

IRS Provides Guidance for Sponsors of Section 457 Plans

The IRS has recently published two Revenue Procedures providing guidance for sponsors of section 457 plans, in view of the changes made to section 457 rules by the Small Business Job Protection Act of 1996 (SBJPA) and the Taxpayer Relief Act of 1997 (TRA'97). [Revenue Procedure 98-40](#) describes the conditions under which the sponsor of a section 457 plan may obtain an IRS ruling that the plan satisfies the SBJPA and TRA'97 requirements. [Revenue Procedure 98-41](#) provides Model Amendments that section 457 plan sponsors may adopt to comply with the SBJPA and TRA'97 rules.

Trust Requirement

To ensure the safety of 457 plan savings, SBJPA included a provision requiring all such plans sponsored by state or local governments to hold the plan assets in a trust or custodial account for the sole benefit of plan participants and their beneficiaries. This requirement applies to assets and income held by these plans on and after August 20, 1996. However, if the plan was in existence on August 20, 1996, the trust does not need to be established until January 1, 1999. This trust requirement does not apply to plans sponsored by non-governmental tax-exempt organizations. See [Model Amendment 4](#).

Deferral Contribution Limit Indexed for Inflation

Effective for tax years beginning January 1, 1997, and later, SBJPA provides that the basic \$7,500 section 457 plan deferral contribution limit is subject to cost-of-living adjustments. These adjustments will be made in \$500 increments. See [Model Amendment 3](#).

Certain In-Service Distributions Are Allowed

As provided under SBJPA and amended by TRA'97, an in-service distribution from a section 457 plan made after December 31, 1996, is not taxable if:

- The total amount payable does not exceed \$5,000;
- The participant has not previously received an in-service distribution of the total amount payable under the plan; and
- The participant has not made deferral contributions to the plan during the two-year period ending on the distribution date.

See [Model Amendment 1](#).

*Republished December 2004 to reflect Prudential Financial's acquisition of CIGNA's retirement business

Elections to Delay Distributions Do Not Trigger Taxation

SBJPA also provided that a participant's election to delay distributions from a section 457 plan will not trigger taxation if the election is made after the amounts may be distributed but before benefit payments actually begin, and the participant has made no more than one other such election. This provision was effective January 1, 1997. See [Model Amendment 2](#).

Requesting Letter Rulings

Beginning August 10, 1998, an employer that wants assurance that its section 457 plan meets the requirements for a section 457(b) eligible nonqualified deferred compensation plan, as amended by SBJPA and TRA'97, may request a private letter ruling (PLR) from the IRS. However, the IRS will *not* issue a new PLR to a plan that previously received a favorable PLR and is now being amended solely to conform to the SBJPA and TRA'97 changes by the adoption of one or more of the Revenue Procedure 98-41 Model Amendments. A plan sponsor that adopts the applicable Model Amendments on a word-for-word basis may continue to rely on its prior PLR.

Appendix For Revenue Procedure 98-41 MODEL AMENDMENTS

(Note to sponsors: In this appendix presenting the model amendment language, the portions printed in italics are explanatory notes for the benefit of the section 457(b) plan sponsor and are not to be included in the amendments. The portions not printed in italics are the model amendment language for use by the plan sponsor in amending its section 457(b) plan in accordance with this revenue procedure.)

Optional Amendments That May Be Adopted by Any Eligible 457 Plan

AMENDMENT 1: IN-SERVICE DISTRIBUTION OF \$5,000 OR LESS

Any one of the following model amendments may be adopted for any section 457(b) plan to provide for the in-service de minimis distribution option permitted under section 457(e)(9)(A) of the Internal Revenue Code. These amendments are in addition to any plan provision requiring distribution of small account balances following the general distribution commencement date set by the plan. If it wishes, the plan sponsor may also substitute in the following model amendments a consistent figure lower than \$5,000 in place of "\$5,000 (or the dollar limit under section 411(a)(11) of the Internal Revenue Code, if greater)". The plan may adopt only one of Option A, Option B, or Option C.

