

Part III - Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 98-41

SECTION 1. PURPOSE

This Revenue Procedure provides model amendments that may be used by an eligible employer (as defined in § 457(e)(1) of the Internal Revenue Code) to amend its § 457(b) plan to reflect the revisions made to § 457 of the Internal Revenue Code by the Small Business Job Protection Act of 1996, Pub. L. No. 104-188 ("SBJPA") and by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34 ("TRA '97").

SECTION 2. BACKGROUND AND GENERAL INFORMATION

.01 Section 457 of the Internal Revenue Code applies to nonqualified deferred compensation plans established by state and local government and tax-exempt employers. These plans may be either eligible plans that meet the requirements of § 457(b) or ineligible § 457(f) plans. Under § 457(a), compensation deferred pursuant to eligible plans that meet the requirements of § 457(b) and the income attributable to such deferred compensation are not includible in gross income until the taxable year in which the deferred amounts are actually paid or made available to the plan participant or beneficiary.

.02 Section 1447(a) of the SBJPA and section 1071 of TRA '97 amended § 457(e)(9) of the Code, generally effective for years beginning after December 31, 1996, to permit in-service distributions of amounts of \$5,000 or less payable under a § 457(b) plan under certain conditions, and to permit an additional election by a participant to further defer commencement of distributions under a § 457(b) plan after the first permissible payout date. Section 1447(b) of the SBJPA added new paragraph (15) to § 457(e) of the Code, also effective for years beginning after December 31, 1996, under which the \$7,500 maximum deferral limitation under §§ 457(b) (2) and 457(c)(1) is indexed (in \$500 increments) for cost of living adjustments. (The maximum deferral limitation for 1998 is \$8,000.)

.03 Section 1448 of the SBJPA added new subsection (g) to § 457 of the Code to provide that all assets and income under a § 457(b) plan that is maintained by a state or local government employer must be held in trust for the exclusive benefit of plan participants and their beneficiaries. Before the enactment of the SBJPA, § 457(b)(6) mandated that all § 457(b) plans be unfunded (so that plan assets could not be set aside for the exclusive benefit of participants and beneficiaries). Section

457(g) generally applies to assets and income held by a governmental § 457(b) plan on and after August 20, 1996. However, in the case of a § 457(b) plan in existence on August 20, 1996, maintained by a state or local government employer, a trust is not required to be established pursuant to § 457(g) before January 1, 1999.

.04 In response to these significant revisions made to § 457 by the SBJPA and by TRA '97, the Service published Revenue Procedure 96-56, 1996-2 C.B. 389, which announced that, due to study of these changes, the Service would suspend issuance of rulings regarding the tax effects of provisions under the SBJPA affecting § 457(b) plans until further notice. Notice 96-63, 1996-2 C.B. 228, invited comments on whether the Service should publish model language to provide § 457(b) plan sponsors with a streamlined method for amending their plans to comply with the new SBJPA provisions relating to § 457(b) plans.

.05 In addition, the Service has recently issued Notice 98-8, 1998-4 I.R.B. 6, which provides substantive guidance concerning the revisions to § 457 made by the SBJPA and TRA '97. The Service is issuing this revenue procedure providing model amendments based on the guidance provided in Notice 98-8.

SECTION 3. USE OF THE MODEL AMENDMENTS

.01 Any eligible employer may amend a § 457(b) plan to utilize one or more of the optional changes made to § 457(e) of the Internal Revenue Code by section 1447 of the SBJPA and section 1017 of TRA '97 and described in Section 2.02 of this revenue procedure by adopting one or more of Model Amendments 1, 2 or 3 contained in the appendix to this revenue procedure.

.02 An eligible employer that is a state or local government employer must amend its § 457(b) plan to comply with the mandatory trust requirement of § 457(g) described in Section 2.03. An eligible government employer may adopt Model Amendment 4 in the appendix to this revenue procedure in order to modify the plan to reflect the funding arrangement established under the plan in conformity with § 457(g). In addition, in order to rely on Model Amendment 4, the eligible government employer must adopt a trust, one or more custodial accounts, or one or more annuity contracts that hold all assets and income described in Model Amendment 4. The trust, custodial account or accounts, or annuity contract or contracts must be valid instruments under state law, must otherwise comply with the requirements provided in Notice 98-8, and may contain no language inconsistent with Model Amendment 4. *See* Section 4 below for more information regarding a government entity's right to rely upon a prior private letter ruling concerning its § 457(b) plan if it adopts Model Amendment 4 on a word-for-word basis.

SECTION 4. RELIANCE BY EMPLOYERS WITH PRIOR § 457(b) RULING

.01 Reliance -- An employer entitled to rely on a private letter ruling issued to it prior to [DATE THIS DOCUMENT IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN] regarding the eligibility of a plan under § 457(b) that is a defined contribution plan as defined in § 414(i) will not lose its right to rely on its letter ruling merely because it adopts one or more of the amendments set forth in this revenue procedure on a word-for-word basis. Such an employer may adopt the applicable model amendments provided under this revenue procedure on a word-for-word basis and continue to rely on the previously issued private letter ruling regarding its § 457(b) plan without filing another request with the Service for a new private letter ruling.

