Chapter 5: Tax-Favored Savings Plans

INTRODUCTION **100**

TAX-SHELTERED ANNUITIES **200**
Eligibility 205
Employer's Responsibilities 206
Funding 210
Contribution Limits 211
Concordia Retirement Savings Plan (CRSP) 212
Tax Aspects 220
Written Plan 225
Communication 230
Distributions 240
Plan Reporting to IRS 250

INDIVIDUAL RETIREMENT ACCOUNTS **300**
Eligibility 310
Traditional IRA 320
Roth IRA 330

EDUCATIONAL SAVINGS **600**
Coverdell Education Savings Accounts 610

HEALTH SAVINGS ACCOUNTS **700**

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5.100: Introduction

There are a variety of tax-favored savings plans designed to meet employees' needs for retirement income, children's educational expenses, and out-of-pocket medical expenses. Information included in this publication about some of these plans does not imply that LCMS is recommending participation in them. Neither is the information provided in this chapter considered to be complete or relied upon when making important decisions relative to these plans. As the laws on these subjects are quite technical, any employer or employee contemplating establishing and/or participating in any one of these plans should first seek competent advice.

5.200: Tax-Sheltered Annuities

5.205: Eligibility

Tax-sheltered annuities (TSAs) are retirement plans available only for common-law employees of tax-exempt organizations, including certain ministers performing ministry outside the church; and, only in the event their employer sponsors such plans.

5.206: Employer's Responsibilities

Employer plan sponsorship includes writing, adopting, and maintaining a defined contribution plan, which plan, both in form and operation, satisfies the requirements under Section 403(b) of the Internal Revenue Code and contains all the terms and conditions for eligibility, contribution limits, benefits, and the time and form under which benefit distributions will be made under the plan. Each employee's contract is not technically an "individual" TSA contract; in aggregate with other employee contracts, it is part of the employer's plan. It instructs the employer how much to contribute to an account maintained for the benefit of the participating employee. Employers (or those to whom they delegate the administrative duties) have oversight and compliance responsibilities for each of its employee's TSA accounts.

Employers are not only responsible for withholding the proper amount of elective deferrals from its employees' pay, but also to pass on these amounts to the appropriate financial institution within 15 business days following the month in which these amounts would have been paid to the participant (in other words, within 15 days of the last payday of the month).

5.210: Funding

Typically in churches, you will find employee TSA accounts funded primarily through salary reduction agreements. Each employee chooses whether or not to contribute to an account maintained for his or her benefit. The employee's contribution is termed an "elective deferral" inasmuch as it defers the tax on a portion of his or her current salary. These contributions are non-forfeitable.

However, more employers are beginning to make additional contributions to their employees' TSAs either as a fixed percentage of employee compensation or as a "matching" contribution.

5.211: Contribution Limits

The maximum amount of elective deferrals that employees may contribute in 2014, based on taxable earnings, generally cannot exceed $17,500 (indexed annually for inflation). With respect to ministers, housing allowances are not counted in determining the maximum contribution limit.

However, any qualified employee who has completed 15 years of service with a qualified organization may be able to make additional salary reduction contributions of up to $3,000 annually. Also, for age 50 and older, an additional contribution of $5,500 (subject to inflation adjustments) may be made in 2014.

In 2014, the maximum contribution for combined employer and employee elective deferrals is $50,000 (indexed annually for inflation).

The employer is responsible to ensure the employee does not exceed his or her maximum contribution amount.

5.212: Concordia Retirement Savings Plan (CRSP)

The Concordia Retirement Savings Plan (CRSP) is a 403(b) tax-sheltered annuity program administered through MetLife and its affiliates. Effective July 1, 2014, the CRSP employer contribution is voluntary. Please refer to www.concordiaplanservices.org for additional information.

5.220: Tax Aspects

TSA contributions are tax-deferred (i.e., excluded from the employee's gross income in the year earned; and not becoming taxable until withdrawn), but only if made to certain funding contracts, as follows: (1) annuity contracts issued by a qualified insurance company; (2) custodial accounts exclusively invested in stock of a regulated investment company; or (3) a retirement income account for employees of a church-related organization. Employee elective deferrals are shown on Form W-2 in Box 12, Coded E, but not as income in Box 1.

