TruePlan℠
Benefit and Retirement Advisors

Just the FAQs
FOR PLAN SPONSORS

457(b) and 457(f) plans: 8 questions plan sponsors should ask

457(b) and 457(f) plans are non-qualified deferred compensation plans for eligible highly compensated employees. A non-qualified plan is a type of tax-deferred, employer-sponsored retirement plan that is not subject to Employee Retirement Income Security Act guidelines. Non-governmental 457 plans are not required to file Form 5500 since they are not subject to ERISA, but they are required to file a one-time notification ("top hat letter") with the Department of Labor within 120 days of the plan's existence. These plans are exempt from the non-discrimination testing that is required for qualified plans.

In 1986, Section 457 was added to the Internal Revenue Code to specifically address the unique needs of the nonprofit sector. The rules address governmental plans sponsored by state or local governments and non-governmental plans sponsored by tax-exempt organizations under Section 501(c). This frequently asked question document will specifically address questions regarding non-governmental 457(b) and 457(f) plans.

1. WHAT IS A 457(B) PLAN?

Non-governmental 457(b) or "top hat" plans must limit eligibility to a select group of highly compensated employees, executives, managers, directors or officers, as defined in the plan document. The plan must not cover rank-and-file employees. Failure to limit participation in a non-governmental 457(b) plan will force the plan to comply with ERISA funding requirements. The assets of the plan remain the property of the employer and are available to the company's general creditors in the event of litigation or bankruptcy. Non-governmental 457(b) plans commonly use "rabbi trusts" to hold plan assets. The rabbi trust is funded, but the assets are available to pay creditors at the discretion of the courts.

Non-governmental 457(b) plans are not allowed to offer loans. Although employee salary deferrals are fully vested, employer contributions may be subject to a vesting schedule. However, including a vesting schedule in a 457(b) plan can produce adverse tax consequences for a participant. The amount of compensation deferred, whether as a salary deferral by the participant, an additional employer retirement obligation or any employer contribution that becomes vested during the year cannot exceed the stated dollar limits. Any deferrals that vest during the year are included toward the dollar limit for the year. A vesting schedule can create excess deferrals that, unless corrected by a timely distribution, become taxable to the participant. Non-governmental 457(b) assets are not eligible for rollovers, but transfers to another non-governmental 457(b) plan may be possible.

2. WHAT ARE THE CONTRIBUTION LIMITS FOR 457(B) PLANS?

Contributions to 457(b) plans typically include employee pre-tax salary deferrals, but may also include employer contributions. Roth deferrals are not allowed. Employee and employer contributions are aggregated and cannot exceed the designated IRS annual elective deferrals. However, contributions to 457(b) plans are not aggregated with 403(b) or 401(k) contributions. Eligible employees may contribute up to another full employee deferral limit if their employer offers a 403(b) or 401(k) in addition to the 457(b) plan. Non-governmental 457(b) plans do not allow age 50+ catch-up contributions, but special catch-up provisions may apply. Participants who are within three years of normal retirement age and under-contributed in prior years in which they were eligible, may be able to increase their contribution limits up to twice the normal deferral limits.

more on next page

This material is intended for informational purposes only. It should not be construed as investment/tax/legal advice and is not intended to replace the advice of a qualified investment advisor/attorney or tax advisor.

© 2024 Healthcare Community Securities Corp. All rights reserved.

3. WHAT ARE THE DISTRIBUTION RULES FOR 457(B) PLANS?

Identified in the plan document, distributable events typically include severance from employment, retirement, disability or death. Plan sponsors may — but are not required to — offer participants the ability to take an in-service withdrawal in the event of an "unforeseeable emergency" or financial hardship resulting from an illness or accident, property loss caused by casualty (natural disaster), funeral expenses, or other similar extraordinary and unforeseeable circumstances resulting from events beyond the control of the participant.

Unlike a 403(b) or 401(k), when a distribution is made prior to age 59½, a 10% early withdrawal penalty does not apply, but all distributions are taxed as ordinary income. Benefits can be paid as a lump sum or installments. Although installment payments are only subject to tax when received, any unpaid installment payment remains the property of the employer and is subject to general creditor status. Each 457(b) plan has a default date or specified time period by which a participant must make an election to defer payment and postpone taxation by electing a future distribution date. If no timely election is made by the end of the specified time period ("default date"), payment will commence. A participant must typically choose within 30, 60 or 90 days after the date of severance. Participants are usually allowed to make a one-time change, but the date can never be accelerated. Once final, the distribution conditions are irrevocable.

