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 and administrators understand the rules and requirements that apply to eligible governmental deferred compensation plans under Internal Revenue Code §457(b). Plan sponsors are encouraged to closely review state and local laws that may apply to these plans and consult their own legal counsel on issues that need further clarification.

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

Introduction

State and local government employers may establish and maintain 457(b) deferred compensation plans for employees and independent contractors performing services for them. Most public employers already provide a qualified defined benefit, defined contribution or hybrid plan as their employees' primary retirement plan. The 457 plan is generally designed as a supplemental retirement plan funded by voluntary contributions from employee wages. These plans may be also funded with employer contributions or a combination of employer and employee contributions.

In recent years, seven legislative actions have made significant changes to governmental 457(b) plans:

1. The Small Business Job Protection Act of 1996 (SBJPA)
2. The Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA)
3. The Job Creation and Worker Assistance Act of 2002 (JCWAA)
4. The Pension Protection Act of 2006 (PPA 06)
5. The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART Act)
6. The Worker, Retiree & Employer Recovery Act of 2008 (WRERA)
7. The Small Business Jobs Act of 2010

The Treasury Department and Internal Revenue Service last issued final 457 regulations in 2003, which incorporated changes made to 457 plans by EGTRRA and related guidance. Subsequently, the Internal Revenue Service issued Revenue Procedure 2004-56 which provided 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 model amendments do not, however, reflect changes to 457 plans as a result of PPA 06, the HEART Act of 2008, WRERA, and the Small Business Jobs Act of 2010, all of which were enacted after the final regulations and the model amendments were issued. This Guide includes these changes and relevant guidance issued for these legislative and regulatory changes. Plan documents must reflect any required statutory and regulatory provisions, as well as any optional provisions the plan has adopted, to ensure that the plan is operated according to its terms.

Generally, plan sponsors are not required to amend their plan documents for the various changes under PPA 06 until the end of the 2011 plan year.[1] Governmental 457(b) plans need to be amended for HEART and WRERA provisions no later than the end of the 2012 plan year.

Table 1

Required and Optional Provisions Applicable to Governmental 457(b) Plans After EGTRRA			
	Pension Protection Act of 2006		
Topic	**Provision**	**Required**	**Optional**
RMD Compliance	The Secretary of the Treasury, as directed under Section 823 of PPA 06, issued final regulations in 2009 that treat a governmental plan, including a governmental 457(b) plan, as complying with a reasonable good-faith interpretation of the required minimum distribution (RMD) requirements under 401(a)(9) for all years the RMD rules applied to the government plan.	X	
Direct Rollovers to Roth IRAs	Section 824 of PPA 06 permits direct rollovers from governmental 457(b) plans to Roth IRAs for eligible rollover distributions made after December 31, 2007. The $100,000 modified adjusted gross income limit and tax filing requirements no longer apply for rollovers and conversions to Roth IRAs, beginning with the 2010 tax year. Taxes on the rollover to the Roth IRA are due in the year the rollover is made to the Roth IRA. Taxes on rollovers and conversions to Roth IRAs in 2010 may be spread over the 2011 and 2012 tax year.	X	
Unforeseeable Emergency Withdrawals	PPA Section 826 permits employers to modify the unforeseeable emergency distribution rules for unforeseeable distributions made after August 17, 2006. A 457(b) plan may, but is not required to, consider a participant's non-spouse, nondependent beneficiary under the plan in determining if the participant would be eligible for an unforeseeable emergency distribution. For example, a plan may consider a participant's financial need to pay a plan beneficiary's medical, prescription drug, or funeral expenses in determining if the participant has incurred an unforeseeable financial emergency.		X
Health Care Premiums for Retired Police and Fire Fighters	Section 845 provides for a maximum annual exclusion up to $3,000 from gross income of retired public safety officers for distributions from governmental retirement plans that are sent directly to an insurance carrier to pay health and long-term care premiums for tax years beginning after December 31, 2006. The $3,000 annual limit is an aggregate limit and not a per plan limit. A technical correction under WRERA (see below) clarified that this exclusion from gross income applies to distributions used to pay premiums to both insured and self insured plans.		X
Rollovers to Inherited IRAs for Non-spouse	Section 829 permitted governmental 457(b) plans to offer non-spouse beneficiaries the option to directly roll a plan decedent's 457 account to an IRA that will be treated as an inherited IRA for distributions made after December 31, 2006. This optional provision applies to distributions after December 31, 2006 through December 31, 2009. (See first provision of the WRERA section of this table.)		X

	Worker Retiree and Employer Recovery Act of 2008 (WRERA)		
Topic	**Provision**	**Required**	**Optional**
Beneficiaries	For plan years beginning on or after December 31, 2009, all employer-sponsored retirement plans are required to offer designated non-spouse beneficiaries the option of directly rolling over a plan decedent's account balance to an inherited IRA, including a Roth IRA.	X	
2009 RMD Waiver	Governmental 457(b) plans were permitted to suspend required minimum distributions to plan participants and beneficiaries for the 2009 calendar year, but not for the 2008 calendar year. This waiver affected RMD distributions using the life expectancy rule and the 5-year rule.		X

	Heroes Earnings Assistance and Relief Act of 2008 (HEART Act)		
Topic	**Provision**	**Required**	**Optional**
Survivor Benefits of Participants Killed on Active Duty	The HEART Act requires that a 457 plan provide survivors of a participant who dies while performing qualified military service with any additional benefits, other than benefit accruals, related to qualified military service, that would have been provided under the plan had the participant been reemployed by the employer and then terminated employment on account of death. This provision applies to death and disabilities accruing after January 1, 2007. The types of benefits subject to this provision include accelerated vesting, ancillary life insurance benefits and other survivor benefits under the plan that are contingent on a participant's termination or death.	X	
Earning Benefits While on Active Duty	The plan may, but is not required to, determine death and disability benefits based on benefit accruals for the period of qualified military service. This provision may be applied beginning as of any date on or after January 1, 2007.		X
Plan Contributions During Active Duty	The plan may permit former employees who are active military duty for more than 30 days to contribute to the plan all or a portion of any differential wage payments they receive from their former civilian employer after December 31, 2008.		X
Plan Contributions During Active Duty	Differential wage payments are treated as wages and must be included in the plan's definition of compensation. Differential wage payments may be contributed to the plan.	X	 X
Withdrawals While on Active Duty	For plan years beginning after December 31, 2008, an employee is treated as severed from employment during any period that he or she is performing service in the Uniformed Services (Armed Forces) for more than 30 days. The plan may permit these employees to withdraw elective deferrals from a governmental 457(b) plan without violating the plan's distribution restrictions.		X
Stopping Deferrals After Withdrawals During Active Duty	If the plan permits employees on active military duty for more than 30 days to receive a distribution from the 457(b) plan, employees generally must cease making elective deferrals to the 457 plan during the six-month period beginning on the date of the distribution. This restriction on making elective deferrals does not apply to participants who have an actual severance from employment or who may be able to take a distribution from the plan for another reason.	X	

	Small Business Jobs Act of 2010		
Topic	**Provision**	**Required**	**Optional**
Designated Roth Accounts	Beginning with the 2011 tax year, governmental 457(b) plan sponsors may adopt designated Roth Accounts (DRA) as part of the plan's salary deferral account. Contributions and related earnings to the DRA must be tracked separately from other money contributed to the plan.		X
In-plan Roth Rollovers (Conversions)	Beginning with the 2011 tax year, a 457 plan may permit pretax money to be contributed to the designated Roth account within the same 457 plan, provided the participant is eligible for a distribution from the plan and the distribution is eligible for rollover.		X

Although federal tax laws have made governmental 457(b) plans more like 401(k) and 403(b) plans, significant differences remain. The following table compares governmental 457(b) plans with 401(k) and 403(b) governmental plans.

Table 2

Comparison of Governmental 457(b), 403(b) and 401(k) Plans

Topic	457(b)	403(b)	401(k)	All
Participation of independent contractors as well as employees permitted	X			
Timing restriction for making salary deferral election	X			
Coordination of 457(b) plan deferrals with other 457(b) plans only	X			
Employer contributions subject to FICA	X			
Vested employer contributions reduce deferral limits	X			
In-service transfers allowed for permissive service credit purchases in a governmental defined benefit plan	X	X		
Special catch-ups for under-deferrals in prior years	X	X		
Universal availability requirement for making elective salary deferrals		X		
Special definition for includible compensation		X		
Limited investment options		X		
Post-severance employer non-elective contributions permitted		X		
Eligible employees must be common-law employees		X		
No aggregation with employer's non-403(b) defined contribution plans for 415 annual additions*		X		
Operational/contract defects generally affect participant but not entire plan		X		
Subject to 402(g) deferral and coordination limits		X	X	
Subject to 415 limit on annual additions		X	X	
In-service distribution of elective deferrals at age 59½ permitted		X	X	
Non-Roth employee after-tax contributions permitted		X	X	
Application of 10% early distribution tax**		X	X	
Roth deferral account available				X
In-plan Roth rollovers (conversions) permitted				X
Savers Credit available				X
Sponsorship limited to certain types of employers***				X
Auto rollover for mandatory distributions of small account balances				X
Automatic enrollment permitted*				X

Comparison of Governmental 457(b), 403(b) and 401(k) Plans (continued)				
Topic	**457(b)**	**403(b)**	**401(k)**	**All**
Deferral contributions subject to FICA taxes****				X
Participant loans permitted				X
IRC 401(a)(17) limit on compensation				X
Age 50 catch-up permitted				X
Direct rollover option for non-spouse beneficiaries to inherited IRAs required				X
Direct rollover option to Roth IRAs required				X
In-service distributions from rollover accounts				X
Plan termination permitted				X
Post-severance elective deferral contributions of accumulated unused leave permitted				X
Subject to USERRA				X
Inclusion of differential pay in definition of compensation required for employees on active military duty				X
Employees on active military duty may defer differential pay into plan				X
Employees on active military duty for more than 30 days may be permitted to withdraw elective deferrals				X
Employees on active military duty for more than 30 days generally must cease making elective deferral to the plan for 6 months after taking a withdrawal from the plan unless an exception applies				X
Written plan or plan document required				X
402(f) Notices required for distributions				X
Subject to required minimum distribution (RMD) rules				X
1099-R tax reporting for distributions				X

** Defined contributions plans of the employer sponsoring the 403(b) plan are not aggregated for 415 purposes. However, if a 403(b) participant is in control of more than 50% of an outside business that maintains a defined contribution plan, both the participant's 403(b) plan and the outside plan are aggregated for 415 purposes.*

*** Applies only to rollovers from qualified plans, 403(b) plans and IRAs to the 457 plan that are subsequently distributed from the 457 plan.*

**** Governmental employers may not adopt new 401(k) plans but may continue to maintain existing plans.*

***** Applies only if employment is covered under Social Security. Medicare taxes would still apply.*

457 Plan Fundamentals

This section provides a basic overview of 457 plan types, plan document requirements, and eligibility requirements (employers and participants), as well as a brief discussion of the general governance structure of these plans.

