

PRESENTED AT

5th Annual Higher Education Taxation Institute and Essentials

June 4-6, 2017

Austin, TX

**Overview of 457(b) Plans for
Governmental and Tax-Exempt Employers**

Tara Schulstad Sciscoe

Author Contact Information:

Tara Schulstad Sciscoe

Ice Miller LLP

Indianapolis, IN 46282

(317) 236-5888

Tara.sciscoe@icemiller.com

OVERVIEW OF 457(b) PLANS FOR GOVERNMENTAL AND TAX-EXEMPT ENTITIES

I. Introduction

A. Section 457 of the Internal Revenue Code ("Code") governs the deferred compensation arrangements maintained by certain governmental and tax-exempt entities for their eligible employees.

B. There are two types of 457 plans:

1. An "**eligible deferred compensation plan**" under Code Section 457(b). An eligible deferred compensation plan is a plan that meets the requirements of Treasury Regulation Sections 1.457-3 through 1.457-10 and that is established and maintained by an eligible employer.

2. An "**ineligible deferred compensation plan**" under Code Section 457(f). An ineligible deferred compensation plan is a plan that is established and maintained by an eligible employer, but that does not meet the requirements for an eligible deferred compensation plan.

C. This outline discusses eligible deferred compensation plans under **Code Section 457(b) only**.

D. The IRS issued proposed regulations under Code Section 457 on June 22, 2016. The proposed regulations generally apply to compensation deferred under a plan for calendar years beginning after the proposed regulations are finalized. Prop. Reg. § 1.457-13(a). If legislation is required to amend a governmental plan, the regulations do not apply to compensation deferred under that plan in taxable years ending before the day following the end of the second legislative session of the legislative body with authority to amend the plan after the proposed regulations are finalized. Prop. Reg. § 1.457-13(b)(2). **However, employers can rely on the proposed regulations now.** 81 Fed. Reg. 40548, 40557 (June 22, 2016)

E. The rules governing 457(b) plans can differ significantly depending on whether the employer sponsoring the 457(b) plan is a governmental entity or a tax-exempt entity.

II. Eligible Employers Under Code Section 457

A. Eligible Employers. Employers eligible to sponsor a 457(b) plan include the following:

1. *A State, a political subdivision of a state, and any agency or instrumentality of a State or political subdivision of a State.* Code § 457(e)(1)(A); Treas. Reg. §§ 1.457-2(e), 1.457-2(l).

2. *An organization, other than a governmental unit, that is exempt from tax under Subtitle A of the Code.* Most of these organizations are listed in Code Section 501(c). Code § 457(e)(1)(B); Treas. Reg. §§ 1.457-2(e), 1.457-2(m).

B. Ineligible Employers.

1. A church or a qualified church controlled organization ("QCCO") within the meaning of Code Section 3121(w)(3) is not an eligible employer, even though a church is a tax-exempt entity. Code § 457(e)(13); Treas. Reg. § 1.457-2(e).

a) Churches and QCCOs are instead subject to the rules that apply to for-profit employers sponsoring deferred compensation plans.

b) Note that tax-exempt entities that are controlled by or associated with a church under Code Section 414(e) are eligible employers unless they are a church or a QCCO within the meaning of Code Section 3121(w)(3). Treas. Reg. § 1.457-2(e).

2. The Federal government or any agency or instrumentality thereof is not an eligible employer. Treas. Reg. § 1.457-2(e).

III. Application of Code Section 457

A. General Rule. Code Section 457 applies to any type of agreement or arrangement, including an employment agreement, between an eligible employer and an individual who performs services for the eligible employer, under which the payment of compensation is deferred (whether by salary reduction or by employer contributions). Prop. Treas. Reg. § 1.457-2(k).

B. Exempt Plans. Code Section 457 does not apply to the following types of plans:

1. A qualified pension, profit sharing or stock bonus plan that includes a tax-exempt trust under Code Section 401(a) or 501(a). Code § 457(f)(2)(A).

2. A qualified annuity plan under Code Section 403(a). Code § 457(f)(2)(B).

3. A Code Section 403(b) tax-sheltered annuity. Code § 457(f)(2)(B).

4. A nonqualified employer trust where the participant is subject to tax under Code Section 402(b). Code § 457(f)(2)(D).

5. An individual retirement account or annuity under Code Section 408(d). Code § 408(d).

6. A qualified excess benefit arrangement under Code Section 415(m). Code §§ 457(f)(2)(E), 457(e)(14).

Also available as part of the eCourse

[Compensation and Payment Challenges for Higher Education Tax Professionals](#)

First appeared as part of the conference materials for the

5th Annual Higher Education Taxation Institute session

"Deferred Compensation and Employment Agreements"