Lowenstein Sandler's Executive Compensation and Employee Benefits Podcast: Just Compensation

Episode 60

By Megan Monson, Taryn E. Cannataro, Zachary Bocian

JUNE 2026

Megan Monson: Welcome to the Lowenstein Sandler podcast series. Before we begin, please take a moment to subscribe to our podcast series at Lowenstein.com/podcast or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Now, let's take a listen.

Welcome to the latest episode of *Just Compensation*. I'm Megan Monson, a partner in Lowenstein Sandler's Executive Compensation, Employment and Employee Benefits Practice Group. I'm joined today by two of my colleagues, Zach and Taryn, who I'll let introduce themselves.

Taryn Cannataro: Hi. I'm Taryn, counsel in Lowenstein's Executive Compensation, Employment and Employee Benefits Group.

Zachary Bocian: Hi. I'm Zach, an associate in Lowenstein Sandler's Executive Compensation, Employment and Employee Benefits Group.

Megan Monson: Today we are unpacking two deferred compensation vehicles available to tax-exempt organizations and state and local governments, what's considered an eligible Section 457(b) arrangement and an ineligible 457(f) arrangement, both of which come from the framework of Internal Revenue Code Sections 457(b) and 457(f) as applicable. We'll cover who can sponsor these plans, what type of contributions can be tax deferred, when taxation occurs, and how Section 409A overlays with these rules. As always, this is a high-level discussion and not legal advice, so please consult your advisors about how these rules apply to your specific facts and circumstances.

Zach, let's start with the big picture. Who does Section 457 generally apply to, and why does 457 exist in the first place? What was Congress trying to address?

Zachary Bocian: Thanks, Megan. Section 457 applies to two categories of eligible employers: state and local governments and their agencies and instrumentalities and tax-exempt organizations other than governmental entities. Churches and qualified church-controlled organizations are generally excluded. Practically speaking, we're talking about public sector employers such as schools, public utilities, state governments, and nonprofit organizations that often sponsor these types of plans. These employers can offer eligible Section 457(b) plans and/or ineligible Section 457(f) arrangements. It's important to note that the rules of IRC 457 defer

© 2026 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

from 457A. Code Section 457A applies to tax-indifferent parties, for example, a foreign or offshore fund. Please see our podcast episode focused on 457A arrangements if you're interested in learning more about deferred compensation for those types of entities. We'll put a link in the description.

Section 457 was enacted amidst debate about the proper tax treatment of compensation deferred under government plans. There was a concern that unlike taxpaying entities, the employee's desire to defer taxation would not be countered by the employer's desire for an immediate tax deduction. In 1986, the Tax Reform Act extended Section 457 to cover deferred compensation plans of tax-exempt organizations. The result was that any deferred compensation outside of an eligible 457(b) plan is subject to income tax when it vests, rather than deferring it until it is paid to the participant. Organizations that are not tax-exempt are not constrained by Section 457.

Megan Monson: So, Zach, that was a really helpful overview. With that framework in mind, let's turn to the details of eligible 457(b) plans. Taryn, what are the basic rules of these plans?

Taryn Cannataro: An eligible 457(b) plan generally permits aggregate maximum annual contributions up to the lesser of the IRS 402(g) limit, which for 2026 is $24,500, or 100% of the participant's compensation. Unlike 401(k) plans, there are not separate limits for employee and employer contributions. However, for 2026, individuals aged 50 or over can make a catch-up contribution of up to $8,000, and those aged 60 to 63 can make a super catch-up contribution of $11,250, and those limits will change year by year. Note that these maximum deferral limits apply for any one individual during a taxable year. The key phrase there is “any one individual,” not any one plan. The regulations call this the individual limitation. That means if a participant is in multiple 457(b) plans of unrelated employers, total deferrals across all 457(b) plans are capped at the applicable limit for that individual.

Megan Monson: What about election timing?

Zachary Bocian: The election timing rules defer by employer type, as SECURE 2.0 changed this recently for governmental employers. For governmental employers, a deferral agreement must be entered into before the compensation is currently available to the individual. For tax-exempt employers, a deferral agreement must be entered into before the beginning of the month in which the compensation is paid. The governmental standard offers greater flexibility.

Megan Monson: Taryn, when does income inclusion happen for amounts deferred under a 457(b) plan?

