Design and Implementation Issues for Eligible Deferred Compensation Plans After EGTRRA and the Proposed Regulations[1]

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Summary

Section 457(b) of the Internal Revenue Code (the "Code") permits governmental and tax-exempt employers to offer an additional tax-advantaged employee benefit plan to their employees.[3] The Economic Growth and Tax Relief Reconciliation Act of 2001[4] ("EGTRRA") and recently proposed regulations under Code section 457[5] provide significant additional guidance for employers who maintain or are considering adopting 457(b) plans. This article highlights some key issues facing plan sponsors in light of this new guidance.

Introduction

The past two years have brought great changes for eligible deferred compensation plans described in Code section 457(b).

Prior to EGTRRA, several factors limited the availability of 457(b) plans. First, the maximum contribution limits applicable to 457(b) plans were linked to

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[3] These plans are often referred to as 457(b) plans, governmental 457s, or tax-exempt 457s.

[4] P.L. 107-16.

[5] 62 F.R. 30826 (May 8, 2002). These regulations may be relied on for taxable years beginning on and after August 20, 1996, and are intended, once finalized (currently expected in mid-2003), to apply for taxable years beginning after December 31, 2001. 62 F.R. 30831 (May 8, 2002). These regulations also address "mutual fund stock options," a compensation tool that has been adopted by some tax-exempt organizations. However, this article does not focus on this aspect of the proposed regulations. See

amounts contributed to an employer's other plans – such as 403(b)s and 401(k)s – with the result that many employees were not eligible to contribute to their employer's 457(b) plan. Second, the rules governing 457(b) plans did not provide some important flexibility – such as rollovers – available to qualified defined benefit and defined contribution plans, and were therefore less attractive to both sponsors and participants. However, after EGTRRA, the limits on contributions to 457(b) plans are no longer affected by contributions to non-457(b) plans and many of the differences between 457(b) plans and qualified plans have been eliminated, thus increasing the appeal of 457(b) plans.

EGTRRA and the recently proposed regulations under Code section 457 have made many changes to the Code section 457(b) rules.[6] This analysis focuses on the following ten significant areas of 457(b) plan design and implementation that plan sponsors should consider when deciding how to amend or implement their 457(b) plans: (I) contribution rules; (II) distribution rules; (III) EGTRRA sunset provisions; (IV) rollover rules for governmental 457(b) plans; (V) constructive receipt rules for governmental 457(b) plans; (VI) reporting and withholding obligations for governmental 457(b) plans; (VII) state law issues for governmental 457(b) plans; (VIII) claims procedures for tax-exempt 457(b) plans; (IX) private letter rulings; and (X) future changes.

I. Contribution Rules

Brisendine, New Proposed 457 Regulations: Why Have All The Options Gone?, Tax Management Memorandum, July 29, 2002, for a discussion of "mutual fund stock options".

[6] The enclosed side-by-side analysis analyzes the list of current areas of concern in detail.

In an attempt to conform the 457(b) plan contribution limits to those applicable to qualified retirement plans,[7] EGTRRA modified the contribution limits applicable to 457(b) plans to permit a maximum regular annual contribution of $11,000 in 2002 (with a last-three years catch up contribution maximum under Code section 457(b)(3)(A) of $22,000). In addition, the range of permissible contributions has been greatly expanded by both EGTRRA and the proposed regulations. Sponsors of 457(b) plans may now:

- Base 457(b) plan contributions on unused sick, vacation, and back pay;
- Permit catch-up contributions beginning at age 50 (in addition to the last three years' catch-up contributions permitted under Code section 457(b)(3));[8]
- Allow rollover contributions of "eligible rollover distributions" from IRAs, qualified plans, 403(a) annuities, 403(b)s, and other 457(b) plans.[9]

Code section 457(b) plan documents that currently incorporate the dollar limit changes for regular and catch-up contributions by reference to Code section 457(b) may have automatically picked up the new dollar limits.[10] However,

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[7] H.R. Rep. No. 107-51, pt. 1 at 52-55 (2001); EGTRRA § 611(e).
[8] This provision applies to governmental 457(b) plans only.
[9] This provision applies to governmental 457(b) plans only. For further discussion of the of the rules governing rollover contributions, see Section IV.
[10] Because 457(b) plans are not subject to the anti-cutback rules of Code section 411(d)(6), they may wish to eliminate or restrict these changes. However, contract law issues should be considered by 457(b) plan sponsors considering such a change. See Section III for a discussion of potential contractual claims against 457(b) plans.