Types of 457 Plans

There are two kinds 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 which is subject to different rules and tax treatment than 457(b) plans.[2] This guide covers 457(b) plans of governmental employers exclusively and not the 457(b) plans of non-governmental tax-exempt employers or 457(f) plans of either type of employer.

Eligible Employers

The 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

Employees and independent contractors who perform services for an eligible governmental employer may be eligible to participate in a 457 plan.[4]

The 457 plan document establishes eligibility requirements, which may include all employees, or exclude certain employment categories (union, non-union) or employment status (e.g., full-time, part-time or seasonal). The plan may 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 include:

- All required material terms
- Conditions for eligibility, contributions, benefits and distributions
- Any optional provisions such as participant loans, unforeseeable emergency withdrawals and plan-to-plan transfers that are to be permitted under the plan

The plan sponsor is responsible for ensuring that the plan document is in compliance with current federal tax laws and regulations and that the plan is operated according to its terms. All 457(b) plans of an employer are treated as single 457 plan even if the employer maintains more than one 457(b) 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 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 responsibility for overseeing the day-to-day operations of the 457 plan typically falls to the plan's administrator.

Regardless of where specific responsibilities are assigned, plan sponsors have the ultimate responsibility to:

- Ensure that the plan is operated according to its terms and that it complies with federal as well as applicable state and local laws
- Base all actions and decisions regarding the plan for the exclusive benefit of participants and beneficiaries

It may be prudent for plan sponsors to utilize tax or legal counsel to assist the plan sponsor with its responsibilities with regard to the plan. Plan sponsors are encouraged to closely review state and local laws that may apply to these plans and consult their own legal counsel on issues that need further clarification.

457 Plans and ERISA

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; attorneys general opinions and case law; and other federal laws may determine fiduciary requirements that apply to a 457 plan. Many times state and local laws have fiduciary requirements similar to those found in ERISA, which is one of the reasons state and local governments often consult ERISA for guidance when formulating best practices for their retirement plans.

Contributions

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

Salary Deferral Agreements

To make contributions to a 457 plan, eligible employees must complete and sign a salary deferral agreement (participation agreement), to voluntarily defer a portion of their wages (compensation) into the 457 plan. This agreement specifies the amount or percentage of pretax compensation or designated Roth contributions an employee chooses to defer to the plan from each paycheck.

The agreement to defer compensation and any subsequent changes to the agreement cannot take effect before the first day of the month following the employee's completion of the deferral agreement. However, newly hired 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 generally goes into effect as soon as it is administratively possible for the plan administrator to implement the employee's instructions, and remains in force until the employee changes the election to increase, reduce or stop deferrals.

Like 401(k) and 403(b) elective deferrals, governmental 457 elective deferrals are subject, at the time of deferral, to any applicable FICA (Social Security and Medicare) taxes.[8] Governmental 457(b) plans may also include employer matching and non-elective contributions. Unlike 401(k) and 403(b) plans, employer matching and non-elective contributions to the 457 plan are subject to applicable FICA taxes and reduce a participant's elective deferral limit when those contributions vest. Since employer 457 matching and non-elective contributions to a 401(a) defined contribution plan do not reduce the 457 deferral limit and are not be subject to FICA taxes, employers often make 457 matching contributions and other employer contributions to a 401(a) defined contribution plan.

Table 3

Application of FICA Taxes on Contributions to Employer-sponsored Retirement and Welfare Benefit Plans

Type of Plan Contribution	Contributions Subject to All FICA Taxes (Social Security and Medicare Taxes for Covered Employment)	Medicare Taxes for Employment not Covered Under Social Security
457(b), 403(b) or 401(k) elective salary deferrals	Yes	Yes. Applies to employees hired after March 31, 1986
Employee after-tax contributions to an employer-sponsored retirement plan	Yes	Yes. Applies to employees hired after March 31, 1986
Mandatory employee contributions to a 401(a) plan picked-up (paid) by the employer under a salary reduction agreement*	Yes	Yes. Applies to employees hired after March 31, 1986
Employer contributions to a 457(b) plan**	Yes, as they vest	Yes. Applies to employees hired after March 31, 1986
Employer-matching, discretionary, fixed or supplemental contributions to a 401(a), 401(k)- or 403(b) plan	No	No
Employer contributions to health and welfare plans	No	No
Employee pretax contributions to a cafeteria plan (Section 125)	No	No

** Mandatory employee contributions to a qualified plan or 403(b) plan are not salary deferrals and do not reduce elective deferral limits.*

*** Employer contributions are not common but will reduce participant's 457(b) salary deferral limits when they vest and may cause the plan to have excess deferrals.*

Contributions to Social Security Replacement Plans

Some employers 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 or OBRA plans) are used instead of covering workers under Social Security. Employers sponsoring and employees participating in Social Security replacement plans will each still be subject to Medicare taxes. 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] Employers should review state laws and their State's agreements with 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 may automatically enroll new hires and/or 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 default investment alternatives (QDIAs) that applies to ERISA covered plans. QDIAs shield ERISA plan fiduciaries, but not governmental plan sponsors, from fiduciary liability for investing participant assets in certain default investment options when participants do not provide investment direction for their accounts.[11] Although governmental plans are exempt from ERISA,[12] plan sponsors may want to review the DOL default investment guidelines when developing their own default investment policies and options.

Designated Roth Contributions

Designated Roth Contributions (DRC) are after-tax elective salary deferrals that were originally permitted in 401(k) and 403(b) plans, but not in governmental 457(b) plans.[13] Effective in 2011, governmental 457(b) plan sponsors may permit participants to defer after-tax contributions to designated Roth accounts if the plan has been amended to allow designated Roth accounts. The inclusion of designated Roth accounts was part of the Small Business Jobs Act of 2010.

The Small Business Jobs Act of 2010 also permits 457 plan participants to rollover, i.e., convert, 457 pretax contributions to the same 457 plan's designated Roth account. The participant must be eligible for a distribution, and the distribution must be an eligible rollover distribution. To offer this in-plan Roth rollover option to participants, a 457 plan:

- Has to be timely amended to provide for this option, and
- Must establish designated Roth accounts within the plan prior to accepting a rollover of pretax contributions with the same plan

Since 457 plan participants must be eligible for a distribution that is an eligible rollover distribution, in-plan Roth rollovers generally would not be available until a participant has terminated employment unless the plan permits in-service distribution from the plan's pretax rollover accounts. Taxes on the conversion/rollover of pretax contributions to the same plan's designated Roth account are due in the year pretax contributions are rolled over to the plan's designated Roth account.

Key Action Points

Plan sponsors that want to offer these Roth options will need to:

- Amend their plan documents by the last day of the plan year that Roth accounts became available under the plan
- Ensure that the plan's recordkeeping systems and administrative procedures separately account and track designated Roth contributions and related earnings, rollovers from another plan's designated Roth account, in-plan Roth rollovers and loan repayments attributed to loans made with funds from the designated Roth accounts
- Modify plan administrative procedures and materials (forms, etc.) and participant communication materials
- Provide additional employee education about designated Roth accounts

Table 4

The following table, based on current available guidance, summarizes designated Roth contributions, in-plan Roth rollovers (conversions) of pretax salary deferrals to designated Roth elective deferral accounts in 401(k), 403(b) and governmental 457(b) plans as well as Roth and deemed Roth IRAs.

Designated Roth Accounts, In-plan Roth Rollovers and Roth IRAs

Topic	Designated Roth Accounts	In-plan Roth Rollovers	Roth IRAs
Definitions	• Hold employee after-tax elective deferrals which are included in a participant's gross income in the year they are contributed to the account • Are coordinated with pretax elective deferral limits • Are subject to most of the rules that govern the plan • Do not affect Roth IRA contributions	Allows participants to convert/roll over taxable eligible rollover distributions to a Roth elective deferral account within the same plan.	**Roth IRA** A tax-favored individually owned account that accepts non-deductible after-tax contributions from taxpayers who meet prescribed income requirements. **Deemed Roth IRA** A separate account or annuity maintained under an employer-sponsored retirement plan to accept voluntary employee after-tax contributions. If the separate account or annuity otherwise meets the requirements of a Roth IRA, it will be subject only to Roth IRA rules, and not those of the employer's retirement plan or a traditional IRA. Both traditional and Roth deemed IRAs may be included in: • 401(a) qualified plans, including 401(k) plans • 403(b) plans • Governmental 457(b) plans
Effective Date for Designated Roth Accounts	**Governmental 457(b) Plans** Beginning after Dec. 31, 2010 **401(k) & 403(b) Plans** Available since 2006	**Governmental 457(b) Plans** Tax years after 2010 **401(k) & 403(b) Plans** After September 27, 2010	**Roth IRA** Since 1998 **Deemed Roth IRA** Plan years beginning after 2002