Taryn Cannataro: For eligible 457(b) plans, tax timing depends on the type of employer. For a governmental employer, deferred amounts and income attributable to those amounts are taxable when they're paid to the participant or

© 2026 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

beneficiary, whereas for tax-exempt entities that is not a governmental entity, amounts are taxable when they are paid or otherwise made available to the participant or beneficiary. This means that 457(b) participants of tax-exempt entities can face the possibility of constructive receipt and, therefore, be taxed on deferred amounts even before they're actually paid.

Megan Monson: That's a really helpful distinction to be aware of. When can participants get distributions of their money?

Taryn Cannataro: Distributions from a 457(b) plan can be made available on the earliest of the calendar year in which the participant attains age 70 and a half, or 59 and a half if it's a governmental plan, severance from employment with the employer, an unforeseeable emergency, death, or for governmental plans only, with respect to amounts in a lifetime income investment, 90 days before the investment may no longer be held as a plan option. Also, effective December 29th, 2025, under SECURE Act 2.0, deferred amounts can also be accessed as qualified long-term care distributions. This was intended to help participants defray the cost of certified long-term care insurance.

Megan Monson: And how are the plan assets held for a Section 457(b) plan?

Zachary Bocian: Well, Megan, this defers whether you are a state or local government or a tax-exempt organization. For governmental 457(b) plans, all assets and income must be held in trust for the exclusive benefit of participants, similar to a 401(k). For tax-exempt employer plans, all deferred amounts and attributable income and property must remain the property and rights of the employer, subject to the claims of general creditors. In other words, tax-exempt entity plans must remain unfunded. However, a tax-exempt organization may be able to hold such assets and income in a Rabbi trust, which is one that is subject to the claims of general creditors.

Megan Monson: And what about rollovers?

Taryn Cannataro: This is another area that differs, depending on what kind of employer you are. Rollovers may be made from a governmental 457(b) plan to another governmental 457(b) plan, a 401(a) plan, or a 403(b) plan, or an IRA. However, rollovers may not be made to or from any 457(b) plan maintained by a non-governmental tax-exempt employer.

Megan Monson: This has been a very helpful overview with respect to 457(b) plans. I think one item that I've heard throughout is that there are a lot of differences between what type of employer you are, so again, just to be mindful of that as you're approaching and thinking about implementing a 457(b) plan. So, let's pivot to ineligible 457(f) plans. Zach, how do they generally work?

Zachary Bocian: If a deferred compensation plan of state or local government or tax-exempt entity does not satisfy the requirements of an eligible 457(b) plan, usually because the amounts exceed the 457(b) limits or the plan is

© 2026 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

designed to otherwise operate outside of the 457(b) framework, it is an ineligible 457(f) plan. A 457(f) plan isn't subject to any contribution limits, like a 457(b) plan. Both employees and employers may contribute to a 457(f) plan, and those contributions and the earnings thereon remain tax deferred until the first taxable year, in which there is no substantial risk of forfeiture of such amounts, often referred to as vesting.

Megan Monson: So that leads us to an important question. Taryn, how is a substantial risk of forfeiture defined for purposes of 457(f)?

Taryn Cannataro: Under 457(f), a substantial risk of forfeiture exists if the compensation is, quote, "conditioned upon the future performance of substantial services by the individual," end quote. The substantial risk of forfeiture definition under 457(f) is narrower than under Section 83. Typically, under Section 457(f), in order for there to be a good substantial risk of forfeiture, there should be a requirement of continued employment for a fixed period, generally, at least two years per IRS guidance to be considered substantial. Likewise, mere consulting availability or sporadic consulting may not be recognized as substantial services either.

Megan Monson: It sounds like what constitutes a substantial risk of forfeiture is not always clear. Are there any other ways you can have a good substantial risk of forfeiture besides continued employment?

Taryn Cannataro: Yes. Unlike Sections 83 and 409A, a non-compete obligation may be recognized as a substantial risk of forfeiture in limited circumstances. The 457(f) proposed regulations state that a non-compete may be treated as a substantial risk of forfeiture if three conditions are satisfied. First, the right to compensation must be expressly conditioned on the employee complying with a non-compete under a written agreement that is enforceable under applicable law. This means that the analysis is going to be sensitive to state law restrictions of non-competes. Second, the employer must consistently make reasonable efforts to verify compliance with the non-compete. Third, at the time the non-compete becomes binding, the facts and circumstances must show that the employer has a substantial and Bonafide interest in preventing the employee from performing the prohibited services and that the employee has a Bonafide interest in engaging, and an ability to engage, in the prohibited services.

Megan Monson: Zach, what about the requirement that these plans remain unfunded?