457(b) plan sponsors should determine whether they wish to apply these increased limits and whether they want to implement any of these changes.

II. Distribution Rules

As part of its efforts to conform the rules governing 457(b) plans to the qualified plan rules, Congress also adjusted the rules governing distributions from both governmental and tax-exempt 457(b) plans. These rules have been further modified in the proposed regulations.

There are six key components to the revision of the Code section 457(d) distribution rules: (1) the elimination of the term "separation from service" and its replacement with the phrase "severance from employment"; (2) the conforming of the minimum required distribution rules for 457(b) plans to those of qualified plans; (3) the addition of guidance on implementation of qualified domestic relations order ("QDROs") in 457(b) plans; (4) the addition of statutory language permitting governmental 457(b) plans to transfer accounts for purchases of service credit described in Code section 415(n)(3)(A); (5) the issuance of new guidance on the permissibility of governmental 457(b) plan loans; and (6) the continuing distinction between unforeseeable emergencies and hardship distributions. Sponsors of 457(b) plans will want to review their implementation of each of these changes to the distribution rules.

First, sponsors who may be divesting certain functions or divisions (e.g., governmental privatization or tax-exempt organization division sale), or contemplating such changes in the future, should review their current plan terms to

determine whether the adoption of the phrase "severance from employment" in place of the pre-EGTRRA phrase "separation from service" would impact distributions when future divestitures occur. Because the term "separation from service" has been interpreted more narrowly than the term "severance from employment", a 457(b) plan sponsor need not adopt the term "severance from employment" unless it affirmatively desires to do so.[11]

Second, sponsors may want to reconsider how their 457(b) plans apply the distribution limitations under Code section 457(d). Prior to EGTRRA, Code section 457(d) contained a complex set of required distribution rules that, while incorporating the minimum required distribution rules applicable to qualified retirement plans under Code section 401(a)(9), also imposed additional minimum distribution requirements.[12] EGTRRA reduced this complexity by conforming the Code section 457(d) required distribution rules to the minimum required distribution rules under Code section 401(a)(9). In addition, in April 2002, the Internal Revenue Service issued new final and temporary regulations under Code section 401(a)(9)[13] that simplify the application of these minimum required distribution rules. These new minimum required distribution regulations may be permissively applied in 2002 and are mandatory for required distributions payable on or after January 1, 2003. Sponsors of 457(b) plans should review their plan documents and administrative practices to determine what impact the revisions to

[11] H.R. Conf. Rep. No. 107-84, pt. 1 at 257.
[12] E.g., a maximum 15 year distribution period for payments to a beneficiary that commence after a participant's death.

Code section 457(d) and the minimum required distribution rules will have on their plans.

Third, EGTRRA and the proposed regulations[14] have provided guidance on whether a 457(b) plan can enforce a QDRO without violating the 457(b) plan requirements. 457(b) plans are not generally subject to the detailed requirements of Code section 414(p).[15] Instead, a domestic relations order "which creates or recognizes the existence of an alternate payee's right to, or assign to an alternate payee the right to, receive all, or a portion of, the benefits payable with respect to a participant under a plan" may be treated as a QDRO under a 457(b) plan.[16] Although the Internal Revenue Service has informally encouraged 457(b) plans to permit QDROs,[17] Code section 414(p), as drafted, does not require a 457(b) plan to treat domestic relations orders as QDROs. Sponsors may want to reconsider whether they want to implement QDROs and, if QDROs are to be implemented, should consider establishing procedures to govern the review of QDROs.

Fourth, EGTRRA and the proposed regulations[18] permit a governmental 457(b) plan to allow a direct transfer of funds to a defined benefit plan for the purchase of service credit described in Code section 415(n)(3)(A).[19]

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[13] 67 Fed. Reg. 18988 (Apr. 17, 2002).
[14] Prop. Treas. Reg. § 1.457-10(c).
[15] E.g., 457(b) plans are not required to establish QDRO procedures.
[16] Code §§ 414(p)(1)(A)(i) and 414(p)(10).
[17] The Internal Revenue Service has encouraged the addition of plan language allowing the enforcement of QDROs during the review process for a recent private letter ruling request.
[18] Code § 457(e)(17) and Prop. Treas. Reg. § 1.457-10(b)(4).
[19] Other forms of plan-to-plan transfer are also available under the proposed regulations. See Prop. Treas. Reg. § 1.457-10. A distinguishing characteristic of plan-to-plan transfers for purchases of service credit is

