirement plan under Code § 402(c) do not include distributions from a 457(b) plan of a tax-exempt employer. A distribution from a governmental 457(b) plan can be rolled over to an eligible retirement plan if the distribution satisfies the requirements of Code § 457(e)(16) and the receiving plan accepts such rollovers. An eligible retirement plan for this purpose includes a 403(b) plan, another governmental 457(b) plan, a Code § 403(a) annuity plan, an individual retirement account or annuity under Code § 408, or a defined benefit or defined contribution plan qualified under Code § 401(a), such as a 401(k) plan.[78]

Plan Loans

A 457(b) plan of a tax-exempt employer is not permitted to provide loans, because any amount deferred under the plan received as a loan is treated as having been paid or made available in violation of the distribution requirements of Code § 457(d). Whether the availability or making of a loan, or the failure to repay a loan, from a governmental 457(b) plan is treated as a distribution (directly or indirectly), or is otherwise a violation of the requirements of Code § 457(b), depends on the relevant facts and circumstances. Among the relevant facts and circumstances is whether the loan has a fixed repayment schedule, bears a reasonable rate of interest, and has repayment safeguards to which a prudent lender would adhere. For example, a loan must bear a reasonable rate of interest in order to satisfy the exclusive benefit requirement of Code § 457(g)(1). Except to the extent the loan satisfies Code § 72(p), any loan amount to a participant or beneficiary (including any pledge or assignment treated as a loan) is includible in the gross income of the participant or beneficiary for the taxable year in which the loan is made.[79]

Permissive Withdrawals from Automatic Contribution Arrangements

Permissive withdrawals, as allowed under Code § 414(w) for governmental 457(b) plans, facilitate automatic enrollment by providing limited relief from the distribution restrictions under Code § 457(d)(1)(A) in the case of an eligible automatic contribution arrangement (EACA). An automatic contribution arrangement (ACA) is a cash or deferred arrangement which provides that, in the absence of an affirmative election by an eligible employee, a default election applies under which the employee is treated as having made an election to have a specified salary reduction contribution made under the plan. More specifically, an EACA is an ACA under which: (1) a participant may elect to have the employer make payments either as contributions under the plan on behalf of the participant or to the participant directly in cash; (2) the participant is treated as having elected to have the employer make such contributions in an amount equal to a uniform percentage of compensation provided under the plan until the participant specifically elects not to have such contributions made (or specifically elects to have such contributions made at a different percentage); and (3) participants are provided a notice that satisfies the requirements of Code § 414(w)(4).[80]

A governmental 457(b) plan that contains an EACA is permitted to allow employees to elect to receive a distribution equal to the amount of default elective contributions (and attributable earnings) made with respect to the employee beginning with the first payroll period to which the EACA applies to the employee and ending with the effective date of the election. The election must be made within 90 days after the date of the first default elective contribution with respect to the employee under the plan. The amount of the distribution is includible in gross income for the taxable year in which the distribution is made, but is not subject to the additional income tax under Code § 72(t).

Qualified Military Benefits

Certain rules relating to qualified military service, within the meaning of the Uniformed Services Employment and Reemployment Rights Act (USERRA) and Code § 414(u)(5), apply to 457(b) plans, although certain survivor benefits only apply to governmental 457(b) plans.[81]

Differential Wage Payments

Differential wage payments must be treated as compensation for purposes of applying the Code, such as for purposes of Code § 415(c)(3), but are not required to be treated as compensation for purposes of determining contributions and benefits under a 457(b) plan. A differential wage payment is any payment which: (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services while on active duty for a period of more than 30 days, and (2) represents all or a portion of the wages the individual would have received from the employer if the individual were performing service for the employer.[82] A plan will not be treated as failing to satisfy the requirements of 457(b) by reason of any contribution or benefit based on differential wage payments only if all employees of the employer (as determined under Code §§ 414(b), 414(c), 414(m), and 414(o)) performing service in the uniformed service (as described in Code § 3401(h)(2)(A)) are entitled to receive differential wage payments on reasonably equivalent terms and, if eligible, to make contributions on reasonably equivalent terms based on the differential wage payments.[83]

