

any of the four plans, assuming at least \$5,000 is contributed to Plan W; or \$22,000 to Plan W and none to any of the other three plans.

(iii) If the underutilized amount under Plans W, X, and Y for year 2006 were in each case zero (because E had always contributed the maximum amount or E was a new participant) or an amount not in excess of \$5,000, the maximum exclusion under this section would be \$20,000 for Participant E for year 2006 (\$15,000 plus the \$5,000 age 50 catch-up amount), which Participant E could contribute to any of the plans assuming at least \$5,000 is contributed to Plan W.

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§ 1.457-6 Timing of distributions under eligible plans.

(a) *In general.* Except as provided in paragraph (c) of this section (relating to distributions on account of an unforeseeable emergency), paragraph (e) of this section (relating to distributions of small accounts), § 1.457-10(a) (relating to plan terminations), or § 1.457-10(c) (relating to domestic relations orders), amounts deferred under an eligible plan may not be paid to a participant or beneficiary before the participant has a severance from employment with the eligible employer or when the participant attains age 70½, if earlier. For rules relating to loans, see paragraph (f) of this section. This section does not apply to distributions of excess amounts under § 1.457-4(e). However, except to the extent set forth by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin (see § 601.601(d) of this chapter), this section applies to amounts held in a separate account for eligible rollover distributions maintained by an eligible governmental plan as described in § 1.457-10(e)(2).

(b) *Severance from employment—(1) Employees.* An employee has a severance from employment with the eligible employer if the employee dies, retires, or otherwise has a severance from employment with the eligible employer. See regulations under section 401(k) for additional guidance concerning severance from employment.

(2) *Independent contractors—(i) In general.* An independent contractor is considered to have a severance from em-

ployment with the eligible employer upon the expiration of the contract (or in the case of more than one contract, all contracts) under which services are performed for the eligible employer if the expiration constitutes a good-faith and complete termination of the contractual relationship. An expiration does not constitute a good faith and complete termination of the contractual relationship if the eligible employer anticipates a renewal of a contractual relationship or the independent contractor becoming an employee. For this purpose, an eligible employer is considered to anticipate the renewal of the contractual relationship with an independent contractor if it intends to contract again for the services provided under the expired contract, and neither the eligible employer nor the independent contractor has eliminated the independent contractor as a possible provider of services under any such new contract. Further, an eligible employer is considered to intend to contract again for the services provided under an expired contract if the eligible employer's doing so is conditioned only upon incurring a need for the services, the availability of funds, or both.

(ii) *Special rule.* Notwithstanding paragraph (b)(2)(i) of this section, the plan is considered to satisfy the requirement described in paragraph (a) of this section that no amounts deferred under the plan be paid or made available to the participant before the participant has a severance from employment with the eligible employer if, with respect to amounts payable to a participant who is an independent contractor, an eligible plan provides that—

(A) No amount will be paid to the participant before a date at least 12 months after the day on which the contract expires under which services are performed for the eligible employer (or, in the case of more than one contract, all such contracts expire); and

(B) No amount payable to the participant on that date will be paid to the participant if, after the expiration of the contract (or contracts) and before that date, the participant performs services for the eligible employer as an independent contractor or an employee.

(c) *Rules applicable to distributions for unforeseeable emergencies*—(1) *In general.* An eligible plan may permit a distribution to a participant or beneficiary for an unforeseeable emergency. The distribution must satisfy the requirements of paragraph (c)(2) of this section.

(2) *Requirements*—(i) *Unforeseeable emergency defined.* An unforeseeable emergency must be defined in the plan as a severe financial hardship of the participant or beneficiary resulting from an illness or accident of the participant or beneficiary, the participant's or beneficiary's spouse, or the participant's or beneficiary's dependent (as defined in section 152, and, for taxable years beginning on or after January 1, 2005, without regard to section 152(b)(1), (b)(2), and (d)(1)(B)); loss of the participant's or beneficiary's property due to casualty (including the need to rebuild a home following damage to a home not otherwise covered by homeowner's insurance, such as damage that is the result of a natural disaster); or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant or the beneficiary. For example, the imminent foreclosure of or eviction from the participant's or beneficiary's primary residence may constitute an unforeseeable emergency. In addition, the need to pay for medical expenses, including non-refundable deductibles, as well as for the cost of prescription drug medication, may constitute an unforeseeable emergency. Finally, the need to pay for the funeral expenses of a spouse or a dependent (as defined in section 152, and, for taxable years beginning on or after January 1, 2005, without regard to section 152(b)(1), (b)(2), and (d)(1)(B)) of a participant or beneficiary may also constitute an unforeseeable emergency. Except as otherwise specifically provided in this paragraph (c)(2)(i), the purchase of a home and the payment of college tuition are not unforeseeable emergencies under this paragraph (c)(2)(i).

(ii) *Unforeseeable emergency distribution standard.* Whether a participant or beneficiary is faced with an unforeseeable emergency permitting a distribution under this paragraph (c) is to be

determined based on the relevant facts and circumstances of each case, but, in any case, a distribution on account of unforeseeable emergency may not be made to the extent that such emergency is or may be relieved through reimbursement or compensation from insurance or otherwise, by liquidation of the participant's assets, to the extent the liquidation of such assets would not itself cause severe financial hardship, or by cessation of deferrals under the plan.

