

457 Guidebook

Answers to your questions about 457 plans



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457 Guidebook

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457 Guidebook

One of the most important roles of a 457 plan sponsor is to maintain the tax-favored status of the plan for participants and beneficiaries. This Guidebook is a basic reference designed to help public sector plan sponsors understand the rules and requirements that apply to eligible governmental deferred compensation plans governed under Internal Revenue Code §457(b).

Introduction

State and local government employers may establish and maintain 457(b) deferred compensation plan for employees (and independent contractors performing services for the employer) who have elected to defer a portion of their compensation into the plan. Most public employers provide a qualified defined benefit, defined contribution or hybrid plan as their employees' primary retirement plan.

A governmental 457(b) plan, generally designed as a supplemental retirement plan, is funded by voluntary deferrals from employee wages but may be also funded with employer contributions or a combination of employer and employee contributions. Contributions and earnings in the 457 plan remain tax-deferred while in the plan and are not taxable until actually distributed to the participant from the plan.

Six legislative actions have made significant changes to governmental 457(b) plans:

- The Small Business Job Protection Act of 1996 (SBJPA)
- The Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA)
- The Job Creation and Worker Assistance Act of 2002
- The Pension Protection Act of 2006 (PPA 06)
- The Heroes Earnings Assistance and Relief Tax (HEART) Act of 2008
- The Worker, Retiree & Employer Recovery Act (WRERA) of 2008

Definition

Eligible governmental deferred compensation plan is a 457 plan established and maintained by an eligible employer that meets the requirements of IRC §457(b) and its applicable regulations.

In 2003, the Treasury Department and Internal Revenue Service issued final 457 regulations. The final regulations incorporated changes made to 457 plans under these laws and related guidance, except for changes made by PPA06, the HEART Act of 2008 and WRERA, which were enacted after the final regulations were published. Although federal tax laws have made governmental 457(b) plans more like 401(k) and 403(b) plans, significant differences remain.

In 2004, the Internal Revenue Service issued Revenue Procedure 2004-56 providing model plan amendments that governmental employers and sponsors could use to amend or draft plan documents to comply with the requirements of IRC §457(b) and its regulations. The IRS has indicated informally that it does not expect to update the model amendments to reflect changes made to 457 plans since the model amendments were originally published. A copy of the full text of the §457 regulations is available online at:

www.treas.gov/press/releases/reports/td9075finalregs457.doc

Although the 457 regulations have not been revised to include PPA 06, HEART, WRERA and other guidance issued since their publication, this guide includes these changes. Generally, plan sponsors are not required to amend their plan documents to address the various changes under PPA 06 until 2011.¹

While this guide may be used as a basic reference, employers and plan sponsors should always consult their own legal counsel and carefully review plan documents when designing, amending and administering their 457 plans.

457 Plan Basics

This section is a basic overview of the types of 457 plans, plan document requirements, eligible employers and participants, and the general governance structure of public sector plans.

Types of 457 Plans

There are two types of 457 deferred compensation plans — eligible plans [457(b) plans] and ineligible plans [457(f) plans]. A plan that meets all the requirements of IRC 457(b) is an eligible plan. A plan that does not meet the requirements of IRC 457(b) is an ineligible [457(f) plan] and is subject to different rules and tax treatment than 457(b) plans.² This guide covers only 457(b) plans of governmental employers.

Tip

Exhibit A of this booklet contains a Glossary of Terms.

Eligible Employers

The types of eligible employers that may adopt a 457(b) plan are:

- States (including the District of Columbia), local governments and any of their agencies or instrumentalities. The federal government, its agencies and instrumentalities may not establish 457(b) plans.
- Non-governmental tax exempt entities under IRC §501, except for churches and church-controlled organizations.³ Many of the rules for non governmental tax exempt plans differ from the rules that apply to governmental 457(b) plans and are not discussed in this guide.

Eligible Participants

Only employees and independent contractors who perform services for an eligible governmental employer may defer compensation into a 457 plan.⁴ The plan document establishes eligibility requirements. The document may restrict eligibility to certain employment categories (union, non-union) or employment status (e.g., full, part-time or seasonal), and include or exclude independent contractors.

Plan Document(s)

A governmental 457(b) plan must be established in writing and maintained by an eligible governmental employer. The plan document must contain all material terms and conditions for eligibility, contributions, distributions and benefits. The plan may also be designed to incorporate optional provisions

such as participant loans, unforeseeable emergency withdrawals and plan to plan transfers. The plan sponsor must ensure that the plan document is in compliance with current federal tax laws and regulations. All 457(b) plans of an employer are treated as single 457 plan even if the employer maintains more than one 457 plan.⁵

Required plan provisions and any optional provisions included in the plan must meet the form and operation requirements of the 457 regulations and subsequent interpretative guidance. Exhibit B lists the required 457 plan provisions and Exhibit C identifies optional plan provisions.

Plan Governance

Many public sector employers assign responsibility for the 457 plan to the same agency or individual responsible for the primary retirement plan (usually a defined benefit plan). Other employers may assign it to the human resource department, budget and accounting office, or other designated area within the entity. The area responsible for the 457 plan is typically referred to as the plan administrator.

Regardless of where responsibility resides, plan sponsors have a responsibility to:

- Ensure that the plan is administered operated according to its terms and to keep the plan compliance with federal as well as applicable state and local laws, and
- Base all actions and decisions regarding the plan in the best interest of participants and beneficiaries.

Government plans are not subject to the fiduciary standards, non discrimination and the reporting and disclosure requirements that apply to private sector plans under Title I of ERISA (Employee Retirement Income Security Act of 1974).⁶ State enabling legislation, statutes or local ordinances, attorney general opinions, case law and other federal laws determine any fiduciary requirements that would apply to a 457 plan. State and local government employers often review ERISA for guidance when formulating best practices for their retirement plans.

Contributions

Federal laws and regulations specify the maximum amounts public sector employees and employers can contribute to a 457(b) plan.

Deferral Agreements

Eligible employees must complete and sign a salary deferral agreement, also called a participation agreement, to voluntarily defer a portion of their wages (compensation) into the plan. This agreement designates the amount or percentage of pre-tax compensation an employee chooses to defer to the plan from each paycheck and must be completed before the first day of the calendar month the compensation would be paid or made available.

The initial agreement to defer cannot take effect before the first day of the month following the employee's completion of the deferral agreement. However, new employees may begin deferrals during the initial month of employment if the deferral agreement is completed on or before the first day the employee performs services for the employer.⁷ The deferral agreement may remain in force until the employee changes the election to increase, reduce, or stop deferrals and can be effective as soon as administratively practicable.

Governmental 457(b) plans may also include employer matching and non elective contributions. Unlike 401(k) and 403(b) plans, employer contributions to the 457 plan reduce the 457 deferral limits when those contributions vest and are subject to any applicable FICA taxes.⁸ If employer 457 matching contributions are made to a 401(a) defined contribution plan, they will not reduce the deferral limit and would not be subject to any FICA taxes. For these reasons, employers often make matching contributions and other employer contributions to a 401(a) defined contribution plan.

An employer may also establish mandatory 457 employee contribution arrangements, that require employees as part of the employment contract to contribute a portion of their compensation to the plan. These mandatory 457 contribution plans (referred to as Social Security replacement plans) are used instead of covering workers under Social Security.

All 457 Social Security replacement plans are subject to the contribution and distribution rules of the 457 plan and not the rules that apply Social Security. Social Security replacement plans generally require participants and employers to pay Medicare taxes on employee wages.⁹ Government employers should review state laws and agreements between governmental employers and the Social Security Administration before adopting a Social Security replacement plan.

Automatic Enrollment

Governmental employers may adopt automatic enrollment programs for their 457(b) plans if permitted under state law. These arrangements automatically enroll new hires and current employees who have not voluntarily enrolled in the 457 plan.¹⁰

The plan sets a prescribed deferral amount such as 3% of compensation for automatically enrolled employees. Employees may elect not to have automatic deferrals made to the plan or they may change the percentage or amount of the deferral contribution. The plan may also permit the automatic deferral percentage to be increased annually. If an automatically enrolled employee does not provide investment direction for these contributions, the employer selects default investments for these contributions until the employee provides investment direction.

The Department of Labor has issued a final regulation for qualified investment alternatives (QDIAs) which provide ERISA plan fiduciaries with relief from fiduciary liability for investing participant assets when participants do not provide investment direction for their accounts.¹¹ Although governmental employers are not subject to these rules,¹² they may want to review the DOL default investment guidelines when developing their own default investment options.

Maximum Deferral Limits

The maximum annual salary deferral that an employee can contribute to the 457 plan, unless the plan specifies otherwise, parallels the maximum deferral limit that applies to 403(b) and 401(k) plans. This limit, excluding rollover contributions, is the lesser of:

- 100% of a participant's includible compensation, or
- An annual dollar amount as indexed under the IRC.¹³

For 2009, the maximum dollar limit per participant is \$16,500. The 457 contribution limits apply to all contributions made to all eligible 457 plans in which the employee participates regardless of employer. The 457 annual deferral limit includes all elective deferrals, any vested employer matching or non-elective contributions, and any mandatory contributions imposed by the employer.

Prior to 2002, includible compensation for 457 plans was defined as gross taxable compensation. All pre-tax deferrals to a 457(b), 401(k), 403(b), and 414(h) pick-up plans, and section 125 cafeteria plan were deducted from gross compensation to calculate maximum 457 contribution limit for the year. The Jobs Creation and Workers Assistance Act of 2002 changed the definition of includible compensation for 457(b) plans to the same definition that is used for qualified defined contribution plans under IRC 415(c)(3). Includible compensation for 457 plans now includes gross taxable

Important

When an employee makes any change in deferral amount, it is no longer an automatic deferral election.

compensation plus all pre-tax elective salary deferrals to 457, 401(k) and 403(b) plans, 125 cafeteria plans and 132(f) qualified transportation plans.¹⁴ Although the definition of compensation under 415(c)(3) now applies to 457 plans, the 415 contribution limits do not apply to 457 plans.

Roth Elective Deferrals

Roth elective deferrals are after-tax salary deferrals that are permitted in 401(k) and 403(b) plans.¹⁵ Although legislation has been proposed to permit Roth 457 elective deferrals, 457 plans cannot currently offer after-tax Roth elective deferrals or any other type of employee after-tax contribution.

Contributions of Differential Pay for Employees on Military Duty

Differential pay is all or a portion of the wages some employers pay to employees who are on active duty in the Uniformed Services which represents pay the employees would have received if still working for the employer instead of serving in the military.

