Part I

Section 457.--Deferred Compensation Plans of State and Local Governments and Tax-exempt Organizations

26 CFR 1.457-2: Definitions.

Rev. Rul. 2004-57

ISSUE

Does a plan fail to be an eligible governmental plan under § 457(b) of the Internal Revenue Code solely because the plan is offered and administered by a labor union for the benefit of those State employees who are union members?

FACTS

An organization (including its local affiliates) that is a labor organization described in § 501(c)(5) (Union) represents professional firefighters employed by various city, municipal, and other local governments in State X ("Governmental Employers") under collective bargaining agreements between the Union and the Governmental Employers.

State X maintains an eligible governmental § 457(b) plan (Plan A). Plan A is available to employees of State X and employees of any political subdivision of State X, including both unionized and non-unionized public safety employees and civilians.

The Union would like to offer an additional eligible governmental § 457(b) plan (Plan B) that is available only to members of the collective bargaining units represented by the Union who are employed by the Governmental Employers

Under Plan B, the members of the Union who are employees of the Governmental Employers that adopt Plan B are eligible to participate and elect to have the Governmental Employers make contributions on their behalf to Plan B out of their compensation from the Governmental Employers. Plan B states that the plan is established and maintained by the Governmental Employers and participants are informed of this. Only investments approved by the Union are offered under Plan B and amounts deferred by employees of Governmental Employers that adopt Plan B, plus any amounts transferred directly from any other eligible governmental § 457(b) plan, provide Plan B's exclusive source of funding.

Union members employed by Governmental Employers that do not adopt Plan B are not eligible to participate in Plan B, and no contributions may be made on their

behalf regardless of whether their Governmental Employer is part of any collective bargaining agreement with the Union or its affiliates and regardless of whether the employees are union members. Employees of the Union are not eligible to participate in Plan B.

Plan B provides that all annual deferrals for a participant under the plan are combined with the participant's annual deferrals under Plan A and all other eligible plans of the same employer for purposes of the Plan B limitations designed to comply with the limitations of § 457(b), and are combined with annual deferrals under eligible plans of other employers to the extent information concerning such plans is provided by the participant. Thus, Plan B treats all deferrals under all eligible plans in which an individual participates by virtue of his or her relationship with a single employer as a single plan for purposes of determining whether deferrals in excess of the § 457(b) limitations have been made.

Because both Plan A and Plan B must comply with these limitations, they each include terms providing for correction of any excess deferrals under all plans. Plan B provides that if an excess deferral arises which is only an excess amount as a result of the combined annual deferrals under both Plan A and Plan B, then the excess amount will be corrected by Plan B (even though there would be no excess if only annual deferrals under Plan B were taken into account). By adoption of Plan B, each Governmental Employer agrees not only to forward payroll amounts representing annual deferrals under Plan B, but also to inform Plan B of the amount of the annual deferrals made under Plan A by participants in Plan A who also participate in Plan B and such other information known to the Governmental Employers as Plan B may need for proper administration. The adoption agreement also requires the Union to provide to the Governmental Employers such information from Plan B as the Governmental Employers may need to complete tax returns for their employees and to administer Plan A.

In addition, for purposes of Plan B's special catch-up contribution rules for participants who are within the three-year period ending before the year they reach normal retirement age, Plan B provides a normal retirement age which is the same as the normal retirement age under Plan A. Further, Plan B permits a plan-to-plan transfer of assets from Plan A (or any other eligible governmental plan) to Plan B for employees who have not had a separation from employment only if the following conditions are satisfied: (i) the transfer is from Plan A or any other plan that is an eligible governmental plan of State X; (ii) the transferring plan provides for the transfer; (iii) the participant whose deferred amounts are being transferred is performing services for a Governmental Employer that has adopted Plan B (and, for this purpose, Plan B treats the employer as the same employer only if the participant's compensation is paid by the same entity); and (iv) the participant or beneficiary whose amounts deferred are being transferred must have an amount deferred immediately after the transfer at least equal to the amount deferred with respect to that participant or beneficiary immediately before the transfer.

LAW AND ANALYSIS

Section 457 provides rules for the deferral of compensation by an individual participating in an eligible deferred compensation plan as defined in § 457(b). Section 457(b)(1) provides that the term "eligible deferred compensation plan" means a plan "established and maintained by an eligible employer" in which only individuals who perform services for the employer may be participants. The performance of services includes performance of services as an employee or as an independent contractor. Section 457(e)(2).