- **OPTION A: INVOLUNTARY DISTRIBUTIONS**

The following amendment may be adopted by an eligible employer that wishes to provide for the mandatory in-service distribution to participants with aggregate account balances under the section 457(b) plan that total \$5,000 or less:

"Involuntary In-Service Distribution: The Plan shall distribute the total amount payable under the Plan to a participant who is an active employee of an eligible employer if the following requirements are met:

- i. the total amount payable to the participant under the Plan does not exceed \$5,000 (or the dollar limit under section 411(a)(11) of the Internal Revenue Code, if greater),
- ii. the participant has not previously received an in-service distribution of the total amount payable to the participant under the Plan; and
- iii. no amount has been deferred under the Plan with respect to the participant during the two-year period ending on the date of the in-service distribution."

• **OPTION B: VOLUNTARY DISTRIBUTIONS**

The following amendment may be adopted by an eligible employer that wishes to provide for the voluntary in-service distribution to participants with aggregate account balances under the section 457(b) plan that total \$5,000 or less:

"Voluntary In-Service Distribution: A participant who is an active employee of an eligible employer shall receive a distribution of the total amount payable to the participant under the Plan if the following requirements are met:

- i. the total amount payable to the participant under the Plan does not exceed \$5,000 (or the dollar limit under section 411(a)(11) of the Internal Revenue Code, if greater),
- ii. the participant has not previously received an in-service distribution of the total amount payable to the participant under the Plan,
- iii. no amount has been deferred under the Plan with respect to the participant during the two-year period ending on the date of the in-service distribution; and
- iv. the participant elects to receive the distribution."

• **OPTION C: COMBINATION VOLUNTARY AND INVOLUNTARY DISTRIBUTIONS**

The following amendment may be adopted by an eligible employer that wishes to provide for both a mandatory in-service distribution of small account balances (such as \$500) and a voluntary in-service distribution election to participants with higher aggregate account balances under the section 457(b) plan that total \$5,000 or less:

"Involuntary In-Service Distribution: The Plan shall distribute the total amount payable under the Plan to a participant who is an active employee of an eligible employer if the following requirements are met:

- i. the total amount payable to the participant under the Plan does not exceed *[enter a dollar amount that is less than \$5,000]*,

- ii. the participant has not previously received an in-service distribution of the total amount payable to the participant under the Plan; and
- iii. no amount has been deferred under the Plan with respect to the participant during the two-year period ending on the date of the in-service distribution.

Voluntary In-Service Distribution: A participant who is an active employee of an eligible employer shall receive a distribution of the total amount payable to the participant under the Plan if the following requirements are met:

- i. the total amount payable to the participant under the Plan does not exceed \$5,000 (or the dollar limit under section 411(a)(11) of the Internal Revenue Code, if greater),
- ii. the participant has not previously received an in-service distribution of the total amount payable to the participant under the Plan,
- iii. no amount has been deferred under the Plan with respect to the participant during the two-year period ending on the date of the in-service distribution; and
- iv. the participant elects to receive the distribution."

AMENDMENT 2: ADDITIONAL DEFERRAL ELECTION

The following model amendment may be used to provide for the one "additional" distribution election authorized by section 457(e)(9)(B) of the Internal Revenue Code.

"If a participant has elected, in accordance with the Plan, to defer the commencement of distributions beyond the first permissible payout date, then the participant may make an additional election to further defer the commencement of distributions, provided that the election is filed before distributions actually begin and the later commencement date meets the required distribution commencement date provisions of sections 401(a)(9) and 457(d)(2) of the Internal Revenue Code. A participant may not make more than one such additional deferral election after the first permissible payout date.

