



- **457(b) Opportunities for TPA Business Owners**
- This session is geared to 401(k) administrators who want to learn about 457(b) plans and includes a comparison and contrast of 457(b)s and 401(k)s. Learn about the market for 457(b) plans and how they work with your 401(k) clients. Come broaden your plan design and administrative skills.
- Learning objectives:
- Summarize the benefits of the 457(b) plan.
- Discuss the benefits of a 457(b) plan with the plan sponsor.
- Assess if a client is a good prospect for a 457(b) plan.



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The attractiveness of a 457(b) plan as compared with a 401(k) plan or a 401(k) plan may vary greatly depending on the circumstances. For example, a state or local governmental entity other than a public school or university may need to have a 457(b) plan, because it cannot normally have either of the other types of plans. A private university that is tax-exempt under Internal Revenue Code ("I.R.C.") § 501(c)(3) but maintains a health maintenance organization that is tax-exempt under I.R.C. § 501(c)(4) and/or taxable research subsidiaries may prefer a 401(k) plan, so that it can cover all employees under the same plan. A private school that does not have affiliates, and wants to provide only for salary reduction contributions, may find that a 403(b) plan gives it the greatest ability to cover rank-and-file employees while minimizing administrative requirements. A public or private nonprofit school or university that maintains a qualified defined contribution plan may want to have a separate 403(b) plan as well, since it need not combine 403(b) contributions with contributions to the school or university's qualified plans in applying the I.R.C. § 415(c) limits.

With the passage of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), under which 457(b) plan deferrals no longer have to be coordinated with 401(k) or 403(b) deferrals, more employees may want to consider maintaining more than one type of plan to maximize total permitted deferrals. This is particularly true given that EGTRRA permits 457(b) and 403(b) plan money, as well as 401(k) plan money, to be used to purchase service credit under a defined benefit plan.

The following chart sets forth some primary differences among the different types of plans:

	457(b) Plan	401(k) Plan	403(b) Plan	Deferred IRA
May state or local governmental employer maintain this type of plan?	Yes.	No, unless it has a grandfathered 401(k) plan.	Only if it is a public school or university, or a portion of another agency that is located at an educational institution (e.g., an educational program for convicts that is part of a state prison system).	Yes.
Can a church employer that has not made an election under I.R.C. § 4100(a) be subject to ERISA ("nonsectarian church" maintained)?	A nonsectarian church is exempt from I.R.C. § 457(b). Thus, it can maintain an unfunded defined contribution plan, but is not subject to the I.R.C. § 403(b) requirements. To avoid unfavorable tax consequences, such a plan must not be funded and must meet the requirements of I.R.C. § 408(a).	Yes.	Yes.	Yes.
Can a tax-exempt employer other than a government or nonsectarian church maintain?	Only for highly compensated and management employees.	Yes.	Only if it is a § 501(c)(3) organization.	Yes.
Can the plan cover employees of related taxable entities?	No, although an unfunded defined contribution plan can be maintained for highly compensated and management employees of taxable affiliates.	Yes.	No.	Yes. However, because a deferred IRA can be part of another kind of plan (e.g., 402(b) or 408(a)), a related taxable entity that also wishes to maintain a deferred IRA may have to use a different plan for the deferred IRA, if it is not eligible to maintain the plan of which the deferred IRA is a part.
Are there limits on elective deferrals?	Lesser of a dollar limit or 100% of pre-plan compensation. The dollar limit is \$18,000 in 2015, and is indexed for cost-of-living changes in future years. Special catch-up provisions are available for certain long-service employees in the last three years of employment prior to normal retirement date. 457(b) plans need to be coordinated with other 401(k) or 403(b) plans (not 457(b) plans) in applying limits.	Lesser of a dollar limit or 100% of pre-plan compensation. The dollar limit is \$18,000 in 2015, and is indexed for cost-of-living changes in future years. 401(k) plans may be coordinated only with other 401(k) or 403(b) plans (not 457(b) plans) in applying limits.	Lesser of a dollar limit or 100% of pre-plan compensation. The dollar limit is \$18,000 in 2015, and is indexed for cost-of-living changes in future years. 403(b) plans need only be coordinated with other 403(b) plans or 401(k) plans (not 457(b) plans) in applying limits.	\$5,000 in any one year. This limit will be subject to cost-of-living adjustments for years after 2013. To the extent that an employee covered by a deferred IRA has income in excess of certain specified levels, and also participates in an employer plan, the deductibility of contributions may be limited. However, contributions are not offset against other types of employer plans, but only against other IRAs or deferred IRAs.
Are catch-up provisions available to increase the maximum elective deferrals?	Catch-up available under 457(b)(5) for one or more of the participant's last 3 taxable years ending before he or she attains normal retirement age under the plan. Catch-up available under 457(a)(2) and 414(c) for governmental plans only, for participants age 50 or over. If both catch-up apply, only the higher of the two, not both of the two, may be taken.	Catch-up available under 401(k)(13) for participants age 50 or over.	Catch-up available under 402(a)(7) for participants age 50 or over. Catch-up available under 402(a)(7) for employees who have at least 15 years of service with certain organizations. If both catch-up apply, the individual can take the sum of the two.	None.
Are there limits on total contributions?	Same as the limit on elective deferrals.	Lesser of \$53,000 (for 2015), as indexed in later years, or 100% of pre-plan compensation. Other qualified plans are combined in determining the limit. 403(b) and 457(b) plans do not count in determining the limit for a governmental 401(k) plan.	Lesser of \$53,000 (for 2015), as indexed in later years, or 100% of pre-plan compensation. Qualified plans, other than a plan maintained by a financial services company, are not counted in determining the limit for 403(b) plans. 457(b) plans do not count in determining the limit for a governmental 403(b) plan. Other 403(b) plans are combined in determining the limit.	Same as the limit on elective deferrals.