Differential pay paid to all participants on active military duty for more than 30 days must now be treated as employee compensation for retirement plan purposes. The 457 plan may permit employees on active military duty to contribute all or a portion of their differential pay to their employer's 457 plan. Previously the inclusion of differential pay for defining retirement plan compensation was an optional provision under the final 415 regulations. The new rules applies for differential pay received after December 31, 2008.

Make-up Deferrals for Employees Returning from Military Service

Under the Uniformed Services Employment and Reemployment Rights Act (USERRA), employees who perform qualified military service [IRC §414(u)] must be have the opportunity to make up missed deferrals when they resume employment with their former civilian employers. These employees may elect to make additional deferrals to the plan representing deferrals they could have made if they had not been on active military duty.

The period for making up missed deferrals is generally five years after returning from military service or a period equal to three times the period of military leave, whichever is less.

Coordination of 457 Deferrals

Prior to 2002, contributions to 457 plans had to be coordinated (reduced) by deferrals to Section 403(b), Section 401(k), SEP and SIMPLE plans as well as with any other 457(b) plan - which reduced the available 457 limit for that year (\$8,500 for 2001).

Today, 457 plan deferrals are coordinated only with other 457(b) plan deferrals. The total contribution amount to all 457(b) plans (of the same

employer and 457 plans of other employers that an individual may participate in) cannot exceed the annual maximum deferral limit.¹⁶

Example: In 2009 Joe, age 45, earns \$65,000 from the school district. He participates in the school district's 457 and 403(b) plans. He is not eligible for any form of catch-up under either plan. The maximum amount, assuming both plans permit deferrals up to the maximum amount, he can defer for 2009 would be \$16,500 to the 403(b) plan and \$16,500 to the 457 plan.

Special 457 Catch-up Contributions

A 457 plan may offer participants an additional deferral opportunity using the Special 457 Catch-up provision. This optional plan provision permits participants to catch-up underutilized deferrals from prior years during any or all of the three calendar years ending before the tax year they reach the plan's normal retirement age (NRA).¹⁷ All 457(b) plans of the employer must have the same NRA.

The three-year period that the participant can catch up underutilized deferrals begins with the fourth calendar year prior to the year the participant attains the plan's NRA and ends on the final day of the calendar year before NRA is attained. To determine the age at which a participant can use the Special 457 Catch-up provision, the plan document must assign a specific NRA (e.g., age 65), or indicate the NRA is a range of ages beginning with the earliest age the participant can retire and receive an unreduced benefit from their basic defined benefit plan (or money purchase plan if not participating in a defined benefit plan) and ending at age 70½. The plan document may also specify a range of ages (between age 65 and 70½ permitting the participant to designate his or her NRA for purposes of Special 457 Catch-up.¹⁸

Example: A 457 plan document allows participants to designate an NRA (range of ages between age 65 and age 70½) for purposes of the Special 457 Catch-up. Participants who elect an NRA as age 65, can defer, under the Special 457 Catch-up Provision, in the calendar years they are ages 62, 63 and 64. This provision cannot be used in the year NRA is reached, in this case, age 65.

Governmental 457(b) plans may adopt a special rule for police and firefighters permitting them to designate an NRA earlier than the earliest age that they can retire with an unreduced benefit from their defined benefit pension plan. Alternatively, the plan document can designate a special NRA for police and firefighters, which can be as early as age 40 or a range of ages between 40 and 70½.

For Special 457 Catch-up, the total unused deferral amounts from prior years are determined by calculating the amount the participant was eligible to

Catch-up Provisions

Plan sponsors may adopt two provisions to allow participants an opportunity to increase contributions:

- 1) The Special 457 Catch-up provision and*
 - 2) The Age 50 Plus Catch-up provision.*
-

defer to the employer's 457 plan in each year (based on the IRC limit for each year and the rules that applied to those deferrals) minus the amount that the participant actually deferred. The difference is the amount the participant may be able to catch up during this three-calendar year period up to a maximum of twice the annual dollar maximum amount in effect for the year Special Catch-up contributions are being made to the plan.¹⁹

Example: For 2009 the maximum contribution including Special Catch-up would be:

	\$16,500 annual maximum
	<u>\$16,500</u> Special 457 Catch-up
	\$33,000 total maximum

Participants can use the Special 457 Catch-up only once with the employer sponsoring the plan based on under deferrals to that employer's plan and not under deferrals to another employer's 457 plan.²⁰ Although the NRA is used to determine when special catch-up may be used, participants are not required to retire on that date.

It is important to recognize the deferral coordination rule effective prior to 2002 when calculating underutilized deferrals. The calculation of underutilized deferrals must include any other deferrals contributions to 403(b), 401(k), SEP and SIMPLE plans, as well as deferrals to other 457 plans for years prior to 2002.

Example: In 2009, Bill, age 62, is within the final three-year period prior to the year he reaches the plan's NRA normal retirement age of 65. He wants to maximize his deferrals to the 457 plan using the Special 457 Catch-up option. In 2001 and in the years prior to 2001, Bill was eligible to participate in both a 401(k) plan and a 457 plan. He participated only in the 401(k) plan and deferred the maximum amount possible under the 401(k) plan. For 2002 through 2009, he participated in both plans and contributed the maximum amounts permitted to both plans.

To determine if he has any underutilized deferrals for the Special 457 Catch-up, Bill must reduce the 457 deferral limits for each year prior to 2002 by his 401(k) deferrals for the year being calculated. For years after 2001, 457 deferral limits are no longer reduced by the annual 401(k) deferral contributions.

Based on this calculation, Bill has no underutilized deferrals for the years prior to 2002 because he deferred amounts to the 401(k) plan in excess of the 457 limits. For 2002 to 2009, even though deferrals to the 401(k) plan no longer reduce amounts he may contribute to the 457 plan, he has no underutilized deferrals because he deferred the maximum amounts in each of those years to the 457 plan and is not eligible for the Special 457 Catch-up provision.

Age 50 Catch-Up

EGTRRA added another catch-up contribution for 457 participants. Participants age 50 and older may, if the plan permits, defer an additional amount (\$5,500 in 2009). The additional amount permitted under this provision will increase periodically in \$500 increments based on cost of living adjustments. Unlike the Special 457 Catch-up, the age 50 catch-up does not require underutilized deferrals from prior years.²¹

Participants are eligible to begin using the age 50 catch-up provision in the calendar year they reach age 50. The age 50 catch-up cannot be used in the same year the participant uses the Special 457 Catch-up. If a participant is eligible for both options, the one that produces the greater contribution for the participant is the one that should be used for that year.²²

Example: In 2009, Frieda, a 64 year-old plan participant, is eligible for both the Special 457 Catch-up and the age 50 catch-up contribution. She has \$4,000 in total underutilized deferrals from prior years. She could defer:

1. \$20,500 based on \$16,500 normal maximum deferral and \$4,000 in underutilized deferrals under the Special 457 Catch-up provision; or
2. \$22,000 based on \$16,500 maximum deferral limit plus \$5,500, the age 50 catch-up.

The age 50 plus catch-up provision produces the greatest deferral amount and is applied for 2009.

Deferring Sick, Vacation or Back Pay

A 457 plan may allow current employees to defer an amount representing the value of unused sick, vacation, and/or back pay to the plan. A plan offering this option is required to specify that the agreement to defer these amounts must be completed before the first of the month these amounts would be paid and the participant is considered an employee in that month. Deferrals of unused sick, vacation and back pay apply towards the 457 annual maximum deferral limit in the year they are contributed to the plan. The amount that can be deferred from unused sick, vacation and back pay, combined with regular deferrals, cannot exceed the annual maximum deferral limit for that calendar year.²³

If the participant has had a severance of (from) employment the deferral agreement is deemed to satisfy the first of the month rule if it is entered into before the amounts are paid. Post-severance deferrals may be contributed to the plan 2½ months after termination of employment or if later, by December 31 of the year termination of employment occurs.²⁴

This rule applies to post-severance deferrals only if the participant would have been paid these amounts had (s)he had continued working, or in the case of leave-related payments only if the employee could have used the

leave if employment had continued. The following examples illustrate how post-severance payments may be deferred into a 457 plan.

Example 1: George, age 62, is a participant in County X's 457 plan as well as his employer's bona fide sick and vacation pay program. The 457 plan's normal retirement age is 65. Under the terms of the 457 plan and the sick and vacation plan, George is permitted to make a one-time election to contribute amounts representing unused accumulated sick and vacation pay into the 457 plan when he terminates employment. George terminates employment on January 12, 2009 at which time his accumulated sick and vacation pay totals \$12,000.

Under the terms of the sick and vacation pay program and the 457 plan, George may defer the accumulated sick and vacation pay no later than the end of the calendar year that includes his date of severance (December 31, 2009).

Example 2: Same as above except George terminates employment on November 1, 2009. He has made regular deferrals to his 457 and has reached the maximum deferral limit for 2009. Although George cannot defer any unused sick and vacation pay into his 457 plan for 2009, he could defer his accumulated sick and vacation pay into the plan by January 15, 2010 provided the deferral does not exceed the deferral limit for 2010.

Prompt Remittance of Deferral Contributions

Participant deferrals must be transferred to the 457 trust or 457 investment providers within a period that is reasonable for proper administration of the plan. Generally this period, based on the 457 model amendments, should be no longer than 15 business days following the end of the month in which the amount would have been paid to the participant.²⁵ (Note: It is important to check if state law requires deferrals to be contributed to the plan earlier than this federal requirement.)

Excess Contributions

If a participant's total deferrals to a 457 plan during a calendar year exceed the maximum annual contribution allowed (normal deferral plus any allowable catch-up amounts), the excess amount is taxable to the participant in the year the excess deferral was made to the plan.

The plan must provide for distribution of excess deferrals and any earnings attributed to the excess deferral to the participant as soon as administratively practicable after the excess deferral has been discovered. A 457(b) plan may become a 457(f) (ineligible) plan with potentially severe tax consequences for all participants if excess contributions and earnings are not distributed to participants who made excess contributions.²⁶

Distributions

The 457 plan determines when participants may take or are required to take distributions from their 457 accounts. This section examines these rules and their application. As previously noted, plan sponsors should also review any applicable state and local laws to determine if there are additional restrictions or limitations that must be incorporated into the plan.

