

eligible employer. K does not, within the 30-day window period, elect to postpone distributions to a later date or to receive payment in 10 fixed annual installments.

(ii) *Conclusion.* The single sum payment is payable to K 60 days after the date K has a severance from employment (January 12, 2005), and is includible in the gross income of K in 2005 under section 457(a).

Example 2. (i) *Facts.* The terms of eligible Plan X are the same as described in *Example 1*. Participant L participates in eligible Plan X. On November 11, 2003, L has a severance from the employment of the eligible employer. On November 24, 2003, L makes an initial deferral election not to receive the single-sum payment payable 60 days after the severance, and instead elects to receive the amounts in 10 annual installments to begin 60 days after severance from employment.

(ii) *Conclusion.* No portion of L's account is considered made available in 2003 or 2004 before a payment is made and no amount is includible in the gross income of L until distributions commence. The annual installment payable in 2004 will be includible in L's gross income in 2004.

Example 3. (i) *Facts.* The facts are the same as in *Example 1*, except that eligible Plan X also provides that those participants who are receiving distributions in 10 annual installments may, at any time and without restriction, elect to receive a cash out of all remaining installments. Participant M elects to receive a distribution in 10 annual installments commencing in 2004.

(ii) *Conclusion.* M's total account balance, representing the total of the amounts deferred under the plan, is considered made available and is includible in M's gross income in 2004.

Example 4. (i) *Facts.* The facts are the same as in *Example 3*, except that, instead of providing for an unrestricted cashout of remaining payments, the plan provides that participants or beneficiaries who are receiving distributions in 10 annual installments may accelerate the payment of the amount remaining payable to the participant upon the occurrence of an unforeseeable emergency as described in §1.457-6(c)(1) in an amount not exceeding that described in §1.457-6(c)(2).

(ii) *Conclusion.* No amount is considered made available to participant M on account of M's right to accelerate payments upon the occurrence of an unforeseeable emergency.

Example 5. (i) *Facts.* Eligible Plan Y of a tax-exempt entity provides that distributions will commence 60 days after a participant's severance from employment unless the participant elects, within a 30-day window period following severance from employment, to defer distributions to a later date (but no later than the year following the calendar year the participant attains age 70½). The plan provides that a participant who has

elects to defer distributions to a later date may make an election as to form of distribution at any time prior to the 30th day before distributions are to commence.

(ii) *Conclusion.* No amount is considered made available prior to the date distributions are to commence by reason of a participant's right to defer or make an election as to the form of distribution.

Example 6. (i) *Facts.* The facts are the same as in *Example 1*, except that the plan also permits participants who have made an initial election to defer distribution to make one additional deferral election at any time prior to the date distributions are scheduled to commence. Participant N has a severance from employment at age 50. The next day, during the 30-day period provided in the plan, N elects to receive distribution in the form of 10 annual installment payments beginning at age 55. Two weeks later, within the 30-day window period, N makes a new election permitted under the plan to receive 10 annual installment payments beginning at age 60 (instead of age 55). When N is age 59, N elects under the additional deferral election provisions, to defer distributions until age 65.

(ii) *Conclusion.* In this example, N's election to defer distributions until age 65 is a valid election. The two elections N makes during the 30-day window period are not additional deferral elections described in paragraph (c)(2)(iii) of this section because they are made before the first permissible payout date under the plan. Therefore, the plan is not precluded from allowing N to make the additional deferral election. However, N can make no further election to defer distributions beyond age 65 (or accelerate distribution before age 65) because this additional deferral election can only be made once.

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§ 1.457-8 Funding rules for eligible plans.

(a) *Eligible governmental plans—(1) In general.* In order to be an eligible governmental plan, all amounts deferred under the plan, all property and rights purchased with such amounts, and all income attributable to such amounts, property, or rights, must be held in trust for the exclusive benefit of participants and their beneficiaries. A trust described in this paragraph (a) that also meets the requirements of §§ 1.457-3 through 1.457-10 is treated as an organization exempt from tax under section 501(a), and a participant's or beneficiary's interest in amounts in

the trust is includible in the gross income of the participants and beneficiaries only to the extent, and at the time, provided for in section 457(a) and §§ 1.457-4 through 1.457-10.

(2) *Trust requirement.* (i) A trust described in this paragraph (a) must be established pursuant to a written agreement that constitutes a valid trust under State law. The terms of the trust must make it impossible, prior to the satisfaction of all liabilities with respect to participants and their beneficiaries, for any part of the assets and income of the trust to be used for, or diverted to, purposes other than for the exclusive benefit of participants and their beneficiaries.

(ii) Amounts deferred under an eligible governmental plan must be transferred to a trust within a period that is not longer than is reasonable for the proper administration of the participant accounts (if any). For purposes of this requirement, the plan may provide for amounts deferred for a participant under the plan to be transferred to the trust within a specified period after the date the amounts would otherwise have been paid to the participant. For example, the plan could provide for amounts deferred under the plan at the election of the participant to be contributed to the trust within 15 business days following the month in which these amounts would otherwise have been paid to the participant.

(3) *Custodial accounts and annuity contracts treated as trusts—(i) In general.* For purposes of the trust requirement of this paragraph (a), custodial accounts and annuity contracts described in section 401(f) that satisfy the requirements of this paragraph (a)(3) are treated as trusts under rules similar to the rules of section 401(f). Therefore, the provisions of § 1.401(f)-1(b) will generally apply to determine whether a custodial account or an annuity contract is treated as a trust. The use of a custodial account or annuity contract as part of an eligible governmental plan does not preclude the use of a trust or another custodial account or annuity contract as part of the same plan, provided that all such vehicles satisfy the requirements of section 457(g)(1) and (3) and paragraphs (a)(1) and (2) of this section and that all as-

sets and income of the plan are held in such vehicles.

