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Benefits Guide: Basics

Defined Contribution Plans, Government and Tax-Exempt Organizations

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Defined Contribution Plans

Government and Tax-Exempt Organizations

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GOVERNMENT AND TAX-EXEMPT ORGANIZATIONS BASICS

The Basics —

Governmental Plans: A “governmental plan” is a qualified retirement plan that is established and maintained for its employees by the federal government, a state government, any agency or instrumentality of the federal or state government, or Indian tribal governments. The term governmental plan also includes a plan to which the Railroad

Retirement Act of 1935 or 1937 applies and that is financed by contributions required under that act, and any plan of an international organization that is exempt from tax under the International Organizations Immunities Act.[1]

[1] I.R.C. § 414(d).

Governmental Plan Restrictions: Governmental plans are exempt from the application of the requirements of the Employee Retirement Income Security Act (ERISA), other than the amendments that ERISA made to the Internal Revenue Code.[2] They are exempt from some (but not all) of the requirements of the Internal Revenue Code.[3] However, because they are not covered by ERISA's preemption of state law, they must also comply with state constitutional and statutory provisions. And because ERISA's fiduciary standards were developed from common law fiduciary rules, governmental plans will typically look to ERISA in interpreting their own state's fiduciary rules.

[2] ERISA § 4 and ERISA § 4021.

[3] I.R.C. § 401(a)(5)(G), I.R.C. § 401(a)(9)(C)(iv), I.R.C. § 401(a)(10)(B)(iii), I.R.C. § 401(a)(24), I.R.C. § 401(a)(26)(G), I.R.C. § 401(a)(32)(A), I.R.C. § 401(a)(33)(C), I.R.C. § 401(a)(34), the flush language of § 401(a) following I.R.C. § 401(a)(37), I.R.C. § 401(k)(3)(G), I.R.C. § 414(p)(9), I.R.C. § 410(c)(2), I.R.C. § 411(e)(2), I.R.C. § 415(b)(2), I.R.C. § 415(b)(10), I.R.C. § 415(b)(11), and I.R.C. § 415(k)(3) and IRS News Release IR-1869 (Aug. 10, 1977).

Types of Governmental Plans: A governmental plan can maintain a qualified plan described in I.R.C. § 401(a). A state or local government can also maintain a deferred compensation plan described in I.R.C. § 457(b). A public school, college, or university can maintain a tax-sheltered annuity or tax-sheltered custodial account described in I.R.C. § 403(b). A public organization may also maintain a 403(b) plan if it is a government “instrumentality” separate from the government that does not have governmental powers (such as imposing taxes, regulating the public, or enforcing laws), which has chosen to obtain status as an organization described in I.R.C. § 501(c)(3) (an entity organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals).

In the case of qualified plans, governmental employers are much more likely than private employers to sponsor defined benefit plans (plans in which the benefit is a specific amount, such as 2% of compensation times years of service.) Almost all private plans these days, other than certain collectively bargained plans, are defined contribution plans (ones in which the benefit is based on contributions made plus earnings on those contributions). To the extent a governmental entity sponsors a defined contribution plan, it is often a 403(b) plan or a 457(b) plan rather than a qualified plan.

Governmental Plan Status: Historically, the Department of Labor took the position that the governmental status of a plan would not be jeopardized where a small or insignificant—de minimis—number of private sector employees participate in the plan, a governmental plan accepts back employees who were originally privatized in a failed joint venture, and a governmental plan elects to offer deemed individual retirement arrangements.[4] However, more recent guidance questions whether such a rule should exist at all, and if so, what restrictions should apply.[5]

[4] DOL Opinion Letter 99-10A; DOL Opinion Letter 2003-01A.

[5] Advance Notice of Proposed Rulemaking REG-157714-06, 76 Fed. Reg. 69172 (Nov. 8, 2011).

Determination, Advisory, or Opinion Letter Requests: A governmental qualified plan may apply for a determination letter from the IRS confirming that the plan is qualified under the Internal Revenue Code in both form and operation. In the case of individually designed qualified plans, the IRS issues determination letters only for new plans, terminating plans, and in other special situations.[6] However, the determination letter process is typically less useful for governmental plans than for plans of private employers, for three reasons:

[6] Rev. Proc. 2020-4.

- Many governmental plans are quite old. If they have ever obtained a determination letter in the past, they cannot obtain one based on having a "new plan." If they have never obtained a determination letter, requesting one now risks calling the IRS's attention to defects in prior years.
- In many instances, a governmental plan is precluded by federal or state constitutional requirements from ever terminating a plan.
- In many instances, a governmental plan document consists of a statute establishing the plan. If amendments are required as a condition of obtaining the determination letter, plan staff has no assurances that the relevant legislative body will adopt the necessary amendment.

Alternatively, a governmental entity can adopt a pre-approved qualified plan (i.e., a form document sold to employers by a document provider such as a financial institution or benefits practitioner), which can obtain an opinion letter on a six year cycle.[7] However, many of the available pre-approved plans are not suitable for use by governmental entities.

[7] Rev. Proc. 2017–41.

A governmental entity that adopts an individually designed 403(b) plan cannot obtain an IRS determination letter on the plan's status, but it can adopt a pre-approved 403(b) plan that can obtain an opinion or advisory letter on its status.[8] The IRS does not issue determination letters with regard to 457(b) plans.

[8] Rev. Proc. 2013-22.

Remedial Amendment Period: The remedial amendment periods for governmental qualified and 403(b) plans generally track the same start and end dates as nongovernmental plans, except that various rules apply that may extend the remedial amendment period to allow for the legislature with authority to amend the plan to do so.[9]

[9] Rev. Proc. 2016-37; Rev. Proc. 2019-39.

There is no specific remedial amendment period for a governmental 457(b) plan. However, a governmental 457(b) plan that is administered in a manner which is inconsistent with the requirements of section 457(b) shall be treated as not meeting the requirements of 457(b) only as of the first plan year beginning more than 180 days after the IRS notifies the employer of the problem and then only if the employer fails to correct the inconsistency before the first day of such plan year.[10]

[10] I.R.C. § 457(b), flush language following I.R.C. § 457(b)(6).

Contribution and Benefit Limits: As with all plans, the annual contribution and benefits limits for governmental and tax-exempt organization plans are adjusted annually by the IRS to reflect inflation. For more on the cost-of-living adjustments, see Employee Benefits COLA Chart. However, governmental plans are subject to various modifications of the limits that apply to nongovernmental plans.