.02 Superseding obsolete prior provisions -- An employer that satisfies the conditions of Section 4.01 above and that amends its § 457(b) plan to include one or more of the model amendments set forth in this revenue procedure on a word-for-word basis will also not lose its right to rely on its prior letter ruling merely because it replaces obsolete terms (such as replacing "bookkeeping accounts" or "hypothetical accounts" with "accounts"), or deletes prior provisions that are inconsistent with the model amendment so adopted.

SECTION 5. EFFECTIVE DATE

This revenue procedure is effective [DATE THIS DOCUMENT IS PUBLISHED IN THE INTERNAL REVENUE BULLETIN].

DRAFTING INFORMATION

The principal author of this revenue procedure is John Tolleris of the Office of Associate Chief Counsel (Employee Benefits/ Exempt Organizations). However, other personnel from the Internal Revenue Service and Treasury participated in its development. For further information regarding this revenue procedure, contact John Tolleris at (202) 622-6030 (not a toll-free number).

APPENDIX FOR REVENUE PROCEDURE 98-41

MODEL AMENDMENTS

(Note to sponsors: In this appendix presenting the model amendment language, the portions printed in italics are explanatory notes for the benefit of the § 457(b) plan sponsor and are not to be included in the amendments. The portions not printed in italics are the model amendment language for use by the plan sponsor in amending its § 457(b) plan in accordance with this revenue procedure.)

OPTIONAL AMENDMENTS THAT MAY BE ADOPTED BY ANY ELIGIBLE 457 PLAN

AMENDMENT 1 IN-SERVICE DISTRIBUTION OF \$5,000 OR LESS

Any one of the following model amendments may be adopted for any § 457(b) plan to provide for the in-service de minimis distribution option permitted under § 457(e)(9)(A) of the Internal Revenue Code and described in Section 2.02 above. These amendments are in addition to any plan provision requiring distribution of small account balances following the general distribution commencement date set by the plan. If it wishes, the plan sponsor may also substitute in the following model amendments a consistent figure lower than \$5,000 in place of "\$5,000 (or the dollar limit under section 411(a)(11) of the Internal Revenue Code, if greater)". The plan may adopt only one of Option A, Option B, or Option C.

OPTION A: INVOLUNTARY DISTRIBUTIONS

The following amendment may be adopted by an eligible employer that wishes to provide for the mandatory in-service distribution to participants with aggregate account balances under the § 457(b) plan that total \$5,000 or less:

"Involuntary In-Service Distribution: The Plan shall distribute the total amount payable under the Plan to a participant who is an active employee of an eligible employer if the following requirements are met:

(i) the total amount payable to the participant under the Plan does not exceed \$5,000 (or the dollar limit under section 411(a)(11) of the Internal Revenue Code, if greater),

(ii) the participant has not previously received an in-service distribution of the total amount payable to the participant under the Plan; and

(iii) no amount has been deferred under the Plan with respect to the participant during the two-year period ending on the date of the in-service distribution."

OPTION B: VOLUNTARY DISTRIBUTIONS

The following amendment may be adopted by an eligible employer that wishes to provide for the voluntary in-service distribution to participants with aggregate account balances under the § 457(b) plan that total \$5,000 or less:

"Voluntary In-Service Distribution: A participant who is an active employee of an eligible employer shall receive a distribution of the total amount payable to the participant under the Plan if the following requirements are met:

(i) the total amount payable to the participant under the Plan does not exceed \$5,000 (or the dollar limit under section 411(a)(11) of the Internal Revenue Code, if greater),

(ii) the participant has not previously received an in-service distribution of the total amount payable to the participant under the Plan,

(iii) no amount has been deferred under the Plan with respect to the participant during the two-year period ending on the date of the in-service distribution; and

(iv) the participant elects to receive the distribution."

OPTION C: COMBINATION VOLUNTARY AND INVOLUNTARY DISTRIBUTIONS

The following amendment may be adopted by an eligible employer that wishes to provide for both a mandatory in-service distribution of small account balances (such as \$500) and a voluntary in-service distribution election to participants with higher aggregate account balances under the § 457(b) plan that total \$5,000 or less:

"Involuntary In-Service Distribution: The Plan shall distribute the total amount payable under the Plan to a participant who is an active employee of an eligible employer if the following requirements are met:

(i) the total amount payable to the participant under the Plan does not exceed [enter a dollar amount that is less than \$5,000],

(ii) the participant has not previously received an in-service distribution of the total amount payable to the participant under the Plan; and

(iii) no amount has been deferred under the Plan with respect to the participant during the two-year period ending on the date of the in-service distribution.

Voluntary In-Service Distribution: A participant who is an active employee of an eligible employer shall receive a distribution of the total amount payable to the participant under the Plan if the following requirements are met:

(i) the total amount payable to the participant under the Plan does not exceed \$5,000 (or the dollar limit under section 411(a)(11) of the Internal Revenue Code, if greater),

(ii) the participant has not previously received an in-service distribution of the total amount payable to the participant under the Plan,

(iii) no amount has been deferred under the Plan with respect to the participant during the two-year period ending on the date of the in-service distribution; and

(iv) the participant elects to receive the distribution."

