

**MEMO# 16293**

July 15, 2003

## **IRS ISSUES FINAL REGULATIONS CONCERNING ELIGIBLE DEFERRED COMPENSATION PLANS UNDER CODE SECTION 457**

[16293] July 15, 2003 TO: PENSION MEMBERS No. 33-03 PENSION OPERATIONS ADVISORY COMMITTEE No. 43-03 RE: IRS ISSUES FINAL REGULATIONS CONCERNING ELIGIBLE DEFERRED COMPENSATION PLANS UNDER CODE SECTION 457 The Internal Revenue Service has issued the attached final regulations under section 457 of the Internal Revenue Code, which governs deferred compensation plans of state and local governmental and tax-exempt entities. The final regulations are effective July 11, 2003, but apply generally for taxable years after December 31, 2001. The final regulations differ from the proposed regulations<sup>1</sup> in a number of respects. For example, the proposed regulations would have permitted eligible governmental plans to self-correct and distribute excess deferrals, but would have provided that such an excess arising under a plan of a tax-exempt employer (other than as a result of the individual limitation under section 457(c)) would cause the plan to no longer be "eligible." The final regulations extend self-correction to both types of eligible plans. In addition, under the final regulations, plan-to-plan transfers from an eligible governmental plan to a governmental defined benefit plan for the purchase of permissive service credit are permitted without regard to whether the defined benefit plan is maintained by a governmental entity that is in the same state. Both the final regulations and the preamble thereto contain detailed discussions of the treatment of amounts rolled over into eligible governmental plans, including the statutory rule that an eligible governmental plan that accepts rollovers from other eligible retirement plans must separately account for such rollovers. The regulations further state, however, that plans may (but are not required to) separately account for particular types of eligible rollover distributions.<sup>2</sup> For example, such a plan could establish two rollover accounts, one of which represents rollover contributions attributable to annual deferrals made under an eligible governmental plan and the other of which represents other rollover contributions. Such an

<sup>1</sup> See Institute Memorandum to Pension Members No. 22-02 (14715), dated May 9, 2002. <sup>2</sup> The preamble notes that the final regulations do not contain provisions requested by some commentators that would allow a participant to receive a distribution of "rolled-in" assets even though the participant might not be eligible for distribution of other assets under the plan. According to the preamble, however, the Treasury Department and the Service intend to issue guidance of general applicability that would resolve this issue in coordination with applicable rules for qualified plans and section 403(b) arrangements. <sup>2</sup> approach would keep rollover amounts from eligible governmental plans separate from rollover amounts subject to the early withdrawal income tax under section 72(t) of the Code. Kathy D. Ireland

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