Deemed Severance from Employment

An individual must be treated as having been severed from employment during any period the individual is performing service in the uniformed services while on active duty for a period of more than 30 days, but a 457(b) plan is not required to provide for distributions upon such deemed severance from employment under Code § 414(u)(12)(B). A plan that does provide for distributions upon such deemed severance from employment also must provide that an individual receiving the distribution may not make an elective deferral or employee contribution during the six-month period beginning on the date of the distribution.[84]

Make-Up Deferrals

If a 457(b) plan provides for elective deferrals, the plan must permit an employee returning from qualified military service to make-up elective deferrals for the period of qualified military service in accordance with Code § 414(u)(2) and, if applicable, provide matching contributions corresponding to those make-up deferrals.[85]

Service Crediting

A period of qualified military service must be credited for purposes of vesting service under a 457(b) plan and for purposes of determining the accrual of benefits under a 457(b) plan upon return from qualified military service in accordance with Code § 414(u)(8)(B) and an individual's USERRA reemployment rights.[86] Such a reemployed individual must be treated as not having a break in service with the employer maintaining a 457(b) plan by reason of the individual's period of qualified military service in accordance with Code § 414(u)(8)(A).

Treatment of Individuals Who Die or Become Disabled

A 457(b) plan may, but is not required to, treat an individual who dies or becomes disabled while performing qualified military service, for contribution or benefit accrual purposes, as if the individual had resumed employment in accordance with the individual's USERRA reemployment rights on the day preceding the death or disability and then terminated employment on the actual date of death or disability. If the plan so provides, all individuals performing qualified military service with respect to the employer maintaining the plan who die or become disabled as a result of performing qualified military service prior to reemployment by the employer must be credited with service and benefits on reasonably equivalent terms. The amount of employee contributions and the amount of elective deferrals of an individual treated as reemployed must be determined on the basis of the individual's average actual employee contributions or elective deferrals for the lesser of the 12-month period of service with the employer immediately prior to qualified military service or the actual length of continuous service with the employer. A plan including such provisions must provide vesting service for the period of qualified military service of an individual who dies while performing such service and may, but is not required to, provide vesting service for the period of qualified military service of an individual who becomes disabled while performing such service.[87]

Survivor Benefits under a Governmental 457(b) Plan

A governmental 457(b) plan must provide that the survivors of a participant who dies while performing qualified military service are entitled to any additional benefits (other than contributions or benefit accruals relating to the period of qualified military service) that would be provided under the plan if the participant had resumed employment and then terminated employment on account of death.[88] Such benefits include accelerated vesting, ancillary life insurance benefits, and other survivor's benefits provided under a plan that are contingent on a participant's termination of employment on account of death. A governmental 457(b) plan must provide vesting service credit for the period of the deceased participant's period of qualified military service. If a participant would not be entitled to reemployment rights under USERRA with respect to the employer maintaining the plan had the participant applied for reemployment rights immediately before death, these rules under Code § 401(a)(37) do not apply in determining the death benefits to which the participant's survivors are entitled under the plan.

Availability of Corrections under EPCRS

Corrections under the IRS Employee Plans Compliance Resolution System (EPCRS) generally are not available to 457(b) plans. However, correction submissions are possible in certain circumstances and governmental 457(b) plans generally have a window during which corrections for failures to satisfy Code § 457(b) requirements are permitted.