Correction of Governmental Plan Errors: The IRS will accept submissions to correct failures relating to 401(a) and 403(b) plans of governmental employers under the Employee Plans Compliance Resolution System (EPCRS) on the same basis as plans of other employers. It will accept submissions relating to 457(b) plans on a provisional basis outside of EPCRS, under standards that are similar to the Voluntary Correction Program (VCP).[11] However, as described above, a governmental plan typically need not engage in an IRS submission in order to correct defects in its 457(b) plan. Beginning on April 1, 2019, governmental plan sponsors submitting applications for correction of §457(b) plan failures under VCP must submit their applications using www.pay.gov.[12] Prior to April 1, 2019, plan sponsors filed paper submissions with the IRS in accordance with the instructions in Rev. Proc. 2016-51 , § 10, § 11.[13]

[11] Rev. Proc. 2019-19.

[12] Rev. Proc. 2019-19, § 10, § 11.

[13] Rev. Proc. 2016-51, § 10, § 11.

Tax-Exempt Organization Plans: A “tax-exempt organization plan” is a plan sponsored by tax-exempt nonprofit organizations. This may be an organization described in I.R.C. § 501(c)(3), as described above under “Types of Governmental Plans.” However, there are also a wide variety of other tax-exempt organizations such as civic leagues, social clubs, unions, business leagues, and the like.

Except in the case of churches, the qualified plans of tax-exempt organizations are similar to those of other nongovernmental employers. However, as described below, a 501(c)(3) organization can also maintain a 403(b) plan. And any tax-exempt organization can maintain a 457(b) plan.

Correction of Tax-Exempt Organization Plan Errors: The IRS will accept submissions to correct failures relating to 401(a) and 403(b) plans of tax-exempt employers under EPCRS on the same basis as plans of other employers. It will accept submissions relating to 457(b) plans on a provisional basis outside of the Employee Plans Compliance Resolution System, under standards that are similar to the Voluntary Correction Program (VCP), only in very limited circumstances.[14]

[14] Rev. Proc. 2019-19.

Additional Resources: 373 T.M., *Employee Benefits for Tax-Exempt Organizations*; Benefits Guide: *Determination Letter Process*; *Section 457 Plans for Public and Nonprofit Entities*; *Section 403(b) Plans: Tax-Deferred Annuities*; TPS: ¶ 5560 Specialized Retirement Plans, Governmental Plans.

GOVERNMENTAL PLAN RULES

Governmental Plan Rules Basics —

Governmental qualified plans must meet some of the private sector qualified plan provisions, such as having a formal written plan and ensuring that assets are used exclusively for the benefit of participants and beneficiaries.[15] However, governmental plans are also exempt from certain rules that apply to other plans, such as the rules prohibiting discrimination in benefits in favor of highly compensated employees, from the minimum coverage rules, and from the top-heavy plan rules. They are also excluded from the comparable rules for 403(b) plans.

[15] I.R.C. § 401(a).

For 457(b) plans, the rules are very different for governmental plans and for plans of tax-exempt organizations (which are the only nongovernmental organizations that have 447(b) plans). A governmental 457(b) plan is typically open to rank and file employees and must be funded. A 457(b) plan of a private employer can only be open to a select group of highly compensated and management employees and must be unfunded.

De Minimis Number of Private-Sector Employees in Governmental Plans —

Historically, the Department of Labor has taken the position that the status of a governmental plan under ERISA was not affected by participation of a de minimis number of private-sector employees.[16] However, how many private-sector employees would be considered de minimis was unclear.

[16] DOL Opinion Letter 99-10A.

Example: Participation of 28 employees of the Western Association of Schools and Colleges in the California Public Employees' Retirement System (CalPERS) would not adversely affect the status of CalPERS as a “governmental plan," within the meaning of ERISA § 3(32). CalPERS has more than 1 million participants, including about 750,000 active employees and 300,000 retirees. The WASC employees would represent a small fraction of one percent of all CalPERS participants and would be de minimis. Opinion Letter 95-27A came to a similar conclusion.[17]

[17] DOL Opinion Letter 99-10A.

Example: Participation of five employees of the Massachusetts Public Employees Fund in the fund would not adversely affect the status of that fund as a governmental plan. The term “governmental plan” is not limited to plans established by the unilateral action of governmental employers. Rather, it includes plans established and maintained pursuant to collective bargaining between a governmental employer and a labor union, where the plan covers only governmental employees and former employees and is substantially funded by the governmental employer.[18]

[18] DOL Opinion Letter 2005-17A.

Moreover, this rule has now been thrown into question by Advance Notice of Proposed Rulemaking (ANPR) REG-157714-06.[19] The ANPR states as follows:

[19] 76 Fed. Reg. 69172 (Nov. 8, 2011).

> [T]hese proposed regulations do not include special rules addressing existing practices under which a small number of private employees participate in a plan that would otherwise constitute a governmental plan under section 414(d). Comments are requested on whether an exception should be provided in such cases. Parameters that could be taken into account for such a special rule include the following: (1) whether the private employees were previously employees of the sponsoring governmental entity; (2) whether the private employees were previously participants in the governmental plan; (3) whether the number or percentage of such former employees who participate in the governmental plan is de minimis (and, if so, what constitutes a de minimis number or percentage); (4) whether the coverage is pursuant to pre-existing plan provisions; (5) whether the private employer performs a governmental function and has been officially designated as a State entity for plan participation purposes; and (6) whether the employer is ineligible to sponsor the particular type of governmental plan (for example, whether a private employer is a tax-exempt organization under section 501(c)(3) that can sponsor a section 403(b) plan, and whether the private employer sponsors or has sponsored plans that cannot be sponsored by a State governmental entity, such as a cash or deferred arrangement under section 401(k) or an unfunded section 457(b) plan of a tax-exempt entity (described in section 457(e)(1)(B)).

Practice Tip: Consequently, it can no longer be assumed that inclusion of even a de minimis number of nongovernmental employees in a governmental plan is acceptable, especially if those employees do not have a special connection to the governmental plan such as those described in the ANPR.

Private-Sector Qualified Plan Requirements That Apply to Governmental Plans —

The requirements for private-sector plans that apply to governmental plans are as follows:

- a written plan and trust;

- a requirement that all assets of a governmental plan be used exclusively for the benefit of employees or their beneficiaries;

- a requirement that plan benefits be definitely determinable and not subject to employer discretion, and that the actuarial assumptions used to calculate the participants' benefits be specified in the plan document;

- prohibition against using forfeitures to increase plan benefits to participants in defined benefit plans;

- provision of sickness, accident, hospitalization, and medical benefits for retirees, their spouses, and their dependents, subject to the “incidental benefit" rules that limit the amount of nonretirement benefits that a plan may provide;

- taxation of plan in-service withdrawals, loans, and the penalty tax for early withdrawals; and

- taxation of distributions, including rollovers, withholding, and employee communications about the distributions.[20]

- requirements that a plan be qualified for the associated trust to be tax-exempt.[21]

[20] I.R.C. § 72; I.R.C. § 401(a); I.R.C. § 402.