Timing of Distributions

The plan document, based on the federal tax code and regulations, specifies when distributions may be made from the plan. The 457 plan document may or may not incorporate all of the following permissible distribution events listed in the tax code [IRC §457(d) and §414(w)]:

- **Severance from (of) employment**—includes termination, retirement or death of the employee. Independent contractors participating in the 457 plan are considered to have a severance of employment at the expiration of their contract (If the expiration is a complete termination of the relationship between the contractor and the employer). There must be a clear expectation that no further contracts will be entered into for additional work with the employer. The regulations provide a special rule employers can follow to ensure distributions to independent contractors comply with the severance of employment requirement which must be included in their plan documents.
- **Attainment of age 70½**—The plan may permit participants who are still working at age 70½ (or older) to begin taking distributions from the plan in the calendar year they attain age 70½.
- **Unforeseeable emergency withdrawals**—If the plan document permits these withdrawals, it will include the requirements for these types of distributions. These withdrawals are permitted only for the portion of the account needed to cover the stated emergency situation.
- **Withdrawal of automatic enrollment contributions**—For plan years beginning on or after January 1, 2008, the plan may, but is not required to, permit automatically enrolled employees who elect not participate to withdraw their automatic contributions, adjusted for gains and losses, within 90 days after the first contribution is contributed to the plan for them. The withdrawn amounts are not eligible for rollover and are taxable in the year they withdrawn from the plan.

- **Withdrawals of elective deferrals for employees on active military duty**—The HEART Act of 2008 permits 457 plans to allow employees who are on active military duty for more than 30 days to withdraw their elective contributions from the 457 plan. For this purpose, employees on active military duty are considered to have terminated employment with the employer and the plan's distribution rules are not violated because of these distributions.

However, any eligible participant that makes these withdrawals must cease making elective deferrals to the plan for 6 months beginning on the date the distribution is made. This optional plan provision is effective for plan years beginning on or after December 31, 2008.

- **Distributions of smaller accounts**, or de minimis distributions, permit the plan to distribute small account balances of (\$5,000 or less), to participants with or without their consent.

Unforeseeable Emergency Withdrawals

A 457 plan may include a provision to allow participants to request an in-service distribution (severance of employment is not required) from their accounts for an unforeseeable emergency. An unforeseeable emergency is defined as severe financial hardship of the participant, dependent or beneficiary resulting from one or more of the following:

- Illness or accident of the participant or beneficiary, participant's spouse or a dependent as defined in section 152(a) of the IRC
- Loss of the participant's or beneficiary's property due to casualty (not covered by insurance) or
- Other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary

The 457 final regulations provide specific examples of what may constitute an unforeseeable emergency, such as:

- Imminent foreclosure or eviction from the participant's or beneficiary's primary residence
- Need to pay medical expenses, including non-refundable deductibles, as well as prescription drug costs
- Need to pay funeral expenses of a spouse or dependent [as defined in IRC Section 152(a)], which may include children and relatives.²⁷

Situations that don't meet the definition of unforeseeable emergency include the purchase of a home and the payment of college tuition. Plan sponsors, or their designees, should evaluate the facts and circumstances of each case to determine if it meets the requirements for an unforeseeable emergency withdrawal. Because of the subjective nature of decisions to

Unforeseeable
emergency
determinations

The decisions to approve or deny unforeseeable emergency withdrawals are subjective interpretations of the rules and how they apply to individual situations. The key to administering this provision is to consistently apply the rules and procedures for these distributions to all participants.

grant emergency distributions, it is important to document the review and determination process and to apply approvals and denials consistently.

When requesting a distribution under the unforeseeable emergency provision, **the participant must also document that a financial need exists that cannot be relieved through any other means.** Other means to alleviate the financial hardship include reimbursement or compensation from insurance, discontinuing deferrals into the plan and liquidation of assets to the extent the liquidation itself doesn't cause a financial hardship.

If the emergency withdrawal request meets the above requirements, only an amount that is reasonably necessary to satisfy the stated emergency need can be distributed. This amount may include any amounts that are necessary to pay federal, state and local income taxes (and any tax penalties) applicable to the distribution.

Under IRS Notice 2007-7, beginning in 2007, a plan may modify the unforeseeable emergency withdrawal provision to consider financial hardship situations relating to the participant's plan beneficiary, even if the beneficiary is not the participant's spouse or dependent, when determining if the withdrawal can be approved. In other words, the participant's designated plan beneficiary can be treated the same as a participant's spouse or dependent when making decisions to approve or deny a participant's unforeseeable emergency request. A plan that adopts this expanded unforeseeable emergency withdrawal provision must satisfy all other applicable requirements (e.g., withdrawal must be necessary to satisfy financial need).

Required Minimum Distributions

Required minimum distributions (RMDs) are the minimum amounts that must eventually be distributed from the plan to participants and beneficiaries. Participants and beneficiaries who do not take timely RMDs from the plan will be subject to a 50% excise tax on the amount of the required minimum distribution that should have been distributed.

Governmental 457(b) plans are generally subject to the same RMD rules that apply to qualified and 403(b) plans under section IRC 401(a)(9). In general, a plan is required to begin distributions to a participant no later than April 1 of the calendar year following the later of:

- The calendar year the participant attains age 70½, or
- The calendar year the participant retires.

Minimum distributions to participants and beneficiaries are calculated under either the:

- Life expectancy rule or
- 5 year rule.²⁹

RMD Waiver

The Worker, Retiree and Employer Recovery Act of 2008 waived the RMD requirement for 2009. See page 19 for detailed information.

Most plans distribute a participant's account balance during a participant's lifetime based on the participant's life expectancy. If, however, the participant's spouse is the sole beneficiary and at least 10 years younger than the participant, the plan may calculate participant RMDs during the participant's lifetime based on the joint life expectancies of the participant and the sole surviving spouse beneficiary.³⁰

RMD rules continue to apply after the participant's death. Generally, RMDs to beneficiaries must begin no later than December 31 of the calendar year following a participant's death if these distributions use the life expectancy rule. Alternatively, a plan may require that the plan distribute a deceased participant's account to the designated beneficiary by December 31 of the calendar year that includes the 5th anniversary of the participant's death.³¹

Example: Mary participated in County X's 457 plan and dies on June 15, 2008. Her plan requires that all designated plan beneficiaries, be paid out under the 5 year rule. Mary's designated plan beneficiaries must be paid out no later than December 31, 2013.

Under the life expectancy rule, there is a special rule if the surviving spouse is the sole beneficiary of the participant's account and if the participant dies prior to his or her required beginning date (April 1 of the calendar year after the participant would have been age 70½). In this case the sole surviving spouse beneficiary may postpone taking a distribution from the participant's account until the calendar year the participant would have attained age 70½.

Example: A 457 plan participant dies in 2008 at the age of 68. His surviving spouse is the sole beneficiary on the retirement account. He would have been age 70½ in 2011. His surviving spouse could postpone taking RMDs from his account until December 31, 2011.

Alternatively the surviving spouse could roll the deceased participant's account balance into his or her own IRA and postpone taking minimum distributions from the IRA until the surviving spouse attains age 70½.

Multiple Beneficiaries

In the above example using the life expectancy rule, if there were multiple beneficiaries instead of a sole surviving spouse beneficiary, all beneficiaries (including the spouse) would have to begin taking RMD distributions no later than December 31, 2009—the year following the calendar year of the participant's death.

If the plan uses the 5 year rule instead of the life expectancy rule, deceased Mary's account balance would have to be paid out to all beneficiaries (including a surviving spouse) no later than December 31, 2013.

Plan administrators and sponsors should review plan documents for specific requirements applicable to required minimum distributions since the RMD regulations provide a good deal of flexibility and their plan may be more restrictive than the required minimum distribution regulations.

RMD PAYMENTS 2008-2011	WAIVER OF RMD RULES FOR 2009														
RMD Payments to begin April 1, 2009	Trap for the Unwary - A participant's first-time RMD payment scheduled to begin by their RMD is not waived and must still be paid by April 1, 2009. It represents a payment that was due December 31, 2008, but was permitted to be delayed until April 1, 2009.														
Application of RMD Waiver	<table border="0"> <thead> <tr> <th data-bbox="488 499 771 527">Original date of RMD</th> <th data-bbox="771 499 1466 527">Does RMD waiver apply?</th> </tr> </thead> <tbody> <tr> <td data-bbox="488 527 771 554">April 1, 2009 (RBD)</td> <td data-bbox="771 527 1466 554">No</td> </tr> <tr> <td data-bbox="488 554 771 581">December 31, 2009</td> <td data-bbox="771 554 1466 581">Yes</td> </tr> <tr> <td data-bbox="488 581 771 609">April 1, 2010 (RBD)</td> <td data-bbox="771 581 1466 609">Yes</td> </tr> <tr> <td data-bbox="488 609 771 636">December 31, 2010</td> <td data-bbox="771 609 1466 636">No</td> </tr> <tr> <td data-bbox="488 636 771 663">April 1, 2011 (RBD)</td> <td data-bbox="771 636 1466 663">No</td> </tr> <tr> <td data-bbox="488 663 771 690">December 31, 2011</td> <td data-bbox="771 663 1466 690">No</td> </tr> </tbody> </table>	Original date of RMD	Does RMD waiver apply?	April 1, 2009 (RBD)	No	December 31, 2009	Yes	April 1, 2010 (RBD)	Yes	December 31, 2010	No	April 1, 2011 (RBD)	No	December 31, 2011	No
Original date of RMD	Does RMD waiver apply?														
April 1, 2009 (RBD)	No														
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December 31, 2010	No														
April 1, 2011 (RBD)	No														
December 31, 2011	No														
Rollovers for RMD paid for 2009 Calendar Year	<p>RMD payments are not generally eligible to be rolled over to another retirement plan. Since RMDs are waived for the 2009 calendar year, payments that would have been treated as an RMD for the 2009 calendar year may be eligible to be rolled over, (directly or indirectly) to another retirement plan.</p> <p>With respect to all or a portion of a distribution made in 2009 which is an eligible rollover distribution because it is no longer an RMD, the plan is not required to:</p> <ul style="list-style-type: none"> • Offer participants the option to directly rollover the RMD to another eligible retirement plan • Provide participants with a 402(f) special tax notice informing them of their right to directly rollover the distribution to another eligible retirement plan or • Comply with the mandatory 20% withholding rules that apply to eligible rollover distributions that are not directly rolled over. 														
Rollovers and payments based on life expectancy or installment payments	Substantially equal periodic payments that are based on life expectancy or payments paid over a specific period of 10 years are not eligible for rollover. These payments would still not be eligible for rollover, even if they would have been RMD payments for the 2009 calendar year.														
RMD Waiver and the Five-Year Rule	<p>If the plan does not make RMD payments to a beneficiary which are based on life expectancy, the plan must make distributions using the Five-Year Rule. The Rule requires a decedent's entire account balance be distributed no later than the calendar year that contains the fifth anniversary of the date of the participant's death.</p> <p>The 2009 calendar year will be disregarded in determining the date by which a decedent's entire account must be paid to a beneficiary under the Five-Year Rule. Consequently the plan will have 6 years instead of 5 years to make a complete distribution of a decedent's account balance for any 5 year period that includes the 2009 calendar year.</p>														
Amending plan for RMD waiver	<p>A governmental plan including a governmental 457(b) plan will be treated as being operated according to its terms in applying the RMD rules if the plan is amended on or before the last day of the first plan year beginning on or after January 1, 2012.</p> <p>Example: State Z's 457(b) plan is a calendar year plan and must have to be amended by December 31, 2012.</p>														

