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Two of a Kind? Not All 457(b) Plans Are the Same

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You may already know there are significant differences between a 457(b) plan sponsored by a governmental entity and a 457(b) plan sponsored by a tax-exempt organization. **But do you know what they are?** It can be confusing for plan sponsors because the plans are so similar and articles on the subject of 457(b) plans do not always point out the distinctions.

How All 457(b) Plans Are Alike

A 457(b) plan is a deferred compensation plan that permits certain employers or employees to contribute money for retirement on a tax-deferred basis. Internal Revenue Code (Code) Section 402(g) provides the contribution limit (402(g) Limit) which for 2019 is $19,000. Earnings on these contributions are also tax-deferred. A 457(b) plan is not subject to coverage or nondiscrimination testing.

If you are familiar with 401(k) plans, you'll recognize many of the other common requirements or provisions described below that apply to both tax-exempt and governmental 457(b) plans.

- **Documentation:** the plan must be in writing.
- **Catch-up contributions:** a participant may be permitted to elect to increase salary reductions for the final three years before reaching normal retirement age up to the *lesser of*
  a) two times the applicable dollar limit ($38,000 for 2019), or
  b) the applicable dollar limit plus the sum of unused deferrals in prior years provided the prior deferrals were less than the applicable deferral limits (not counting any age 50 catch-up contributions (permitted only in governmental plans)).
- **Deferral election timing:** the election to make contributions through salary reduction must be made before the first day of the month in which the compensation is paid or available.
- **402(g) Limit:** employer and employee contributions in the aggregate are measured against the 402(g) Limit.
- **Hardship distributions:** these are permitted if the distribution is required as the result of an unforeseeable emergency beyond the participant's or beneficiary's control, all other sources of financing have been exhausted and the amount distributed is necessary to satisfy the need (and the tax liability arising from the distribution).
- **Required minimum distributions:** Code Section 401(a)(9) rules apply.
- **Distributable events:** these include attainment of age 70½, severance from employment, hardships, plan termination, qualified domestic relations orders, and small account distributions (with a minor difference).

How Governmental and Tax-Exempt 457(b) Plans Differ

The differences between a tax-exempt 457(b) plan and a governmental 457(b) plan include:

- **Eligible employees:** governmental plans can include any employee or independent contractor who performs services for the employer while tax-exempt plans can only make select management or highly compensated employees eligible.
- **Automatic enrollment:** governmental plans may provide for automatic enrollment while tax-exempt plans may not.
- **Roth contributions:** governmental plans may provide for the designation of Roth contributions for all or a portion of salary reductions while tax-exempt plans may not permit Roth contributions.
- **Catch-up contributions:** governmental plans may permit age 50 catch-up contributions ($6,000 in 2019) while tax-exempt plans may not.
- **Correction of excess deferrals:** governmental plans must distribute any excess contribution (plus income) as soon as practicable after the plan determines that an amount is in excess while tax-exempt plans must distribute the excess by April 15 following the close of the taxable year in which the excess deferral was made.
- **Loans:** governmental plans may permit loans while tax-exempt plans may not.
- **Contributions to a trust:** governmental plans are permitted to contribute to a trust while tax-exempt plans are not.
- **Rollovers:** governmental plans may provide for rollovers to other eligible retirement plans (401(k), 403(b), governmental 457(b), and IRAs) while tax-exempt plans may not.
- **Taxation:** for governmental plans, taxation is at the time of distribution, while for tax-exempt plans, taxation is at the earlier of when amounts are made available or distributed.
- **Statutory period for correction of plan failures:** governmental plans have until the first day of the plan year beginning more than 180 days after notice from the Internal Revenue Service regarding failure to meet applicable requirements while such correction period is not available to tax-exempt plans.
- **Correction programs:** a governmental plan can apply for a closing agreement with a proposal to correct failures that will be evaluated under EPCRS standards while such corrections are generally not available to tax-exempt plans.

If you sponsor a 457(b) plan, you may want to review your plan design to make sure it provides the available optional features you want for your employees. In addition, you'll want to make sure that the plan is compliant as written and in operation.

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