[21] IRS News Release IR-1869 (Aug. 10, 1977).

Requirements from Which Governmental Qualified Plans Are Exempt —

Governmental plans are exempt from many of the ERISA and I.R.C. requirements for qualified private sector plans. The private sector provisions may not apply because the nature of government differs from private employers, or because governmental plans remain subject to the pre-ERISA law or the law prior to tax reform in 1986.

The exemptions from the I.R.C. and ERISA for governmental plans include the following:

- rules prohibiting discrimination in favor of highly compensated employees[22] (for more information, see *Nondiscrimination Rules: Testing*);

- minimum coverage rules[23] (for more information, see *Nondiscrimination Rules: Testing*);

- participation rules imposing age or length-of-service requirements[24] (for more information, see *Participation Requirements*);

- preservation of the accrued benefits of participants in the event of a plan merger, consolidation, or asset transfer;

- prohibition against assignment or alienation of benefits;

- prohibition on early commencement of benefits without the participant's consent;

- requirement that plan not decrease plan benefits on account of certain Social Security increases (for more information, see *Social Security Benefits*);

- requirement that certain benefits not be forfeited on account of participant withdrawals;

- joint and survivor annuity requirements;[25]

- top-heavy plan provisions[26] (for more information, see *Key Employee and Top Heavy Provisions*);

- payment of termination insurance to the Pension Benefit Guaranty Corporation (for more information, see *PBGC Termination Insurance Program*);[27]

- filing of the Form 5500 series reports, or Schedule SSA, reporting separated participants with deferred benefits, or actuarial reports—Schedule B to Form 5500;[28] and

- participant disclosure requirements under ERISA, including furnishing participants with summary plan descriptions.[29]

[22] I.R.C. § 401(a)(5)(G).
[23] I.R.C. § 410(c)(1)(A).
[24] I.R.C. § 410(c)(2).
[25] Last sentence of I.R.C. § 401(a) (following I.R.C. § 401(a)(37)).
[26] I.R.C. § 401(a)(10)(B).
[27] ERISA §4021(b)(2).
[28] IRS Announcement 82-146.
[29] ERISA § 4(b)(1).

Private-Sector Qualified Plan Requirements That Apply in Modified Form to Governmental Plans —

The following apply to governmental qualified plans, but in modified form:

- vesting requirements, as pre-ERISA rules apply[30] (for more information, see *Governmental Plan Vesting Requirements*);

- minimum funding requirements, as pre-ERISA rules apply[31] (for more information, see *Application of the Minimum Funding Standard to Governmental Plans*);

- prohibition on eliminating or reducing an early retirement benefit or a retirement type subsidy, or eliminating an optional form of benefit;

- application of the minimum required distribution rules;[32]

- application of limits on benefits or contributions (for more information, see “Contribution and Benefit Limits for Governmental Plans,” below, and the Employee Benefits COLA Chart);[33]

- application of maximum amount of a participant's compensation that is taken into account in determining benefits, as adjusted for inflation (for more information on the compensation limits, see “Compensation Limits for Governmental Entity Plans,” below, and the Employee Benefits COLA Chart);[34]

- domestic relations orders (a governmental plan may comply with any domestic relations order, not just a qualified domestic relations order, and the order will be treated as if it were a qualified domestic relations order for purposes of taxing the alternate payee);[35]

- prohibited transaction rules (the rules for governmental plans are entirely different from those for private plans).[36]

[30] I.R.C. § 411(e).

[31] I.R.C. § 412(e)(2).

[32] A governmental plan may comply with the required minimum distribution rules by using a reasonable and good faith interpretation of § 401(a)(9). 26 C.F.R. § 1.401(a)(9)-1.

[33] I.R.C. § 415.

[34] I.R.C. § 417.

[35] I.R.C. § 414(p)(9).

[36] I.R.C. § 503.

401(k) Plans for Governmental Entities —

State and local governmental entities can sponsor a 401(k) plan only if they had such a plan before May 6, 1986.[37] In the case of a governmental entity that is permitted to have a 401(k) plan (see preceding section), the plan is exempt from the actual deferral percentage test requirements of I.R.C. § 401(k)(3).

[37] I.R.C. § 401(k)(4)(B)(ii); Tax Reform Act of 1986, Pub. L. No. 99-514, § 123, § 1116(f)(2)(B)(i).

Benefit Limits for Governmental Entity Plans —

Benefits under nongovernmental qualified defined benefit plans are limited to a dollar amount (adjusted for inflation), or 100 percent of compensation. For more on the cost-of-living adjustments, see Employee Benefits COLA Chart. However, governmental plans are exempt from the 100 % of compensation limit.[38]

[38] I.R.C. § 401(a)(5)(G).

The annual dollar limit for benefits in a governmental plan is reduced for benefits commencing before age 62 and increased for benefits commencing after age 65, rather than Social Security retirement age. For more on the cost-of-living adjustments, see Employee Benefits COLA Chart.

In addition, benefits provided under a qualified governmental excess benefit arrangement won't be taken into account in determining whether a governmental plan meets the § 415 requirements.[39] For a governmental plan to have a qualified governmental excess benefit arrangement, it must maintain a portion of the plan to solely provide participants with annual plan benefits that exceed § 415 limits; not provide the participants an election to directly or indirectly defer compensation to this portion of the plan; and pay these benefits from a trust solely maintained to pay these benefits.[40] Government plan sponsors may request a private letter ruling as to whether their plans' excess benefit arrangement is a qualified arrangement under § 415(m)(3) and related Rev. Ruls.[41]

[39] I.R.C. § 415(m)(1).

[40] I.R.C. § 415(m)(3).

[41] Determination Letters for Governmental Plans Don't Address Pick-up Contributions and Excess Benefit Arrangements.

A state and local government plans, can elect either:

- to treat the accrued benefit derived from all contributions to buy permissive service credit as part of the benefit subject to I.R.C. § 415(b); or
- to treat the contributions to buy permissive service credit as annual additions subject to I.R.C. § 415(c).[42]

[42] I.R.C. § 415(n).

Permissive service credit under § 415(n) means service credit that is recognized by a governmental plan for purposes of calculating a participant's benefit under the plan, that the participant has not received under the governmental plan, and that the participant may receive only by making a voluntary additional contribution, in an amount determined under the governmental plan, that does not exceed the amount necessary to fund the benefit attributable to such service credit. Service credit may include periods for which there is no performance of service and may include service credited in order to provide an increased benefit for service credit which a participant is receiving under the plan.[43]

[43] I.R.C. § 415(n)(3)(A).