Distributions of Smaller Accounts

457 plans may, but are not required, to permit the distribution of small accounts (de minimis distributions) to participants, without a severance of employment if:

Distributions of smaller accounts *(continued)*

- The participant's total account balance (deferrals plus investment earnings) is \$5,000 or less. This dollar amount excludes any amounts rolled into the 457 plan from other plans and IRAs.
- The participant has not made any deferrals into the plan during the two-year period ending on the date of the distribution.
- There has been no prior distribution under this provision to the participant.³²

The plan may also automatically distribute amounts of \$5,000 or less with or without a participant consent.

Example: The plan document could require that distributions of smaller accounts (e.g., \$500) will be automatically distributed to participants and beneficiaries, but distributions of accounts between \$500 and \$5,000 are only permitted if the participant or beneficiary elects.

If the plan provides for mandatory distributions of account balances that are in excess of \$1,000, the employer is required to pay the distributions as a direct rollover to an IRA, if the participant does not provide distribution instructions. Employers must notify participants, in writing, that their account balance will be rolled over to an IRA unless the participant provides distribution instructions (such as a rollover to another plan or IRA or direct payment to the participant). IRS Notice 2005-5 clarifies that the automatic rollover rules apply to all qualified retirement plans, including eligible governmental Section 457 plans.

Distributions for Qualified Health, and Long-term Care Premiums

Beginning in 2007, a government plan may, but is not required to, permit retired or disabled public safety officers to elect to have a maximum of \$3,000 per year subtracted from their plan distributions and sent directly to a health or long term care provider to pay premiums. The \$3,000 limit applies to premiums paid to both insured and self-insured health care plans and cannot exceed \$3,000 from all governmental retirement plans including defined benefit, defined contribution and governmental 457(b) plans.³³

A retired or disabled public safety officer may elect to have these amounts excluded from gross income for federal income tax purposes. This favorable tax treatment is available only if retired or disabled public officers make this election on their federal income tax returns.

An eligible public safety officer is defined in federal laws for purposes of the \$3,000 federal income tax exclusion as individuals serving in a public agency in an official capacity, including,

- Professional firefighters
- Individuals involved in crime and juvenile delinquency control or reduction, or enforcement of the criminal laws (including juvenile delinquency), including, but not limited to police, corrections, probation, parole, and judicial officers
- Officially recognized or designated public employee members of a rescue squad or ambulance crew
- Officially recognized or designated members of a legally organized volunteer fire department
- Officially recognized or designated chaplains of volunteer fire departments, fire departments, and police departments.³⁴

Death and Disability Benefits For Employees On Active Military Duty

Benefit Accruals for Employees Who Die or Become Disabled on Active Military Duty

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART) which amended IRC section 414(u)(9) permits, but does not require, a 457 plan to treat employees who die or become disabled while on qualified military duty as if they had resumed employment with their former employer on the day before death or disability and terminated employment on the actual date of death or disability. This provision allows the plan to restore some or all of the benefits the employee would have been entitled to if the employee had actually resumed employment with the employer including accounting qualified military service for vesting and benefit accrual purposes.

This optional provision applies for deaths and disabilities occurring on or after January 1, 2007. Plan sponsors that want to include this provision in their plans must amend their plans by the last day of the plan year that begins on or after January 1, 2012. For calendar year plans, this amendment would have to be adopted no later than December 31, 2012.

Survivor Benefits

The HEART Act requires 457 plans to provide survivors of employees killed on qualified military duty with any additional benefits the plan would have provided if the employees had returned to work with their former employer and then terminated employment because of death. These benefits could include such benefits as accelerated vesting or life insurance proceeds but exclude benefit accruals while on qualified military duty. This provision applies for deaths occurring on or after January 1, 2007. 457 plans must be amended to reflect this provision no later than the last day of the plan year beginning on or after January 1, 2012.

Rollovers

Some taxable distributions from governmental 457(b) plans may be eligible to be rolled over and contributed to an Individual Retirement Arrangement (IRA), Roth IRA, governmental 457(b), 401(a), 401(k) or 403(b) plan.³⁵

Types of Rollovers

Direct rollover (or trustee-to-trustee transfer) is a direct transfer of assets from an eligible governmental plan to an IRA or another eligible retirement plan and is not includible in the gross income of a participant, spousal beneficiary, or spousal alternate payee until distributed from the receiving plan or IRA. Taxable distributions that are eligible for rollover, but are not directly rolled over, are subject to a mandatory 20% withholding tax.

Indirect Rollover allows a participant, spousal beneficiary or spouse or former spouse alternate payee to retain the tax deferred status of the distribution that is received from the 457 account by rolling this distribution to another eligible plan that they participate in [i.e., IRA, 401(a), 401(k), 403(b), or 457(b) governmental plan] within 60 days from the date the distribution was received.

Effect of Rollovers

Rollover contributions to the 457 plan take on the characteristics of the 457 plan except for the application of a 10% distribution tax for distributions from the rollover account that includes non-457 plan rollovers. These rollover accounts may be subject to the exceptions to the 10% penalty distribution tax that apply to qualified plans even if the rollover comes from an IRA.

Rollovers from the 457 plan take on the characteristics and requirements of the plan or IRA that accepts the rollover. The early distribution penalty, which doesn't apply to 457 distributions, may apply to rollovers from a 457 plan to an IRA or other non-457 retirement plan when distributions are subsequently made from these plans.

The 10% early distribution excise tax (10% penalty) applies to taxable distributions from these plans unless exceptions apply such as:

- Distributions eligible that are rolled over to another plan or IRA
- Distributions to participants on or after age 59½
- Distributions to participants who terminated employment in the year they are age 55 or older (This exception does not apply to IRAs)

Definition

Rollovers are distributions from a 401(a), 403(b), 457(b) plan or IRA that are eligible to be contributed to another eligible retirement plan or IRA after a distributable or access event such as severance from employment. Rollovers should not be confused with plan-to-plan transfers.

- Distributions to terminated participants, regardless of age, that are based on their life expectancy
- Distributions from the plan for public safety officers that are used to pay for health and long term care premiums
- Withdrawals from eligible automatic contribution arrangements to participants who have opted out of the plan within 90 days after the first automatic contribution is made to the plan on their behalf
- Distributions because of death or disability
- IRS tax levy
- Timely return of excess contributions and earnings³⁷

Rollovers contributions to other eligible retirement plans and traditional IRAs continue to be tax-deferred (not included in gross income of a participant, beneficiary or alternate payee when rolled over) until ultimately distributed from the receiving plan. Conversely, direct rollover contributions, except direct rollovers to a Roth IRA, from 457 plans are included in gross income of a participant, beneficiary or alternate payee in the tax year in which the rollover contributions are made to Roth IRAs. Participants, spousal beneficiaries and spousal alternate payees may be permitted to roll 457 distributions (that qualify as eligible rollover distributions) into IRAs or workplace plans in which they participate.

Governmental 457 plans may permit participants, spousal beneficiaries and alternate payees who are employees of the employer sponsoring the 457 plan to roll distributions from IRAs or other eligible plans [including Section 401(a), 401(k), 403(b) and 457(b) governmental plans] into the 457 plan provided the rollovers are tracked in a separate rollover account.³⁸ Rollover contributions do not count toward the annual contribution limits.

Rollovers from non-457 plans into the 457 plan may be still be subject to the 10% early distribution tax that applies to 401(a) qualified plans even if the rollover funds come from an IRA³⁹ The 10% distribution tax applies to taxable distributions that are made prior to the year a participant attains age 59½ unless one of the exceptions that applies to 401(a) defined contribution plans applies. Rollovers from IRAs and all other plan types into the 457 plan can be combined into a single general rollover account for record keeping purposes.

However, rollovers from another 457 plan that are combined in a general rollover account may become subject to the early distribution tax. The plan document may permit the plan to establishment two separate rollover accounts to shield 457 rollovers from this tax.

Rollover Notice

Prior to making a distribution to a participant, the plan, is required to distribute an IRC Section 402(f) special tax notice to participants, spousal beneficiaries and/or spousal alternate payees explaining rollover rules and tax consequences of not rolling eligible distributions to other retirement plans including IRAs. These notices must be distributed between 30 and 180 days prior to the distribution.³⁶

Example: A participant rolls his account balances from a previous employer's 457 plan, 403(b) plan and his IRA account balance to his current employer's 457 plan. The 457 plan establishes two rollover accounts (in addition to his normal accumulation account for ongoing deferrals) to receive the rollovers - one for the IRA, 401(a) and 403(b) rollovers and the second for the 457 rollovers.

Anytime Distributions from 457 Rollover Accounts

The plan may also allow the participant to request a distribution from the rollover account(s) at any time, even if the participant is not yet eligible for a distribution from the plan. This "anytime distribution" is permitted only if the rollover amounts are in a separate rollover account and the 457 plan document permits anytime distributions from the rollover account(s). Non-taxable plan-to-plan transfers are not rollovers and cannot be distributed under this anytime distribution rule.⁴⁰

Definition

Revenue Ruling 2004-12 clarifies that amounts rolled into a retirement plan may be distributed anytime the participant requests a distribution from the rollover account.