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For the ***lay employee*** these amounts are subject to Social Security and Medicare tax and must be included on Form W-2 in Box 3 and Box 5. However, for the ***minister*** these amounts are not included as income subject to self-employment tax according to IRS Revenue Ruling 68-395.

Contributions that exceed the maximum contribution limits constitute an excess contribution that is included in the participant's gross income for the taxable year in which it was contributed. Excess contributions may also be subject to excise taxes. To avoid this penalty, a plan may provide that contributions found to be in excess will be distributed to the participant (along with allocable net income) by April 15 of the following taxable year.

A tax credit (called "Saver's Credit") may also be claimed by lower income taxpayers funding a TSA. The income limitations are indexed annually for inflation. The maximum elective contribution eligible for credit is $2,000 for each the taxpayer and spouse if filing jointly. The credit is in addition to the exclusion that already applies. For more information about this retirement savings contribution credit, see IRS Publication 571, Tax Sheltered Annuity Programs.

5.225: Written Plan

It is mandatory that these plans are in writing. In the absence of a written defined contribution plan describing *all* the provisions of the way the plan works, the tax-deferred benefits for all participants will be jeopardized. Written plans can range from simple to very complex. In some situations, the plan might merely be a compilation of several documents: a salary reduction agreement; the various contracts that fund the plan; as well as, a narrative of the administrative procedures regarding which employees are eligible, how benefits are made available and account contribution limits. In other situations, the employer may incorporate all the necessary elements into a single written document. If an employer has more than one plan, IRS requires a written master plan document that accounts for the provisions in each individual employee funded account and all employer funded accounts at all financial institutions. In any event, it is always prudent that employers write their TSA plans with help from their legal or tax professionals. NOTE: If any employer offers **only** the Concordia Retirement Savings Plan as its 403(b) plan, Concordia Plan Services provides a written plan document that complies with IRS requirements, and employers will not have to create their own written plan.

5.230: Communication

It is not sufficient to have a written plan if you do not make all eligible employees aware of the availability of your TSA plan and give them a summary of its provisions.

Also, since employers have oversight and compliance responsibilities with respect to each of their employees' contracts, certain information about all existing employee contracts must be obtained from the financial institutions holding those accounts and contracts. This task may pose difficulties for employers trying to coordinate with a multitude of different financial institutions.

5.240: Distributions

Elective deferrals and employer contributions generally may only be distributed upon severance from employment, death, disability, attainment of age 59½, or in the event of hardship. However, employer contributions held in a 403(b)(9) retirement income account may also be withdrawn to buy a home. This presumably would permit the withdrawal of employer contributions before retirement to purchase or build a retirement home.

Some plans may permit participants to borrow from a TSA plan, subject to strict tax code requirements. However, this is an optional provision that an employer may or may not decide to include in the plan.

Some plans may permit contract-to-contract exchanges within the same plan and plan-to-plan transfers. Investment changes between contracts within the same plan must follow certain requirements; an important one of which includes an information-sharing agreement with the issuer of the recipient contract. For example, it is essential that the employer and issuer share information about whether the employee has severed employment, whether hardship distribution rules have been satisfied, and participant plan loan information (if any).

All plans however require that contributions made under it must eventually begin to be distributed, giving IRS its long-awaited source of tax revenue. This event is termed "latest distribution date." In no event shall any distribution begin later than the later of (a) April 1 of the year following the calendar year in which the Participant attains age 70½ or (b) April 1 of the year following the year in which the Participant retires or otherwise has a severance from employment.

5.250: Plan Reporting to IRS

A welcome relief, you will not have to file an IRS Form 5500 for a TSA pension plan that is a church plan.

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5.300: Individual Retirement Accounts

5.310: Eligibility

All eligible individuals, including ministers, may contribute to an individual retirement account or annuity (referred to collectively as IRAs). Annual contributions to both traditional and Roth IRAs are limited to an aggregate of $5,500 through 2014. Persons age 50 and older may contribute an additional $1,000. The employees, not their employer, open these accounts and fund them with their own contributions.

For more information about all IRAs, see *IRS Publication 590, Individual Retirement Accounts*.