Plan participants cannot buy more than five years of permissive service credit for “nonqualified service,” which includes service for employers that are not governmental or educational employers.[44] However, plan-to-plan transfers from § 403(b) and § 457 plans to purchase service credit are exempt from § 415(n) limits on nonqualified service credit purchases.[45]

[44] I.R.C. § 415(n)(3)(B).

[45] I.R.C. § 403(b)(13); I.R.C. § 415(n)(3)(D); I.R.C. § 457(e)(17).

Repayments of cashouts are not included in the benefits limit of governmental plans or considered to be permissive service credit.[46]

[46] I.R.C. § 415(k)(3).

Contributions to a defined benefit plan taken from employee's pay pursuant to a “pick-up” arrangement described in I.R.C. § 414(h)(2) are treated as if they were employer contributions subject to the limits on benefits of I.R.C. § 415(b), rather than as if they were employee contributions that would be subject to the limits on annual additions of I.R.C. § 415(c).[47]

[47] I.R.C. § 414(h)(2).

Compensation Limits for Governmental Entity Plans —

The limits on compensation that may be taken into account for plan purposes[48] became applicable to governmental plans effective for the first plan year beginning on or after Jan. 1, 1996, or 90 days after the opening of the first legislative session beginning on or after Jan. 1, 1996 of the governing body with authority to amend the plan, if that body did not meet continuously. A transitional rule permits a governmental plan to apply section 401(a)(17) only to persons who become plan participants after the effective date, if certain conditions are met. One of those conditions is that the plan must have been amended before the beginning of the first plan year beginning on or after Jan. 1, 1996.

[48] I.R.C. § 401(a)(17).

Governmental Plan Vesting Rules —

Neither the vesting rules of the I.R.C., nor the parallel provisions of ERISA, apply to governmental plans.[49] Instead, such plans must meet the vesting requirements of the I.R.C. "resulting from" certain I.R.C. qualification rules as in effect on Sept. 1, 1974, before amendment by ERISA. Those qualification rules prohibited a plan from discriminating in contributions or benefits in favor of officers, shareholders, supervisors, or highly compensated employees, and required a plan to provide immediate and full vesting for the accrued benefits of participants upon the plan's termination or the complete discontinuance of employer contributions.[50]

[49] I.R.C. § 411(e)(1)(A); I.R.C. § 4021(b)(2); ERISA § 203(a).

[50] I.R.C. § 411(e)(2).

Normal Retirement Age in Governmental Plans —

Governmental plans, as defined in I.R.C. § 414(d), must comply with normal retirement age regulations beginning with the close of the first regular legislative session of the legislative body with the authority to amend the plan that begins on or after the date that is three months after final regulations are published in the Federal Register.[51]

[51] IRS Notice 2012-29. While in general, governmental plans are no longer subject to prohibitions on discriminating in favor of officers, shareholders, supervisors, or highly compensated employees due to I.R.C. § 401(a)(5)(G), the IRS nonetheless takes the position that pre-ERISA section 401(a)(7) requires that benefits become vested upon attainment of normal retirement age. Preamble to the proposed regulations on the Applicability of Normal Retirement Age Regulations to Governmental Pension Plans, 81 Fed. Reg. 4599 (Jan. 27, 2016).

"Normal retirement age" is the earliest age considered to be a normal retirement age in the industry for whose workforce a pension plan is established.[52]

[52] 26 C.F.R. § 1.401(a)-1(b)(2).

An exception to that interpretation permits pension plans to begin paying retirement benefits to participants who reach normal retirement age, even if the employee continued to work for the employer that sponsors the plan. The regulation implemented tax provisions on phased retirement added by the Pension Protection Act of 2006.

Practice Tip: Plans can use a normal retirement age of 62 or later and still comply with normal retirement age distribution rules. In addition, plans can define normal retirement age as 55 or older, depending on facts and circumstances. Plans designed primarily for public safety employees can establish age 50 as a normal retirement age. All these situations have in common that the government plans allow retirement after a certain number of years of service, regardless of age.

Under proposed IRS rules issued Jan. 26, 2016, a governmental plan that doesn't provide for the payment of in-service distributions before age 62 wouldn't fail to satisfy the requirement in 26 C.F.R. § 1.401(a)-1(b)(1) that the plan provide a definitely determinable benefit to employees after retirement or attainment of normal retirement age, merely because the plan has a normal retirement age that is earlier than otherwise permitted under § 1.401(a)-1(b)(2).[53]

[53] Prop. 26 C.F.R. § 1.401(a)-1(b)(2), 81 Fed. Reg. 4599 (Jan. 26, 2016).

Also, as proposed, the normal retirement age "under a pension plan must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed." A normal retirement age of at least 62 would be considered "reasonably representative" of the typical retirement age for the covered workforce. In addition to this general safe harbor, the proposed rules also would provide four age-plus-service safe harbors with the following age and service parameters:

- age 60 and five years of service;
- age 55 and 10 years of service;
- combined age and years of service of 80 or more; and
- 25 years of service in combination with any of the other safe harbors that includes an age, except for those designed for public safety employees.[54]

[54] Prop. 26 C.F.R. § 1.401(a)-1(b)(2), 81 Fed. Reg. 4599 (Jan. 26, 2016).

The rules would apply to employees hired during plan years beginning on or after Jan. 1, 2017, or the close of the first regular legislative body with the authority to amend the plan, beginning on or after the date that is three months after the final rules are published in the Federal Register, whichever is later.[55]

[55] Prop. 26 C.F.R. § 1.401(a)-1(b)(2), 81 Fed. Reg. 4599 (Jan. 26, 2016).

Police and Fire Department Plans: A special rule applies to qualified participants in police and fire department plans. Qualified participants must be employed by a police or fire department operated by a state or political subdivision, or an Indian tribal government or its political subdivision, to provide police protection, firefighting services, or emergency medical services within that particular jurisdiction.[56]

[56] I.R.C. § 415(b)(2)(H).

A qualified public safety employee may receive a distribution from a governmental defined benefit plan under § 414(d) after separation from service without incurring the early distribution penalty if the officer is at least age 50 in the calendar year when the separation from service occurs. The exception is not available if the employee rolls over distributions from a governmental defined benefit plan into an IRA, or a defined contribution plan, and later takes an early distribution from the IRA.[57]

[57] I.R.C. § 72(t).

In addition, retired public safety officers may exclude from their gross income distributions of up to $3,000 from eligible governmental plans—§ 401(a), § 403(a), or § 403(b) plans-- used to pay for their qualified health insurance premiums. Qualified health insurance premiums include those for accident and health insurance or qualified long-term care insurance contracts for the officer, spouse, and dependents. The exclusion applies to coverage by self-insured plans as well as by insurance companies, and only with respect to distributions from the plan maintained by the employer from which the individual retired as a public safety officer.[58]

[58] I.R.C. § 402(l).

