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[Chart of Section 457\(f\) Carve-Outs Under New Proposed Regulations](#)

The IRS recently announced [proposed regulations](#) under Internal Revenue Code (“Code”) Section 457 that update prior, [final regulations issued in 2003](#) and other subsequent guidance from IRS. Section 457 governs deferred compensation rules for government employees, and for executives of private, tax-exempt organizations it permits deferrals from compensation over and above limits set forth in Code § 403(b). The proposed Section 457 regulations impact “ineligible” deferred compensation plans under Code § 457(f) more substantially than “eligible” deferred compensation plans under Code § 457(b) which were more comprehensively covered in the 2003 final regulations.

By contrast to eligible Section 457(b) plans, which limit annual contributions to \$18,000, as adjusted for inflation (and without the age 50 catch-up for private non-profit executives), there is no dollar limit on annual contributions to a Section 457(f) plan (although as explained below other laws do set reasonableness limits upon nonprofit executive compensation in general). However, amounts set aside under Section 457(f) plans must be included in the executive’s taxable compensation once the amounts are no longer subject to a substantial risk of forfeiture, for instance upon completion of a vesting schedule, even if amounts are not physically paid out from the plan. Due to the requirement that income inclusion/taxation occur when the substantial risk of forfeiture lapses, Section 457(f) plans generally work best when retirement is in the fairly near future (e.g., 5 to 7 years out), and where vesting occurs on or near the anticipated retirement date.

As summarized in the chart, below, the proposed regulations clarify how certain pay arrangements are carved out from Section 457(f) compliance, either because the arrangement is not deemed to provide for a deferral of compensation, or because it defers compensation but not in a manner that does not fall under Code § 457(f). Where no deferral of compensation occurs, the pay arrangement generally is also exempt from the “Enron rules” applicable to for-profit deferred compensation plans under Code § 409A, and related regulations. ([Final regulations under Code § 409A](#) were published in 2007; the second of two sets of proposed regulations were [published the same day](#) as the proposed Section 457 regulations). The proposed Section 457 regulations clarify that Section 457(f) arrangements generally are also subject to Code § 409A, although there are some important distinctions between the two sets of rules which I will address in a future post.

Carve-Outs from Section 457(f) Deferred Compensation Rules

Type of Compensation	Deferral of Compensation?	Subject to Code § 457(f)?	Requirements for Exclusion	Comments
Short-term deferral	No	No	<ul style="list-style-type: none"> Participant actually or constructively receives payment on or before the last day of the "applicable 2.5 month period," which generally is March 15 of the year following the calendar year in which the substantial risk of forfeiture (SROF) lapses. 	<ul style="list-style-type: none"> If the employer follows a fiscal year, the applicable 2.5 month period ends on the later of March 15 or the 15th day of the third month following the end of the employer's first fiscal year in which the SROF lapses.
Recurring part-year compensation (e.g., teacher pay)	No	No	<ul style="list-style-type: none"> Recurring arrangement Arrangement does not defer payment past last day of 13th month following the beginning of the service period; and Recurring part-year compensation does not exceed the annual limit under Code § 401(a)(17) (\$265,000 in 2016) in effect for the calendar year in which the service begins. 	<ul style="list-style-type: none"> With regard to dollar limit, compensation for executives of non-profit organizations must be determined to be reasonable or intermediate sanctions may apply under Code § 4958.
Bona fide severance pay plan	Yes	No	<ul style="list-style-type: none"> Payable only on an involuntary severance from employment Severance amount does not exceed two times the employee's annualized compensation based on compensation received in the prior calendar year; and Severance payments are completed by the last day of the second calendar year following the year in which severance occurs. 	<ul style="list-style-type: none"> Involuntary severance for these purposes includes resignation for "good reason" as defined by proposed regulations; generally tracks definition under Code § 409A. Exception also applies to window programs (typically not exceeding 12 months) and to "voluntary early retirement incentive plans" which may be established only by certain education agencies or education associations representing education agencies. Note that similar exception under Code § 409A limits the "two times" compensation amount to the Code § 401(a)(17) limit mentioned above. Severance pay must meet reasonableness standard or intermediate sanctions may apply under Code § 4958.
Bona fide sick leave and vacation leave	Yes	No	<ul style="list-style-type: none"> Whether plan qualifies for exception depends upon the facts and circumstances. Primary purpose of plan must be to provide employees with paid time off from work because of sickness, vacation, and other personal reasons. 	<ul style="list-style-type: none"> Relevant factors include whether amount of leave, etc. could reasonably be expected to be used by the employee in the normal course of employment prior to termination, and limitations or controls, if any, placed on cash out of accrued, unused leave, etc.
Bona fide disability pay plan	Yes	No	Benefits payable only in the event of an employee's "disability" as defined in proposed regulations.	Definition of "disability" tracks Code § 409A definition and includes definition for Social Security Disability purposes.

Important Note: The above information is a brief summary of legal developments that is provided for general guidance only and does not create an attorney-client relationship between the author and the reader. Readers must seek individualized legal advice in regard to any particular factual situation. This is not an exhaustive list of exceptions or exclusions.