(iii) *Distribution necessary to satisfy emergency need.* Distributions because of an unforeseeable emergency must be limited to the amount reasonably necessary to satisfy the emergency need (which may include any amounts necessary to pay for any federal, state, or local income taxes or penalties reasonably anticipated to result from the distribution).

(d) *Minimum required distributions for eligible plans.* In order to be an eligible plan, a plan must meet the distribution requirements of section 457(d)(1) and (2). Under section 457(d)(2), a plan must meet the minimum distribution requirements of section 401(a)(9). See section 401(a)(9) and the regulations thereunder for these requirements. Section 401(a)(9) requires that a plan begin lifetime distributions to a participant no later than April 1 of the calendar year following the later of the calendar year in which the participant attains age 70½ or the calendar year in which the participant retires.

(e) *Distributions of smaller accounts*—(1) *In general.* An eligible plan may provide for a distribution of all or a portion of a participant's benefit if this paragraph (e)(1) is satisfied. This paragraph (e)(1) is satisfied if the participant's total amount deferred (the participant's total account balance) which is not attributable to rollover contributions (as defined in section 411(a)(11)(D)) is not in excess of the dollar limit under section 411(a)(11)(A), no amount has been deferred under the plan by or for the participant during the two-year period ending on the date of the distribution, and there has been no prior distribution under the plan to the participant under this paragraph (e). An eligible plan is not required to

permit distributions under this paragraph (e).

(2) *Alternative provisions possible.* Consistent with the provisions of paragraph (e)(1) of this section, a plan may provide that the total amount deferred for a participant or beneficiary will be distributed automatically to the participant or beneficiary if the requirements of paragraph (e)(1) of this section are met. Alternatively, if the requirements of paragraph (e)(1) of this section are met, the plan may provide for the total amount deferred for a participant or beneficiary to be distributed to the participant or beneficiary only if the participant or beneficiary so elects. The plan is permitted to substitute a specified dollar amount that is less than the total amount deferred. In addition, these two alternatives can be combined; for example, a plan could provide for automatic distributions for up to \$500, but allow a participant or beneficiary to elect a distribution if the total account balance is above \$500.

(f) *Loans from eligible plans—(1) Eligible plans of tax-exempt entities.* If a participant or beneficiary receives (directly or indirectly) any amount deferred as a loan from an eligible plan of a tax-exempt entity, that amount will be treated as having been paid or made available to the individual as a distribution under the plan, in violation of the distribution requirements of section 457(d).

(2) *Eligible governmental plans.* The determination of whether the availability of a loan, the making of a loan, or a failure to repay a loan made from a trustee (or a person treated as a trustee under section 457(g)) of an eligible governmental plan to a participant or beneficiary is treated as a distribution (directly or indirectly) for purposes of this section, and the determination of whether the availability of the loan, the making of the loan, or a failure to repay the loan is in any other respect a violation of the requirements of section 457(b) and the regulations, depends on the facts and circumstances. Among the facts and circumstances are whether the loan has a fixed repayment schedule and bears a reasonable rate of interest, and whether there are repayment safeguards to which a prudent lender would adhere. Thus, for exam-

ple, a loan must bear a reasonable rate of interest in order to satisfy the exclusive benefit requirement of section 457(g)(1) and §1.457-8(a)(1). See also §1.457-7(b)(3) relating to the application of section 72(p) with respect to the taxation of a loan made under an eligible governmental plan, and §1.72(p)-1 relating to section 72(p)(2).

(3) *Example.* The provisions of paragraph (f)(2) of this section are illustrated by the following example:

Example. (i) *Facts.* Eligible Plan X of State Y is funded through Trust Z. Plan X permits an employee's account balance under Plan X to be paid in a single sum at severance from employment with State Y. Plan X includes a loan program under which any active employee with a vested account balance may receive a loan from Trust Z. Loans are made pursuant to plan provisions regarding loans that are set forth in the plan under which loans bear a reasonable rate of interest and are secured by the employee's account balance. In order to avoid taxation under §1.457-7(b)(3) and section 72(p)(1), the plan provisions limit the amount of loans and require loans to be repaid in level installments as required under section 72(p)(2). Participant J's vested account balance under Plan X is \$50,000. J receives a loan from Trust Z in the amount of \$5,000 on December 1, 2003, to be repaid in level installments made quarterly over the 5-year period ending on November 30, 2008. Participant J makes the required repayments until J has a severance from employment from State Y in 2005 and subsequently fails to repay the outstanding loan balance of \$2,250. The \$2,250 loan balance is offset against J's \$80,000 account balance benefit under Plan X, and J elects to be paid the remaining \$77,750 in 2005.

(ii) *Conclusion.* The making of the loan to J will not be treated as a violation of the requirements of section 457(b) or the regulations. The cancellation of the loan at severance from employment does not cause Plan X to fail to satisfy the requirements for plan eligibility under section 457. In addition, because the loan satisfies the maximum amount and repayment requirements of section 72(p)(2), J is not required to include any amount in income as a result of the loan until 2005, when J has income of \$2,250 as a result of the offset (which is a permissible distribution under this section) and income of \$77,750 as a result of the distribution made in 2005.

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