For more on distribution requirements in governmental plans, see 373 T.M., *Employee Benefits for Tax-Exempt Organizations*, II.I.

Government Pick-Up Contributions —

Government employees often have to make contributions to a governmental plan. In general, if a contribution to a qualified plan is designated as an employee contribution, it will not be treated as an employer contribution. As a result, the amount of the employee contribution will normally be includable in the income of the employee in the year made.[59]

[59] I.R.C. § 61; I.R.C. § 414(h)(1); 26 C.F.R. § 1.402(a)-1(d).

However, if the employing unit "picks up" the contribution that the employee is required to make, those pick-up contributions will be treated as employer contributions for federal income tax purposes. Thus, they are not included in the employee's income in the year made and are not subject to income tax withholding. Taxation occurs only upon distribution. Pick-up contributions may be treated as employee contributions for all other purposes, such as for calculating benefits under the plan, state taxes, cost-of-living increases, salary increases, and bonuses. The employer may "pick-up" the required contributions by a reduction in cash salary, by an offset against future salary increases, or by a combination of both.[60]

[60] I.R.C. § 414(h)(1); 26 C.F.R. § 1.402(a)-1(d); GCM 39540 and 38820.

For a governmental plan to have a valid "pick-up contributions" arrangement, the employer's duly authorized person must state in writing that the:

- employer will make the contributions to the plan but designate them as employee contributions;[61] and
- employees must not have the option to receive the contributions directly in cash or by an election to defer them either before or after the date the employer pays them to the plan.[62]

[61] Determination Letters for Governmental Plans Don't Address Pick- up Contributions and Excess Benefit Arrangements.

[62] I.R.C. § 414(h)(2).

Generally, governmental employers must provide a formal accounting when they pick up responsibility for making the plan contributions of their employees. An action, such as a plan amendment or meeting minutes documenting the conversion of contribution payments, must be in writing to show that the amounts are employer, rather than employee, contributions for federal tax purposes.[63]

[63] Rev. Rul. 2006-43.

Under the documentation requirement, government employers must provide a contemporaneous, written account that the pick-up contribution amounts will no longer be included as part of the employee's gross income. In addition, participating employees must not be permitted to opt out of the "pick-up," or to receive the contributed amount to the plan.[64]

[64] Rev. Rul. 2006-43.

Example: Contributions of a school district that assumes and pays, or "picks up," the required contributions of its teachers to the qualified state pension plan are employer contributions to the plan that are excludable from employees' wages for purposes of income tax withholding and from gross income until subsequent distribution or availability to the employees.[65]

Example: A plan amendment to a political subdivision's pension plan in which it agreed to pick up the required contributions to the plan of all its participating employees and to treat all picked up contributions as employer contributions in determining tax treatment satisfied the criteria for picked-up contributions under I.R.C. § 414(h)(2).[66]

Governmental plan sponsors who apply for determination letters cannot rely on a favorable letter for whether contributions made to the plan are the employer's “pick-up contributions.” Sponsors, however, may apply for a private letter ruling from IRS for a determination that their plan has a valid “pick-up contributions” arrangement under § 414(h)(2) and related Rev. Ruls.[67]

Application of the Minimum Funding Standard to Governmental Plans —

A governmental plan subject to the code's minimum funding standard must meet the funding requirements of pre-ERISA law only. These rules require only that a plan be funded by a trust rather than being paid out of the employer's general assets.[68] Thus, the rules of the I.R.C. and ERISA requiring plans to maintain a funding standard account, among other things, do not apply.[69]

Application of Prohibited Transaction Rules to Governmental Plans —

The I.R.C.'s prohibited transaction rules for governmental plans are in general much less strict than those for private plans. However, instead of being subjected to an excise tax the way a private plan would be, a governmental plan that engages in a prohibited transaction suffers the sanction of complete loss of the tax exemption under I.R.C. § 501(c) for its trust.[70]

This does not mean that the trust ceases to be tax-exempt. Under IRS News Release *IR-1869* (August 10, 1977), the IRS will not impose tax on a governmental plan, even if the plan is in violation of the qualification rules. However, because the trust is no longer tax-exempt under 501(a), the participants are treated as though they were participants in a nonqualified plan. And while the IRS would be unlikely to penalize participants for a prohibited transaction that was not their fault, it has the right to collect from the employer the amount that would have been withheld from the employee's wages (for both income and FICA tax purposes) if the vested benefits under the plan had been treated as taxable.[71]

[65] Rev. Rul. 77-462.

[66] PLR 8630073.

[67] Determination Letters for Governmental Plans Don't Address Pick- up Contributions and Excess Benefit Arrangements.

[68] Rev. Rul. 71-19, 1971-1 CB 116.

[69] I.R.C. § 412(e)(2)(C).

[70] I.R.C. § 503; I.R.C. § 4975(g)(2).

[71] IRS News Release IR-1869 (Aug. 10, 1977).

Governmental Plans Offering 'Deemed IRAs' —

Offering Deemed IRAs: A governmental plan may provide a "deemed IRA" under I.R.C. § 408(q) to its employees and not render itself subject to any provision of Title I of ERISA disqualifying the plan for governmental plan status. The opinion assumed the deemed IRA continued to meet the definition of a government plan.[72]

[72] DOL Opinion Letter 2003-01A.

A governmental unit may serve as the trustee of any deemed IRA established by that governmental unit as part of its qualified employer plan if that governmental unit establishes to the satisfaction of the IRS commissioner that it will administer the deemed IRA consistent with the requirements of § 408. For example, a governmental unit need not demonstrate that it satisfies net worth requirements if it demonstrates instead that it possesses taxing authority under applicable law.[73]

[73] 26 C.F.R. § 1.408-2(e).

Social Security Alternative Plans —

Certain state and local governments are permitted to opt out of Social Security (though not Medicare) taxes--(which also means that their employees will not receive Social Security benefits.[74] In order to be eligible for this exemption, one of the requirements is that an employee must be covered under a separate plan that entitles the employee to an annual benefit commencing on or before his or her Social Security retirement age that is at least equal to the annual Primary Insurance Amount the employee would have under Social Security. In instances in which an employee might not be covered under a state retirement system due to such factors as length of service or part-time status, the state or locality much maintain a separate retirement system providing the mandated benefits.

[74] I.R.C. § 3121(b)(7).

DEFERRED RETIREMENT OPTION PLANS (DROPs)

Deferred Retirement Option Plan Basics —

Many governmental plans are designed to allow employees to retire with 20 or 30 years of service. As more employees become eligible for retirement in a tight labor market, some governmental employers are adding incentives to keep their employees longer. In the private sector, employers may use "phased retirement" to allow employees to continue working part-time. Some governmental employers have implemented deferred retirement option plans or programs (DROPs), which are roughly the private sector equivalent of phased retirement plans.[75]

[75] See, for example, Florida's Deferred Retirement Option Program (DROP).