Direct Rollovers to Roth IRAs

Beginning in 2008, 457 plans may offer participants the option of rolling 457 account balance directly to a Roth IRA, instead of rolling the balance first to a traditional IRA and then converting the traditional IRA to a Roth IRA. Rollovers from the 457 plan to a Roth IRA will be subject to federal income tax in the year the rollover is contributed to the Roth IRA.⁴¹ Until 2010, rollovers from a 457 plan to a Roth IRA will be available only to participants with modified adjusted gross incomes of \$100,000 or less. In 2010 and later, this income limitation will no longer apply for rollovers to Roth IRAs from the 457 plan.

Rollovers for Non-Spousal Beneficiaries

Currently, an employer-sponsored retirement plan may, but is not required to, offer designated non-spouse beneficiaries of a decedent's qualified, 403(b) or 457(b) account the option of directly transferring these account balances to their own individual retirement arrangement (IRA). The IRA will be treated as an inherited IRA and subject to the distribution rules that apply to IRA beneficiaries.⁴² The retirement plan will be required to provide the IRA trustee or custodian with the name of the deceased participant, the name of the beneficiary and other applicable information the IRA trustee or custodian would need to properly administer the inherited IRA. Retirement plans will be required to offer the direct rollover option to non-spousal beneficiaries for distributions for plan years beginning after December 31, 2009. Plans will be required to provide non-spousal beneficiaries with 402(f) notices. IRS Notice 2007-7 currently exempts the plan from providing 402(f) notices to non-spousal beneficiaries and exempts non-spousal beneficiaries from the mandatory 20% withholding tax if the distribution is paid to the non-spousal beneficiary instead of being directly transferred to an inherited IRA.

Distributions not eligible for rollover

- Unforeseeable emergency withdrawals
- Required Minimum Distribution (RMD) payments
- Returned excess contributions and earnings
- Deemed participant loan distributions
- Payments based on life expectancy, or payments that are expected to last 10 or more years
- Distributions to automatically enrolled participants who opt out of an automatic enrollment arrangement within 90 days after the first contribution is made to the plan for them.⁴³

Other Plan Provisions

There are several additional optional provisions such as participant loans, service credit purchases, deemed IRAs, plan-to-plan transfers and plan termination that a sponsor may include in the design of the 457 plan document.

Participant Loans

A plan may permit participants to borrow from the 457 plan using their account balances as security for the loan. Participant loans are non-taxable and are not treated as actual plan distributions, if certain conditions are met. Plan sponsors may establish loan programs for their 457 plans provided the programs are for the *exclusive benefit of participants or beneficiaries*.

The maximum non-taxable loan amount, including loans from any life insurance contracts used as an investment option under the plan, is the lesser of:

- 50% of a participant's vested account balance in the 457 plan (excluding any balances held in a deemed IRA, which are discussed on page), or
- \$50,000 reduced by outstanding loan balances from this and other retirement plans sponsored by the employer during the preceding 12 month period.⁴⁴

457 loan programs generally follow the same rules as loans from qualified plans [under IRC §72(p) and regulation §1.72(p)1] which require that the plan's

Tip

Section 457 includes many optional provisions that can be included in the plan to provide employees with more flexibility in retirement planning. Plan Sponsors should carefully examine these additional features to determine if including them in the plan design could benefit participants.

loan program follow a bona fide borrower lender loan process which includes:

- An application procedure, an approval and denial process
- An expectation that the participant can fulfill the repayment plan
- Safeguards to require repayment as any other prudent lender, with an enforceable agreement and repayment schedule

Loans will be not be treated as a taxable distribution to the participant if:

- The loan does not exceed the loan limits described in the loan program (generally the lesser of 50% of the participant's vested account balance or \$50,000)
- The loan bears a commercially reasonable rate of interest
- Loan repayments are made at least quarterly in level payments of principal and interest over 5 years. Loans to acquire the participant's principal residence may be repaid over a longer period provided the repayment period is considered reasonable. The plan's loan program may require that loans be repaid through payroll deduction.⁴⁵

A loan is treated as a deemed taxable distribution if the participant:

- Does not make scheduled loan repayments on time,
- Does not repay the loan balance within a specified time period (as specified in the plan's loan program), or
- Obtains a loan that exceeds the IRC maximum loan limits on the loan origination date. Amounts that exceed the IRC loan limits are taxed.

When a default occurs, the remaining principal and interest accrued through the date of default are reported as a taxable distribution to the IRS although no distribution is actually made from the plan. Defaulted loans are required to be repaid and interest continues accrue until the loan is repaid.⁴⁶

Loan repayments may be suspended while an employee is on qualified military leave. Interest on loans made prior to qualified military leave will continue to accrue but generally cannot exceed 6% during qualified military leave.⁴⁷

Example: Loan of less than \$50,000 - Sue has a vested account balance in her 457 plan of \$105,000. On January 15, 2008, she obtains a \$40,000 loan from the plan. She has taken no other loans from this or any of her employer's other plans. On November 1, 2008, when she requests another loan, her outstanding loan balance is \$35,000. Her highest loan balance for the prior 12 months is \$40,000. The \$5,000 repayments reduce the \$50,000 maximum limit to 45,000. Sue may borrow up to another \$10,000 without exceeding the \$50,000 maximum loan limit.

Example: \$50,000 Loan - Jack has a vested account balance of \$200,000 and has no prior plan loans. Under the terms of the plan's loan program, the maximum amount he can borrow from his account is \$50,000 (50% of his vested account up to \$50,000). On March 1, 2008, he borrows \$50,000. He has repaid \$8,000, making his outstanding loan balance \$42,000. On December 1, 2008 he requests an additional loan of \$8,000.

Jack's maximum non-taxable loan amount on December 1, 2008 is calculated by reducing the \$50,000 maximum amount by the amount repaid during the past 12 month period, which is \$8,000. This produces a new loan maximum of \$42,000. Since his current outstanding balance equals \$42,000 and he still owes \$42,000, Jack is not eligible for an additional loan from the plan. Jack would need to wait until the next 12 month period after his original loan initiation date to be eligible for a new loan from the plan.

Example: Loan payoff and a new loan - Same as above except Jack repays his \$50,000 loan on October 1, 2008 and asks for a new loan on November 1, 2008. His available loan limit is now zero since his highest outstanding loan balance during the last 12 months was \$50,000. Jack will need to wait at least 12 months from October 1, 2008 before his loan limit will be greater than \$0.

Loan programs can be designed to use lower vested percentages and dollar limits than those permitted under the loan regulations. For example, a loan program may provide that only 40% of a participant's vested account balance may be used in calculating the maximum loan amount available. The plan does not have to allow more than one loan at a time.

Plan-to-Plan Transfers

An 457(b) plan may permit certain non-taxable plan-to-plan transfers (which are not rollovers) of participant and beneficiary account balances to another governmental 457(b) plan. Governmental 457(b) plans may accept transfers only from other governmental 457(b) plans. Both the transferring plan and the receiving plan must agree to the transfer and their plan documents must include a transfer provision.

A governmental 457(b) plan cannot transfer assets to the eligible plans of non-governmental tax-exempt entities and vice versa. Assets from ineligible 457(f) plans cannot be transferred to 457(b) plans.⁴⁸

The various permissive 457 plan-to-plan transfers and the specific conditions or restrictions that apply to each type of transfer are:

1. Post-severance plan-to-plan transfers among governmental 457(b) plans are permitted if both the transmitting and receiving plans agree to the transfer; the participant has had a severance of employment with the

transferring employer and is now working for the employer sponsoring the plan that will receive the transfer.

2. Plan-to-plan transfer of all 457 plan assets of the governmental plan may be permitted if the employer transfers all of the assets of its plan to another governmental 457 plan within the same state; participants and beneficiaries are only eligible to defer to the receiving plan if they are working for the employer maintaining the receiving plan. This option is used most frequently in lieu of plan termination when the employer no longer is eligible to sponsor a governmental 457(b) plan.
3. Plan-to-plan transfers among eligible 457 governmental plans of the same employer—if a governmental employer offers more than one eligible plan, participants and beneficiaries may transfer assets between these plans without a severance of employment provided both plans agree to the transfer.⁴⁹

Purchase of Permissive Service Credit

A governmental 457(b) plan and a 403(b) plan may also permit in-service plan-to-plan transfers of all or a portion of a participant's or beneficiary's account balance to a governmental defined benefit plan to purchase permissive service credits. This transfer is not treated as a reportable distribution for tax purposes and a severance of employment is not required.

The plan-to-plan transfer to purchase permissive service credits is typically initiated at the request of the participant or beneficiary, by the pension system. Generally, it is the pension system's responsibility to determine if the service is eligible to be purchased with 457 or 403(b) plan assets.

Under PPA 06, the definition of permissive service credit was clarified to include time periods where no service has been performed (airtime). Service can be purchased to increase benefits even if the years of service that are being purchased are already being used to determine retirement benefits (prior employee service upon which a retirement benefit is based).

Direct transfers from 457(b) and 403(b) to governmental defined benefit plans are not subject to the limits that apply to non qualified service credit purchases and are not required to be made to the governmental defined benefit plan of the same employer that is sponsoring the 457(b) or 403(b) plan.⁵⁰

Qualified Domestic Relations Orders (QDRO)

Federal law permits governmental 457(b) plan to treat domestic relations orders (DROS) as qualified domestic relations orders (QDRO) [as defined in IRC §414(p)] for distribution timing and taxation purposes. 457 plans may,

Definition

Qualified Domestic Relations Order is an order, judgment or decree generally issued by a state domestic relations court (including approval of a property settlement agreement), made pursuant to a State domestic relations law (including a community property law). The order relates to the provision of child support, alimony payments, or marital property rights to a spouse, former spouse, child, or other dependent of a participant.

but are not required to accept DROS under Federal law. State laws need to be carefully reviewed to determine if any additional requirements apply to DROs.

Under a DRO, a court may require that a portion (or all) of a participant's account balance be segregated and paid to an alternate payee (the participant's spouse former spouse or child) named in the DRO. The 457 plan administrator is usually responsible for determining the validity of the DRO before making distributions to the alternate payee. An alternate payee has the same rights of ownership of the plan account balance as the participant, but may request an immediate distribution of his or her share of the participant's account balance. A spouse or former spouse (alternate payee) may then roll this distribution to an IRA or workplace 401(a), 401(k), 403(b) or other 457(b) plan in which the alternate payee (spouse) is a participant. The spousal alternate payee who does not roll over the distribution will be liable for any taxes due on the distribution.⁵¹

Deemed IRAs

Employers establish a deemed IRA as a separate account within the 457 plan that is treated as an IRA. Voluntary employee contributions to a "deemed IRA", as designated by the employee, are treated as either traditional or Roth IRA contributions.⁵²

Final deemed IRA regulations (26 CFR Parts 1 and 602) provide employers with guidance on how to administer deemed IRAs that are part of an employer-sponsored retirement plan. Deemed IRAs are subject to the rules governing IRAs and the employer-qualified plan is subject to the rules governing the qualified plan.