Governmental 457(b) sponsors may want to allow this additional method of purchasing service credit to their participants. However, when implementing this transfer right, governmental 457(b) plans should be aware of the potential restrictions on the transfer for purchase of service credit rules. For example, although EGTRRA appears to permit transfers for purchase of service credit without being subject to the limit on "nonqualified service credit" in Code section 415(n)(3)(B) and (C), an example in the proposed regulation indicates that the Internal Revenue Service may consider all of the Code section 415(n) requirements, including the limits on nonqualified service credit, applicable to transfers from 457(b) plans. In addition, the proposed regulations limit EGTRRA transfers to plans within the same state.[20]

Fifth, the proposed regulations update the Internal Revenue Service's guidance as to the permissibility of plan loans from governmental 457(b) plans.[21] The proposed regulation expressly permits plan loans when such loans comply with the requirements of Code section 72(p) and a facts and circumstances pre-Employee Retirement Income Security Act of 1974 ("ERISA") reasonableness standard.[22] Although these loan requirements would appear be the same as the loan rules for qualified plans, the inclusion of pre-ERISA facts and circumstances

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that, unlike most other 457(b) plan-to-plan transfers, such transfers may occur while an individual is still employed by the employer sponsoring the plan.

[20] Code § 457(e)(17) and Prop. Treas. Reg. § 1.457-10(b)(4).

[21] Prop Treas. Reg. § 1.457-6(f). Currently, the Internal Revenue Service is maintaining a no-ruling position on private letter ruling requests for 457(b) plans that contain loan provisions. However, the Internal Revenue Service has indicated that it expects to reconsider this position.

[22] Prop. Treas. Reg. § 1.457-6(f) and Prop. Treas. Reg. § 1.457-7(b)(3).

standards remains a distinction between 457(b) plan and qualified plan loans. Sponsors wishing to implement loan programs should review potential loan policies to determine that they comply with these requirements.

Sixth, there are still distinctions between "hardship" distributions from a Code section 401(k) arrangement and an "unforeseeable emergency" under a 457(b) plan. The proposed regulations expand the term unforeseeable emergency to encompass a beneficiary's unforeseeable emergencies, rather than just a participant's unforeseeable emergencies, and provide additional examples of what constitutes an unforeseeable emergency. However, the proposed regulations specifically provide that purchase of a home and payment of college tuition are not unforeseeable emergencies despite the fact that these expenses generally would be a hardship for Code section 401(k) plan distribution purposes.[23] Thus 457(b) plan sponsors will need to focus on ensuring that both administrators and participants understand the special characteristics of unforeseeable emergencies.

III. EGTRRA Sunset Provisions

Due to the legislative rules under which EGTRRA was passed,[24] the provisions of Code section 457 amended by EGTRRA will cease to apply as of the first taxable, plan, or limitation year commencing after December 31, 2010.[25] Although EGTRRA's sunset provisions include language generally designed to

[23] Treas. Reg. § 1.401(k)-1(d)(2).
[24] EGTRRA was enacted as part of a budget reconciliation bill subject to the "Byrd Rule" which restricts the ability of budget reconciliation bills to contain extraneous provisions beyond the scope of the budgetary period being reconciled. 2 U.S.C. 644.
[25] EGTRRA § 901.

protect qualified plans under Code section 401(a) from future cutback claims under the Code and ERISA,[26] EGTRRA's sunset provisions expose both governmental and tax-exempt 457(b) plans to liability risks if these plans implement EGTRRA changes.

For example, if EGTRRA sunsets in 2010, governmental 457(b) plans may be caught in a conflict between state and federal law. Some states, such as New York, prohibit the reduction of retirement benefits provided by governmental plans.[27] Thus, sponsors of affected 457(b) plans may face potentially conflicting state and federal law compliance obligations. Furthermore, sponsors of tax-exempt 457(b) plans may also face breach of contract claims from participants with affected benefits because they are subject to the civil enforcement rules in ERISA section 502.[28]

To avoid this potential litigation risk, the Internal Revenue Service has informally indicated in the qualified plan context that plan sponsors may add sunset anti-cutback language to their plans. Because of the potential for contractual litigation risk under 457(b) plans, plan sponsors should consider adding this sunset language to their 457(b) plans as well. This anti-cutback plan language would provide that all benefits provided by EGTRRA-related changes

[26] P.L. 107-147, § 901(b).
[27] See N.Y. Const., Art. V, Sec. 7 ("membership in any pension or retirement system of the state or of a civil division thereof shall be a contractual relationship, the benefits of which shall not be diminished or impaired.").
[28] Tax-exempt 457(b) plans are "top hat" plans that are subject to a limited number of ERISA's requirements. For greater discussion of the role of the "top hat" concept in tax-exempt 457(b) plans, see Section VIII.

will automatically sunset after 2010 (or a later date if the provisions of EGTRRA are extended) unless the EGTRRA changes are made permanent. Thus, participant contributions and earnings after this amendment would be subject to this additional contractual term, reducing a 457(b) plan sponsor's potential litigation risk.

