

# IRS Issues Proposed Regulations for Deferred Compensation Arrangements Sponsored by Tax-Exempt Organizations

Article By:

Gregory L. Needles

R. Randall Tracht

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The IRS released long-awaited [regulations under Internal Revenue Code Section 457](#) that apply to non-qualified deferred compensation plans of tax-exempt organizations and state and local governments. The regulations contain detailed rules and guidance addressing issues that have long been the subject of debate under Code Section 457.

In particular, the proposed regulations

- describe what constitutes a deferral of compensation for purposes of Code Section 457, including the application of the Code Section 409A “short-term deferral” rule;
- preserve the use of a non-compete as a valid “substantial risk of forfeiture” for purposes of Code Section 457, provided the non-compete meets the four requirements set forth in the regulations;
- permit the elective deferral of current compensation, which the IRS had previously said was not permitted under Code Section 457(f), provided that the elective deferral arrangement meets certain requirements, including that the employer make a meaningful contribution as well (for example, an employer matching contribution);
- preserve the ability to extend the substantial risk of forfeiture beyond the initial vesting date provided the employee is compensated for extending the risk of forfeiture beyond his or her original vesting date;
- define for the first time what constitutes a bona fide severance pay plan that is not subject to Code Section 457;
- describe for the first time what constitutes a bona fide sick and vacation leave programs and, in particular, call into question programs that provide for large payouts of accrued sick and vacation leave upon termination of employment;

- describe the manner in which Code Section 409A and Code Section 457 rules interact and overlap; and
- describe how to determine the amount and timing of compensation to be included in income for certain “ineligible” Code Section 457 deferred compensation arrangements. (Note: The IRS simultaneously released proposed regulations addressing income inclusion rules under [Code Section 409A](#).).

The regulations currently are in proposed form and will become effective for calendar years beginning after the regulations are issued in final form. Organizations may rely on the proposed regulations until they are issued in final form. We anticipate issuing further commentary on these proposed regulations soon.

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