Deemed IRA assets may be held in:

- Separate individual IRA trusts,
- A single trust holding both traditional and Roth IRAs that is separate from the trust for the employer-sponsored plan, or
- A single trust that includes the employer-sponsored qualified plan and the deemed IRA, but with the trustee maintaining a separate account for each deemed IRA.

Life insurance contracts are not permitted investments for IRAs. The final regulations, however, clarify that retirement plans can use a single trust for both the qualified plan and the deemed IRA—provided that deemed IRA assets are not invested in life insurance contracts. Deemed IRAs that are individual retirement annuities may be held under a single annuity contract or under separate annuity contracts. These contracts, however, must be separate from any annuity contract or contracts of the employer's retirement plan.

Definition

***Deemed IRA(s)** is a separate account or annuity under a Section 457 or other employer sponsored qualified plan that is treated and administered as an Individual Retirement Account (IRA). A deemed IRA can be either a Roth or traditional IRA.*

The deemed IRA trustee must be a bank or non-bank trustee approved by the IRS. The IRS issued final rules permitting governmental entities to serve as non-bank trustees of the deemed IRA trusts, provided governmental employers demonstrate in writing to the IRS that they are able to administer the IRA trust according to the federal laws and regulations that govern traditional and Roth IRAs and the deemed IRA will be administered in the best interest of participants and beneficiaries.

Governmental employers do not have to satisfy the net worth requirements if they have taxing authority under applicable state or local laws. The IRS Commissioner may exempt a governmental unit from other requirements.⁵³

Plan Terminations and Frozen Plans

A governmental 457(b) plan may permit the employer to terminate the plan and distribute all account balances to participants and beneficiaries.

Terminated plans must:

- Distribute account balances to all participants and beneficiaries as soon as administratively practicable after the termination of the plan, and
- Give participants the option of directly rolling their account balances to an IRA or another plan that will accept the rollover.⁵⁴

Alternatively, the plan could be frozen. Frozen plans cease accepting future contributions but must continue to comply with all requirements necessary to maintain the plan including amending the plan when necessary to incorporate any required changes.⁵⁵

457 plans may be frozen instead of terminated when governmental employers cease to be governmental employers and cannot continue to maintain 457 plans. Instead of terminating the plan and distributing plan assets to participants, these employers may transfer all plan assets to another eligible 457 governmental plan within the same state. Both plans must agree to the transfer, all assets of the frozen plan must be transferred to the receiving plan and only employees who are employees of the employer sponsoring the receiving plan are permitted to make deferrals to the plan.

457 Plan Funding Rules

Contributions to governmental 457(b) plans must be held in tax-exempt trusts, custodial accounts or annuities for the exclusive benefit of participants and beneficiaries. This section discusses the rules that apply to this requirement.

Trusts

Under federal law, plan assets must be held in 457(g) governmental trust, custodial account or an annuity contract purchased from an insurance company for the exclusive benefit of participants and beneficiaries.⁵⁶ The trust must be established in writing and a valid trust under state law. The terms of the trust must not permit the trust assets or income to be used for any reason other than for the exclusive benefit of participants and their beneficiaries. The trust protects plan assets from employer and employee creditors in bankruptcy proceedings.

Custodial Accounts and Annuity Contracts

Instead of using a trust for the governmental 457(b) plan, the plan sponsor may establish a custodial account or annuity contract which, under federal law, is treated as 457(g) trust. The custodian must be a bank, or non-bank trustee. Non-bank trustees must submit to the Internal Revenue Service a written application which demonstrates their ability to comply with IRC Section 457(g)(1) and (3).⁵⁷

Annuity contracts purchased from an insurance company are also treated as a trust in if:

- The insurance company is qualified to do business in the state that governs the public employer's plan, and
- The contract meets the requirements of the trust provisions as stated in the final regulations, other than the requirement that it be a trust.

An annuity contract that meets these conditions cannot include a life, health or accident, property, casualty or liability insurance contract. (Note: Life insurance contracts held in a custodial account may be used to fund a 457 plan.)⁵⁸

Improperly Administered Governmental 457(b) Plans

Governmental 457(b) plans that are not operated in accordance with their terms, including both required and optional design provisions, can jeopardize the tax-deferred status of the plan for participants and beneficiaries.

457(f) Contributions

Contributions to a 457(f) plan are taxable in the year they become vested even if the participant is not eligible to receive a distribution.

Failure of a governmental 457(b) plan to meet the requirements, regulations and applicable guidance under IRC §457 may result in the plan becoming an “ineligible deferred compensation arrangement”, or as described under IRC §457(f).⁵⁹ Compliance errors should be corrected as soon as possible after discovery. When the IRS audits a plan and finds compliance mistakes, it will notify the plan in writing of these mistakes. The IRS also informs the sponsor that the plan will cease to be a governmental 457(b) plan on the first day of the plan year that begins more than 180 days after the date of the IRS written notice. If the plan corrects these compliance errors before the first day of the plan year after the 180-day period, it will retain its status as a 457(b) plan.

However, if the plan ceases to remain a governmental 457(b) plan after this period, amounts after the plan status has changed will become taxable to participants and included in gross income in the year of the deferral. Any amounts deferred (as well as corresponding earnings) prior to the year that the plan becomes ineligible.

- Would continue to be treated as if they were held in a governmental 457(b) plan, and
- Would not be included in the participants’ or beneficiaries’ gross income until they are distributed.⁶⁰

Additional Information

Additional information is included as exhibits in this booklet to clarify the federal rules and guidance that govern the governmental 457(b) plans. Plan sponsors are encouraged to closely review state and local laws that may apply to these plans plan and consult their own internal legal counsel on any issues that need further clarification.

Sources

- ¹ Section 1107 of the Pension Protection Act of 2006
- ² I.R.C. §457(f); Treas. Reg. §4 1.457-9
- ³ I.R.C. §457(e)(1); Treas. Reg. §1.457-2(e).
- ⁴ I.R.C. §457(b)(1); Treas. Reg. §1.457-2(e)
- ⁵ Treas. Reg. §1.457-3(b)
- ⁶ ERISA §4(b)(1).
- ⁷ I.R.C. §457(b)(4); Treas. Reg. §1.457-4(b)
- ⁸ I.R.C. §3121(a)(5); §3121(v)(2)
- ⁹ Consolidated Omnibus Budget Reconciliation Act of 1985; Revenue Ruling 86-88; I.R.C. §121(u)
- ¹⁰ Preamble to Proposed Treas. Reg. 133300-07
- ¹¹ ERISA §404(c)(5)
- ¹² Proposed Treas. Reg. §414(w)-1(b)(4).
- ¹³ I.R.C. §457(b)(2); Treas. Reg. §1.457-4(c)(1)
- ¹⁴ I.R.C. §457(e)(5); §415 (c) (3); Treas. Reg §1.456-2(g)
- ¹⁵ Treas. Reg. §1.402A-1; §1.408A-10
- ¹⁶ Treas. Reg. §1.457-4
- ¹⁷ I.R.C. §457(b)(3); Treas. Reg. 1.457-4(c)(3)
- ¹⁸ Treas. Reg. §1.457-4(c)(3)(d)(v)(B)
- ¹⁹ Treas. Reg. §1.457-4(c)(3)
- ²⁰ Treas. Reg. §1.457-4(c)(3)(A)
- ²¹ I.R.C. §414(v); Treas. Reg. §1.457-4(c)(2)(i)
- ²² Treas. Reg. §1.457-4(c)(2)(ii)
- ²³ Treas. Reg. §1.457-4(d)
- ²⁴ Treas. Reg. §1.415(c)-2(e)(3)(ii)
- ²⁵ Treas. Reg. §1.457-8(1)(2); Revenue Procedure 2004-56, Model Amendment 2.5
- ²⁶ Treas. Reg. §1.457-4(e); §1.457-9(a)
- ²⁷ I.R.C. §457(d)(1)(A)(iii); Treas. Reg. §1.457-6(c)(2)
- ²⁸ I.R.C. §457(d)(1)(B); Treas. Reg §1.457-6(d)
- ²⁹ I.R.C. §401(a)(9); Treas. Reg. §1.401(a)(9)-3, Q&A 1(a); §1.401(a)(9)-5, Q&A 1
- ³⁰ Treas. Reg. §1.401(a)(9)-5, Q&A 4(b)
- ³¹ Treas. Reg. §1.401(a)(9)-3, Q&A 2
- ³² I.R.C. §457(e)(9)(a); Treas. Reg. §1.457-6(e)
- ³³ I.R.C. §402(l); Notice 2007-7, Q&A 22; 2007-71
- ³⁴ I.R.C. §402(l)(4)(c)
- ³⁵ I.R.C. §402(c)(8)(b)
- ³⁶ I.R.C. §402(f); Treas. Reg. §1.402(f)-1
- ³⁷ I.R.C. §72(t); §402(l); §414(w)
- ³⁸ I.R.C. §401(a)(31); Treas. Reg. 1.457-10(e)
- ³⁹ I.R.C. §72(t)(9)
- ⁴⁰ Revenue Ruling 2004-12
- ⁴¹ Treas. Reg. §1.408(a)(e)(2)(b)
- ⁴² I.R.C. §402(c)(11); Notice 2007-7 Q&A 10
- ⁴³ I.R.C. §457(e)(16(n), 402(c)(4), 414(w)(1)(b)
- ⁴⁴ I.R.C. §72(p)(1); Treas. Reg. §§ 1.72(p)-1, 1.457-6(f)
- ⁴⁵ Treas. Reg. §1.72(p)-1 Q&A 3-6
- ⁴⁶ Treas. Reg. §1.72(p)-1 Q&A 11,12,14-19
- ⁴⁷ I.R.C. §414(u)(4-5); Treas. Reg. §1.72(p)-1, Q&A 9; Service members Civil Relief Act of 2003
- ⁴⁸ Treas. Reg. §1.457-10(b)(1)
- ⁴⁹ Treas. Reg. §1.457-10(b)(2)
- ⁵⁰ I.R.C. §415(n)(3)(d); Treas. Reg. §1.457-10(b)(8)
- ⁵¹ I.R.C. §414(p); §402(e)(1); Treas. Reg. §1.457-10(c)
- ⁵² I.R.C. §408(q); Treas. Reg. §1.457-10(f)
- ⁵³ Treas. Reg. §1.408(q)(1)(2)
- ⁵⁴ Treas. Reg. §1.457-10(a)(2)(ii)
- ⁵⁵ Treas. Reg. §1.457-10(a)(2)(i)
- ⁵⁶ I.R.C. §457(g); Treas. Reg. §1.457-8(a)(2); Bankruptcy Protection Act of 2005
- ⁵⁷ I.R.C. §457(g); Treas. Reg. §1.457-8(a)(3)(b)
- ⁵⁸ I.R.C. §457(g); Treas. Reg. §1.457-8(a)(3)(b)(iii)
- ⁵⁹ I.R.C. §457 (f); Treas. Reg. §1.457-9(a); §1.457-11
- ⁶⁰ I.R.C. §457(b)(6)

Exhibit A Glossary of Terms

The definition of terms noted here are specific to 457 plans and their administration, unless otherwise noted.

