

50 catch-up limit of section 414(v) (\$5,000). For 2007, F's special section 457 catch-up amount is the lesser of two times the basic annual limitation (\$30,000) or the sum of the basic annual limitation (\$15,000) plus the \$13,000 underutilized limitation under paragraph (c)(3)(ii) of this section (the \$15,000 plan ceiling in 2006, minus the \$2,000 contributed for F in 2006), or \$28,000. Thus, the maximum amount that F may defer in 2007 is \$28,000.

Example 3. (i) Facts. The facts are the same as in *Examples 1* and *2*, except that F does not make any contributions to the plan before 2010. In addition, assume that the applicable basic dollar limitation of paragraph (c)(1)(i)(A) of this section continues to be \$15,000 for 2010 and the additional dollar amount permitted under the age 50 catch-up in paragraph (c)(2) of this section for an individual who is at least age 50 continues to be \$5,000 for 2010. In F's taxable year 2010, the year in which F attains age 65 (which is the normal retirement age under the plan), F desires to defer the maximum amount possible under the plan. F's compensation for 2010 is again \$40,000.

(ii) Conclusion. For 2010, the maximum amount that F may defer is \$20,000. The special section 457 catch-up provisions under paragraph (c)(3) of this section are not applicable because 2010 is not a taxable year ending before the year in which F attains normal retirement age.

(4) Cost-of-living adjustment. For years beginning after December 31, 2006, the \$15,000 dollar limitation in paragraph (c)(1)(i)(A) of this section will be adjusted to take into account increases in the cost-of-living. The adjustment in the dollar limitation is made at the same time and in the same manner as under section 415(d) (relating to qualified plans under section 401(a)), except that the base period is the calendar quarter beginning July 1, 2005 and any increase which is not a multiple of \$500 will be rounded to the next lowest multiple of \$500.

(d) Deferral of sick, vacation, and back pay under an eligible plan—(1) In general. An eligible plan may provide that a participant may elect to defer accumulated sick pay, accumulated vacation pay, and back pay under an eligible plan if the requirements of section 457(b) are satisfied. For example, the plan must provide, in accordance with paragraph (b) of this section, that these amounts may be deferred for any calendar month only if an agreement providing for the deferral is entered into before the beginning of the month in which the amounts would otherwise be paid or made available and the participant is an employee in that month. In the case of accumulated sick pay, vacation pay, or back pay that is payable before the participant has a severance from employment, the requirements of the preceding sentence are deemed to be satisfied if the

agreement providing for the deferral is entered into before the amount is currently available (as defined in regulations under section 401(k)).

(2) Examples. The provisions of this paragraph (d) are illustrated by the following examples:

Example 1. (i) Facts. Participant G, who is age 62 in 2003, is an employee who participates in an eligible plan providing a normal retirement age of 65. Under the terms of G's employer's eligible plan and G's sick leave plan, G may, during November of 2003 (which is one of the three years prior to normal retirement age), make a one-time election to contribute amounts representing accumulated sick pay to the eligible plan in December of 2003 (within the maximum deferral limitations). Alternatively, such amounts may remain in the "bank" under the sick leave plan. No cash out of the sick pay is available until the month in which a participant ceases to be employed by the employer. The total value of G's accumulated sick pay (determined, in accordance with the terms of the sick leave plan, by reference to G's current salary) is \$4,000 in December of 2003.

(ii) Conclusion. Under the terms of the eligible plan and sick leave plan, G may elect before December of 2003 to defer the \$4,000 value of accumulated sick pay under the eligible plan, provided that G's other annual deferrals to the eligible plan for 2003, when added to the \$4,000, do not exceed G's maximum deferral limitation for the year.

Example 2. (i) Facts. Same facts as in *Example 1*, except that G will separate from service on January 17, 2004, and elects, on January 4, 2004, to defer G's accumulated sick and vacation pay (which totals \$12,000) that is payable on January 15, 2004.

(ii) Conclusion. G may elect before January 15, 2004 to defer the accumulated sick and vacation pay under the eligible plan, even if the election is made after the beginning of January, because the agreement providing for the deferral is entered into before the amount is currently available and G does not cease to be an employee before the amount is currently available. G will have \$12,000 of includible compensation in 2004 because the deferral is taken into account in the definition of includible compensation.

Example 3. (i) Facts. Employer X maintains an eligible plan and a vacation leave plan. Under the terms of the vacation leave plan, employees generally accrue three weeks of vacation per year. Up to one week's unused vacation may be carried over from one year to the next, so that in any single year an employee may have a maximum of four weeks vacation time. At the beginning of each calendar year, under the terms of the eligible plan (which constitutes an agreement providing for the deferral), the value of any unused vacation time from the prior year in excess of one week is automatically contributed to the eligible plan, to the extent of the employee's maximum deferral limitations. Amounts in excess of the maximum deferral limitations are forfeited.

(ii) Conclusion. The value of the unused vacation pay contributed to X's eligible plan pursuant to the terms of the plan and the

terms of the vacation leave plan is treated as an annual deferral to the eligible plan in the calendar year the contribution is made. No amounts contributed to the eligible plan will be considered made available to a participant in X's eligible plan.

(e) Excess deferrals under an eligible plan—(1) In general. Any amount deferred under an eligible plan for the taxable year of a participant that exceeds the maximum deferral limitations set forth in paragraphs (c)(1) through (3) of this section, and any amount that exceeds the individual limitation under § 1.457-5, constitutes an excess deferral that is taxable in accordance with § 1.457-11 for that taxable year. Thus, an excess deferral is includible in gross income in the taxable year deferred or, if later, the first taxable year in which there is no substantial risk of forfeiture.

(2) Excess deferrals under an eligible governmental plan other than as a result of the individual limitation. In order to be an eligible governmental plan, the plan must provide that any excess deferral resulting from a failure of a plan to apply the limitations of paragraphs (c)(1) through (3) of this section to amounts deferred under the eligible plan (computed without regard to the individual limitation under § 1.457-5) will be distributed to the participant, with allocable net income, as soon as administratively practicable after the plan determines that the amount is an excess deferral. For purposes of determining whether there is an excess deferral resulting from a failure of a plan to apply the limitations of paragraphs (c)(1) through (3) of this section, all plans under which an individual participates by virtue of his or her relationship with a single employer are treated as a single plan (without regard to any differences in funding). An eligible governmental plan does not fail to satisfy the requirements of paragraphs (a) through (d) of this section or §§ 1.457-6 through 1.457-10 (including the distribution rules under § 1.457-6 and the funding rules under § 1.457-8) solely by reason of a distribution made under this paragraph (e)(2). If such excess deferrals are not corrected by distribution under this paragraph (e)(2), the plan will be an ineligible plan under which benefits are taxable in accordance with § 1.457-11.

(3) Excess deferrals under an eligible plan of a tax-exempt employer other than as a result of the individual limitation. If a plan of a tax-exempt employer fails to comply with the limitations of paragraphs (c)(1) through (3) of this section, the plan will be an ineligible plan under which benefits are taxable in accordance with § 1.457-11.