AMENDMENT 2 ADDITIONAL DEFERRAL ELECTION

The following model amendment may be used to provide for the one "additional" distribution election authorized by § 457(e)(9)(B) of the Internal Revenue Code and described in section 2.03 above.

"If a participant has elected, in accordance with the Plan, to defer the commencement of distributions beyond the first permissible payout date, then the participant may make an additional election to further defer the commencement of distributions, provided that the election is filed before distributions actually begin and the later commencement date meets the required distribution commencement date provisions of sections 401(a)(9) and 457(d)(2) of the Internal Revenue Code. A participant may not make more than one such additional deferral election after the first permissible payout date.

For purposes of the preceding paragraph, the "first permissible payout date" is the earliest date on which the Plan permits payments to begin after separation from service, disregarding payments to a participant who has an unforeseeable emergency or attains age 70 1/2, or under the in-service

distribution provisions of the Plan." *(Any of the provisions mentioned in the preceding sentence may be omitted if the plan does not include such a provision.)*

AMENDMENT 3 COST-OF-LIVING-ADJUSTMENTS

Any § 457(b) plan may be amended to provide for implementing cost of living adjustments to the "\$7,500" maximum deferral amount pursuant to § 457(e)(15) by substituting the following for "\$7,500" wherever it appears as a limitation on the maximum deferral amount under the plan:

"\$7,500, adjusted for the calendar year to reflect increases in cost-of-living in accordance with sections 457(e)(15) and 415(d) of the Internal Revenue Code."

MODEL AMENDMENT TO REFLECT MANDATORY § 457(g) REQUIREMENTS FOR GOVERNMENTAL § 457(b) PLANS

AMENDMENT 4 § 457(g) TRUST REQUIREMENTS FOR GOVERNMENTAL § 457(b) PLANS

Any one of the following three model amendments may be used to reflect the mandatory trust requirement applicable to eligible plans of state and local government entities under § 457(g) of the Code. None of these amendments are applicable to § 457(b) plans sponsored by tax-exempt organizations that are not state or local government entities, and they may not be adopted by such organizations. The last sentence of each of the following model amendments (requiring amounts to be transferred within a 15-day period) is optional.

OPTION A: TRUST

"Notwithstanding any contrary provision of the Plan, in accordance with section 457(g) of the Internal Revenue Code, all amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights shall be held in trust for the exclusive benefit of participants and beneficiaries under the Plan. Any trust under the Plan shall be established pursuant to a written agreement that constitutes a valid trust under the law of [insert name of applicable state].

All amounts of compensation deferred under the Plan shall be transferred to a trust established under the Plan within a period that is not longer than is reasonable for the proper administration of the accounts of participants. To comply with this requirement, all amounts of compensation deferred under the Plan shall be transferred to a trust established under the Plan

not later than 15 business days after the end of the month in which the compensation would otherwise have been paid to the employee."

OPTION B: ANNUITY CONTRACT

"Notwithstanding any contrary provision of the Plan, including any annuity contract issued under the plan, in accordance with section 457(g) of the Internal Revenue Code, all amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights shall be held in one or more annuity contracts, as defined in section 401(g) of such Code, issued by an insurance company qualified to do business in the state where the contract was issued, for the exclusive benefit of participants and beneficiaries under the Plan. For this purpose, the term "annuity contract" does not include a life, health or accident, property, casualty, or liability insurance contract.

All amounts of compensation deferred under the Plan shall be transferred to an annuity contract described in section 401(f) of the Internal Revenue Code within a period that is not longer than is reasonable for the proper administration of the accounts of participants. To comply with this requirement, all amounts of compensation deferred under the Plan shall be transferred to a contract described in section 401(f) of such Code not later than 15 business days after the end of the month in which the compensation would otherwise have been paid to the employee."

OPTION C: CUSTODIAL ACCOUNT

"Notwithstanding any contrary provision of the Plan, in accordance with section 457(g) of the Internal Revenue Code, all amounts of compensation deferred pursuant to the Plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights shall be held in one or more custodial accounts for the exclusive benefit of participants and beneficiaries under the Plan. For purposes of this paragraph, the custodian of any custodial account created pursuant to the Plan must be a bank, as described in section 408(n) of the Internal Revenue Code, or a person who meets the nonbank trustee requirements of paragraphs (2)-(6) of section 1.408-2(e) of the Income Tax Regulations relating to the use of non-bank trustees.

All amounts of compensation deferred under the Plan shall be transferred to a custodial account described in section 401(f) of the Internal Revenue Code within a period that is not longer than is reasonable for the proper administration of the accounts of participants. To comply with this requirement, all amounts of compensation deferred under the Plan shall be transferred to a

custodial account described in section 401(f) of such Code not later than 15 business days after the end of the month in which the compensation would otherwise have been paid to the employee."