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What are the similarities between a 401(k) plan and a 457 plan?

- Both a 401(k) and 457(b) plan are funded through employee payroll deduction contributions.
- Annual contributions limits are the same for both 401(k) and 457(b) plans (\$18,000 for 2015)
- The age of 50 “catch-up” provision is the same for both plan types. (\$6,000 for 2015)
- A 457(b) plan contribution can qualify for the employee “Saver’s Tax Credit”
- A 457 (b) plan can allow Roth contributions



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What is the difference between a 401(k) plan and a 457 plan?

401(k) plans are IRC tax-advantaged qualified retirement savings plans and are subject to the Employee Retirement Income Security Act of 1974 (ERISA).

457(b) plans were originally designed to be “deferred compensation” (non-qualified) plans rather than qualified retirement plans and are not governed by ERISA.



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What is the difference between a 401(k) plan and a 457 plan?

A 457 plan is a program in which employees of tax-exempt employers or state and local governmental employers can defer compensation to a later date. In other words, a 457(b) plan is not an elective tax provision. It applies as a matter of law. Any deferred compensation by an eligible employer is done so under section 457 whether the employer intended to offer a plan or not.

In 2001, EGTRRA provisions changed “includible compensation” to have the same meaning used for qualified plans under IRC 457. Today, the market considers and views 457(b) plans as tax-advantaged retirement plans like a 401(k).



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What is the difference between a 401(k) plan and a 457 plan?

Employers that can establish 401(k) plans include: private, for-profit employers, some nonprofit employers and some governmental employers where a 401(k) plan existed and was grandfathered upon the creation of the 403(b) plan.

Employers that can establish a 457(b) plan include:

- A state or political subdivision
- An agency or instrumentality of a state or political subdivision
- Any tax-exempt organization that is not a government or a church within the meaning of IRC 3121(w)



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What is the difference between a 401(k) plan and a 457 plan?

- 401(k) plans do not allow independent contractors to participate.
- Both governmental and non-profit organizations can allow independent contractors to participate under a 457 plan
- A 457(b) plan cannot cover employees of related taxable entities whereas a 401(k) plan can cover employees of related entities. **However, an unfunded deferred compensation plan can be maintained for highly compensated and management employees of taxable affiliates.**



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What is the difference between a 401(k) plan and a 457 plan?

The IRS does not assess a penalty for premature withdrawals (age 59½) from a 457 account since ERISA rules do not apply. Any withdrawal is still subject to normal income tax.

Early withdrawals (before age 59 ½) from a 401(k) plan are subject to the additional 10% tax penalty.