Age 50 Catch-up permits participants to defer an amount in addition to the maximum deferral limit up to the limit specified in the IRC [section 414(v)] as indexed, to their deferred compensation account beginning in the year they attain age 50. This amount will not count against the deferral limit in effect for the year.

Alternate payee is the participant's spouse, former spouse, child or other dependent who is entitled to all or a portion of a participant's benefit under a court issued domestic relations order.

Annuity is a contract (issued by an insurance company or with a retirement system) to make a series of regular payments, usually over the lifetime of the participant and/or the participant's beneficiary (joint survivor option) or for a fixed period of years.

Automatic enrollment arrangements (programs) permits a plan to automatically enroll new hires and current employees who have not voluntarily enrolled the 457 plan. The plan sets a prescribed deferral amount such as 3% of compensation which may be increased in subsequent years. Employees may elect not to have automatic deferrals made to the plan or they may change the percentage or amount of the automatic deferral contribution.

Beneficiary(ies) is a person or persons designated by the participant or the plan who is entitled to benefits under the Plan after the death of a participant or as an alternate payee.

Custodial account generally refers to an account established to hold 457, 403(b), qualified plan or IRA assets. The custodian must be a bank or qualified non bank trustee.

Deemed IRA is a separate account or annuity under a Section 457 or other employer sponsored qualified plan that is treated and administered as an Individual Retirement Account (IRA). A deemed IRA can be either a Roth or traditional IRA.

Deferral means the amount of compensation deferred under an eligible plan by, or on behalf of, a participant during the calendar year.

De minimis distribution is an in-service distribution of small, inactive accounts (up to the maximum amount permitted under the IRC) that is initiated either by the participant or employer.

Differential Pay are wages some employers pay an employee who is on active duty in the Uniformed Services which represents pay the employee would have received if still working for the employer instead of serving in the military. Differential pay paid to all participants on active military duty for more than 30 days must be treated as employee compensation for retirement plan purposes and may be contributed to the 457 plan for payments made after December 31, 2008.

Direct rollover (or trustee-to-trustee transfer) is a direct transfer of assets from an eligible governmental plan to a traditional IRA or another eligible retirement plan and is not includible in the gross income of a participant, spousal or non spousal beneficiary or spousal alternate payee until distributed from the receiving plan or IRA.

Distributable event is an event that is stated in the plan document that permits participants to request and receive distributions from their deferred compensation account.

EGTRRA (Economic Growth and Tax Relief Reconciliation Act) is legislation that was enacted in 2001 that made significant changes to Section 457 deferred compensation programs.

Eligible Automatic Contribution Arrangement (EACA) is an optional plan provision that permits automatically enrolled participants who opt out of the plan to withdraw their automatic contributions within 90 days after the first automatic contribution is made to the plan for them.

Eligible governmental employer is an entity that is a State (including the District of Columbia), a political subdivision of a State, and any agency or instrumentality of a State. The federal government, its agencies and instrumentalities may not establish and maintain 457 plans. However, non governmental tax exempts (except for churches) may establish 457(b) plans but these plans are subject to different rules than the governmental 457(b) plans.

Eligible governmental deferred compensation plan is a 457(b) plan that meets the requirements of 1.457-3 to 1.457-10 that is established and maintained by an eligible governmental employer.

ERISA (Employee Retirement Income Security Act) regulates the design and administration of most private sector retirement plans in the United States and was enacted to safeguard of employee benefit plan participants and their beneficiaries. Governmental employers are not subject to ERISA.

Excess deferral is the amount that is deferred into a 457 plan during a calendar year that exceeds the annual maximum deferral limit for that year.

Includible compensation is the participant's wages in box 1 of Form W-2 for the calendar year, up to a maximum of \$200,000 as indexed, for services performed for the eligible employer plus elective deferrals to 403(b), 457(b), 401(k), and Section 125 or 132(f) plans.

Independent contractor is an individual who performs services for the eligible employer but is not considered an employee.

Indirect Rollover allows a participant, spousal beneficiary or spouse or former spouse alternate payee to retain the tax deferred status of the distribution that is received from the 457 account by rolling this distribution to another eligible plan in which they participate [i.e., IRA, 401(a), 401(k), 403(b), or 457(b) governmental plan] within 60 days from the date the distribution was received.

Ineligible plan is a plan that is established and maintained by an eligible employer but is not administered in compliance with 1.457-3 through 1.457-10 and is subject to the rules under IRC 457(f)

Loan permits a participant or beneficiary to "borrow" from his/her account under a bona fide borrower-lender loan process, pursuant to IRC 72(p) without the loan proceeds being subject to federal income taxes.

Normal retirement age (NRA) is an age or range of ages designated by the Plan for purposes of the Special 457 Catch-up provision. NRA must be spelled out in the plan document, either as a specified age or a range of ages, beginning with the earliest age the participant can retire with a full and immediate benefit from the primary pension plan and ending not later than age 70½. The plan document may designate an earlier NRA for police or firefighters only, which can be no earlier than age 40 or a range of ages between

age 40 and 70½. An entity sponsoring more than one eligible 457 plan cannot permit participants to have more than one NRA under all plans that it sponsors.

Optional provision is plan provision such as a loan or unforeseeable emergency provision that an employer may adopt for its 457 governmental plan but is not a required to retain eligible plan status. If adopted, however, optional provisions must comply in both form and operation with the Code and all applicable regulations and be included in the plan document.

Participant(s) is an employee who is currently, or has previously (current employee or former employee), deferred compensation into the plan by salary deferral agreement, or by non-elective employer contributions, and has not received a full and complete distribution from his/her account. Only individuals who perform services for the employer as an employee or independent contractor are eligible to defer income into the plan.

Participation agreement (or salary deferral agreement) is the agreement that an employee signs to participate in the plan, and designates the amount of income the employee elects to defer from his/her paycheck.

Pension Protection Act of 2006 made permanent the EGTRRA retirement plan provisions that were due to sunset in 2010. It also contained provisions for automatic enrollment programs and clarified a number of existing provisions such as service credit purchases with transfers from governmental 457(b) plans.

Permissive service credits is service an employee is eligible to buy from a qualified government defined benefit plan, using amounts that have been directly transferred in a non taxable transfer from 457(b), 403(b), and 401(k) plans to the governmental defined benefit plan.

Plan document is a written document or set of documents adopted by the plan sponsor to establish and maintain the eligible plan. The plan document sets forth the terms for eligibility for participation and benefits as well as the rules and requirements for operating the plan in compliance with all applicable laws and regulations. All eligible 457 plans of an employer are treated as single eligible plan.

Plan sponsor is an eligible employer who establishes/sponsors and maintains an eligible deferred compensation plan (457(b) plan).

Plan-to-plan transfers are in-service non-taxable transfers of assets from one plan trustee to another. Plan-to-plan transfers can be initiated by participants or employers between eligible 457 governmental of the same employer, between 457 plans of a former and new employer or from the eligible 457 plan to a qualified governmental defined benefit plan for purchase of permissive service credits.

Qualified Domestic Relations Order is an order, judgment or decree generally issued by a state domestic relations court (including approval of a property settlement agreement), made pursuant to a State domestic relations law (including a community property law), and relates to the provision of child support, alimony payments, or marital property right to a spouse, former spouse, child, or other dependent of a participant.

Required minimum distribution (RMD) is the federal statute [under Section 401(a)(9)] that establishes the latest date that a participant or beneficiary (spousal or non spousal) must begin taking minimum payments from a retirement plan. Participants are generally required to begin taking RMDs by April 1 of the calendar year following the year they attain age 70½, or the year of retirement if this is later).

Rollovers are generally distributions from a 401(a), 403(b), 457 plan or IRA that are transferred to another eligible retirement plan or IRA when there is a distributable event such as severance of employment. There are two types of rollovers, direct and indirect (defined separately in this section). Certain distributions, such as for unforeseen emergencies, deemed distributions for defaulted loans, required minimum distributions, corrective distributions and payments expected to last more than 10 years are not eligible for rollover.

Salary Deferral Agreement (or participation agreement) is the agreement that an employee signs to participate in the plan, and designates the amount of income the employee elects to defer from his/her paycheck.

Severance of employment occurs when a participant dies, retires, or otherwise has a severance from employment with the eligible employer.

Special 457 Catch-up is a optional plan provision that allows participants to contribute underutilized deferrals to the employer's plan from prior years in any or all of the three consecutive calendar years immediately prior to the year the participant reaches the plan's normal retirement age.

457(g) Trust is a written document that constitutes a valid trust under State law. The terms of the trust must require that the assets and income of the trust are for the exclusive benefit of 457 participants and their beneficiaries. Custodial accounts and annuity contracts are treated as trusts. An annuity contract does not include a life, health or accident, property, casualty, or liability insurance contract.

Trustee-to-trustee transfers (or direct rollover) are transfers of assets from eligible governmental plans to an IRA or another eligible retirement plan, and is not includible in the gross income of a participant or beneficiary in the year transferred. A 20% tax withholding does not apply to amounts that are directly rolled over to another retirement plan or IRA.

Underutilized deferrals represent the amount that the participant was eligible to defer to the plan in prior years, but did not contribute to the plan. Underutilized deferrals are calculated by determining the maximum amount that the participant was eligible to defer in each of the years that he/she was eligible to participate in the plan, and then deducting the amount actually deferred. The remaining amount is the total underutilized deferrals that can be contributed under the Special 457 Catch-up provision.