IV. Rollover Rules for Governmental 457(b) Plans

EGTRRA permits governmental 457(b) plans to accept amounts rolled over from IRAs, qualified plans, 403(a) annuities, 403(b)s, and other governmental 457(b) plans.[29] In addition, governmental 457(b) plans are now subject to the rules permitting participants (and their spouses) to roll over amounts to IRAs, qualified plans, 403(a) annuities, 403(b)s, and other governmental 457(b) plans.[30]

Rollover contributions to governmental 457(b) plans are generally treated in the same manner as rollover contributions to qualified plans. However, 457(b) plan sponsors should be aware of three special rules governing rollover contributions to 457(b) plans. First, amounts rolled over from plans other than 457(b) plans and earnings on these amounts must be separately accounted for by the 457(b) plan.[31] Second, these rolled in amounts, other than rollovers from 457(b) plans, will remain subject to the Code section 72(t) early withdrawal 10% additional income tax. Third, amounts rolled into a 457(b) plan may not be made available to participants until the requirements of Code section 457(d) permit a

[29] Code § 402(c)(8)(B).
[30] Code § 402(c)(8)(B) and Code § 457(e)(16)(A).
[31] Code § 402(c)(10).

distribution.[32] This third provision should be of special concern for 457(b) plan sponsors. In the qualified plan context, amounts contributed as rollover contributions may generally distributed at any time. However, this rule apparently does not carry over to rollover contributions to a governmental 457(b) plan. Thus, sponsors should focus on communicating this special rule for 457(b) plan rollover contributions to participants who may want to make rollover contributions to 457(b) plans.[33]

Although governmental 457(b) plans are not required to accept rollover contributions, all governmental 457(b) plans must comply with the rollover distribution requirements of Code section 401(a)(31) and 457(e)(16). These requirements include: (1) the requirement that a 457(b) plan provide an explanation of rollover distribution rights[34] and (2) the application of the rollover withholding rules.[35] All governmental 457(b) plan sponsors must comply with these requirements regardless of whether they are incorporated in their 457(b) plan documents.

V. Constructive Receipt Rules for Governmental Plans

[32] Prop. Treas. Reg. § 1.457-10(e). Under Code § 457(d) amounts may not be distributed earlier than (1) the year in which a participant attains age 70 1/2, (2) when the participant has a severance from employment, or (3) when the participant is faced with an unforeseeable emergency.
[33] Other important consequences of rollovers include differences among types of plans in whether funds are available to creditors in the event of a participant's bankruptcy.
[34] Notice 2002-3, 2002-2 I.R.B. 289, provides a model notice that should be provided to participants in governmental 457(b) plans. The applicable notice requirements are set forth in Code § 402(f).
[35] The reporting and withholding rules are discussed in Section VI.

The Small Business Job Protection of 1996[36] added a new subsection (g) to Code section 457 requiring that the assets of a governmental 457(b) plan be held in trust for the benefit of participants and beneficiaries. Despite the addition of this trust requirement, governmental 457(b) plans remained subject to constructive receipt rules that required a participant (or beneficiary) in a 457(b) plan be subject to tax on his or her 457(b) plan benefit when such benefit was paid or made available to the participant (or beneficiary).[37] However, EGTRRA revised the constructive receipt rules applicable to governmental 457(b) plans in order to generally conform the tax treatment of governmental 457(b) plans to the qualified plan constructive receipt rules. As a result of this revision, amounts paid from a governmental 457(b) plan will only be taxed upon their payment to a participant or beneficiary.[38]

Although the general rules governing constructive receipt have been conformed to those governing qualified plans, sponsors of governmental 457(b) plans remain subject to the distinct section 457(b) plan requirement that deferral elections must usually be entered into prior to the first day of the month in which the election takes effect.[39] This same rule does not apply to 401(k) deferral

[36] P.L. 104-188, § 1448(a).
[37] Code section 457(a) prior to amendment by EGTRRA.
[38] H.R. Rep. No. 107-51, pt. 1 at 88-89 (2001); EGTRRA § 646.
[39] Prop. Treas. Reg. § 1.457-4(b).

elections.[40] Sponsors should already be applying this requirement under the pre-EGTRRA version of the Code section 457 regulations.

