



## Practical Insights - Non-Profits: Hidden Insurance Contracts Are a Problem for Your Tax Sheltered Annuities

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### Problem

Tax-exempt employers have offered tax sheltered annuities to employees for years. Traditionally, the employers would often assume only a nominal role. No formal plan document would be drawn, and the only written instruments would be one or more annuity contracts (or custodial accounts) entered into directly by the employee with an insurance company or bank custodian. The employer would then withhold money from the employee's paycheck and deposit it with the insurance company or custodian for the employee's account. Until paid out, the money deposited is income tax free and accrues interest tax free.

Effective January 1, 2009, this is all changing, because a new IRS regulation for tax sheltered annuities, also known as §403(b) plans, requires that these plans have a formal written plan document, which, among other things, must identify all of the insurance contracts (or custodial accounts) used by employees under the plan. Because employers may not even be aware of all the contracts (and custodial accounts) entered into by their employees over the years, even if employers adopt formal plan documents, they will not be able to satisfy the contract-listing requirement. Yet failure to comply fully with this requirement by January 1, 2009 will cause the contracts (and custodial accounts) to cease to qualify for special tax treatment.

***As an employer, how can I make sure that my plan accurately lists all of the contract (or custodial account) providers that are used under the plan?***

### Solution

Ask your employees. There is no other way to ensure that you have a complete list of insurers who have issued them contracts, as you might never have had a reason to know – or to care – about certain of their contracts. Now that most contracts are required to be a part of your plan, you will need that information.

You should do this as soon as possible. Once you find out the details of those contracts and custodial accounts, you may need to take further action with respect to some of them. Do not wait until year end to "discover" that there is another insurance company with whom you must deal by December 31.

Depending upon the issue date and the contribution status of a contract, you may have to incorporate that contract into your plan's terms and administration, and possibly enter into a formal agreement, known as an Information Sharing Agreement or ISA, with the issuer of that contract. Only insurers of contracts issued before 2005, which have received no contributions since 2004, need not be identified in the plan. For those, the issuer of the contract is wholly responsible for making sure it complies with the new regulations and for administering the contract in accordance with all applicable rules, such as reporting distributions from those contracts. All other contract issuers must be recognized in your plan documents, and their contracts must comply with the terms and conditions of your plan. Both your plan and the insurance companies (or custodians) holding participants' accounts will have to furnish each other information to make certain that transactions under the contracts are consistent with the plan. But the first step for any sponsor of a §403(b) plan is to identify the contracts that are, or may be, subject to its plan, before time runs out.

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