(ii) *Custodial accounts—(A) In general.* A custodial account is treated as a trust, for purposes of section 457(g)(1) and paragraphs (a)(1) and (2) of this section, if the custodian is a bank, as described in section 408(n), or a person who meets the nonbank trustee requirements of paragraph (a)(3)(ii)(B) of this section, and the account meets the requirements of paragraphs (a)(1) and (2) of this section, other than the requirement that it be a trust.

(B) *Nonbank trustee status.* The custodian of a custodial account may be a person other than a bank only if the person demonstrates to the satisfaction of the Commissioner that the manner in which the person will administer the custodial account will be consistent with the requirements of section 457(g)(1) and (3). To do so, the person must demonstrate that the requirements of § 1.408-2(e)(2) through (6) (relating to nonbank trustees) are met. The written application must be sent to the address prescribed by the Commissioner in the same manner as prescribed under § 1.408-2(e). To the extent that a person has already demonstrated to the satisfaction of the Commissioner that the person satisfies the requirements of § 1.408-2(e) in connection with a qualified trust (or custodial account or annuity contract) under section 401(a), that person is deemed to satisfy the requirements of this paragraph (a)(3)(ii)(B).

(iii) *Annuity contracts.* An annuity contract is treated as a trust for purposes of section 457(g)(1) and paragraph (a)(1) of this section if the contract is an annuity contract, as defined in section 401(g), that has been issued by an insurance company qualified to do business in the State, and the contract meets the requirements of paragraphs (a)(1) and (2) of this section, other than the requirement that it be a trust. An annuity contract does not include a life, health or accident, property, casualty, or liability insurance contract.

(4) *Combining assets.* [Reserved]

(b) *Eligible plans maintained by tax-exempt entity—(1) General rule.* In order to be an eligible plan of a tax-exempt entity, the plan must be unfunded and plan assets must not be set aside for

participants or their beneficiaries. Under section 457(b)(6) and this paragraph (b), an eligible plan of a tax-exempt entity must provide that all amounts deferred under the plan, all property and rights to property (including rights as a beneficiary of a contract providing life insurance protection) purchased with such amounts, and all income attributable to such amounts, property, or rights, must remain (until paid or made available to the participant or beneficiary) solely the property and rights of the eligible employer (without being restricted to the provision of benefits under the plan), subject only to the claims of the eligible employer's general creditors.

(2) *Additional requirements.* For purposes of paragraph (b)(1) of this section, the plan must be unfunded regardless of whether or not the amounts were deferred pursuant to a salary reduction agreement between the eligible employer and the participant. Any funding arrangement under an eligible plan of a tax-exempt entity that sets aside assets for the exclusive benefit of participants violates this requirement, and amounts deferred are generally immediately includible in the gross income of plan participants and beneficiaries. Nothing in this paragraph (b) prohibits an eligible plan from permitting participants and their beneficiaries to make an election among different investment options available under the plan, such as an election affecting the investment of the amounts described in paragraph (b)(1) of this section.

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§ 1.457-9 Effect on eligible plans when not administered in accordance with eligibility requirements.

(a) *Eligible governmental plans.* A plan of a State ceases to be an eligible governmental plan on the first day of the first plan year beginning more than 180 days after the date on which the Commissioner notifies the State in writing that the plan is being administered in a manner that is inconsistent with one or more of the requirements of §§ 1.457-3 through 1.457-8 or 1.447-10. However, the plan may correct the plan inconsistencies specified in the written noti-

fication before the first day of that plan year and continue to maintain plan eligibility. If a plan ceases to be an eligible governmental plan, amounts subsequently deferred by participants will be includible in income when deferred, or, if later, when the amounts deferred cease to be subject to a substantial risk of forfeiture, as provided at § 1.457-11. Amounts deferred before the date on which the plan ceases to be an eligible governmental plan, and any earnings thereon, will be treated as if the plan continues to be an eligible governmental plan and will not be includible in participant's or beneficiary's gross income until paid to the participant or beneficiary.

(b) *Eligible plans of tax-exempt entities.* A plan of a tax-exempt entity ceases to be an eligible plan on the first day that the plan fails to satisfy one or more of the requirements of §§ 1.457-3 through 1.457-8, or § 1.457-10. See § 1.457-11 for rules regarding the treatment of an ineligible plan.

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§ 1.457-10 Miscellaneous provisions.

(a) *Plan terminations and frozen plans—(1) In general.* An eligible employer may amend its plan to eliminate future deferrals for existing participants or to limit participation to existing participants and employees. An eligible plan may also contain provisions that permit plan termination and permit amounts deferred to be distributed on termination. In order for a plan to be considered terminated, amounts deferred under an eligible plan must be distributed to all plan participants and beneficiaries as soon as administratively practicable after termination of the eligible plan. The mere provision for, and making of, distributions to participants or beneficiaries upon a plan termination will not cause an eligible plan to cease to satisfy the requirements of section 457(b) or the regulations.

(2) *Employers that cease to be eligible employers—(i) Plan not terminated.* An eligible employer that ceases to be an eligible employer may no longer maintain an eligible plan. If the employer was a tax-exempt entity and the plan is not terminated as permitted under