Tax-Exempt Employers

A plan of a tax-exempt entity ceases to be an eligible plan on the first day that the plan fails to satisfy one or more of the requirements of Code § 457(b) and becomes subject to Code § 457(f).[89] The IRS generally will not enter into an agreement to address problems associated with 457(b) plan that is an unfunded deferred compensation plan established for the benefit of top hat employees of a tax-exempt entity. However, the IRS may consider a submission, for example, where the plan was erroneously established to benefit the entity's nonhighly compensated employees and the plan has been operated in a manner that is similar to a plan intended to satisfy the requirements of Code §§ 401(a) or 403(a).[90]

Governmental Employer

A governmental plan ceases to be an eligible governmental plan on the first day of the first plan year beginning more than 180 days after the date on which the IRS notifies the government maintaining the plan in writing that the plan is being administered in a manner inconsistent with one or more of the requirements of Code § 457(b). However, the plan may correct the inconsistencies specified in the written notification before the first day of that plan year and continue to maintain 457(b) plan status. If a plan ceases to be an eligible governmental plan, amounts subsequently deferred by participants will be includible in income when deferred, or, if later, when the amounts deferred cease to be subject to a substantial risk of forfeiture, as provided under Code § 457(f). Amounts deferred before the date on which the plan ceases to be an eligible governmental plan, and any earnings thereon, will be treated as if the plan continues to be an eligible governmental plan and will not be includible in participant's or beneficiary's gross income until paid to the participant or beneficiary.[91] Submissions to correct failures relating to a governmental 457(b) plan will be accepted by the IRS on a provisional basis outside of EPCRS through standards that are similar to EPCRS.[92]

CONCLUSION

The very different rules applicable to governmental 457(b) plans and 457(b) plans of tax-exempt entities require that eligible employers, their advisers, and employees understand the differences between the two types of 457(b) plans. This is all the more true given the increased popularity of 457(b) plans and the increasing differences in the rules applicable to governmental and nongovernmental plans. Legislative changes since EGTRRA continue to increase the differences. Employees moving between governmental and tax-exempt employers, whether as plan administrators or plan participants, may find the differences particularly confusing and appreciate assistance in sorting through them.

NOTES

1. *See* Code §§ 457(b), 457(e)(1), and 457(f) and Treas. Reg. § 1.457-2(h).
2. *See* Code §§ 457(f)(1) and 457(f)(2) and Treas. Reg. §§ 1.457-2(k) and 1.457-11(b).
3. *See* Code §§ 409A(d)(1) and 409A(d)(2). Although a plan that does not satisfy the requirements of 457(b) can become a 457(f) plan and, thereby, become subject to 409A. Due to the different election and timing rules for a 457(b) plan, becoming a 457(f) plan subject to 409A could result in substantial tax penalties and interest, particularly for a tax-exempt employer plan which has lesser opportunity to correct 457(b) failures than does a governmental 457(b) plan.
4. *See* Code § 457(a)(1).
5. *See* Code § 457(f)(1)(A) and Treas. Reg. § 1.457-11(a).
6. *See* Code § 457(f)(3)(B).
7. *See* Code § 457(b)(6); Treas. Reg. §§ 1.457-1 and 1.457-8(b); IRS Publication 4484; and ERISA § 201(2).
8. *See* Code § 457(g)(1).
9. *See* EGTRRA §§ 611(i)(1), 615(b), 632(a)(4), 641(f)(1), 646 (b), 647(c), 648(c), and 649(c).
10. *See* Code § 457(c)(2) prior to the enactment of EGTRRA.
11. *See* EGTRRA §§ 611(e) and 615(a).
12. *See* EGTRRA §§ 611(e) and 632(c).
13. *See* EGTRRA § 649(a).
14. *See* EGTRRA § 646(a)(3).
15. *See* EGTRRA § 641(a)(1).
16. *See* Code § 401(k)(3)(G) and Treas. Reg. § 1.401(k)-1(e)(4).
17. *See* Code § 401(k)(4)(B)(ii) and Treas. Reg. § 1.401(k)-1(e)(4).
18. *See* Code § 403(b)(1)(A)(ii) and Treas. Reg. §§ 1.403(b)-2(b)(8)(i)(A) and 1.403(b)-2(b)(14).
19. *See* Code § 457(b) and Treas. Reg. § 1.457-3(a).
20. *See* Rev. Proc. 2004-56.
21. Treasury Regulations under 457(b) have been updated to reflect the 415 regulations issued in 2007, but neither the model governmental plan language nor the regulations have been updated for the Pension Protection Act of 2006 (PPA); Worker, Retiree, and Employer Recovery Act of 2008 (WRERA); Heroes Earnings Assistance and Relief Tax Act of 2008; Small Business Jobs Act of 2010; or American Taxpayer Relief Act of 2012 (ATRA).
22. *See* Treas. Reg. § 1.457-4(b).
23. *See, e.g.,* IRS 457 Examination Guidelines § 4.72.19.10.1 at *http://www.irs.gov/irm/part4/irm_04-072-019.html and IRS Publication 4484*. *See also* Treas. Reg. § 1.409A-1(d)(1), which states that "a salary deferral generally may not be made subject to a substantial risk of forfeiture" and IRS Notice 2007-62, which states that Treasury and the IRS "anticipate issuing guidance regarding a substantial risk of forfeiture for purposes of § 457(f)(3)(B) under rules similar to those set forth under § 1.409A-1(d)."
24. *See* Treas. Reg. § 1.457-2(i).
25. *See* Code § 401(k)(4)(A) and Treas. Reg. § 1.403(b)-5(b)(2); *see also* D. Schwallie, "Anti-Conditioning Rule of 403(b): Do You Know Where Your Match Is?" 18 *Journal of Deferred Compensation* 7 (Fall 2012).