VI. Reporting and Withholding Obligations for Governmental Plans

Because of the change in the constructive receipt rules applicable to governmental 457(b) plans[41] and the expansion of the rollover rules to include governmental 457(b) plans, governmental 457(b) plans must comply with two new reporting and withholding requirements.

First, distributions from governmental 457(b) plans are now subject to reporting on Form 1099-R rather than Form W-2.[42] Sponsors should update their recordkeeping systems to ensure that these requirements are met.[43] In addition, sponsors may want to consider whether any of their other benefit programs are impacted by the reclassification of 457(b) plan distributions as non-wage distributions under Code section 3401.[44]

Second, governmental 457(b) plans are now subject to the withholding rules applicable to qualified plans under Code section 401(a). Under these rules, the following withholding requirements apply:

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[40] There is no first day of the month requirement for qualified plans. Treas. Reg. § 1.401(k)-1(a)(3) (amounts to be deferred must not be currently available when a participant makes a deferral election).
[41] See Section V.
[42] Code §§ 3401(a)(12)(E), 3405, and 6047(d).
[43] Code §§ 6721 and 6722 impose penalties for failures to comply with these reporting requirements.
[44] E.g., a severance program that is based on Code § 3401(a) wages.

- Periodic payments, such as installment payments of at least ten years and life annuities, are subject to withholding at standard wage-based rates; and[45]
- Eligible rollover distributions, such as lump sum payments, are subject to mandatory withholding at a rate of 20% when they are not directly rolled over.[46]

Sponsors should coordinate with their recordkeeping staff to ensure that their 457(b) plans comply with these requirements.

VII. State Law Issues for Governmental 457(b) Plans

Governmental 457(b) plans are often subject to state laws governing their features and operation.[47] Although most states have implemented some form of EGTRRA conformity, this conformity is not necessarily linked to other state law requirements governing governmental 457(b) plans. These inconsistencies can involve the following areas:

- Permitted investments and funding mechanisms;[48]
- Classes of individuals who may be covered under a governmental 457(b) plan;[49]
- Required administrative approvals for 457(b) plan amendments;[50]

[45] Code § 3405(a). Participants may elect out of this withholding on Form W-4P.
[46] Code § 3405(c). Participants may not elect out of this withholding.
[47] See, e.g., N.J. Rev. Stat. § 43:15B-1. The interaction of the EGTRRA sunset provisions and state law is discussed in Section III.
[48] See, e.g., N.J. Rev. Stat. § 43:15B-3.
[49] See, e.g., N.Y.C.R.R. tit. 9, § 9001.3 (2002).
[50] See, e.g., N.J. Admin. Code tit. 5, § 37-4.3 (2002).

- Loans;[51] and
- Administrative requirements governing the procurement of 457(b) plan services.[52]

Governmental sponsors should check with their local state authorities to determine whether any of these requirements are invoked in their particular state.

VIII. Claims Procedures for Tax-Exempt 457(b) Plans

Tax-exempt 457(b) plans are usually top hat plans that are maintained for a select group of management or highly compensated employees which are generally exempt from many provisions of ERISA.[53] If a tax-exempt 457(b) plan were to benefit more than this select group, it would be subject to ERISA's requirement that assets of the plan be held in trust.[54] However, holding the assets in trust would result in the violation of the Code requirement that the assets of the plan remain the sole property of the plan sponsor.[55] Thus, because of the potential whipsaw between Code and ERISA, tax-exempt 457(b) plans must benefit a select group of an employer's employees.

However, despite their exemption from many provisions of ERISA, tax-exempt 457(b) plans remain subject to the claims rules under section 503 of

[51] See, e.g., N.Y.C.R.R. tit. 9, § 9001.4(d) (2002).
[52] See, e.g., N.J. Admin. Code tit. 5, § 37-5.2 (2002).
[53] Tax-exempt plans sponsored by certain entities related to church entities may be eligible to sponsor 457(b) plans that are exempt from ERISA as church plans under Section 3(33) of ERISA. Top hat plans are generally exempt from the reporting, participation and vesting, funding, and fiduciary responsibility requirements. ERISA §§ 201, 301, and 401 and Department of Labor Regulation § §2520.104-23.
[54] ERISA § 403.
[55] Code § 457(b)(6).

