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Non-Governmental 457(b) Deferred Compensation Plans

Internal Revenue Code Section 457 provides tax-advantaged treatment for certain non-qualified deferred-compensation plans. A 457 plan sponsor must be either:

- a governmental unit (a state or political subdivision of a state or an agency or instrumentality of one of these), or
- an entity exempt from income tax under IRC Section 501(c) (a non-governmental sponsor).

Non-governmental 457(b) ("Top Hat") plans must limit participation to groups of highly compensated employees or groups of executives, managers, directors or officers. The plan may not cover rank-and-file employees.

Plan must remain unfunded

Non-governmental 457 plans must remain unfunded. Plan assets are not held in trust for employees, but remain the property of the employer (available to its general creditors in the event of litigation or bankruptcy). Non-governmental 457(b) plans commonly use "rabbi trusts" to hold employee deferrals. The rabbi trust is funded, but the trust assets remain available to creditors. Employees are lower in priority than general creditors in the event of legal claims against the employer.

Regular contributions

Contributions to 457(b) plans may include employee salary deferrals and employer contributions. The contributions are reported on Form W-2.

Catch-up contributions

1. [Age 50 catch-up](#) contributions for participants who are age 50 or older at the end of the current tax year:

- are allowed in governmental 457(b) plans
- are not allowed in non-governmental 457(b) plans.

2. Catch-up contributions for participants who are [within 3 years](#) of normal retirement age:

- Available for both governmental and non-governmental 457(b) plans.
- Allows eligible employees to contribute up to another full employee deferral limit.
- Amount limited to "unused" deferrals from previous years.
- An employee who already deferred the maximum in the 457(b) plan for all years of employment would not be able to use this type of catch-up.
- The three year period must be continuous and must not include the year of retirement.
- This provision requires the compilation of prior year underused limits, and the potential for errors is high, due primarily to the lack or inaccuracy of historical records.

Ineligible 457(f) plans distinguished

Non-governmental 457 plans can be established by tax-exempt organizations as:

- "eligible" under IRC Section 457(b), or
- "ineligible" under IRC Section 457(f).

Non-governmental, tax-exempt entities can establish 457(f) (ineligible) plans that are tax deferred and that allow contributions exceeding the annual deferral limit. These plans and the associated deferrals are possible only if there is a "substantial risk of forfeiture" – when the risk has been removed, the participant's deferral amounts become taxable.

Select group of management or highly compensated employees

While there is no formal legal definition of a "select group of management or highly compensated employees," it generally means a small percentage of the employee population who:

- are key management employees, or
- earn a salary substantially higher than that of other employees.

Over the years, the courts and the Department of Labor have looked at one or more factors:

- total employees versus the number of employees covered under the plan
- the average salaries of the select group versus the average salaries of other employees;
- the average salaries of the select group versus the average salary of all management or highly compensated employees;
- range of salaries of employees in the select group; and
- the extent to which the select group can negotiate salary and compensation packages.

Non-Governmental 457(b) Deferred Compensation Plans

Filing and reporting requirements

IRC Section 457 plans are not required to file Form 5500 as they are not subject to Title I of ERISA.

Non-governmental 457(b) (Top Hat) plans must file a notification of the plan's existence with the Department of Labor.

Common compliance issues for 457(b) plans

1. Failure to limit participation in a non-governmental 457(b) plan subjects the plan to ERISA Title I funding requirements.
2. Non-governmental 457(b) plans that must comply with the ERISA funding requirements will fail to satisfy IRC 457(b)(6), which provides that the plan must be unfunded.
3. Contributions to a funded non-governmental 457(b) plan are immediately taxable.

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