Unforeseeable emergency is defined 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 dependent; loss of the participant's or beneficiary's property due to casualty; or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary such as imminent foreclosure on or eviction from the employee's home, medical and funeral expenses. Distributions for unforeseeable emergencies 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.

USERRA (Uniformed Services Employment and Reemployment Rights Act) is a federal law designed to prevent employers from discriminating or retaliating against any employee or future employee with regard to hiring, retention, promotion or any employment benefit because of military service.

Exhibit B

Required 457 Plan Provisions

The following table identifies the provisions of 457 regulations that the plan sponsor must comply with to be considered an eligible governmental deferred compensation plan. These provisions generally must be incorporated into the plan document.

Topic/Reference	Required §457 Plan Provisions
Compliance in form and operation §1.457-3	An eligible plan must be established in writing and contain all the material terms and conditions for benefits under the plan. If optional provisions are included in the plan, they must meet, both in form and operation, the requirements set forth in the Code and regulations.
Agreement for Deferral §1.457-4(b)	Salary deferral agreement must be entered into prior to 1st day of calendar month in which amount deferred would otherwise be paid to the employee (cash basis) or otherwise made available. For new employees, the deferral agreement must be entered into before the first day the employee performs services for the employee.
Maximum Deferral §1.457-4(c)	The maximum amount that an employee can contribute to the eligible plan is established in the Internal Revenue Code, which is a specified dollar amount (\$16,500 in 2009) up to 100% of includible compensation. The employer could establish a lower dollar limit than the IRC maximum.

Topic/Reference	Required §457 Plan Provisions
Excess Deferrals §1.457-4(e)	Excess deferrals (deferrals that exceed the annual maximum deferral limits) are taxable to the participant in the year the deferral was made to the plan. The plan must provide for distribution of the excess deferrals (and net income) as soon as administratively practicable after the excess is identified.
Timing of Distribution §1.457-6	An eligible plan cannot distribute assets to a participant or beneficiary unless a distributable event has occurred. Distributable events are defined as: severance of employment, attainment of age 70½, unforeseeable emergency withdrawals, de minimis distributions (small account balances) and loans.
Required Minimum Distribution Rules §1.457-6(d)	The plan must comply with the required minimum distribution rules specified in 401(a)(9). In general, the plan is required to begin distributing participant accounts by April 1 of the calendar year following the later of the calendar year the participant attains age 70½, or retires.
Trust, Custodial Account or Annuity §1.457-8	Assets of an eligible governmental 457(b) plan must be held in a governmental 457(g) trust, custodial account or annuity contract.
Contribution of Differential Pay IRC §3401(h) 414(u)(12)	For payments made after December 31, 2008 differential pay must be counted as compensation for retirement plan purposes and may be contributed to the plan.
Survivor Benefits for Employees Who Die on Active Military Duty IRC §401(a)(36)	Survivors of employees killed on qualified military duty are entitled to any additional benefits the plan would have provided if the employee had returned to work with his or her former employer and then terminated employment because of death.

Exhibit C

Optional 457 Plan Provisions

The following table identifies provisions of the 457 regulations that may be adopted by the plan but are not required for eligible 457 governmental plans. Any optional provision included in the plan must meet the relevant requirements under section 457 and 1.457-2 through 1.457-10 in both form and operation.

Topic/Reference	Optional §457 Plan Provisions
Age 50 Plus Catch-up §1.457-4(c)(2)	The plan may permit age 50 catch-up contributions in accordance with §414(v) to be made by participants beginning in the calendar year they attain age 50. This additional contribution and the Special 457 Catch-up cannot be made in the same calendar year.
Special §457 Catch-up §1.457-4(c)(3)	A participant may be allowed to contribute underutilized deferrals, up to two times the annual limit, during one or more of the participant's last 3 consecutive taxable years ending before the year in which the participant attains Normal Retirement Age (NRA).
Optional Normal Retirement Age for Police and Firefighters §1.457-4(c)(3)(v)	A special rule may be included in the plan to allow qualified police or firefighters to designate an earlier NRA than under the general rule (no earlier than the age the participant is eligible to retire from their primary plan without an actuarially reduced benefit), but not earlier than age 40. The employer can designate a specific age (e.g., age 40) or a range of ages between 40 and 70½ for these groups NRA.
Deferral of Sick, Vacation, and Back Pay §1.457-4(d) 1.415(c)-2(e)(5)	<p><i>Deferral of sick, vacation, and back pay for current employees.</i></p> <p>The plan may permit a participant to elect to defer accumulated sick pay, accumulated vacation pay, or back pay to the plan..</p> <p><i>Post severance deferrals.</i> The plan may also provide for the post severance deferrals. These amounts must be paid to the plan by the later of 2½ months after severance from employment or the last day of the <i>calendar year</i> in which the severance occurs.</p>
Unforeseeable Emergency Withdrawals §1.457-6(c)	The plan may permit participants and plan beneficiaries other than spouses and dependents to receive unforeseeable emergency withdrawals that meet the requirements of the regulations [under 6(c)(2) and IRS Notice 2007-7.

Topic/Reference	Optional §457 Plan Provisions
Withdrawal of Elective Deferrals from Eligible Automatic Contribution Arrangements (EACA) IRC §414(w)(2)	<p>This provision permits automatically enrolled participants who opt out of the plan to withdraw their automatic contributions and earnings within 90 days after the first automatic contribution is made to the plan for them. EACA distributions are not eligible for rollover.</p>
Withdrawal of Elective Deferrals for Active Duty Military Personnel IRC §414(u)(12)(B)	<p>The plan may permit employees who are active military duty for more than 30 days to withdraw their elective deferrals from the plan. Employees who make these withdrawals may not make contributions to the plan for 6 months from the date the elective deferrals were distributed.</p>
Benefit Accruals for Death and Disability Resulting from Active Military Service. IRC §414(u)(9)	<p>The plan may, but is not required to, treat an employee who dies or becomes disabled while on qualified military duty as having been rehired by the employer on the day before the date of death or disability and having terminated employment on the actual date of death or disability. This provision entitles such an employee to any restoration benefits available under the plan such as counting qualified military service for vesting and benefit accrual purposes.</p>
Distributions of Smaller Accounts (de minimis distributions) §1.457-6(e)	<p>A provision may be included to allow the distribution of small account balances, no greater than the dollar limit established in Section 411(a)(11)(d), when the account has been inactive (no new deferrals during the past 2 years) and the participant has not received a distribution under this de minimis distribution provision in the past. This can be established as an automatic distribution (authorized by the plan sponsor) or at the direction of the participant. These distributions are eligible to be rolled over into another eligible plan or IRA.</p>
Loans from Eligible Plans §1.457-6(f)	<p>A loan program may be established in eligible deferred compensation programs that follow the same rules as loans from qualified plans under IRC Section 72(p) and 1.72(p)-1.</p>

Topic/Reference	Optional §457 Plan Provisions
<p>Frozen and Terminated Plans §1.457-10(a)</p>	<p>The plan may provide for a plan freeze or plan termination.</p> <p>Frozen plans no longer accept ongoing contributions from all participants or may limit contributions to existing participants.</p> <p>If an employer is no longer eligible to maintain a governmental 457(b) plan, the employer may transfer the frozen plan to another governmental entity for administration. Participants will not be eligible for a distribution from the frozen plan until they have a distributable event such as severance from employment. Distributions from frozen plans may be eligible for rollover.</p> <p>Terminated plans must distribute all plan assets to all participants and beneficiaries within a reasonable period of time after the plan is terminated. Distributions may be eligible for rollover.</p>
<p>Plan-to-Plan Transfers §1.457-10(b)(1)</p>	<p>An eligible plan may permit certain non-taxable and non tax reportable plan-to-plan transfers of participant and beneficiary assets to another eligible governmental plan, if both plans provide for such transfers and certain other conditions are met. Plans may permit the following types of non taxable transfers:</p>
<p>-10(b)(2)</p>	<p>Post severance of employment transfer between eligible governmental plans —participant must have a severance of employment with transmitting plan and be performing services for the employer sponsoring the receiving plan.</p>
<p>-10(b)(3)</p>	<p>Transfers among eligible governmental plans of the same employer —if an employer offers more than one eligible governmental plan, participants and beneficiaries may be allowed to transfer their assets between these without a severance of employment.</p>
<p>-10(b)(4)</p>	<p>Transfers among eligible governmental plans of the same employer —if an employer offers more than one eligible governmental plan, participants and beneficiaries may be allowed to transfer their assets between these without a severance of employment.</p>
<p>-10(b)(8)</p>	<p>Exception for purchase of permissive service credit – an eligible plan may permit an in-service transfer of assets from an eligible plan to a qualified governmental defined benefit plan for the purpose of buying permissive service credit [as defined in Section 414(d)].</p>
<p>Qualified Domestic Relations Orders (QDRO) §1.457-10(c)</p>	<p>Plan sponsor may execute qualified domestic relations orders (as defined in §414(p)) that apply to participants' accounts in an eligible deferred compensation plan. Plans are allowed to make distributions to an alternate payee prior to the date that the participant is entitled to a distribution and the distributed amount is taxable to the spousal or ex-spouse alternate payee.</p>

Topic/Reference	Optional §457 Plan Provisions
<p>Rollovers into the Eligible Plan §1.457-10(e)</p>	<p>Eligible government §457 plans may accept eligible rollover distributions from other eligible retirement plans, including 401(a), 401(k), 403(b), other 457(b) plans, and IRAs only if the rolled-in amount and subsequent earnings are maintained in a separate rollover account. The rules of the transferring plan continue to apply and rolled-in amounts (plus associated investment earnings) must be maintained in a separate account. A 10% early distribution tax may apply to distributions from a non 457 rollover account prior to age 59½ unless an exception applies.</p>
<p>Anytime Distributions from Rollover Accounts IRS Revenue Ruling 2004-12</p>	<p>The plan may, at the request of the participant, distribute amounts from the rollover account prior to the participant being eligible for a distribution from the plan. These distributions will be subject to the taxation rules that apply to rollover distributions that are not rolled over to another retirement plan or IRA.</p>
<p>Deemed IRAs §1.457-10(f)</p>	<p>A plan sponsor may adopt a deemed IRA provision as part of the eligible plan design. The deemed IRA can be either a traditional or Roth IRA and must comply with the requirements as outlined in the final deemed regulations (26 CFR Parts 1 and 602).</p>

