457(f) Deferred Compensation Plan

Background: A 457(f) plan is a deferred compensation arrangement. They involve an individual agreement between the employer and an employee. These plans are also know as 'golden handcuff' plans as they are often used as an incentive to keep a specific employee until a certain date or number of years of employment. 457(f) plans are subject to 409A regulations.

Details: The agreement must provide for a 'substantial risk of forfeiture'. This is most often stated as a specific date upon which the funds become available to the employee. When the conditions of the substantial risk of forfeiture are satisfied, the accumulation is immediately taxable as ordinary income regardless of when distributed. Distributions are reported on a W-2 as ordinary income.

Limits: There are no limits on the amount of annual or cumulative contributions made to a 457(f) plan. Earnings are also tax deferred until distribution.

Ownership: The assets are owned by the employer until distributed and are subject to the employer's creditors.

Advantages: There are no limits on contributions.

Disadvantages: Requires a legal agreement drafted by an experienced attorney. Taxation is immediate when the substantial risk of forfeiture conditions are met. The accumulation is taxed as ordinary income and is subject to all federal, state and local taxes including FICA, Medicare and FUTA. The employer must also pay their portion of applicable taxes related to FICA and FUTA.