Topic	Designated Roth Accounts	In-plan Roth Rollovers	Roth IRAs
Availability	If the plan permits, these accounts are established as part of the governmental 457(b), 401(k) or 403(b) plan's elective salary deferral account.	Plan must have a provision for in-plan conversions and have established a designated Roth account before in-plan conversion amounts may be contributed to the plan's designated Roth account.	**Roth IRA** Available to taxpayers whose modified adjusted gross income and filing status are within prescribed limits for annual ongoing contributions, excluding rollovers and conversions. **Deemed Roth IRA** Same as Roth IRA. Employers may establish eligibility requirements for the deemed Roth IRA that differ from the employer's retirement plan.
Requirements	Designated Roth accounts may be established only in plans that offer employee pretax elective deferral contributions and are subject to the plan's eligibility requirements. Elective deferrals must be designated as a Roth elective deferral or pretax elective deferral before contribution is made to the plan. Roth elective deferrals and earnings must be accounted for separately within the plan's elective deferral account. Designated Roth contributions are included in the deferral limits ($17,000 for 2012).	Distribution must be an eligible rollover distribution, and the plan must have a designated Roth elective deferral account. Plan may specify other pretax distributions that may be converted and contributed to the plan's designated Roth account. In-plan Roth conversions are treated as rollovers and do not count in the plan's annual contribution or catch-up limits.	**Roth IRA** Contributions held in Roth IRAs cannot be part of a traditional deductible or non-deductible IRA. **Deemed Roth IRA** Same as above. Contributions, earnings and charges are tracked separately in the deemed Roth IRA and not part of the employer plan or the deemed traditional IRA. Note: Deemed Roth IRAs may be held in the same trust that holds traditional deemed IRAs provided that the IRA trustee maintains separate accounts and each IRA is designated as either a Roth or traditional IRA.
Automatic Enrollment	Permitted	N/A	**Roth IRA** – N/A **Deemed Roth IRA** May be used with deemed traditional and Roth IRAs.
Coordination with Other Elective Deferral Plans	**457 Plans** Pretax and Roth deferrals are coordinated under all 457(b) plans in which the employee participates. **401(k) and 403(b) Plans** Pretax and designated Roth elective deferrals are coordinated with each other under all 401(k) and 403(b) plans in which the employee participates.	In-plan conversions are not subject to plan's annual contribution limits or any deferral coordination rules.	**Roth and Deemed Roth IRAs** Coordinated with all contributions to other IRAs both Roth and traditional IRAs, including deemed IRAs.
100% Vesting	When contributed to the plan.	When contributed to the plan.	When contributed to the IRA.

Topic	Designated Roth Accounts	In-plan Roth Rollovers	Roth IRAs
Allocation of Forfeitures, Matching and Employer Non-elective Contributions to Roth Elective Deferral Account	Not permitted.	Not permitted.	**Roth IRA** – N/A **Deemed Roth IRA** Matching contributions or forfeitures from the employer's qualified plan cannot be allocated to the deemed Roth IRA.
Loans, Hardships and Unforeseeable Emergency Distributions	May be used for loans, hardships and unforeseeable emergency distributions if plan permits. Require complex recordkeeping capabilities and administration.	Same as designated Roth account but may trigger a 10% recapture tax.	**Roth IRAs and Deemed Roth IRAs** Not applicable. IRAs cannot be used as collateral for any type of loan. Hardship and unforeseeable emergency distributions are not necessary because IRA accountholders can access the money in their IRAs for any reason at any time.
Conversion of Pretax Elective Deferrals to Designated Roth Elective Deferrals	See In-plan Roth Rollovers.	Plan may permit the taxable portion of an eligible rollover distribution to be converted and contributed to the same plan's designated Roth account.	**Roth and Deemed IRAs** Traditional IRAs may be converted to Roth IRAs regardless of an individual's tax filing status or modified adjusted gross income after 2009.
Conversion of Roth Elective Deferrals to Pretax Deferrals	Not permitted.	Not permitted.	**Roth or Deemed Roth IRAs** Roth and Deemed Roth IRAs can be re-characterized as traditional or deemed traditional IRAs within certain timeframes.
Conversion of Other Pretax Contributions	See In-plan Roth Rollovers.	The plan document must specify if other taxable eligible rollover distributions can be converted and rolled into the Roth elective deferral account.	N/A
Catch-up Contributions (Dollar Limit)	**Age 50+ Catch-up** Coordinated 401(k) and 403(b) catch-up contributions, both pretax and Roth deferrals cannot exceed $5,500 for 2012. **457 plan** Catch-up cannot exceed $5,500 for 2012 for Age 50+ catch-up contributions to all 457 plans. **Special 457 Catch-up** Pretax and Roth elective deferrals, including Special 457 Catch-up, cannot exceed a total of $34,000 for 2012.	**N/A** Catch-up contributions may be converted when they are eligible to be distributed from the plan in an eligible rollover distribution.	**Roth and Deemed Roth IRAs** Total aggregate IRA catch-up contributions to all IRAs (Roth and traditional, including deemed IRAs) cannot exceed $1,000.
Withdrawal Restrictions	Same as those for pretax elective deferrals.	Same as those for pretax elective deferrals, unless the plan permits anytime distributions from the plans pretax rollover account.	**Roth IRA / Deemed Roth IRA** Distributions are available at anytime but may be subject to taxes and penalties.

Topic	Designated Roth Accounts	In-plan Roth Rollovers	Roth IRAs
Required Minimum Distributions	Apply to both participants and beneficiaries.	Apply to both participants and beneficiaries.	**Roth and Deemed Roth IRAs** Accountholders are not subject to RMDs. Beneficiaries are subject to RMDs.
Tax-free (Qualified) Distributions	Distributions of contributions and earnings from the Roth account are tax-free after the first contribution has been in the designated Roth account for a period of at least five (5) consecutive tax years and the participant is at least 59½ years old at the time of the distribution.	Not subject to a 10% recapture tax if an in-plan Roth rollover has been in the Roth account more than 5 years after the in-plan Roth rollover was contributed to the same plan's designated Roth account or the participant is at least 59½ years old.	Tax-free distributions are available from a Roth or deemed Roth IRA provided the first contribution made to any Roth or deemed Roth IRA has been held in the IRA for five (5) tax years and the accountholder is at least 59½ years old.
Taxation of Nonqualified Distributions	If the requirements for a qualified distribution are not met, the distribution will be a nonqualified distribution and distributed earnings will be taxable. 403(b) and 401(k) participants may also be subject to a 10% early distribution tax for nonqualified distributions made prior to age 59½.	May be subject to a 10% recapture tax.	**Roth IRA and Deemed Roth IRAs** Distribution of earnings prior to age 59½ will be taxable and subject to a 10% early distribution tax. The exceptions to this tax are those that apply to IRAs and non-employer retirement plans.
Eligible Rollover Distributions	May be contributed to a plan's designated Roth account or to a Roth IRA.	Required for in-plan conversion and contribution to the same plan's designated Roth account.	**Roth and Deemed Roth IRAs** Can only be rolled over to other Roth IRAs.
Distribution Tax Reporting	IRS Form 1099-R.	IRS Form 1099-R.	**Roth and Deemed Roth IRAs** Distributions are reported on IRS Form 1099-R. Trustee must provide IRS Forms 5498 annually reflecting account activity and if an RMD will be required in the following year.
Plan Amendment Requirements	By the last day of the plan year in which designated Roth account becomes effective, unless subsequent IRS guidance for 457(b) plans indicates otherwise.	**457(b)** government plans, unless IRS guidance is provided otherwise, have until the later of the last day of the plan year the amendment becomes effective or December 31, 2011. **401(k)** plans have until the later of the last day of the plan year the amendment becomes effective or December 31, 2011. The amendment must be retroactive as of the date the in-plan Roth rollover option becomes effective. **403(b)** prototype plans or plans that apply for an IRS determination letter will generally have until the next date the 403(b) plan has to be restated to adopt the in-plan Roth rollover amendment.	**Roth IRA** – N/A **Deemed Roth IRA** By the last day of the plan year in which deemed IRA becomes effective.

Maximum Contribution Limits

The maximum annual salary deferrals, both pretax and designated Roth contributions, that an employee can contribute to the 457 plan parallels the maximum deferral limit that applies to 403(b) and 401(k) plans, unless the 457 plan specifies a lower amount. This limit, excluding rollover contributions and loan repayments, is the lesser of:

- 100% of a participant's includible compensation, or
- An annual dollar amount as indexed under the IRC[14]

For 2012, the maximum dollar limit per participant is $17,000. 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, but excludes rollover contributions and loan repayments.

Prior to 2002, *includible compensation* for 457 plans was defined as compensation includible in gross income. All pretax deferrals to a section 457(b), 401(k), 403(b), 414(h) pick-up, and/or 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 is now defined as compensation for federal income tax purposes **plus** all pretax elective salary deferrals to §457, 401(k) and 403(b) plans, 125 cafeteria plans and 132(f) qualified transportation plans.[15] Although the definition of compensation under 415(c)(3) now applies to 457 plans, the 415(c)(3) contribution limits that apply to qualified and 403(b) plans do not apply to 457 plans. Table 5 provides the 2012 contribution limits that apply to 457 and other retirement plans.