DROPs are distribution options provided under qualified defined benefit plans. They are not separate qualified plans.

Under a typical DROP, an employee eligible to retire can elect to participate in the DROP and continue working. At the time of the election, the employee ceases to be an active participant in the retirement plan and assumes retirement status. All or part of the retirement benefit that the employee would have received on a periodic basis is placed into a separate account, where it may or may not earn interest. The retiree continues to work and receive a salary until the end of the DROP period, for example, two to five years. When the DROP period ends, the retiree receives a lump-sum distribution of the amounts in the DROP account, and resumes receiving directly the benefit earned at the date of retirement, when the DROP period began.[76]

[76] Florida's Deferred Retirement Option Program (DROP).

The lump sum received under the DROP is taxable to employees, and may be subject to 20% withholding by the employer unless the amount is rolled over to an individual retirement account in a direct rollover.[77]

[77] I.R.C. § 3405(c).

Deferred Retirement Option Plan Design —

In addition to the traditional DROP design, plan sponsors have developed variations on the theme to fit particular needs. These variations include immediate DROPs, also known as partial lump-sum payout options (PLUS) or partial lump-sum options payouts (PLOPs); retroactive or back DROPs; and DROPs with optional features.

Participants often must elect to participate in the DROP at the time they become eligible for retirement. Under a PLOP, however, the participant can make the election at the time of retirement. If the participant elects the reduced monthly benefit, the monthly benefit becomes payable immediately, in addition to the lump sum that represents the actuarial value of the reduced benefit amount.[78]

[78] New York State and Local Retirement System, Partial Lump Sum (PLS) Payment at Retirement, FAQs.

A retroactive DROP, similar to a PLOP, allows a participant to make the DROP election at the time of actual retirement, rather than when the participant becomes eligible to take early retirement. A participant's benefits in a retroactive DROP are calculated as if the employee had entered the DROP at the earliest time he or she became eligible for retirement benefits. The participant then receives the reduced monthly benefit amount plus a lump sum that represents the monthly benefit amount times the number of months since the earliest retirement age. Usually, the participant also receives an interest credit on the lump sum.[79]

[79] City of Austin Police Retirement System.

Florida and Louisiana are among the governmental employers that sponsor DROP plans. The features of their plans are summarized below.

Florida's DROP —

The Deferred Retirement Option Program of the Florida Retirement System (FRS) allows employees to retire, have their FRS benefits accumulate with interest in a trust fund, and continue to work for Florida.[80]

[80] Florida's Deferred Retirement Option Program (DROP).

Employees who have vested in their benefits and reached their normal retirement date are eligible to participate in the DROP. The normal retirement date for most employees is vesting plus attainment of age 62 or completion of 30 years of service. Generally, employees may elect to participate in DROP as early as six months before the date of expected participation in the program but within 12 months after reaching their normal retirement date. Some groups of employees have special rules.[81]

[81] FAQs–DROP.

DROP participation may last as long as 60 months from the normal retirement date. If participation in the DROP is delayed, the length of participation is shortened by the length of the delay. Employees that keep working after the end of the DROP period will cause the state to cancel both retirement and the DROP retroactively, and require the hiring agency to pay additional pension contributions for FRS service credit.[82]

[82] FAQs–DROP Eligibility.

The participant's normal monthly retirement benefit, including creditable service, option benefit forms, average final compensation, and the retirement effective date are fixed on the date of DROP participation. The DROP accounts earn interest at an effective annual rate of 6.5 percent. Retirement benefits paid into the DROP are increased by the annual 3% cost-of-living adjustment. DROP accounts may be distributed as a lump sum, a direct rollover, or a combined partial lump-sum payment and rollover. Employer contributions continue during DROP.[83]

[83] FAQs–DROP Miscellaneous.

DROP participants are ineligible for FRS disability benefits and their survivors are ineligible for FRS in-line-of-duty death benefits. However, DROP and monthly benefits may be paid to the participant's FRS designated beneficiary at time of death.[84]

[84] FAQs–DROP Survivor Benefits.

Louisiana's DROP —

Another example is the Deferred Retirement Option Plan (DROP) offered by the Louisiana State Employees' Retirement System (LASERS).

State employees must be eligible for regular retirement before participating in the DROP. Regular retirement is met by 30 years of service at any age, 25 years of service at age 55, or 10 years of service at age 60. Employees choosing retirement after 20 years at any age are ineligible for the DROP plan. Unused sick and vacation leave cannot be used to establish DROP.[85]

[85] LASERS Member's Guide to Retirement, Retirement Eligibility and Final Average Compensation.

DROP participation is limited to 36 months. Applications for the DROP must be made at least 30 days before the effective date of participation, or within three years and 60 days from the date of eligibility for regular retirement. The length of the DROP participation must be specified on the application and is irrevocable.[86]

[86] LASERS Member's Guide to Retirement, Retirement Eligibility and Final Average Compensation.

LASERS participants are considered to have retired on the date of DROP participation, and benefit calculations remain the same after DROP participation begins, even if salaries were increased during DROP participation. No employee or employer contributions are paid during the DROP period.[87]

[87] LASERS Member's Guide to Retirement, Retirement Eligibility and Final Average Compensation.

If an employee continues working after DROP participation, he or she will begin making contributions again and, therefore, begin earning service credit again. Monthly additions to the DROP account stop, the account begins to earn interest, and employee and employer contributions are required again. Money cannot be withdrawn from the DROP account until 30 days after all state employment terminates. The total retirement benefit after DROP is equal to the DROP benefit, a supplemental benefit based on additional service after DROP if applicable, and a supplemental benefit based on balances at the time of termination.[88]

[88] LASERS Member's Guide to Retirement, Deferred Retirement Option Plan, Working after DROP.

DROP participants are ineligible for cost-of-living adjustments to their benefits, while participating in the program or when working after DROP. DROP accounts do not earn interest during the participation period. Survivor benefits are payable under certain conditions.[89]

[89] Louisiana State Employees' Retirement System.

Philadelphia's DROP —

Employees who are 55 years of age or older and have at least 10 years of credited pension service are eligible to elect to participate in Philadelphia's DROP, which allows participating employees to continue to work for the city for up to four years. During that period, an employee's earned monthly pension benefit is placed in a DROP account that becomes available to the employee within four years when he officially retires from the city. Employees who are eligible for post-retirement health and welfare benefits begin receiving these benefits, after electing to enroll, on the first day of the month following their actual retirement from the city of Philadelphia.[90]

[90] Philadelphia Board of Pensions and Retirement, Summary Plan Description.

