

October 17, 1990

To: Superintendents, Member School Districts (K-12)

From: Susanne K. Reed, Assistant General Counsel

Subject: Tax Sheltered Annuities
Memo No. 23-90

Several districts have recently requested our advice regarding the rules relating to the number of changes that may be made to salary reductions agreements entered into by districts for their employees under Internal Revenue Code Section 403(b). These agreements are commonly referred to as Tax Sheltered Annuities or TSAs. In addition, districts have requested hold harmless forms to be used in contracting with the annuity companies providing the TSAs. We have attached to this memo sample agreements for use with employees and for use with the providers of the Tax Sheltered Annuities.

We are not certified as tax attorneys and for this and other reasons, we do not give tax advice to individual taxpayers. Nevertheless, we have reviewed the Internal Revenue Code Treasury on this subject and based upon this information believe that there are some fairly clear rules that districts may safely follow in order to remain in compliance with Section 1.403(b)-1-(b)(3) of the Treasury Regulations. This Section provides in pertinent part as follows:

“The employee must not be permitted to make more than one agreement with the same employer during any taxable year of such employee. . . .”

Concern has been expressed by districts that this Section limits their employees with current TSAs to one date, January 1st, for changing the amount of their deductions. The IRS does not interpret this Section this strictly. Revenue Ruling 87-114, which may be relied upon by taxpayers with the same factual situation, holds that a continuing salary reduction agreement entered into in a prior taxable year does not preclude an employee from entering into a new salary reduction agreement at any time during the employee's current taxable year.

In reviewing the sources previously discussed, we feel that the following rules should be followed by districts with regard to individual TSA agreements:

1. The individual employee's TSA agreement may coincide with the employee's contract year, but he or she may not make more than one salary reduction agreement during any taxable year. (Rev.Rul. 67-69)
2. An individual employee's TSA agreement may be based upon a percentage of his or her salary instead of a set amount. The mere change in the amount of the contribution under a percentage formula (based upon changes in salary, hours, etc.) does not constitute the making of a new salary reduction agreement. (Rev.Rul. 68-58) (Note: This method requires certain payroll programming capabilities. Prior to agreeing to a percentage based TSA, Districts should check with their individual County Office.)
3. Changing insurers (with no change in the amount of the deduction) during the same taxable year in which the employee's TSA agreement is made does not result in a new agreement for that year, even though the name of the first insurer was initially specified in the agreement. (Rev.Rul. 68-179)
4. A continuing salary reduction agreement entered into in a prior taxable year for amounts not yet earned. This is true even if the employee entered into or changed the agreement in the same taxable year. However, if a salary reduction agreement was entered into or changed in the same taxable year, if this agreement is terminated, a new agreement may not be entered into until the employee's next taxable year. (IRS Publication 571)

If employees have questions about their tax-sheltered annuities, they should be referred to their annuity provider or their individual accountants.

AGREEMENT

WHEREAS, the Board of Education of the _____ School District, _____ County, California, wished to make available to its employees the provisions of Public Law 87-370, United States Internal Revenue Code Section 403(b), and California Revenue and Taxation Code Section 17512; and

WHEREAS, the Company designated below has offered to provide tax sheltered annuities complying with Federal and State law for eligible employees of the Board of Education of the _____ School District wishing to have such annuities purchased for them by the Board of Education.

IT IS AGREED AS FOLLOWS:

1. _____, hereinafter called the Company, shall provide for purchase by the Board of Education for its employees only annuities complying with the provisions of Public Law 87-370, Section 403(b) of the United States Internal Revenue Code and Section 17512 of the California Revenue and Taxation Code and other pertinent present or future Federal or State law. Such annuities shall be available for purchase by the Board of Education for any legally eligible employee electing to participate.
2. The Company, its agents and representatives, shall comply with all pertinent written directions regarding the solicitation of employees of the Board of Education and the purchase of tax sheltered annuities and/or shares in a regulated investment company.
3. The Company shall hold harmless and indemnify the Board of Education, the School District, their officers and employees, from every claim and demand, including those based upon negligence of the Board of Education, the District, their officers and employees, which may be made by reason of the purchase of annuities and/or shares in a regulated investment company by the Board of Education.
4. The Company, at its own cost, expense and risk, shall defend any legal proceedings that may be brought against the Board of Education, the School District, their officers and employees, on any such claim or demand and shall satisfy any judgment that may be rendered against any of them. The Board of Education shall notify the Company on the receipt of any such claim or demand.

5. In reference to provisions described in paragraph 3 above, the Company shall not be responsible for holding harmless, defending and indemnifying the Board of Education, the School District, their officers and employees, against claims or demands that arise out of the sole negligence, willful misconduct, actual fraud or criminal conduct by the Board of Education, the School District, their officers and employees.

COMPANY

Date: _____ (signature)

_____ (print or type signature)

Title

_____ (Authorized Officer or Company)

Address

City

State and Zip

AMENDMENT OF EMPLOYMENT CONTRACT (ANNUITY)

Between _____, Employee, and
_____ School District, Sonoma County, State of California, Employer:

IT IS MUTUALLY UNDERSTOOD AND AGREED AS FOLLOWS:

That for the purpose of enabling the employee to take advantage of the “Deferred Compensation” provisions of Section 403(b) of the Internal Revenue Code, as amended:

The employee