ERISA.[56] Department of Labor regulation 2560.503-1 provides claims procedure requirements that are generally applicable to tax-exempt 457(b) plans. These requirements were updated as of January 1, 2002 and impact tax-exempt 457(b) sponsors in several key ways:

- The information required to be provided after a claim denial has been revised;[57]
- The concept of "deemed denials"[58] appears to have been eliminated; and
- The rights of participants who have been denied an initial claim and who would like to file an appeal have been modified to allow them greater access to plan materials for preparing their appeal.

Tax-exempt 457(b) sponsors should review their plan documents and administrative procedures to ensure that these changes have been properly reflected.

IX. Private Letter Rulings

The Internal Revenue Service has not issued any formal guidance as to whether it will issue private letter rulings on the EGTRRA-compliant 457(b)

[56] Governmental plans are not subject to ERISA. ERISA § 4(b)(1).
[57] E.g., in the pre-2002 version of the Department of Labor claims procedure regulation, an initial denial of a claim was required to provide "appropriate information as to the steps to be taken if the participant or beneficiary wishes to submit her or her claim for review." In the 2002 version of the Department of Labor claims procedure regulation, this requirement has been replaced with a more detailed requirement that the denial provide "a description of the plan's review procedures and the time limits applicable to such procedures, including a statement of the claimant's right to bring a civil action under section 502(a) [of ERISA] following an adverse benefit determination on review."
[58] E.g., a plan's failure to provide notice of a claim determination within 90 days of its filing may be treated as a "deemed denial".

plans. However, unlike the determination letter process for qualified plans,[59] the Internal Revenue Service has continued to process ruling requests and is now issuing letters with an EGTRRA caveat for 457(b) plans that have been updated for EGTRRA. This caveat reflects the Internal Revenue Service's willingness to rule on certain EGTRRA changes, and its unwillingness to issue rulings approving of 457(b) plan amendments based on the proposed regulations.

Sponsors adopting new 457(b) plans may wish to avail themselves of this continued availability of the private letter ruling process.

X. Future Changes

This analysis has briefly summarized various changes to the rules governing 457(b) plans made by EGTRRA and the interpretation of some of the EGTRRA changes in the proposed regulations. However, other areas of the proposed regulations that are not yet in force should be on the radar screens of 457(b) plan sponsors.

First, 457(b) plan sponsors who have not previously prepared a detailed plan document should be ready to prepare a detailed plan document including all material terms of the plan once final regulations are issued.[60]

Second, effective in 2003, governmental 457(b) plan sponsors will be able to add "deemed IRAs" to their plans.[61] These deemed IRAs can be used to

[59] The Internal Revenue Service has not yet opened the qualified plan determination letter process to EGTRRA issues. Rev. Proc. 2002-6, 2002-1 I.R.B., 203, § 3.03 (Jan. 6, 2002). Qualified plans may adopt model "good faith" EGTRRA amendments to implement provisions of EGTRRA provided that such "good faith" amendments are adopted by the end of the plan year in which the EGTRRA change takes effect.
[60] Prop. Treas. Reg. § 1.457-3(a).

encourage further employee savings and are subject to the IRA rules under Code sections 408 (for IRAs) and 408A (for Roth IRAs). These deemed IRAs are not subject to the Code section 457(b) requirements even though the deemed IRA is contained within the 457(b) plan assets.

Third, the proposed regulations contain rules for correcting excess 457(b) plan deferrals.[62] This changes would represent a change in the correction rules many 457(b) plan sponsors have relied on for years. Flush language at the end of Code section 457(b) permits correction of Code section 457(b) violations so long as such correction occurs by the first day of the first plan year following the date 180 days after the Secretary of the Treasury has been notified of the failure. A formal process of excess deferrals would have to be monitored closely by 457(b) sponsors and their administrators.

Conclusion

Sponsors of 457(b) plans face many new obligations and have many new design options available to them as a result of the passage of EGTRRA and the issuance of the proposed regulations. This analysis has summarized many of the major requirements and changes facing 457(b) plan sponsors at this time. Because of these changes, 457(b) plans are a far more attractive retirement planning option for plan sponsors and their employees than they were only a year ago. As such,

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[61] See Dold, Deemed IRAs – A Welcomed New Plan Design Feature, Pension & Benefits Week, November 18, 2002, for a discussion of "deemed IRAs".
[62] Prop. Treas. Reg. § 1.457-4(e) and Prop. Treas. Reg. § 1.457-5.

many plan sponsors and potential plan sponsors would be well served by reconsidering the advantages of a 457(b) plan.