26. *See* Treas. Reg. § 1.457-2(b)(1).
27. *See* Treas. Reg. § 1.457-2(b)(2).
28. *See* Code §§ 457(b)(2), 457(c), and 457(e)(5) and Treas. Reg. §§ 1.457-2(b)(1) and 1.457-4(c)(1). Rollover amounts received by a governmental 457(b) plan under Treas. Reg. § 1.457-10(e) do not count against the basic contribution limit. *See* Treas. Reg. § 1.457-4(c)(1)(iii).
29. Thus, the rules for compensation under the final 415 regulations issued in 2007 generally apply. *See* Treas. Reg. §§ 1.415(c)-2 and 1.457-4(d). Also note that, prior to EGTRRA, the compensation limit was 33-1/3 percent, rather than 100 percent, of a participant's compensation.
30. *Compare* Code §§ 402(g)(1)(B), 402(g)(4), and 457(e)(15).
31. *See* Treas. Reg. §§ 1.415(c)-1(a)(2), 1.415(c)-2(b)(1), and 1.415(c)-2(d). *See also* Treas. Reg. § 1.415(c)2(f), which suggests that Code § 401(a)(17) should not apply even indirectly through 415(c)(3), since compensation is not used for purposes of applying the limitations of Code § 415 under a 457(b) plan.
32. *See* Treas. Reg. § 1.457-4(c)(3)(i).
33. *See* Treas. Reg. § 1.457-4(c)(3)(ii). A prior taxable year is only taken into account if it begins after December 31, 1978, in which the participant was eligible to participate in the plan and in which any compensation deferred under the plan during the year was subject to a basic contribution limit. *See* Treas. Reg. § 1.457-4(c)(3)(iii).
34. *See* Treas. Reg. § 1.457-4(c)(3)(iv) and the examples therein.
35. *See* Treas. Reg. § 1.457-4(c)(3)(v).
36. *See* Treas. Reg. § 1.457-6(a).
37. *See* Treas. Reg. §§ 1.457-6(b)(1) and 1.401(k)-1(d)(2).
38. *See* Treas. Reg. § 1.457-6(b)(2)(i).
39. *See* Treas. Reg. § 1.457-6(b)(2)(ii).
40. *See* EGTRRA § 649(a), Code §§ 457(d)(1)(B) and 457(d)(2) and Treas. Reg. § 1.457-6(d). Note that the temporary suspension of required minimum distributions for 2009 (due to passage of WRERA) applied only to governmental 457(b) defined contribution plans. *See* Code § 401(a)(9)(H)(i)(II).
41. *See* PPA § 823 and Treas. Reg. § 1.401(a)-1, Q&A-2(d).
42. A financial need that would permit a hardship distribution from a 403(b) or 401(k) plan may exist even if it was reasonably foreseeable or voluntarily incurred by the employee. *See* Treas. Reg. § 1.401(k)-1(d)(3)(iii)(A).
43. The safe harbor reasons for a 401(k) or 403(b) hardship distribution can be found at Treas. Reg. § 1.401(k)-1(d)(3)(iii)(B).
44. *See* Treas. Reg. § 1.457-6(c).
45. *See* Treas. Reg. § 1.457-6(c)(1) and Rev. Rul. 2010-27. Rev. Rul. 2010-27 provides two examples of distributions permitted due to unforeseeable emergency (to pay the cost of significant water damage due to a water leak discovered in the basement of the principal residence and to pay funeral expenses for an adult son who was not the participant's dependent) and one example of a request that would not be eligible for such a distribution (to pay accumulated credit card debt that was not due to any events that were extraordinary and unforeseeable arising as a result of events beyond the control of the participant).