Table 5

Retirement Plan Contribution Limits					
	2012	**2011**	**2010**	**2009**	**2008**
Retirement Plan and IRA Dollar Limits					
Annual compensation limit (per participant)	$250,000	$245,000	$245,000	$245,000	$230,000
Defined contribution limit (per participant)	$50,000	$49,000	$49,000	$49,000	$46,000
401(k)/403(b) elective deferral limit (excluding applicable catch-up contributions)	$17,000	$16,500	$16,500	$16,500	$15,500
457(b) elective deferral limit (excluding applicable catch-up contributions)	$17,000	$16,500	$16,500	$16,500	$15,500
Age 50 catch-up 401(k)/403(b) and 457(b) plans	$5,500	$5,500	$5,500	$5,500	$5,000
Compensation limit for grandfathered participants in government plans	$375,000	$360,000	$360,000	$360,000	$345,000
Defined benefit annual benefit limit (per participant)	$205,000	$195,000	$195,000	$195,000	$185,00
Key employee threshold (non-government plans only)	$165,000	$160,000	$160,000	$160,000	$150,000
Highly compensated employee (HCE) threshold	$115,000	$110,000	$110,000	$110,000	$105,000
Traditional and/or Roth IRA contribution limit	$5,000	$5,000	$5,000	$5,000	$5,000
Age 50+ Catch-up for Roth & traditional IRAs	$1,000	$1,000	$1,000	$1,000	$1,000
Roth conversion income requirements	None	None	None	$100,000	$100,000

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 those to any other 457(b) plan – which reduced the available 457 limit for that year ($8,500 for 2001). Beginning in 2002, 457 plan deferrals are now 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) cannot exceed the annual maximum deferral limit.[16]

Example: In 2012, Joe, age 45, earns $65,000 from a public 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 2012 would be $17,000 to the 403(b) plan and another $17,000 to the 457 plan.

Special 457 Catch-up Contributions

A 457 plan may offer participants an additional deferral opportunity by adopting the Special 457 Catch-up provision. This optional plan provision permits participants to contribute underutilized (unused) 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), as defined in the plan document.[17]
All of an employer's 457(b) plans must have the same NRA.

The participant must have sufficient compensation and unused deferrals from prior years to make Special 457 Catch-up contributions.

The three-year period that the participant can make catch-up contributions of underutilized deferrals from prior years 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 reached.
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 participants 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]

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 may be as early as age 40 or a range of ages between 40 and 70½.

Example 1: 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 62, 63 and 64 years old. Special 457 Catch-up cannot be used in the year participants reach age 65, the plan's NRA.

For Special 457 Catch-up, the total unused deferral amounts from prior years are determined by calculating the amount the participant was eligible to 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 before reaching the plan's normal retirement age. The maximum amount that a participant could contribute in annual deferrals and Special 457 Catch-up is twice the annual dollar maximum amount in effect for the year Special 457 Catch-up contributions are being made to the plan.[19]

Example 2: For 2012, the maximum contribution including Special 457 Catch-up would be:

$17,000 annual maximum

+

$17,000 Special 457 Catch-up

——————————————————

= $34,000 total maximum contribution

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 457 Catch-up may be used, participants are not required to retire on that date.

Calculating under-deferrals for years prior to 2002

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 deferral contributions to 403(b), 401(k), SEP and SIMPLE plans, as well as deferrals to other 457 plans for years prior to 2002.

Example 3: In 2012, 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 his employer's 401(k) plan and 457 plan. He participated only in the 401(k) plan and deferred the maximum amount possible under the 401(k) plan. For 2002 through 2011, 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 those years. For 2002 to 2011, 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. Therefore, he is not eligible to make Special 457 Catch-up contributions. He could in 2012, if the plan permits, make age 50 catch-up contributions.

Age 50 Catch-Up Contributions

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 2012). 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 2012, 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. $21,000 based on $17,000 normal maximum deferral plus $4,000 in underutilized deferrals under the Special 457 Catch-up provision; or
2. $22,500 based on $17,000 maximum deferral limit plus $5,500, under the age 50 catch-up. The age 50 catch-up calculation produces the greatest deferral amount and is applied for 2012.

Deferring Sick, Vacation and 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 that the participant is considered an employee in that month. Deferrals of unused sick, vacation and back pay count 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 assuming 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 had employment 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, 2012, 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 into the 457 plan no later than the end of the calendar year that includes his date of severance (December 31, 2012).

Example 2: Same as above except George terminates employment on November 1, 2012. He has made regular deferrals to his 457 plan account and has reached the maximum deferral limit for 2012. Although George cannot defer any unused sick and vacation pay into his 457 plan for 2012, he could defer his accumulated sick and vacation pay into the plan by January 15, 2013, provided the deferral does not exceed the deferral limit for 2013.

Contributions of Differential Pay for Employees on Active Military Duty

Differential pay, for this purpose, is defined as all or a portion of the wages employers pay to employees who are on active duty in the Uniformed Services. It represents pay the employees would have received if they were still working for the employer instead of serving in the military.

Differential pay paid after December 31, 2008, to all employees on active military duty for more than 30 days must be treated as employee compensation for retirement plan purposes and included in the plan's definition of compensation.

The 457 plan may, but is not required to, permit employees on active military duty to contribute all or a portion of their differential pay to their employer's 457 plan.

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 given the opportunity to make up (contribute) missed deferrals when they resume employment with their former civilian employer. These employees may elect to make additional elective deferrals (pretax and/or designated Roth contributions) 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.

Prompt Remittance of Deferral Contributions

Participant deferrals must be remitted to the 457 trust or 457 investment providers within a period that is reasonable for proper administration of the plan. Generally this period, according to 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(b) 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 deferrals were contributed 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 deferrals have been discovered. A 457(b) plan may become a 457(f) (ineligible) plan with potentially severe tax consequences for all future contributions of all participants if excess contributions and earnings are not distributed to participants who made excess contributions.[26]

Saver's Credit

The Saver's Credit offers low- and moderate-income taxpayers a way to save on federal income taxes. Eligible individuals may be able to take a credit on their federal income taxes up to $1,000 (up to $2,000 for joint filers) depending on their adjusted gross income and tax filing status for contributions they make to their employer-sponsored retirement plans or IRAs.

Table 6

2012 Saver's Credit Adjustments			
	Adjusted Gross Income / Filing Status		
Amount of Credit	**Joint**	**Head of Household**	**Single/Others**
50% of first $2,000 deferred	$0 to $ 34,500	$0 to $25,875	$0 to $17,250
20% of first $2,000 deferred	$34,501 to $37,500	$25,876 to $28,125	$17,251 to $18,750
10% of first $2,000 deferred	$37,501 to $57,500	$28,126 to $43,125	$18,751 to $28,750

Taxpayers must attach IRS Form 8880 to their federal income tax returns to claim the Saver's Credit. If joint filers have each contributed to their respective IRAs or retirement plans, they could be eligible for up to twice the dollar limit ($2,000) instead of the $1,000 limit that applies to non-joint filers.

Distributions

The provisions of a 457 plan document must describe when participants and beneficiaries may take or are required to take distributions from the plan. This section discusses these rules and their application. 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 457 plan document specifies when distributions may be made from the plan. It may or may not include all of the following permissible distribution events listed in the tax code [IRC §457(d) and §414(w)]:

- **Severance from (of) employment** — is defined as termination of employment, 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 amount needed to cover the stated emergency situation and any applicable federal and state taxes. See the section immediately below for a broader explanation of this point.
- **Withdrawal of automatic enrollment contributions** — For plan years beginning on or after January 1, 2008, plans with an automatic enrollment feature may, but are 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. 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** — Under the HEART Act of 2008, 457 plans may allow employees who are on active military duty in the Uniformed Services for more than 30 days to withdraw their elective contributions from the 457 plan. For this purpose, employees on active military duty are considered (deemed) to have terminated employment with the employer so 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 six 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.

  Subsequent IRS guidance (Notice 2010-15) clarifies that this six-month restriction on making elective deferrals to the plan does not apply to Active Duty participants who:
  - Have an actual severance from employment
  - May be able to take a distribution from the plan for another reason

  Other types of in-service plan distributions are not affected if permitted under other rules and terms of the plan.
- **Distributions of small accounts** — called *de minimis distributions*, permits the plan to distribute small account balances ($5,000 or less) to participants, with or without their consent. See page 27 for a broader explanation of this point.

Unforeseeable Emergency Withdrawals

The key to administering this provision is to consistently apply the rules and procedures for these distributions to all participants. 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 typically defined as a severe financial hardship of the participant, dependent or plan 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)
- Other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or beneficiary[27]

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[28]

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

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.

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.

According to 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).

IRS Revenue Ruling 2010-47 provided additional examples of unforeseeable emergency distribution based on plan language similar to the IRS model amendment for unforeseeable emergency withdrawals. This ruling discusses "other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary."

- *Situation 1*: A participant requests an unforeseeable emergency distribution to pay for the cost of repairing significant damage from a water leak discovered in the basement of the participant's principal residence. The water damage is not covered by insurance. The participant provides written cost estimate for the necessary repairs to the plan administrator. According to the revenue ruling, this situation would be an unforeseeable emergency arising from extraordinary and unforeseeable circumstances beyond the participant's control similar to a natural disaster.
- *Situation 2*: A participant requests an unforeseeable emergency distribution to pay for the funeral expenses for the participant's adult son, who is not a dependent [as defined in §152(a)]. This request would meet the requirements of an unforeseeable emergency because the situation is beyond the control of the participant and similar to the need to pay funeral expenses of a dependent.
- *Situation 3*: A participant requests an emergency withdrawal to pay accumulated credit card debts, which were not due to any events that are extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant. This request would not meet the requirements for an unforeseeable emergency withdrawal.

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
- The calendar year the participant retires

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

- Life Expectancy Rule
- The Five-year Rule[29]

Many plans distribute a participant's account balance during a participant's lifetime based the participant's life expectancy. If, however, the participant's spouse is the sole designated 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 like plan uses the life expectancy rule. Alternatively, a plan may require that the plan distribute the value of a deceased participant's account to the designated beneficiary by December 31 of the calendar year that includes the fifth anniversary of the participant's death.[31]

Example 1: Mary participated in County X's 457 plan and dies on June 15, 2010. Her plan requires that all designated plan beneficiaries, be paid out under the Five-year Rule. Mary's designated plan beneficiaries must be paid out no later than December 31, 2015.