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What is the difference between a 401(k) plan and a 457 plan?

While both plans allow for early withdrawals, the qualifying circumstances for early withdrawal eligibility are different.

Under a 401(k) plan, participants can take early withdrawals using financial "hardship" provisions.

Under a 457 plan, account holders are allowed hardship distributions are allowed under "unforeseeable emergency" provisions in the plan document.



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What is the difference between a 401(k) plan and a 457 plan?

Rules for financial hardship:



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What is the difference between a 401(k) plan and a 457 plan?

457 plans feature a "Double Limit Catch-up" provision that 401(k) plans do not. This provision is designed to allow participants who are nearing retirement to compensate for years in which they did not contribute to the plan but were eligible to do so. Thus, under the right conditions, a 457 plan participant may be able to contribute as much as \$35,000 to his plan in one year.

- Historical data sometimes not available
- Calculate individually
- Calculate for all employees to demonstrate plan's ability to expand savings for tenured employees



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Benefits of a 457(b) Plan

- Since 457 plans are nonqualified retirement plans, it is possible to contribute to both a 401(k) and 457 plan at the same time. Many large government employers offer both plans. In such cases, the participant is able to contribute maximum amounts to both.
- Cost savings by combining assets under one product platform - Asset Size Savings if a product provider can support multiple plan products on one platform.
- If the employer has strategic needs for employees to retire before the age of 55 and begin immediate withdrawals, there is no early withdrawal penalty on assets from a 457(b) plan.
- There are no excise taxes on excess contributions in a 457(b) plan. Governmental entities with 401(k) plans are also exempt from the excise tax on excess contributions.



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Discuss the benefits of a 457(b) plan with the plan sponsor.

- Employer pitfalls with a 457(b) plan
 - A second benefit plan has additional administration costs
 - You can withdraw funds from a 401(k) for a home purchase or college tuition, but not from a 457 account.
 - **What are other effects of violating limits on total contributions? In the case of a governmental plan that includes the limits in the plan but violates them administratively, the plan continues to be considered a 457(b) plan until the first day of the first plan year that begins more than 180 days after the date the IRS notifies the employer of the problem and will continue to be a 457(b) plan then if the employer has fixed the problem.**



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Church Employers (Source p.402)

- **A nonelecting church is exempt from I.R.C. § 457(b). Thus, it can maintain an unfunded deferred compensation plan, but is not subject to the I.R.C. § 457(b) requirements. To avoid unfavorable tax consequences, such a plan must not be funded and must meet the requirements of I.R.C. § 409A**



Tax-Exempt Employers

- A tax-exempt employer, other than a government or non-electing church, can have a 457(b) plan ONLY for highly compensated and management employees.
- Known as a “Top Hat” Plan



- Ineligible 457 plans vs eligible 457 plans



Assess if a client is a good prospect for a 457(b) plan.

- If they have no plan at all, what are the factors that would lead to starting the employer with a 457(b) plan?
- Severance Pay Plans vs. Deferred Compensation – IRS looks closely at severance pay plans to determine if they are exempt under IRC 457(e). Don't unintentionally create an ineligible 457(f) plan. Some relief with Announcement 2000-1 and the Job Protection Act of 2004. (The Source p.401)
 - Certain kinds of "separation pay" are considered includible compensation as long as such amounts are paid no later than the end of the tax year following the employee's final day of employment, or if later, within 2 ½ months of the end of the tax year. (Source p. 403)
- Non-Profit trying to set aside compensation for an executive. If it does not qualify under any of the IRC sections 401, 403(b) or 457, the employee will owe taxes once the money is set aside in a trust or funding vehicle or there is a substantial risk of forfeiture. (Source p.402)
- "Golden Handcuff" option -



Deferral of Sick Leave

- Can an employee defer sick leave cash out under the Organization's 457(b) Deferred Compensation Plan ("the Plan") where the amount actually cashed out to the employee is different (more or less) than the dollar amount of sick leave the employee would have received if employment had continued and the leave had been used during employment?
- **Proposed Response:** No. If the sick leave cash-out is an amount different than that which the employee would received had employment continued, the sick leave that is paid after severance is not includable compensation and cannot be deferred under 457(b).