46. The safe harbor requirements for a 401(k) or 403(b) hardship distribution to be deemed necessary to satisfy a hardship can be found at Treas. Reg. § 1.401(k)-1(d)(3)(iv)(E).
47. *See* Treas. Reg. § 1.457-6(e).
48. *See* Treas. Reg. § 1.457-10(c).
49. *See* Treas. Reg. § 1.457-8 andIRS 457 Examination Guidelines § 4.72.19.9.1 at *http://www.irs.gov/irm/part4/irm_04-072-019.html*.
50. *See* Treas. Reg. § 1.457-10(a)(1).
51. *See* Treas. Reg. § 1.457-10(a)(2).
52. *See* IRS 457 Examination Guidelines § 4.72.19.10.1 at *http://www.irs.gov/irm/part4/irm_04-072-019.html*.
53. *See* Treas. Reg. § 1.457-2(b)(3).
54. *See* IRS Notice 2003-20 for federal income tax and Federal Insurance Contributions Act (FICA) tax withholding and reporting requirements applicable to 457(b) plans for periods after December 31, 2001.
55. *See* Treas. Reg. §§ 1.457-4(c)(1) and 1.457-4(e) and the examples under those sections; *see also* D. Schwallie, "Pitfalls of a Vesting Schedule in a 457(b) Plan of a Tax-Exempt Employer," 18 *Journal of Deferred Compensation* 1 (Fall 2012).
56. *See* Treas. Reg. § 1.457-8(b).
57. *See* IRS 457 Examination Guidelines § 4.72.19.19.2 at *http://www.irs.gov/irm/part4/irm_04-072-019.html*.
58. *See* Treas. Reg. § 1.457-8(a).
59. *See* SBJA §§ 2111 and 2112, ATRA § 902, and Code § 402A. At the time of this writing, the Treasury and IRS are preparing guidance regarding ATRA changes to permit in-plan Roth conversions without a distributable event, including how to treat nonvested amounts that might be taxed upon conversion and then forfeited. *See, e.g.*, BNA *Daily Tax Report,* February 5, 2013.
60. *See* Treas. Reg. § 1.457-4(c)(2).
61. *See* Code § 414(v)(3)(A).
62. *See* Code §§ 402(c)(4), 402(c)(8), 402(c)(10), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16) and Treas. Reg. § 1.457-10(e).
63. *See* Treas. Reg. § 1.457-4(e)(1).
64. *See* Treas. Reg. §§ 1.457-4(e)(4) and 1.457-5.
65. *See* Treas. Reg. § 1.457-4(e)(3).
66. *See* Treas. Reg. § 1.457-4(e)(2).
67. *See* Treas. Reg. § 1.457-7(b)(1).
68. *See* Treas. Reg. § 1.457-7(b)(2).
69. *See* Treas. Reg. § 1.457-7(c)(1) and the examples in Treas. Reg. § 1.457-7(c)(3).
70. *See* Treas. Reg. § 1.457-7(c)(2)(i).
71. *See* Treas. Reg. § 1.457-7(c)(2)(ii).
72. *See* Treas. Reg. § 1.457-7(c)(2)(iii).
73. *See* Treas. Reg. § 1.457-7(c)(2)(iv).
74. *See* Treas. Reg. §§ 1.457-10(b)(1) and 1.457-10(b)(6).
75. *See* Treas. Reg. § 1.457-10(b)(5).