Under the life expectancy rule, there is a special rule if the surviving spouse is the sole beneficiary of the participant's account and 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 2: A 457 plan participant dies in 2010 at the age of 68. His surviving spouse is the sole beneficiary of his retirement account. He would have been age 70½ in 2013. His surviving spouse could postpone taking RMDs from his account until December 31, 2013. 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, 2011 — the year following the calendar year of the participant's death. Conversely, if the plan uses the Five-year Rule instead of the life expectancy rule, deceased participant's account balance would have to be paid out to all beneficiaries (including a surviving spouse) no later than December 31, 2015.

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 plans may be more restrictive than the required minimum distribution regulations.

Waiver of RMD Payments for 2009

The Worker, Retiree and Employer Recovery Act of 2008 (WRERA) permitted qualified defined contribution plans, 403(b) and governmental 457(b) plans, and IRAs to waive RMD payments for the 2009 calendar year. However, initial RMD distributions for 2008 that were scheduled to begin by April 1, 2009, were not waived and still had to be paid by April 1, 2009.

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 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 six years instead of five years to make a complete distribution of a decedent's account balance for any five-year period that includes the 2009 calendar year.

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.

Example: State Z's 457(b) plan is a calendar year plan and would have to be amended by December 31, 2012.

Complying with the RMD Rules

In 2009, the Treasury Department and IRS issued final regulations that permit a governmental plan, including a governmental 457(b) plan, to comply with the required minimum distribution (RMD) rules using a reasonable and good faith interpretation of the RMD statute. These final regulations apply to participants and beneficiaries in governmental 401(a) qualified plans [including 401(k) plans], 403(b) plans and 457(b) plans for all years the RMD rules apply to these plans.

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:

- The participant's total account balance (deferrals plus investment earnings) is $5,000 or less
- 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 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 to have these amounts distributed.

If the plan provides for mandatory distributions of account balances of more than $1,000 but less than $5,000, it may be 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 they provide 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. Amounts under $1,000 do not have to be automatically contributed to an IRA, and may be distributed in cash.

Distributions to Public Safety Workers

The Pension Protection Act of 2006 (PPA 06) included two new distribution provisions for *public safety employees* and/or *public safety officers*. Public safety employees are defined as employees of a State or political subdivision of a State whose primary duties include services requiring specialized training in the area of police protection, firefighting or emergency medical services for any area within the jurisdiction of the State or its political subdivision. The definition of a *public safety employee* is fairly narrow but the definition for *public safety officer* is fairly broad. These two provisions:

- Permit up to $3,000 exclusion from annual gross income attributed to pension payments to public safety officers to pay health insurance or long-term care premiums; for a more in-depth discussion of this exclusion, please see Page 30

- Provide an exception to the 10% early distribution penalty to public safety employees who separate from service at age 50 or older who take lump-sum distributions from their governmental defined benefit plan

This provision also includes lump-sum distributions to public safety employees from governmental defined benefit plans with a DROP feature.

CAUTION

This waiver applies only to actual lump-sum distributions from a governmental defined benefit plan to retired public safety employees. **It does not apply to distributions from defined benefit plans that are rolled over into an eligible defined contribution, 403(b), or governmental 457(b) plan or IRA**. In other words, eligible rollover amounts distributed from a governmental defined benefit plan that are rolled into a governmental 457(b) plan cannot use this exception to avoid the 10% early distribution tax for distributions from a 457 rollover account prior to age 59½ even if the distributee was a retired public safety employee.

Example 1: Firefighter Frank, a public safety employee, retires at age 52. Prior to retirement, he participated in State O's defined benefit DROP (Deferred Retirement Option Plan). After completing his DROP period of service, he is required to retire and take his DROP benefit as a lump sum as soon as administratively feasible after leaving service. If Frank takes the taxable portion of his DROP distribution and spends it or puts it in the bank, he will not be subject to the 10% early distribution tax, but he will still have to include the distribution in his gross income in the year it is distributed to him from the defined benefit DROP. If, instead, he rolls the DROP distribution into State O's 457 plan or into an IRA and takes distribution prior to age 59½, he will be subject to the 10% early distribution tax unless an applicable exception to the tax for 401(a) defined contribution plans applies. The fact that he was a retired public safety employee does not affect the application of the early distribution tax to distributions from a 457 plan, defined contribution plan or IRA.

Example 2: At age 53, Detective Draper retires from City X. After completing his participation in City X's defined benefit DROP, he is required to take a lump-sum distribution from his DROP account as soon as administratively feasible after leaving employment with the City. Immediately after retiring from City X, Detective Draper is hired as a security consultant with a private sector security firm that sponsors a 401(k) plan. He has his DROP distribution rolled directly from his governmental defined benefit plan into his new employer's 401(k) plan. He is not subject to taxes or penalties because he had the distribution directly rolled over into another eligible retirement plan. Later, he retires from his private sector security job at age 57 and takes a lump-sum distribution from his 401(k) plan which includes the money he had rolled from City X's DROP. None of his 401(k) distribution is subject to the 10% early distribution tax because he terminated employment with the employer sponsoring the 401(k) plan after age 55 and not because the rollover money came from a governmental defined benefit plan.

Table 7

Primary Exceptions to the 10% Early Distribution Tax		
Exceptions Under IRC §72(t) for Distributions Which are:	**Traditional and Roth IRAs, Including Deemed IRAs**	**401(a), 403(b) Plans and Governmental 457 Plan Rollover Accounts Holding Roll-ins from Non-457 Plans**
Made on or after age 59½	X	X
Made to employee after separation from service and after attainment of age 55 (age 50 for public safety employees in governmental defined benefit plans)	N/A	X Requires termination of employment
Distribution to beneficiary	X	X
Qualified Reservist distributions	X	X Does not apply to distributions from 457 plan accounts
Attributable to an employee's total and permanent disability	X	X
Made to qualified first time home buyer	X	N/A
Refunds of economic stimulus payment deposited directly into IRA	X	N/A
Conversion from traditional IRA or Simple IRA to a Roth IRA	X	N/A
In-plan rollovers (conversions) to the plan's designated Roth account	N/A	X
Made for qualified higher education expenses	X	N/A
Payment of qualified medical insurance premiums for unemployed persons	X	N/A
Unreimbursed medical expenses up to 7.5% of adjusted gross income	N/A	X
Seizure by IRS for tax levy on qualified plan	X	X
Substantial equal periodic payments made at least annually based on life expectancy	Payments must be made until age 59½ or for 5 years whichever is longer. Separation from service is not required.	Payments must be made until age 59½ or for 5 years whichever is longer and individual must be separated from service.
QDRO payments to an alternate payee	N/A	X
Qualified disaster recovery distribution or qualified disaster recovery assistance distribution	X	X
Rollover from a 401(a), 403(b) or governmental 457(b) plan to a Roth IRA	X	X

Plan Distributions for Qualified Health and Long-term Care Premiums

Beginning in 2007, a government plan, including a 457 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 health and long-term care premiums. The $3,000 annual limit applies to premiums paid to both insured and self-insured health care plans from all governmental retirement plans including defined benefit, defined contribution and governmental 457(b) plans.[33]

Retired or disabled public safety officers may elect to have these amounts excluded from gross income on their federal income tax returns. **This exclusion from gross income does not apply to surviving spouses or dependents that use plan distributions to pay for their own health or long-term care premiums.**

For purposes of this annual $3,000 federal income tax exclusion, eligible public safety officers are defined 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]

Benefits Available to Employees on Active Military Duty

Benefit Accruals for Employees Who Die or Become Disabled

The Heroes Earnings Assistance and Relief Tax Act of 2008 (HEART) 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 option 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 plan 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.

Withdrawals by Employees on Active Military Duty

Under the HEART Act, employees are treated as having terminated employment during any period that they are performing qualified service in the Uniformed Services for more than 30 days. The plan may permit these employees to withdraw elective deferrals from the governmental 457(b) plan without violating the plan's distribution restrictions for plan years beginning after December 31, 2008.

Additional IRS guidance clarifies that:

- All individuals who are on active duty for more than 30 days, whether or not they are receiving differential pay, are considered (deemed) to have severed employment for distribution purposes under a 401(k), 403(b) or governmental 457(b) plan
- The plan may permit distributions for this deemed severance from employment
- The plan must also provide that an individual receiving the distribution not make elective deferral or employee contribution during the six-month period beginning on the date of the distribution
- The restriction on making elective deferrals to the plan does not apply to participants who have an actual severance from employment or who may be able to take a distribution from the plan for another reason

Other types of in-service plan distributions are not affected if the plan permits them.

Distributions made because of a deemed severance from employment are:

- Not considered hardship distributions
- Not eligible for rollover
- Subject to mandatory 20% withholding rules if the distribution is not rolled over to another eligible retirement plan or IRA

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 employee had returned to work with his/her 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

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.

Some distributions from governmental 457(b) plans may be eligible to be rolled over and contributed to an Individual Retirement Arrangement (traditional and Roth IRAs), as well as a governmental 457(b), 401(a), 401(k) or 403(b) plan.[35]

Types of Rollovers

Direct rollover (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, non-spouse beneficiary or spouse or former spouse 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.

Sixty-day rollover (indirect rollover) allows a participant, spousal beneficiary or spouse or former spouse alternate payee to retain the tax-deferred status of a distribution 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, providing the receiving plan agrees to accept the rollover. Indirect rollovers to an inherited IRA are not available to non-spouse beneficiaries.

The following table outlines the rollover options to and from employer-sponsored retirement plans and IRAs.

