



OFFICE OF THE COUNTY ATTORNEY

Douglas M. Duncan
County Executive

Charles W. Thompson, Jr.
County Attorney

MEMORANDUM

TO: Marta Perez
Director
Office of Human Resources

VIA: Charles W. Thompson
County Attorney

FROM: Constance Donovan
General Counsel
Board of Investment Trustees

DATE: July 3, 2000

RE: Inclusion of Temporary Employees and in the Montgomery County 457
Deferred Compensation Plan

ISSUE

Whether temporary employees can participate in the Montgomery County 457 deferred compensation plan?

SHORT ANSWER

Temporary or "seasonal" employees can participate in 457 deferred compensation plans. In Montgomery County, the CAO administers the 457 deferred compensation plan and has discretion in deciding plan participation eligibility for any employee or person employed by an agency.¹ Historical files from the law firm of Ober Kaler indicate consideration was given to open participation in the 457 plan to various types of employees including career full time and part time employees, "term" employees, and independent contractors.

Further, pending portability and rollover provisions among tax code sections 401(k), 403(b), and 457 plans remain a top legislative priority in Congress. When Congress passes expanded rollover and portability provisions, employers offering deferred compensation and potential portable retirement income will have a competitive advantage in a tight labor market.

¹Montgomery County Code §33-144(a)(1).

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DISCUSSION

Any individual who performs services for an employer may participate in a 457 plan. Thus, an independent contractor, or common law employee, may be covered, as well as seasonal or part time employees.

Employer policy may limit plan participation to certain employees. An employer may impose age or service conditions, or limit participation to a defined group of employees. For example, "casual" employees, including employees hired temporarily to handle emergencies, election workers paid less than \$100 in a calendar year, or persons hired through summer youth programs can be excluded from the 457 plan. Only those individuals who satisfy the plan's requirements for participation can be participants, and under the Internal Revenue Code (IRC), an employer has complete discretion as to whom it will allow to participate.²

Historical records from the law firm of Ober Kaler indicate that participant eligibility was considered by the County when the 457 plan was established. For example, records indicate that independent contractors were considered as eligible participants, but excluded due to additional administrative and reporting requirements.³ Historical records indicate that initially only "full

²See, IRC § 457(e)(3). The term "participant" means any individual who is eligible to defer compensation under the plan. The plan must provide that only individuals who perform services for the state (or local government), either as employees of the state, or as independent contractors, may defer compensation under the plan. IRS Reg. 31.3401(c)(1) broadly defines the term "employee" to include "every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee". (See, footnote 3 below for commentary on treatment of independent contractors for purposes of 457 plan participation.) Common law principles for determining employee status for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at the Source on Wages essentially require a determination as to who has the requisite control over the individual, without regard as to whether the control is actually exercised or not, with respect to the results to be accomplished, or to the details and means by which the results are to be accomplished. Treatment of temporary employees as "employees" for purposes of 457 plan participation may raise the question whether participation in the 457 deferred compensation plan by temporary employee may result in claims by temporary employees for pension, health and welfare benefits. Temporary employee claims for benefits in addition to 457 plan participation by virtue of their status as "employees" can be addressed by defining the term "employee" within the 457 plan document. Specifically, the term "employee" in reference to temporary employees is used exclusively for purposes of defining 457 plan participation which is the same manner the term "employee" is used to define FICA and FUTA participation. Clarification on the use and definition of the term "employee" for purposes of 457 plan participation for temporary employees should be expressly stated in an amended 457 plan document.

³IRC §457 permits independent contractors to participate in an eligible 457 plan. However, the definition of governmental plan in ERISA section 3(32) includes only a plan for "employees". The Department of Labor has taken the position that including independent contractors of a governmental entity in a 457 plan could jeopardize its

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time employees" were considered as eligible participants, but further debate expanded coverage to include "term" employees and part-time employees.

Enabling legislation to facilitate rollovers among tax code sections 401(k), 403(b) and 457 plans remains a legislative priority heavily lobbied by public pension groups and associations.⁴ Pension portability has been cited by lawmakers and pension specialists as the foremost issue that has bicameral and bipartisan support, so legislative action by Congress is a high probability.⁵

The following §457 tax proposals serve to illustrate just how attractive and competitive deferred compensation arrangements will be for both employers and employees: (1) Raising the elective deferral limit to \$12,000 over four years in \$1000 increments, and then indexed in \$500 increments; (2) allowing individuals age 50 and older to make additional contributions to their 457 plan; (3) permitting distributions of §457 plan benefits pursuant to a qualified domestic relations order to be taxed under the same rules applicable to qualified plans; (4) permitting rollovers among various types of defined contribution arrangements, including 457 plans; (5) permitting surviving spouses to roll over distributions to a qualified plan, §403(b) plan, or 457 plan; and (6) allowing state and local government employees to use funds from 457 plans to purchase service credits under their defined benefit plans. When Congress finds an appropriate legislative vehicle to pass rollover and portability legislation, the growing population of freelance temporary employees will be attracted to employers offering deferred compensation arrangements. Employers offering tax deferred retirement savings plans to both career and temporary employees will have a competitive recruiting advantage in a tight labor market.

CONCLUSION

Temporary employees can participate in the §457 deferred compensation plan, and the CAO has authority to determine participant eligibility and to amend the plan to include the participation of temporary employees. Historical records from the law firm of Ober Kaler indicate consideration

³(...continued)

status as a governmental plan, potentially subjecting the 457 plan to ERISA. (See, ERISA Adv Op 94-02A, n 1). A separate 457 plan for independent contractors mitigates the potential loss of status as a governmental plan, and historical records indicate the County did not want to pursue maintaining a plan for both County employees and independent contractors.

⁴Groups that endorse portability among tax code sections 401(k), 403(b), and 457 plans include the National Association of Government Deferred Compensation Administrators, the National Conference of State Legislators, the National Association of State Retirement Administrators, the National Council on Teacher Retirement, and the National Conference on Public Employer Retirement Systems, among others.

⁵See, Public Plans: Public Plan Groups Push for Portability; Oppose Mandatory Social Security Coverage, BNA Pension and Benefits Daily, February 1, 2000.

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was given to open participation in the 457 plan to various types of employees including career full time and part time employees, "term" employees, and independent contractors. Finally, enabling legislation in Congress permitting potential portability among 401(k), 403(b), and 457 plans, and enhanced benefits for tax deferred compensation present employers with a competitive advantage in recruiting in a tight labor market if career and temporary employees can defer retirement savings through tax exempt plans.

cc Marc Hansen, Chief, General Counsel Division

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