Section 457(e)(1) defines an "eligible employer" as (A) a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State and (B) any other organization (other than a governmental unit) exempt under Subtitle A of the Internal Revenue Code. Section 1.457-2(e) of the Income Tax Regulations further defines the term "eligible employer" as including an entity that is a State that establishes a plan and § 1.457-2(l) provides that State means a State (treating the District of Columbia as a State as provided under § 7701(a)(10)), a political subdivision of a State, and any agency or instrumentality of a State.

Section 1.457-5(b) provides that for purposes of determining the amount of annual deferrals under a § 457 plan that are excluded from a participant's gross income in any taxable year, the participant's annual deferrals under all § 457 plans must be determined on an aggregate basis. For example, under § 1.457-5, all annual deferrals under all eligible plans (whether or not with the same employer) are combined for purposes of determining whether the limitations of § 457(b) have been exceeded. In this regard, § 1.457-4(e)(2) treats all deferrals under all eligible plans in which an individual participates by virtue of his or her relationship with a single employer as a single plan for purposes of determining excess deferrals.

Under § 1.457-10(b)(4), a plan-to-plan transfer from one eligible governmental plan to another eligible governmental plan of the same employer is permitted without a separation from employment if certain conditions are satisfied, including that the transfer is from an eligible governmental plan to another eligible governmental plan of the same employer (and, for this purpose, the employer is not treated as the same employer if the participant's compensation is paid by a different entity).

Section 457(g) provides that a plan maintained by an eligible governmental employer is not to be treated as an eligible deferred compensation plan unless all amounts of compensation deferred under the plan, all property and rights purchased with such deferred compensation amounts, and all income attributable to such amounts, property, or rights of the plan are held in trust for the exclusive benefit of participants and their beneficiaries. In order to be an eligible plan of a tax-exempt entity, § 457(b)(6) provides that the plan must be unfunded and plan assets must not be set aside for participants or their beneficiaries.

An arrangement does not fail to constitute a single eligible governmental plan for purposes of § 457(b) merely because the arrangement is funded through more than one trustee, custodian, or insurance carrier. See § 1.457-8 of the regulations and Notice 98-8, 1998-1 C.B. 355.

Under § 457, therefore, different rules apply depending on whether the entity establishing and maintaining the plan is a tax-exempt entity or a State government entity. A union that is a tax-exempt entity may establish and maintain an eligible § 457(b) plan, but only if the plan is unfunded and is for its employees or other individuals who perform services for the union. A State (including an agency or instrumentality thereof) may establish and maintain an eligible § 457(b) plan, but only if it is funded and only for employees of the State or other individuals who perform services for the State. A union may not establish and maintain a funded plan for its employees or for individuals who do not perform services for the union. However, an eligible governmental employer may adopt, for its collectively-bargained employees, a plan created by the union for employees of the governmental employer and offered and administered by the union, provided that the plan is “established and maintained by” the governmental employer. Thus, if the plan is established and maintained by a governmental employer, it can qualify as an eligible governmental § 457(b) plan, assuming that the plan satisfies all of the other requirements of § 457(b).

If the governmental employer has adopted the plan in a manner that reflects the employer as having established and maintained the plan, a plan does not fail to be an "eligible governmental § 457(b) plan" merely because the plan is created, offered and administered by a union even if it is in addition to another plan that is offered and administered by the governmental employer.

Under these facts, Plan B includes special provisions designed to comply with the rules for eligible governmental § 457 plans of the same employer, including coordination of limitations and corrections under § 1.457-5 and plan-to-plan transfer provisions that comply with § 1.457-10(b)(4). These facts are consistent with the plan being established and maintained by the Governmental Employers. The Union’s involvement in administering the plan to be offered to employees of the Governmental Employers, such as coordinating the information necessary to determine whether any excess contributions are made for a participant and responsibility in providing information necessary for completing wage statements that reflect Plan B, is comparable to the involvement associated with a third party administrator who invests annual deferrals and administers the plan provisions for the employer. In this case, the Union is in effect administering Plan B for the Governmental Employers, as a plan that is established and maintained by the Governmental Employers as the actual employers of the union members.

HOLDING

Plan B does not fail to be an eligible governmental plan under § 457(b) solely

because the plan is offered and administered by the Union, but only with respect to employees of the Governmental Employers that have adopted Plan B as described in these facts.

For § 457(b) plans that do not satisfy the requirements of this revenue ruling see Announcement 2004-52, page ___.

DRAFTING INFORMATION

The principal author of this revenue ruling is Vernon S. Carter of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling contact Vernon S. Carter on (202) 622-6060 (not a toll-free call).