Zachary Bocian: Section 457(f) requires that ineligible plans of tax-exempt entities remain unfunded, meaning that the plan must pay benefits out of the employer's general assets and the assets cannot be segregated from the employer's general assets until benefits are distributed. However, a Rabbi trust whose assets remain subject to the claims of the employer's general creditors in the event of bankruptcy can be used. The requirement that these plans be unfunded limits the ability of employers subject to ERISA to offer an ineligible 457(f) plan to a broad base of employees. Instead, to comply with ERISA, most Section 457(f) plans of tax-exempt entities

© 2026 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

qualify as top hat plans, which means they are offered only to a select group of management or highly compensated employees.

Megan Monson: Since we are talking about deferred compensation, what about Section 409A? Taryn, how does Section 409A interact with Sections 457(b) and 457(f)?

Taryn Cannataro: Section 409A creates another challenge in structuring deferred compensation for these types of entities. While eligible plans under 457(b) are not subject to the requirements of 409A, 409A does apply to the ineligible 457(f) plans. This means that Section 457(f) plans must either be exempt from or comply with the rules of Section 409A. Many ineligible 457(f) plans are structured to be exempt from 409A under the short-term deferral rule. However, there is one nuance that's worth noting. Section 409A defines substantial risk of forfeiture more narrowly than 457(f) does, as I mentioned earlier. Specifically, 409A does not recognize a non-compete provision as substantial risk of forfeiture, which can create a potential trap under 457(f) if you're not being mindful of the rules of both 457(f) and 409A.

Megan Monson: Zach, can you elaborate a little bit on how the non-compete divergence plays out in practice?

Zachary Bocian: Sure. As discussed earlier, under the proposed 457(f) regulations, conditioning a payment upon compliance with a non-competition agreement may result in the payment being treated as subject to a substantial risk of forfeiture for purposes of Section 457(f), and therefore defer taxation 457(f) purposes. However, that same payment would not be treated as subject to substantial risk of forfeiture for purposes of 409A, potentially requiring that the plan comply with the rules of 409A, such as the distribution, acceleration, and election timing requirements. For this reason, practitioners may avoid using compliance with a non-compete as a substantial risk of forfeiture under 457(f). For this reason, practitioners may avoid using compliance with a non-compete as a substantial risk of forfeiture under 457(f) for the sake of simplicity when it comes to 409A compliance.

Megan Monson: So, Taryn and Zach, you've touched on a lot of really interesting and helpful topics. What are some key takeaways that governmental and tax-exempt employers should keep in mind if they want to offer deferred compensation to their employee?

Taryn Cannataro: Governmental and tax-exempt employers face a distinctive and complex regulatory landscape when it comes to designing executive compensation arrangements. They have to navigate not only the rules of 457, but also the interplay with the rules of Section 409A and ERISA. However, when structured properly, these types of plans can be an important tool for recruiting and retaining top talent. It's important to reach out to legal counsel early if you're interested in implementing one of these plans. Legal counsel can help synthesize these overlapping regulatory requirements and help navigate the design, implementation, and ongoing

© 2026 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.

compliance of deferred compensation arrangements for these types of employers.

Megan Monson: Thank you both so much. Today we outlined how Section 457(b) and 457(f) arrangements operate for tax-exempt and governmental employers, including when deferred amounts are taxed. These are nuanced, complex deferred compensation arrangements, and care should be taken when designing, implementing, and administrating them. Engage counsel early and regularly to ensure compliance and avoid unintended pitfalls. As always, this episode is intended to be a high-level discussion, and it is not legal or tax advice. Please consult your own advisors for guidance tailored to your own organization.

If you enjoyed today's episode, please subscribe, leave us a review, and share this episode with your colleagues. You can also reach out to us via email if you have questions or ideas for future topics. We look forward to having you back for our next episode of *Just Compensation*. We'll see you next time.

Megan Monson: Thank you for listening to today's episode. Please subscribe to our podcast series at Lowenstein.com/podcast or find us on Amazon Music, Apple Podcasts, Audible, iHeartRadio, Spotify, SoundCloud, or YouTube. Lowenstein Sandler podcast series is presented by Lowenstein Sandler and cannot be copied or rebroadcast without consent. The information provided is intended for a general audience and is not legal advice or a substitute for the advice of counsel. Prior results do not guarantee a similar outcome. Content reflects the personal views and opinions of the participants. No attorney-client relationship is being created by this podcast, and all rights are reserved.

© 2026 Lowenstein Sandler LLP
The contents of this website contain attorney advertising. Prior results do not guarantee a similar outcome.