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## IRS Probing Non-Qualified 457(b) Plans

Just when you thought the IRS might be taking a breather, what with government furloughs and all, you receive a letter from the IRS asking questions about your 457(b) plan. You may regard that plan as a blip on your radar screen of total retirement plan assets, only recognizable since members of senior management participate in it (by design, such plans, with the exception of those belonging to 414(e) religious organizations, can only benefit select management/highly compensated employees). Now the IRS wishes to know significant details regarding the various provisions of the plan. Could an audit be far behind? How should the questionnaire be handled? This article will attempt to answer these and other important questions.

### Scope and Timing

The good news is that the IRS has sent, or plans to send, a total of only 400 letters to non-governmental tax-exempt 457(b) plan sponsors, which represent a small fraction of the thousands of such plans in existence. Some plan sponsors have already received their letters; others will receive them between now and September 30, 2014. Sponsors have 15 days from the date of the letter to respond. We have received reports that some sponsors did not actually receive the letter until a few days before it was due for response, perhaps on account of inaccurate IRS address/contact information for the plan sponsor. In any case, if a plan sponsor is unable to properly respond to the questions in such a short period of time, a request for extension should be made to the contact in the letter. Generally, the IRS has been flexible in such circumstances.

### The Questions

The questionnaire (see sample at [http://www.irs.gov/pub/irs-tege/letter\\_4663f.pdf](http://www.irs.gov/pub/irs-tege/letter_4663f.pdf)) includes ten questions, ranging from straightforward (“does your organization sponsor a 457(b) plan?”) to more difficult, such as an inquiry regarding who is eligible for the plan. That query can be thorny, since the definition of a “select group of management or highly compensated employees” is far from crystal clear, and any mistake, as is the case with all 457(b) plan defects, is currently not eligible for correction under EPCRS (Employee Plans Compliance Resolution System). However, the IRS has stated that corrections relating to IRC 457(b) will be accepted by the IRS on a provisional basis outside of EPCRS, according to standards similar to those of EPCRS.

Other areas addressed in the questionnaire are:

- The type of tax exempt organization of the plan sponsor. For most reading this article, the answer is 501(c)(3)

- Whether you are a state or local governmental unit. If you are, you likely received this questionnaire in error, since it was only intended to be sent to non-governmental plan sponsors
- A list of other retirement plans that you sponsor
- Whether the plan permits loans. Your plan should not permit loans, since loans are prohibited in non-governmental 457(b) plans
- Whether the age fifty catch-up deferral election is permitted. Your plan should not permit it, since this election is prohibited in non-governmental 457(b) plans
- Whether your plan allows for the special final three-year 457(b) catch-up election. Most plans permit this election, though it is not often utilized
- Whether the assets of the plan are available to the sponsor's general creditors. They should be. Although governmental plan assets are required to be held in trust, the opposite applies to tax-exempt employers. Your plan assets should be available to general creditors, and not in a trust for the exclusive benefit of participants. Note that it is acceptable to hold assets in a rabbi trust, since rabbi trusts are accessible to creditors in the event of insolvency
- Whether the plan has filed a "top-hat" exemption notice with the Department of Labor. It should have done so, and you need to provide a copy of the notice with your questionnaire response
- Whether the plan has made any hardship distributions within the last three years. Likely not, since the hardship rules for such plans are much more restrictive than the rules that apply to 403(b) and 401(k) plans

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## Response

It is important to understand that the compliance questionnaire is not an audit, which would be far more comprehensive than a 10-item list. That said, the questionnaire should not be taken lightly; a failure to respond will most likely result in an audit, as will an inadequate response, or a response which indicates that plan failures may be present.

## Conclusion

If you have not received a letter and sponsor a 457(b) plan, now would be an appropriate time to review the plan with your consultants and appropriate benefits counsel, in order to confirm compliance with applicable regulations, particularly with respect to those issues addressed in the questionnaire. If you have received a letter, you should work closely with benefits counsel familiar with such matters in responding to the questions, as well as in addressing any potential compliance issues.

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