GOVERNMENTAL PLANS UNDER WRERA

Worker, Retiree, and Employer Recovery Act of 2008 Basics —

In 2008, Congress made technical corrections to the Pension Protection Act of 2006 and added additional funding relief provisions in response to the financial crisis in the fall of 2008 and its accompanying effect on pension plans.[91]

[91] The Worker, Retiree, and Employer Recovery Act of 2008, Pub. L. No. 110-458.

Application of Interest Credits to Governmental Plans —

PPA's rules regarding interest credits apply to governmental plans as defined in I.R.C. § 414(d). A rate of return or method of crediting interest that is established pursuant to any provision of federal, state, or local law, including any administrative rule or policy adopted in accordance with any such law, is generally treated as a market rate of return and as a permissible method of crediting interest for purposes of PPA's interest credit requirement. However, this does not apply if the rate of return or method of crediting interest violates another requirement of ADEA.[92]

[92] The Age Discrimination in Employment Act, 29 U.S.C. § 623(i)(10)(B)(i)(III)), as amended by the Worker, Retiree, and Employer Recovery Act of 2008, Pub. L. No. 110-458, § 123.

Medical Reimbursements and Public Retirement Systems —

WRERA added I.R.C. § 105(j), which applies to health plans funded by a medical trust established in connection with a public retirement system. For purposes of § I.R.C. § 105(b) (amounts expended for medical care), amounts paid (directly or indirectly) to a taxpayer from a specified health plan shall not fail to be excluded from gross income solely because the plan provides for reimbursements of health care expenses of a deceased plan participant's beneficiary.[93]

[93] I.R.C. § 105(j), as added by the Worker, Retiree, and Employer Recovery Act of 2008, Pub. L. No. 110-458, § 124.

TAX-EXEMPT ORGANIZATION PLANS

Tax-Exempt Organization Plan Basics —

Tax-exempt organizations are permitted to maintain employee benefit plans of the types maintained by private taxable organizations, subject in some cases to exceptions and special rules.

Tax-exempt organizations may maintain all types of tax-qualified pension plans except stock bonus plans. Tax-exempt organizations generally offer pension and profit-sharing plans even though the tax-exempt organization does not have profits.

Tax-exempt employers, other than state and local governments, can establish a § 401(k) plan for their employees.[94]

[94] I.R.C. § 401(k)(4)(B); I.R.C. § 457; I.R.C. § 501.

While any nongovernmental tax-exempt organization can sponsor a qualified plan described in I.R.C. § 401(a), only a § 501(c)(3) organization can sponsor a tax-sheltered annuity or tax-sheltered custodial account described in I.R.C. § 403(b). And while any nongovernmental tax-exempt organization other than a church can sponsor a deferred compensation plan described in I.R.C. § 457(b), a nongovernmental tax-exempt organization must limit participation in such a plan to a select group of management or highly compensated employees and may not fund the plan.

In general, the rules for nongovernmental tax-exempt organization plans, other than churches, are the same as would apply to similar plans of other nongovernmental entities. However, a nonqualified deferred compensation plan of a tax-exempt organization, unlike that of a taxable entity, will give rise to taxation of the employee when amounts become vested (as opposed to when they are distributed) unless the plan meets the requirements of I.R.C. § 457(b).

For more, see 373 T.M., *Employee Benefits for Tax-Exempt Organizations*, II.B.

ERISA Exemptions for Some Qualified Plans of Tax-Exempt Organizations —

Qualified plans maintained by certain types of tax-exempt organizations are exempt from part or all of the requirements of ERISA and the tax laws.

These exemptions are available to church plans that do not elect to be governed by ERISA and plans funded exclusively by employee contributions and maintained by fraternal beneficiary societies, orders, or associations, or by voluntary employees' beneficiary associations.[95]

[95] ERISA § 3(33).

“Church plans” are plans established and maintained for employees of churches or conventions of churches, recognized as tax-exempt by IRS.

A church plan must provide advance notice of requests for church plan status to participants and other interested parties if the plan applies to IRS for a letter ruling on church plan status. The IRS provides procedures contains procedures for submitting letter ruling requests and a model notice. The plan administrator of what would otherwise be an exempt church plan may irrevocably elect that the plan be governed by ERISA, including the tax provisions.[96]

[96] Rev. Proc. 2011-44.

Because ERISA § 3(33) and I.R.C. § 414(e) define "church plans" in virtually identical language, and because IRS in a private letter ruling issued Oct. 22, 2003, had determined that a health system cash accumulation plan, savings plan, and pension plan constituted "church plans" under I.R.C. § 414(e), the plans therefore also constituted church plans under ERISA § 3(33). DOL stated that, "conditioned on [the health system's] representation, … and the plans not being materially different from facts on which the IRS based … its private letter ruling, the department sees no reason to disagree with the IRS's conclusion."[97]

[97] DOL Opinion Letter 2004-11A.

Plans maintained by fraternal organizations or voluntary employee beneficiary associations are excused from certain coverage, vesting, benefit accrual, and funding requirements that apply to other tax-qualified plans:

- minimum age and service requirements;
- minimum coverage requirements;
- minimum vesting and benefit accrual standards;
- minimum funding standards;
- joint and survivor and preretirement survivor annuity requirements;
- restrictions on mergers, consolidations, and transfers of assets;
- restrictions on assignment or alienation of benefits, except for qualified domestic relations orders relating to division of benefits after divorce;
- mandatory distribution rules;
- prohibition of benefit reduction on account of Social Security increases after termination of employment;
- prohibition of forfeiture of employer contributions upon withdrawal of employee contributions;
- controlled group and predecessor employer rules;
- plan termination notice to PBGC;
- duty to file Schedule SSA; and
- duty to file actuarial reports.[98]

[98] I.R.C. § 401(a).

Other Requirements for Church Plans —

Even though in the absence of an election, church plans are exempt from all or part of ERISA and the I.R.C., they are subject to other requirements:

- minimum coverage requirements of pre-ERISA law;
- vesting rules of pre-ERISA law;
- exclusive purpose and benefit requirements;
- prohibition against increasing benefits by forfeitures in defined benefit plans;
- limits on annual additions and benefits;
- compensation limits;
- use of actuarial assumptions to calculate plan benefits.[99]

[99] I.R.C. § 401(a).

401(k) Plans for Tax-Exempt Entities —

Nongovernmental tax-exempt entities can maintain § 401(k) plans for their employees.[100]

[100] I.R.C. § 401(k)(4)(B)(i).