Table 8

Rollovers									
	Roll To								
Roll From		**Govern-mental 457(b)***	**Qualified Plan****	**403(b) Plan**	**Designated Roth Account in 401(k), 403(b) or Governmental 457(b) Plan**	**Roth IRA**	**IRA (Traditional)**	**SIMPLE IRA**	**SEP-IRA**
	Governmental 457(b)*	Y	Y	Y	Y – as an in-plan rollover	Y	Y	N	Y
	Qualified Plan (pretax)**	Y	Y	Y	Y – as an in-plan rollover	Y	Y	N	Y
	403(b) Plan (pretax)	Y	Y	Y	Y – as an in-plan rollover	Y	Y	N	Y
	Designated Roth Account in 401(k), 403(b) or Governmental 457(b) Plan	N	N	N	Y	Y	N	N	N
	Roth IRA	N	N	N	N	Y	Y	N	N
	IRA (Traditional)	Y	Y	Y	N	Y	Y	N	Y
	SIMPLE IRA	Y – after 2 years	Y – after 2 years	Y – after 2 years	N	Y – after 2 years	Y – after 2 years	Y	Y – after 2 years
	SEP-IRA	Y	Y	Y	N	Y	Y	N	Y

** Rollovers and their earnings must be tracked in a separate rollover account(s) within the 457(b) plan.*

*** Qualified plans are plans subject to 401(a) of the IRC and include both defined contribution and defined benefit plans. 401(k) plans are a subset of 401(a) profit-sharing plans and pre-ERISA money purchase plans.*

Effect of Rollovers

Rollover contributions to the 457 plan take on the characteristics of the 457 plan except for the application of the 10% early distribution tax for distributions prior to age 59½ from the rollover account that holds or includes non-457 plan rollover contributions. Distributions in the rollover accounts may be subject to the exceptions to the 10% penalty distribution tax that apply to qualified plans even if the rollover contribution originated from an IRA.

Prior to making a distribution, the plan is required to give participants, spousal beneficiaries and/or spousal alternate payees a special tax notice known as a *402(f) notice* 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]

Rollovers from the 457 plan take on the characteristics and requirements of the plan or IRA that accepts the 457 rollover. The early distribution penalty, which generally 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.

Rollover contributions to other eligible retirement plans and traditional IRAs as well as their earnings 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 to Roth IRAs and in-plan Roth rollovers are included in gross income of a participant, beneficiary or alternate payee in the tax year in which the rollover contributions are contributed. 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 are participants if the plan agrees to accept their rollover contributions.

Governmental 457(b) plans may permit participants, spousal beneficiaries, spouse and former spouse alternate payees who are employees of the employer sponsoring the 457 plan to roll distributions from their 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.[37] Rollover contributions, including in-plan Roth rollovers, do not count toward the plan's annual contribution limits.

Application of the 10% early distribution tax

When distributed from the 457 plan, 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 IRA.[38] This additional 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 with IRA rollovers or rollovers from other retirement plans may become subject to the early distribution tax. The plan document may permit the plan to establish two separate rollover accounts, one to accept 457 rollovers and one to accept all other rollovers, to shield 457 rollovers from this tax. For more information about the 10% early distribution tax, see the table on Page 29.

Example: Ramon, a participant in City Z's 457 plan, wants to consolidate his retirement accounts from previous employers as well as his traditional IRA accounts, so he rolls these account balances into his current employer, City Z's 457 plan. City Z's 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 so that 457 rollover money will not be subject to the early distribution tax when it is distributed prior to age 59½.

Anytime Distributions from 457 Rollover Accounts

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, 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 from other 457 plans are not rollovers and cannot be distributed under this anytime distribution rule.[39]

Direct Rollovers to Roth IRAs

Beginning in 2008, 457 plans must offer participants the option of rolling their 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.[40] Until 2010, rollovers from a 457 plan to a Roth IRA were available only to participants with modified adjusted gross incomes of $100,000 or less. In 2010 and later, this income limitation status and tax filing status no longer apply for rollovers to Roth IRAs from the 457 plan. Ongoing annual contributions to a Roth IRA are still subject to certain income limitations.

Rollovers for Non-spouse Beneficiaries

PPA 06 permitted employer-sponsored retirement plans [401(a), 401(k), 403(b) and governmental 457(b) plans] to offer designated plan non-spouse beneficiaries the option of directly rolling over a decedent's 457 account balance to an inherited IRA which gives non-spouse beneficiaries in employer-sponsored plans the same rollover option as non-spouse beneficiaries of an IRA.

For plan years beginning after December 31, 2009, governmental 457(b) plans are required to:

- Offer non-spouse beneficiaries the direct rollover option to an inherited IRA
- Provide non-spouse beneficiaries with 402(f) notices informing them of their right to directly roll their eligible distributions into an inherited IRA
- Withhold 20% from the distribution for federal income tax purposes if distribution is not directly rolled into an inherited IRA

For rollovers to inherited IRAs, the 457 plan is 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.[41]

Example 1: John is an employee in Company X's 401(k) plan and the beneficiary of his father's, Ted's, governmental. Ted dies. John can have Ted's 457 account balance directly rolled over to an inherited IRA, but cannot have this distribution rolled into his 401(k) plan or any other employer-sponsored retirement plan in which he participates or to an IRA in which he is the account holder.

Example 2: Same as above except John dies instead of Ted. Ted is John's plan beneficiary and Ted wants to roll John's account balance into his 457 plan account. He cannot roll this money into his 457 account because he is a non-spouse beneficiary of John's account. His only rollover option is to have this money rolled directly into an inherited IRA.

Example 3: Both Bill and his sister Eunice are employees of County Y and participate in its 457 plan. They are each other's designated plan beneficiary. Eunice dies. Bill would like to roll Eunice's account balance into his own 457 account, He cannot roll Eunice's account balance into his own 457 account. His only rollover option is a direct rollover to an inherited IRA.

In-plan Roth Rollovers to 457 Designated Roth Accounts

In-plan Roth rollovers are an optional feature 457 plans may adopt after December 31, 2010, which then permits participants to roll their 457 non-designated Roth account assets into the same 457 plan's designated Roth account. Amounts from non-designated Roth accounts that are converted to Roth contributions and rolled into the plan's designated Roth account are taxable in the year they are contributed to the plan's designated Roth account. Plans that adopt in-plan Roth rollovers may designate that any vested amounts held in a non-designated Roth account may be eligible for an in-plan Roth rollover. These amounts must satisfy the distribution rules of the 457 plan and the IRC, and must be eligible rollover distributions.

Eligible and Ineligible Participants

The plan may permit participants, surviving spouses, and spouse and former spouse alternate payees to make in-plan Roth rollovers. In-plan Roth rollovers are not available to non-spouse beneficiaries or alternate payees who are not spouses or former spouses.

In-plan Roth rollovers are irrevocable and cannot be reversed, unlike like Roth IRAs, which can be recharacterized to deductible traditional IRAs within certain timeframes.

In-plan Roth rollovers must be separately accounted for within the participant's designated Roth account. A designated Roth account may have subaccounts for:

- Roth elective deferrals and earnings
- Rollovers from another plan's designated Roth account and earnings
- In-plan Roth rollovers and earnings

Distribution rules from each of these subaccounts may differ. For example, plans may permit distributions from rollover accounts at any time while the participant is still working but would not permit distributions from other non-rollover accounts unless the participant was eligible for a distribution.

Participant Notice Requirements

IRC 402(f) requires that a plan offering in-plan Roth rollovers include a description of this feature in the written explanation provided to participants prior to their taking a distribution from the plan. Notice 2010-84 Q & A 5 includes sample language plan administrators may use to revise their IRS safe harbor 402(f) Notices for distributions from non-designated Roth accounts.

Taxes and Withholding

Pretax funds that are converted to Roth contributions within the same plan are subject to taxation in the year the in-plan Roth rollover is contributed to the plan's designated Roth account. Direct in-plan Roth rollovers are not subject to the 20% mandatory withholding rules. But participants may have to increase their withholding to avoid an under-payment penalty on their federal income tax. (See IRS Publication 505.)

Recapture Tax

The application of the 10% recapture tax should not be confused with determining whether a Roth 457 distribution is a qualified or nonqualified distribution. A 10% penalty could apply to distributions from the 457 plan's in-plan Roth rollover account if a distribution is made from an in-plan Roth rollover subaccount within a five-year holding period beginning on January 1 of the year an in-plan rollover is contributed to the same 457 plan's designated Roth account. Each in-plan Roth rollover will have its own five-year holding period for purposes of applying recapture tax. Distributions of in-plan Roth rollovers are made on a first in/first out basis, so that the oldest in-plan Roth rollover is treated as being distributed first.

This recapture tax applies in a 457 plan only to distributions of in-plan Roth rollovers that originated from the plan's pretax rollover account holding assets from qualified plans, 403(b) plans and IRAs. The recapture tax does not apply to distributions of Roth elective deferrals, rollovers from another plan's designated Roth account, in-plan Roth rollover that are rolled over to another plan's designated Roth account or a participant's Roth IRA. Nonetheless, the recapture tax may apply to subsequent distributions from another designated Roth account or Roth IRA within the five-year holding period for the taxable portion of the distribution that originated from an in-plan Roth rollover.

Distributions Not Eligible for Rollover

Some plan distributions are not eligible to be rolled over and contributed to another eligible retirement plan, a designated Roth account in another plan or within the same plan or an IRA. The following distributions are not eligible rollover distributions and cannot be contributed to a governmental 457(b) plan:

- Unforeseeable emergency withdrawals and hardship distributions
- Required minimum distribution (RMD) payments, except for 2009 RMDs
- Returned excess contributions and earnings
- Distributions from Roth IRAs
- Deemed participant loan distributions
- Payments based on life expectancy, or payments that are expected to last 10 years or more
- Distributions from foreign retirement plans
- 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[42]

Other Plan Provisions

A plan sponsor may include additional provisions in the 457 plan for participant loans, defined benefit service credit purchases, designated Roth contributions, in-plan Roth rollovers (conversions), deemed IRAs, plan-to-plan transfers and plan termination.

Participant Loans

A plan may permit participants to borrow from the 457 plan using their account balance as security for a loan from the plan. 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 and beneficiaries*.