Distribution rules should be effectively communicated to participants. Many participants erroneously assume that the same distribution rules that are applicable to their 403(b) or 401(k) accounts also apply to their 457(b) accounts. Distributions are made through payroll and reported on a W-2, not a 1099 unless the participant is deceased and a beneficiary is requesting the distribution. If the sponsor withheld Social Security tax at the time of the participant's deferral, it will not need to be levied at the time of distribution. Required minimum distribution rules that take effect at age 70½ apply to 457(b) plans. However, if the plan document allows it, a participant that has attained age 70½ and is still working, can defer their RMDs until they retire.

4. WHAT IS A 457(F) PLAN?

As with 457(b) plans, the assets for non-governmental 457(f) or "ineligible" plans remain the property of the employer and are available to the company's general creditors in the event of litigation or bankruptcy. These plans and the associated deferrals are possible only if there is a "substantial risk of forfeiture." This is a standard applied by IRS to determine whether deferred compensation should be taxed currently to the payee. Typically, a substantial risk of forfeiture exists if an employee's right to deferred compensation is contingent on the performance of services in the future or on the occurrence of a certain event. Often, this is referred to as "golden handcuffs." The financial allurement is designed to encourage a highly compensated employee to remain with an organization. Therefore, the executive is 0% vested until the specified event or date defined in the plan document. If the executive voluntarily terminates employment prior to being vested, the entire 457(f) benefit may be forfeited. Any vesting schedule can be adopted and loans are not available. 457(f) assets are not eligible for rollovers. Portability or rollovers among plans is not a feature of a 457(f) plan.

5. WHAT ARE THE CONTRIBUTION LIMITS FOR 457(F) PLANS?

There is no specific dollar limit for contributions. Since all benefits under a 457(f) plan must be subject to a substantial risk of forfeiture, these plans typically hold employer contributions only.

6. WHAT ARE THE DISTRIBUTION RULES FOR 457(F) PLANS?

Benefits under 457(f) plans receive less tax-favorable treatment than those under 457(b) plans. When a participant becomes vested and therefore the benefit is no longer subject to a substantial risk of forfeiture, the full amount of the vested benefit is taxed as ordinary income, even if the participant does not actually receive it. It is common for plan benefits to be vested periodically in increments, although actual distributions may be delayed until retirement. As is the case with 457(b) plans, tax penalties for distributions prior to age 59½ do not apply. RMD rules do not apply to 457(f) plans. The distributions are reported on a W-2, not a 1099 unless a beneficiary is requesting the distribution. The

more on next page

This material is intended for informational purposes only. It should not be construed as investment/tax/legal advice and is not intended to replace the advice of a qualified investment advisor/attorney or tax advisor.

© 2024 Healthcare Community Securities Corp. All rights reserved.

sponsor is required to withhold Social Security tax at the time of the distribution.

7. WHICH EMPLOYERS CAN OFFER NON-GOVERNMENTAL 457(B) AND 457(F) PLANS?

Nonprofit entities exempt from income tax under IRC Section 501(c) are the only organizations that can offer non-governmental 457(b) and 457(f) plans.

8. WHY WOULD AN EMPLOYER USE A 457(B) OR 457(F) PLAN?

Employers seeking to provide supplementary retirement benefits for executives over and above the maximum compensation limits applicable to 403(b) or 401(k) plans may turn to a 457(b) or 457(f) plan. The 457 limits are not aggregated with 403(b) or 401(k) plan limits. These plans can be an extremely valuable tool in attracting, retaining and rewarding executive-level employees. Employer contributions can enhance the compensation package of key executives since these contributions can be discretionary and determined separately for each covered executive. Since 457 plans must remain "unfunded," the employer's liability can be met by earmarking a specific corporate asset (i.e., corporate owned life insurance, mutual funds, fixed interest investments) to meet future obligations, or benefits can be paid from future cash flow. Section 457 plans provide employers design flexibility to customize compensation plans that balance the organization's goals with the executive's preferences.

This FAQ is written to provide a broad overview of non-governmental 457 plans. It is not intended to describe all the nuances of these plans.

Contact your TruePlan retirement plan advisor to help you determine if a 457 plan will be advantageous to your organization.

trueplanadvisors.com | 800.388.1963
MAIN OFFICE: One Empire Drive, Rensselaer, NY 12144
SATELLITE OFFICE: Melville, NY

TruePlan Benefit and Retirement Advisors is a marketing name of Healthcare Community Securities Corp., Member FINRA/SIPC, and an SEC Registered Investment Advisor.

This material is intended for informational purposes only. It should not be construed as investment/tax/legal advice and is not intended to replace the advice of a qualified investment advisor/attorney or tax advisor.

© 2024 Healthcare Community Securities Corp. All rights reserved.

TruePlan℠
Benefit and Retirement Advisors