

Employee deferrals in a non-governmental IRC Section 457(f) plan

Background

Since 2007, plan sponsors, advisors, and recordkeepers have expected the IRS to provide additional guidance on 457 regulations. In July 2016, the IRS released long-awaited proposed 457(f) regulations regarding deferred compensation plans of state and local governments and tax-exempt entities.¹

Employee deferrals

Previously, the IRS actively discouraged voluntary employee deferrals into Internal Revenue Code Section 457(f) (IRC Section 457(f)) plans, saying that “no rational person” would subject current compensation to a future vesting schedule absent the knowledge that no real “substantial risk of forfeiture” existed. The proposed regulations would allow employee deferrals, subject to an employer-defined future vesting date, in exchange for a larger benefit via a required match. In other words, IRC Section 457(f) plans can now allow for employee deferrals, so long as those deferrals are subject to an employer-defined vesting schedule and match requirement.

The proposed regulations allow voluntary employee deferrals if the following conditions are met:

- An agreement to defer compensation must be made before the beginning of the calendar year in which the compensation is earned.
- An immediate employer match of “more than 25%” is added to each deferral causing additional expense to the organization.
- The vesting date is at least two years from the date of deferral.²

If a participant separates from service prior to achieving the employer-defined vesting event, the participant deferrals, employer match, and any associated market gains must be forfeited. Before deciding to defer current compensation, the participant should carefully consider the probability of continued employment through the employer-defined vesting date to avoid forfeiture.

¹ See Prop. Treas. Reg. Sec. 1.457
² See Prop. Treas. Reg. Sec. 1.457-12(e)(2).



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