The maximum non-taxable loan amount, including loans from any life insurance contracts that are offered as plan investment options, is generally the lesser of:

- 50% of a participant's vested account balance in the 457 plan (excluding any balances held in a deemed IRA)
- $50,000 reduced by outstanding loan balances from this and other retirement plans sponsored by the employer during the preceding 12-month period[43]

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 loan program follow a bona fide lender-borrower loan process that includes:

- An application procedure and 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 not be taxable 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 five 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[44]

A loan is treated as a deemed taxable distribution if participants:

- Do not make scheduled loan repayments on time
- Do not repay the loan balance within a specified time period (as specified in the plan's loan program)
- Obtain a loan that exceeds the IRC maximum loan limits on the loan origination date; amounts that exceed the IRC loan limits are subject to immediate taxation

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.[45]

Example 1 – Loan less than $50,000

Sue's 457 plan allows up to two loans at a time. Her vested account balance is $105,000. On January 15, 2011, she obtains a $40,000 loan from the plan secured by her vested account balance. She has no other loans from this or any of her employer's other retirement plans. On November 1, 2011, when she requests another loan, her outstanding loan balance is $35,000. Her highest loan balance for the prior 12 months is $40,000. Sue may borrow up to another $10,000 without exceeding the $50,000 maximum loan limit.

Example 2 – $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, 2011, he borrows $50,000. He has repaid $8,000, leaving an outstanding loan balance of $42,000. On December 1, 2011, he requests an additional loan of $8,000. Jack's maximum non-taxable loan amount on December 1, 2011, is calculated by reducing the $50,000 maximum amount by the amount repaid during the past 12 month period — $8,000. The new loan maximum is $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 3 – Loan Payoff and Request for a New Loan

Same as above, except Jack repays his $50,000 loan on October 1, 2011, and asks for a new loan on November 1, 2010. 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 12 months after October 1, 2011 (Oct. 1, 2012), 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.

Loans for Employees on Qualified Military Leave

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 period of qualified military leave.[46]

Plan-to-plan Transfers

A 457(b) plan may permit certain non-taxable plan-to-plan transfers of participant and beneficiary account balances to another governmental 457(b) plan without a distribution event. The terms *transfer* and *rollover* should not be used interchangeably. Governmental 457(b) plans may accept plan-to-plan 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 plan-to-plan transfer provision.

The following table compares rollovers with plan-to plan transfers.

Table 9

Plan-to-plan Transfers vs. Rollovers (Trustee-to-trustee Transfers)		
Distribution	**Rollovers (Direct or Indirect)**	**Plan to plan transfer**
Requires plan distribution event such as termination of employment	X	
May be contributed to 401(a), 403(b), governmental 457(b) plans and IRAs	X	
Required plan provision	X	
May be distributed at anytime as requested by participant and if plan permits	X	
Must be tracked in a separate account within plan	X	
Subject to mandatory 20% tax withholding	X — applies if distribution is not directly rolled over to another retirement plan	
402(f) notices and 1099 tax reporting required	X	
Permissive plan provision		X
Cannot be distributed to participant		X
Can only be contributed directly to a like plan*		X

** May also be transferred to a governmental defined benefit plan to purchase service credits while participant is still working. See next page.*

A governmental 457(b) plan cannot transfer assets, in a plan-to-plan transfer, to the 457(b) plans of non-governmental tax-exempt entities, 457(f), 401(k), 401(a), 403(b) plans or IRAs and vice versa.[47]

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 eligible to defer to the receiving plan only 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 457 plan, participants and beneficiaries may transfer assets between these plans without a severance of employment provided both plans agree to the transfer.[48]

Purchase of Permissive Service Credits

Governmental 457(b) and 403(b) plans 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 does not require a severance of employment.

The plan-to-plan transfer to purchase permissive service credits is typically initiated by the pension system at the request of the participant or beneficiary. Generally, the pension system is responsible for determining whether service in the defined benefit plan is eligible to be purchased with 457 or 403(b) plan assets.

PPA 06 clarified the definition of permissive service credit 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) plans to governmental defined benefit plans are not subject to the limits that apply to nonqualified 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.[49]

Qualified Domestic Relations Orders (QDRO)

A 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. Federal law permits governmental 457(b) plans 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, 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.

A court issued DRO 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 an alternate payee. An alternate payee generally 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 a workplace 401(a), 401(k), 403(b) or other 457(b) plan in which the alternate payee (spouse or former 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.[50]

Example 1 – Former spouse alternate payee does not participate in an employer-sponsored retirement plan
Felix is a participant in County Y's 457 plan. He and his wife, Tina, divorce. The 457 plan administrator receives a Domestic Relations Order (DRO) issued by a state domestic relations court and determines that it is a QDRO. Under the terms of the QDRO, Tina is to receive 50% of Felix's 457 account balance payable immediately. Tina is not a participant in any employer-sponsored retirement plan. She, as a former spouse alternate payee, may roll this distribution into a traditional IRA or Roth IRA.

Example 2 – Alternate payee participates in governmental 457 plan
Fred participates in his private sector employer's 401(k) plan, His wife, Ginger, participates in County X's 457 plan. Fred and Ginger divorce. The plan administrator of Fred's 401(k) plan receives a DRO that entitles Ginger to 50% of Fred's 401(k) account, payable immediately. The plan administrator determines that the DRO is a QDRO and that Ginger is entitled to receive 50% of Fred's 401(k) account. Ginger, as a former spouse alternate payee, may roll her distribution from Fred's 401(k) plan into her own 457 account or into an IRA.

Deemed IRAs

Employers may establish a deemed IRA as a separate account within the 457 plan. The deemed IRA is treated as an IRA and subject to the rules governing IRAs, not the rules governing the 457 plan. Voluntary employee contributions to a "deemed IRA," as designated by the employee, are treated as either traditional or Roth IRA contributions.[51] Deemed Roth IRAs should not be confused with a plan's designated Roth accounts.

Annual contribution limits to a deemed IRA, excluding rollovers and conversions, within an employer-sponsored retirement plan use the same criteria that apply to traditional and Roth IRAs.

Table 10

Traditional and Roth IRA Income Limits (Including Deemed IRAs)

2012	Single Filers	Married Filing Jointly	Married Filing Separately	All Others
Traditional IRA — active participant in a retirement plan	$58,000 – $68,000	$92,000 – $112,000	$0 – $10,000	$58,000 – $68,000
Roth IRA — contributions (other than conversions)	$110,000 – $125,000	$173,000 – $183,000	$0 – $10,000	$110,000 – $125,000

The final deemed IRA regulations provide guidance for administering deemed IRAs as part of an employer-sponsored retirement 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
- 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

IRAs may not invest in life insurance contracts. The final deemed IRA regulations 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.

The trustee of a deemed IRA 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
- 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 that apply to IRA trustees and custodians if they have taxing authority under applicable state or local laws. The IRS Commissioner may exempt a governmental unit from other requirements.[52]

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
- Give participants the option of directly rolling their account balances to an IRA or another plan that will accept the rollover[53]

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 document when necessary to incorporate any required changes.[54]

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. Only employees who are employees of the employer sponsoring the receiving plan are permitted to make ongoing contributions to the receiving plan.

Funding a 457(b) Plan

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

457(g) 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.[55] 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 also 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).[56]

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

- The insurance company is qualified to do business in the state that governs the public employer's plan
- The contract meets the requirements of the trust provisions as stated in the final 457 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.)[57]

Tax Compliance

The tax-deferred status of the plan may be jeopardized if the plan is not operated according to all of its written terms — both required and optional terms.

A governmental 457(b) plan that does not meet the requirements, regulations and applicable guidance under IRC §457 may become an "ineligible deferred compensation arrangement," as described under IRC §457(f).[58] 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 and future contributions will continue to be tax-deferred.

However, if the plan ceases to remain a governmental 457(b) plan after the IRS compliance deadline, amounts contributed 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:

- Continue to be treated as if they were held in a governmental 457(b) plan
- Are not included in the participants' or beneficiaries' gross income until they are distributed[59]

Additional Information

Additional information is included as exhibits in this Guide 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 and consult their own internal legal counsel on any issues that need further clarification.

End Notes

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; I. R. C. §3121(u);Revenue Ruling 86-88
[10] Preamble T. D. 9447; Rev. Ruling 2009-3
[11] DOL Reg. §2550.404(c)(5)(e)
[12] ERISA §4(b)(1)
[13] I.R.C. §402A; Treas Reg. §1.402A-1, Q & A 1
[14] I.R. C. §457(b)(3); Treas. Reg. §1.457-4(c)(i)
[15] I.R.C. §§457(e)(5), 415(c)(3); Treas.Reg. §1.457-2(g)
[16] I.R.C. §457(c); Treas. Reg. §1.457-5
[17] I.R. C.§457(b)(3); Treas. Reg.§1.457-4(c)(3)
[18] Treas. Reg. §1.457-4(c)(3)(v)
[19] Treas. Reg. §1.457-4(c)(3)(ii)(B)
[20] I.R.C. §457(b)(3); Treas. Reg. §1.457-4(c)(3)
[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)(1)
[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] Treas. Reg. §1.457-6(c)(2)
[29] I.R.C.§§401(a)(9)(B)(ii,iii), 457(c)(2); Treas. Reg. §1.457-6(d)
[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
[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. §401(a)(31); Treas. Reg. 1.457-10(e)
[38] I.R.C. §72(t)(9)
[39] Revenue Ruling 2004-12
[40] Treas. Reg. §1.408A(e)(2)(B); Notice 2008-30, Q&A 4
[41] I.R.C §402(c)(11); Notice 2007-7 Q&A 10
[42] I.R.C §§§457(e)(16), 402(c)(4),414(w)(1)(B)
[43] I.R.C. §72(p)(1); Treas. Reg. §§ 1.72(p)-1, 1.457-6(f)
[44] Treas. Reg. §1.72(p)-1 Q&A 3-6
[45] I.R.C. §72(p)(2)(B); Treas. Reg. §1.72(p)-1 Q&A 11,12,14-19
[46] I.R.C. §414(u)(4-5); Treas. Reg. §1.72(p)-1, Q&A 9; Service members Civil Relief Act of 2003
[47] Treas. Reg. §1.457-10(b)(1)
[48] Treas. Reg. §1.457-10(b)(4)
[49] I.R.C. §415(n)(3)(d); Treas. Reg. §1.457-10(b)(8)
[50] I.R.C. §414(p), §402(e)(1): Treas. Reg. §1.457-10(c)
[51] I.R.C. §408(q), Treas. Reg. §1.457-10(f)
[52] Treas. Reg. §1.408-2(e)(8)
[53] Treas. Reg. §1.457-10(a)(2)(ii)
[54] Treas. Reg. §1.457-10(a)(2)(i)
[55] I.R.C. §457(g); Treas. Reg. §1.457-8(a)(2); Bankruptcy Protection Act of 2005
[56] I.R.C. §457(g); Treas. Reg. §1.457-8(a)(3)(i)
[57] I.R.C. §457(g); Treas. Reg. §1.457-8(a)(3)(iii)
[58] I.R.C. §457 (f); Treas. Reg. §§1.457-9(a), 1.457-11
[59] I.R.C. §457(b)(6); Treas. Reg. §1.457-9(a)

Exhibit A
Glossary of Terms

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 plan 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 guaranteed 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 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 and required IRA language must be included as part of the plan document.