For purposes of the preceding paragraph, the "first permissible payout date" is the earliest date on which the Plan permits payments to begin after separation from service, disregarding payments to a participant who has an unforeseeable emergency or attains age 70½, or under the in-service distribution provisions of the Plan." *(Any of the provisions mentioned in the preceding sentence may be omitted if the plan does not include such a provision.)*

AMENDMENT 3: COST-OF-LIVING-ADJUSTMENTS

Any section 457(b) plan may be amended to provide for implementing cost of living adjustments to the "\$7,500" maximum deferral amount pursuant to section 457(e)(15) by substituting the following for "\$7,500" wherever it appears as a limitation on the maximum deferral amount under the plan:

"\$7,500, adjusted for the calendar year to reflect increases in cost-of-living in accordance with sections 457(e)(15) and 415(d) of the Internal Revenue Code."

Model Amendment to Reflect Mandatory Section 457(g) Requirements for Governmental Section 457(b) Plans

AMENDMENT 4: SECTION 457(g) TRUST REQUIREMENTS FOR GOVERNMENTAL SECTION 457(b) PLANS

Any one of the following three model amendments may be used to reflect the mandatory trust requirement applicable to eligible plans of state and local government entities under section 457(g) of the Code. None of these amendments are applicable to section 457(b) plans sponsored by tax-exempt organizations that are not state or local government entities, and they may not be adopted by such organizations. The last sentence of each of the following model amendments (requiring amounts to be transferred within a 15-day period) is optional.

- **OPTION A: TRUST**

"Notwithstanding any contrary provision of the Plan, in accordance with section 457(g) of the Internal Revenue Code, all amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights shall be held in trust for the exclusive benefit of participants and beneficiaries under the Plan. Any trust under the Plan shall be established pursuant to a written agreement that constitutes a valid trust under the law of *[insert name of applicable state]*.

All amounts of compensation deferred under the Plan shall be transferred to a trust established under the Plan within a period that is not longer than is reasonable for the proper administration of the accounts of participants. To comply with this requirement, all amounts of compensation deferred under the Plan shall be transferred to a trust established under the Plan not later than 15 business days after the end of the month in which the compensation would otherwise have been paid to the employee."

- **OPTION B: ANNUITY CONTRACT**

"Notwithstanding any contrary provision of the Plan, including any annuity contract issued under the plan, in accordance with section 457(g) of the Internal Revenue Code, all amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights shall be held in one or more annuity contracts, as defined in section 401(g) of such Code, issued by an insurance company qualified to do business in the state where the contract was issued, for the exclusive benefit of participants and beneficiaries under the Plan. For this purpose, the term "annuity contract" does not include a life, health or accident, property, casualty, or liability insurance contract.

All amounts of compensation deferred under the Plan shall be transferred to an annuity contract described in section 401(f) of the Internal Revenue Code within a period that is not longer than is reasonable for the proper administration of the accounts of participants. To comply with this requirement, all amounts of compensation deferred under the Plan shall be transferred to a contract described in section 401(f) of such Code not later than 15 business days after the end of the month in which the compensation would otherwise have been paid to the employee."

- **OPTION C: CUSTODIAL ACCOUNT**

"Notwithstanding any contrary provision of the Plan, in accordance with section 457(g) of the Internal Revenue Code, all amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights shall be held in one or more custodial accounts for the exclusive benefit of participants and beneficiaries under the Plan. For purposes of this paragraph, the custodian of any custodial account created pursuant to the Plan must be a bank, as described in section 408(n) of the Internal Revenue Code, or a person who meets the nonbank trustee requirements of paragraphs (2)-(6) of section 1.408-2(e) of the Income Tax Regulations relating to the use of non-bank trustees.

All amounts of compensation deferred under the Plan shall be transferred to a custodial account described in section 401(f) of the Internal Revenue Code within a period that is not longer than is reasonable for the proper administration of the accounts of participants. To comply with this requirement, all amounts of compensation deferred under the Plan shall be transferred to a custodial account described in section 401(f) of such Code not later than 15 business days after the end of the month in which the compensation would otherwise have been paid to the employee."

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