76. *See* Treas. Reg. §§ 1.457-10(b)(2), 1.457-10(b)(3), and 1.457-10(b)(4).
77. *See* Code § 457(e)(17) and Treas. Reg. §§ 1.457-10(b)(1) and 1.457-10(b)(8).
78. *See* Code §§ 457(e)(16) and 402(c). The rules of Code §§ 402(c)(2)–402(c)(7), 402(c)(9), 402(c)(11), and 402(f) are made applicable, which includes the requirement to allow nonspouse beneficiaries to roll over to an inherited IRA of the beneficiary. *See* Code § 457(e)(16)(B).
79. *See* Treas. Reg. §§ 1.457-6(f) and 1.457-7(b)(3). Loan payment suspensions under Code § 414(u)(4) are permitted.
80. *See* Code § 414(w)(5)(C) and Treas. Reg. § 1.414-1.
81. Note that the "qualified reservist distribution" generally is not applicable to 457(b) plans, because an amount distributed from a 457(b) plan is generally not subject to the 10 percent early distribution penalty under Code § 72(t). An exception would be to the extent the amount is attributable to a rollover contribution to a governmental 457(b) plan from another retirement plan that is subject to the early distribution penalty, and the amount does not qualify for an exception under Code § 72(t), such as the qualified reservist distribution. *See* Code §§ 72(t)(1), 72(t)(2)(G)(iii), 72(t)(9), and 4974(c) and IRS Notice 2010-15, Section IV. Also note that several of the provisions relating to qualified military service had retroactive effective dates and the deadlines to amend existing plans may have already passed.
82. *See* Code §§ 3401(h) and 414(u)(12)(A) and IRS Notice 2010-15, Section III, Q&A-9.
83. *See* Code § 414(u)(12)(C) and IRS Notice 2010-15, Section III, Q&A-17.
84. *See* Code § 414(u)(12)(B) and IRS Notice 2010-15, Section III, Q&A-11 and Q&A-12.
85. *See* Code §§ 414(u)(1), 414(u)(2), and 414(u)(5)–414(u)(8). It would appear that, under Code § 414(u)(8)(C), a defined benefit 457(b) plan which requires employee contributions would have to permit make-up contributions.
86. This requirement includes service for purposes of eligibility to participate as well as for purposes of vesting and benefits. *See also* USERRA Reg. § 1002.259 and the preamble to the final regulations at 70 Fed. Reg. 75,280. This requirement also means that any nonelective contribution is provided for the employee's period of qualified military service based on compensation determined under Code § 414(u)(7). *See also* USERRA Reg. §§ 1002.261 and 1002.262(a).
87. *See* Code § 414(u)(9) and IRS Notice 2010-15, Section II, Q&A-5–Q&A-8.
88. *See* Code §§ 457(g)(4) and 401(a)(37) and IRS Notice 2010-15, Section II, Q&A-1–Q&A-4.
89. *See* Treas. Reg. § 1.457-9(b).
90. *See* Rev. Proc. 2013-12 § 4.09.
91. *See* the last sentence of Code § 457(b) and Treas. Reg. § 1.457-9(a).
92. *See* Rev. Proc. 2013-12 § 4.09.