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

Designated Roth Contributions (DRCs) are voluntary after-tax salary deferrals that were originally permitted in 401(k) and 403(b) plans, but not governmental 457(b) plans. Effective "in employee tax years beginning after December 31, 2010," governmental 457(b) plan sponsors may allow employee contributions to designated Roth accounts in their plans. Designated Roth Contributions should not be confused with deemed IRA or deemed Roth IRA contributions.

Differential Pay (Military) 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. Differential wage payments made after December 31, 2009, may be contributed to the 457 plan.

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, with the exception of a rollover to a Roth IRA, until distributed from the receiving plan or IRA.

Distributable event is an event that is stated in the plan document that permits participants to receive distributions from their deferred compensation account. These distributions may or may not be eligible for rollover to another eligible plan or IRA.

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, along with Indian Tribal Governments, their agencies and instrumentalities may not establish and maintain 457 plans. However, non-governmental tax exempts (except for churches) may establish 457(b) plans. 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 IRC 457(b) and Treasury Regulations §§1.457-3 to 1.457-10 that is established and maintained by an eligible governmental employer.

ERISA (Employee Retirement Income Security Act) governs most private sector retirement plans in the United States and was enacted to safeguard employee benefit plan participants and their beneficiaries. Governmental employers are not subject to Title 1 of 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, for plan purposes, is the participant's wages, and other taxable compensation reported in box 1 of Form W-2 for the calendar year 2012, up to a maximum of $250,000 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 (60-day rollover) allows a participant, spousal beneficiary or spouse or former spouse alternate payee to retain the tax-deferred status of the distribution that they receive 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 they receive the distribution.

Ineligible plan is a plan that is established and maintained by an eligible employer, subject to IRC 457 but does not comply with IRC 457(b) and Treasury Regulations §§1.457-3 through 1.457-10. These plans are subject to both IRC 457(f) and IRC 409A.

In-plan Roth rollovers (conversions) are an optional feature 457 plans may adopt after December 31, 2010, which then permits participants, to roll their non-designated Roth account assets into the same plan's designated Roth account. Plans that adopt in-plan Roth rollovers may designate that any vested amounts held in a non-designated Roth accounts may be eligible for an in-plan Roth rollover. These amounts must satisfy the distribution rules of the plan and the IRC, and must be eligible rollover distributions.

Loan permits a participant or beneficiary to "borrow" from his/her account under a bona fide lender-borrower 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 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.

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. Beneficiaries are not plan participants.

Participation agreement (or salary deferral agreement or salary reduction agreement) is the written agreement that an employee completes and signs to participate in the plan. It designates the amount the employee elects to have withheld from his/her paycheck and contributed to the plan.

Pension Protection Act of 2006 (PPA 06) made permanent the EGTRRA retirement plan provisions that were due to expire after 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 credit purchases are credits an employee may be eligible to buy in qualified government defined benefit plans to enhance his/her benefits in the defined benefit plan, or to repay previously withdrawn employee contributions from the plan. Service credits may be purchased in cash or by 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 457 plan and its trust. 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-to-plan transfers are non-taxable transfers of assets from one governmental 457 (b) plan trustee to another 457 (b) governmental plan trustee. 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. Except for transfer to governmental defined benefit plans to purchase service credits, plan-to-plan transfers cannot be made from governmental 457(b) plans to, 401(a), 401(k), 403(b), 457(b) plans of tax-exempt entities, 457(f) plans, or IRAs and vice versa.

Qualified Default Investment Alternative (QDIA) are default investment alternatives used in ERISA participant directed plans when participants fail to provide investment direction. QDIAs relieve ERISA plan fiduciaries from liability for the investment performance of the default investments if certain notice, disclosure and other requirements are met.

Qualified Domestic Relations Order (QDRO) is an order, judgment or decree generally issued by a state domestic relations court (including approval of a property settlement agreement), made pursuant to 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 that is qualified.

Qualified Military Service is any service in the Uniformed Services (Army, Navy, Marines, Air Force, Coast Guard, their reserve components as well as the National Guard called up by the federal government) that entitles an individual to re-employment rights under USERRA (Uniformed Services Employment and Reemployment Rights Act) because of their military service.

Required Minimum Distribution (RMD) is the federal statute [under IRC Section 401(a)(9)] that establishes the latest date that a participant or beneficiary (spousal or non-spouse) 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). The plan had the option of waiving the 2009 RMDs.

Rollovers are generally distributions from a 401(a), 403(b), 457 plan or IRA that are eligible to be contributed to another eligible retirement plan or IRA. Rollover distributions require the participant be eligible for a distribution under the terms of the plan such as severance of employment. There are two types of rollovers, direct and indirect (defined separately in this section). Certain distributions, such as those for unforeseeable 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 or salary reduction agreement) is the agreement that an employee completes and signs to participate in the plan, and is also used to designate 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 (unused) 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. It applies only to underutilized deferrals to the 457 plan of the employer sponsoring the 457 plan in which the underutilized deferrals occurred. It does not apply to underutilized deferrals to another employer's 457 plan.

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 direct transfers of assets from eligible governmental plans to an IRA or another eligible retirement plan when the participant is eligible for a distribution, and is not includible in the gross income of a participant or beneficiary until it is distributed to the participant or beneficiary from the receiving plan. 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, subsequent laws and guidance that the plan sponsor must comply with for the plan 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 Internal Revenue Code and regulations.
Agreement for Deferral §1.457-4(b)	Salary deferral agreement must be entered into prior to first 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 ($17,000 in 2012) 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 there is a distributable event such 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 (RMD) rules specified in IRC §401(a)(9). In general, the plan is required to begin RMDs to a participant 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 to employees on active military duty must be counted as compensation for retirement plan purposes and may, or may not, 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 and laws enacted since the issuance of the final 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 its regulations and subsequent laws and guidance.

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 three 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 plan 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)	*Deferral of sick, vacation, and back pay for current employees.* The plan may permit a participant to elect to defer accumulated sick pay, accumulated vacation pay, or back pay to the plan, provided the contribution limits for the year are not exceeded. *Post severance deferrals.* 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 ***calendar year*** in which the severance occurs. These contributions are coordinated with the contribution limits in effect for the calendar year.

Topic/Reference	Optional §457 Plan Provisions
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 and IRS Notice 2007-7 and Revenue Ruling 2010-27.
Withdrawal of Elective Deferrals from Eligible Automatic Contribution Arrangements (EACA) IRC §414(w)(2)	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.
Withdrawal of Elective Deferrals for Active Duty Military Personnel IRC §414(u)(12)(B)	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 generally may not make contributions to the plan for six months from the date the elective deferrals were distributed.
Benefit Accruals for Death and Disability Resulting from Active Military Service. IRC §414(u)(9)	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.
Distributions of Smaller Accounts (de minimis distributions) §1.457-6(e)	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 two years) and the participant has not received a distribution under this de minimis distribution provision in the past. These distributions 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.
Loans from Eligible Plans §1.457-6(f)	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.

Topic/Reference	Optional §457 Plan Provisions
Frozen and Terminated Plans §1.457-10(a)	The plan may provide for a plan freeze or plan termination. Frozen plans no longer accept ongoing contributions from all participants or may limit contributions to existing participants. 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 instead of terminating the plan. 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. 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.
Plan-to-plan Transfers §1.457-10(b)(1)	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:
-10(b)(2)	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.
-10(b)(3)	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.
-10(b)(4)	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.
-10(b)(8)	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)].

Topic/Reference	Optional §457 Plan Provisions
Qualified Domestic Relations Orders (QDRO) §1.457-10(c)	Plan sponsor may determine that a domestic relations order is a qualified domestic relations orders [as defined in §414(p)] allowing the plan to an alternate payee prior to the date that the participant is entitled to a distribution. The distributed amount under a QDRO is taxable to the spousal or ex-spouse alternate payee.
Rollovers into the Eligible 457(b) Plan §1.457-10(e)	Eligible government §457 plans may accept eligible rollover distributions from other eligible retirement plans, including 401(a), 401(k), 403(b), other governmental 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 457 plan apply to the rolled-in amounts (plus associated investment earnings) which must be maintained in a separate account. However, a 10% early distribution tax may apply to distributions prior to age 59½ from a 457 rollover account that accepts rollovers from 401(a), 401(k), 403(b) plans and IRA account unless an exception applies.
Anytime Distributions from Rollover Accounts IRS Revenue Ruling 2004-12	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.
Deemed IRAs §1.457-10(f)	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 IRA regulations (26 CFR Parts 1 and 602).
Designed Roth Contributions IRC 402A	Designated Roth contributions are after-tax elective salary deferrals that are contributed to the plan's designated Roth account within the elective deferral account.
In-plan Roth rollovers IRC 402A Notice 2010-84	In-plan Roth rollovers are eligible rollover distributions from the plan's non-designated Roth accounts that are rolled into the plan's designated Roth account.

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