If a for-profit organization is an affiliate of a 501(c)(3) organization, employees of the 501(c)(3) organization who participate in a § 403(b) plan may be excluded in determining whether the coverage of the for-profit organization's § 401(k) plan, or I.R.C. § 401(m) plan that is provided under the same general arrangement as a section 401(k) plan, meets the coverage requirements of I.R.C. § 410(b) if

- no employee of a 501(c)(3) organization is eligible to participate in the 401(k) or (m) plan; and
- at least 95% of the for-profit employer's employees are eligible to participate in the 401(k) or 401(m) plan.[101]

[101] 26 C.F.R. § 1.410(b)-6(g)(3).

Employees of state and local government entities that are ineligible to participate in a § 401(k) plan because of I.R.C. § 401(k)(4)(B)(ii) can be treated as excludable employees for the purpose of the coverage tests applicable to a related nongovernmental tax-exempt if more than 95 percent of the employer's eligible employees benefit under the plan for the year.[102]

[102] 26 C.F.R. § 1.410(b)-6(g)(2).

Practice Tip: This allows a controlled group that includes both taxable and governmental or tax-exempt entities to maintain a 401(k) plan only for the taxable entity or entities while maintaining a 403(b) plan for the governmental or tax-exempt entity or entities.

A 401(k) plan is required either a) to limit the contributions of highly compensated employees relative to the contributions made by nonhighly compensated employees, or b) to provide certain employer nonelective contributions or matching contributions.[103] These rules do not apply to a 403(b) plan, which is merely required to permit all employees (with very limited exceptions) to make pretax contributions to the plan if any employee is permitted to make such contributions.[104] However, employees covered by a 401(k) plan can be excluded from making pretax contributions to a 403(b) plan.

[103] I.R.C. § 401(k)(3); I.R.C. § 401(k)(11).

[104] I.R.C. § 403(b)(12)(i).

Practice Tip: This permits a tax-exempt organization to avoid the limits on contributions by highly compensated employees, while still permitting nonhighly compensated employees to participate in a 401(k) plan, by simply having the highly compensated employees participate only in a separate 403(b) plan.

For more on excludable employees, see 373 T.M., *Employee Benefits for Tax-Exempt Organizations*, II.C.

RULES APPLICABLE TO BOTH GOVERNMENTAL AND TAX-EXEMPT ENTITY PLANS

Contribution Limits for Governmental and Tax-Exempt Entity Plans —

Combined pretax employee contributions to § 401(k) and § 403(b) plans are limited to a dollar amount that is set each year.[105] There is an additional "catch-up" up limit for individuals who attain age 50 by the end of the year.[106] Both the general dollar amount and the catch-up deferral amount are indexed for inflation in $500 increments. Alternatively, an employee who has at least 15 years of service with a public school system, hospital, home health service agency, health and welfare service agency, church, or convention or association of churches (or associated organization), cam be permitted to have a 403(b) elective deferral limit that is increased by the lesser of:

[105] I.R.C. § 402(g).

[106] I.R.C. § 414(v).

- $3,000; or
- $15,000, reduced by the amount of additional elective deferrals made in prior years because of this rule; or
- $5,000 times the number of the employee's years of service for the organization, minus the total elective deferrals made for earlier years.[107]

[107] I.R.C. § 402(g)(7).

In addition, all (employee and employer) annual additions to a defined contribution plan (other than 457(b), plans) are subject to a separate dollar limit that is set each year. However, this limit is calculated separately for 401(k) and 403(b) plans, rather than being aggregated the way the previously discussed limit is.

457(b) plans are subject to the same dollar limit as 401(k) and 403(b) plans.[108] However, the limit applies to all employer and employee contributions to the plan, not just to employee pretax contributions. As a result, many state and local governments provide that matching contributions in the case of a 457(b) plan will be made to a 401(a) plan rather than to the 457(b) plan itself, but this option is not available for plans of nongovernmental tax-exempts. Moreover, a 457(b) plan is not aggregated with a 401(k) or 403(b) plan in applying the limits.

[108] I.R.C. § 457(b)(2) and I.R.C. § 457(b)(15).

In state and local government § 457 plans (but not plans of other tax-exempt employers), participants aged 50 or older by the end of the year may make catch-up contributions similar to those permitted for 401(k) and 403(b) plans.[109] As an alternative to the catch-up contribution in the last three years before a participant attains normal retirement age, the participant may make contributions equal to the lesser of:

[109] I.R.C. § 414(v).

(A) twice the usual dollar amount, or

(B) the sum of—

(i) usual dollar amount, plus

(ii) so much of the usual dollar amount for taxable years before the taxable year as has not previously been used.[110]

[110] I.R.C. § 457(b)(3).

For more on the cost-of-living adjustments, see Employee Benefits COLA Chart.

For more on § 403(b) annuities, see *Section 403(b) Plans: Tax-Deferred Annuities*; for more on § 457 plans, see *Section 457 Plans for Public and Nonprofit Entities.*

Early Distributions —

In-Service Distributions: Under I.R.C. § 401(a)(36), before 2020, a qualified defined benefit plan was not permitted to make in-service distributions before the earlier of normal retirement age under the plan or age 62. The Setting Every Community Up for Retirement Enhancement Act (SECURE Act), which was part of the Further Consolidated Appropriations Act, 2020,[111] amended this section to permit in-service distributions beginning in the calendar year in which a participant reaches age 59½ for plan years beginning after Dec. 31, 2019.[112]

[111] Pub. L. No. 116-94, Div. M.

[112] Pub. L. No. 116-94, Div. M, § 104(b).

Under I.R.C. § 457(d), before 2020, a § 457(b) plan generally was not permitted to make in-service distributions before the calendar year in which a participant reached age 70½.[113] The SECURE Act[114] amended § 457(d)(1)(A)(i) to allow in-service distributions from § 457(b) plans beginning in the calendar year in which a participant reaches age 59½, for plan years beginning after Dec. 31, 2019.

[113] I.R.C. § 457(d)(1)(A)(i).

[114] Pub. L. No. 116-94, Div. M, § 104(b).

These changes made the requirements for qualified defined benefit plans and 457(b) plans comparable to the existing requirements for 401(k) and 403(b) plans.

Excise tax: If a plan participant receives any amount from a qualified retirement plan that is an “early distribution,” the participant must pay an excise tax of 10% of the amount includible in gross income, unless an exception applies. This tax is in addition to any federal income tax.[115] However, this tax does not apply to 457(b) plans, except to the extent the amount being distributed consists of a rollover the 457(b) plan previously received from another type of plan.

[115] I.R.C. § 72(t).

Coronavirus Relief: Under Section 2202 of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act),[116] enacted on March 27, 2020, an employee who takes a coronavirus-related distribution in 2020 from a qualified plan before attaining age 59½ isn't subject to the usual 10-% early withdrawal tax under I.R.C. § 72(t). A plan making such a distribution won't face disqualification. For more on this provision, see In-Service Distributions.

[116] Pub. L. No. 116-136.