5.320: Traditional IRA

Any individual who has income from compensation or is filing a joint return with a spouse who earns compensation may contribute to a traditional IRA provided they have not in that year reached age 70½. Contributions may also be deductible if additional income requirements are met. All distributions become part of taxable income. Penalty-free withdrawals are permitted before age 59½ for certain qualified expenditures. Some of these expenditures include first-time home purchase (up to $10,000), certain medical expenses, qualified higher education expenses, or in the event of death or disability. Withdrawals are required to begin by April 1 of the year following the year in which the account holder reaches age 70½.

Contributions to IRAs are not deductible for self-employment tax purposes. The earnings on IRAs will continue to be tax deferred regardless of whether the initial contribution was deductible or not.

5.330: Roth IRA

Any individual who meets certain income requirements and who has income from compensation or is filing a joint return with a spouse who earns compensation may contribute to a Roth IRA. While contributions are not deductible, earnings grow free of federal tax if account is open for five tax years and withdrawals are for a qualified reason which includes age 59½, certain medical expenses, qualified higher education, disability, death, or a first-time home purchase (up to $10,000). The account holder is not required to begin withdrawals at any particular age.

5.600: Educational Savings

5.610: Coverdell Education Savings Accounts

The sole purpose of this savings instrument is to help pay for your child's elementary, secondary and post-secondary education expenses. Contributions can be made for the child until he or she reaches age 18. Special needs children have no such age limit. Any parent, grandparent, other family member, friend and the child him/herself can make contributions, provided the contributor has modified adjusted gross income within certain limits. Total contributions for the child for a taxable year cannot exceed $2,000. While contributions are not deductible, earnings grow free of federal tax if withdrawals are used for qualified education expenses. Withdrawals are tax and penalty free if used for qualified expenses such as tuition, equipment, fees—even room and board—any time before the child reaches the age of 30.

5.700: Health Savings Accounts

Health Savings Accounts (HSAs) were created to work in conjunction with high-deductible health plans. If an employer offers a high-deductible health plan through the Concordia Health Plan, the worker and covered spouse may qualify to open separate HSA accounts to save money for out-of-pocket medical expenses.

An HSA is an individual account that can be funded with employer or worker money, from which the worker can be reimbursed tax-free for qualified medical expenses. Or, if not used, the money accumulates with tax-free interest until retirement, when the worker can continue to withdraw funds for medical expenses tax free or can withdraw funds for any purpose and pay normal taxes. Individuals own their own HSAs.

If the worker makes the contributions to the HSA under an employer's §125 Cafeteria Plan, he/she estimates how much will be needed in a given year to pay for medical expenses not covered by the health plan (out-of-pocket medical expenses such as the deductible and coinsurance amounts). That HSA amount is divided by the number of paychecks issued throughout the year and then that amount is automatically deducted from each paycheck by the employer, before taxes, and placed into the worker's HSA account so that when the time comes, funds are available to pay for medical expenses not covered by the health plan.

Employer contributions must be reported on the worker's Form W-2, box 12, coded W (See Exhibit 7-K(2) on page 7-26 for example).

Advantages of a Health Savings Account (HSA):

- Before-tax contributions by the worker under an

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employer's §125 Cafeteria Plan, reduce the worker's taxable income, meaning less taxes are paid. Contributions outside a §125 Cafeteria Plan are deductible (a deduction on Form 1040) towards reducing the employee's gross income subject to tax.

- Monies in the HSA account roll over from year to year, and can be used in future years when the worker may have medical expenses.
- It results in lower health plan rates (or premiums), and hopefully the employer will share the savings with the worker through a salary increase or contributions to the HSA account.
- It is portable. The HSA account is owned by the worker and travels with him/her from job to job.
- It earns investment income. HSAs are designed so that money can be withdrawn when needed for medical expenses, but the money that is not withdrawn has the potential to grow and accumulate interest.
- It isn't restrictive: funds can be used for any qualified medical expense.
- The worker is more proactively involved in managing his/her "small dollar" medical expenses, and the incentive is provided to maintain good health.

Employers in the Concordia Health Plan can provide their workers the opportunity to participate in an HSA through SelectAccount, a subsidiary of Blue Cross Blue Shield of Minnesota (see 4.555). HSAs can also be set up through banks, investment firms, and some insurance companies. Lutheran Church Extension Fund of The Lutheran Church—Missouri Synod offers HSAs too (see 19.200). For more information about HSAs, refer to *IRS Publication 969.*

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