

DESCRIPTION OF TAX BILL

(S. 1910)

RELATING TO

TAX TREATMENT OF CHURCH PENSION AND ANNUITY PLANS

Scheduled for a Hearing

Before the

Subcommittee on Savings, Pensions, and Investment Policy

of the

Senate Committee on Finance

on

May 19, 1982

Prepared by the Staff

of the

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## INTRODUCTION

The Senate Finance Subcommittee on Savings, Pensions, and Investment Policy has scheduled a hearing on S. 1910 (introduced by Senators Bentsen and Dole) for May 19, 1982. The bill relates to tax-sheltered annuities and pension plans for ministers and lay employees of churches.

The first part of this document is a summary of the bill. This is followed by a more detailed description of the bill, including present law, explanation of the provisions, and effective dates.



## I. SUMMARY

### Present Law

Under present law, employers which are tax-exempt organizations and public schools may make contributions on behalf of their employees to purchase tax-sheltered annuities. The amount contributed by the employer for a tax-sheltered annuity is excluded from an employee's gross income to the extent that it does not exceed the employee's exclusion allowance (based upon the employee's pay and length of service). In computing an employee's exclusion allowance, service with the contributing employer and previous contributions by that employer are taken into account. In addition, tax-sheltered annuities are subject to the overall limitations on contributions and benefits generally applicable to qualified pension plans. Certain special elections (1) to increase the limitations on contributions for tax-sheltered annuities, or (2) to increase the amount of the tax-sheltered annuity contributions excludable from gross income, apply to church and non-church employees of educational institutions, hospitals, and home health service agencies, but not to other church employees.

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The bill would provide that, with respect to a minister or lay employee of a church or certain organizations associated with churches, all years of service with the church, etc., and all contributions to tax-sheltered annuities by the church, etc., would be aggregated for purposes of determining the applicable limits on exclusions and contributions under tax-sheltered annuities. In addition, the special elections (1) to increase the limitation on contributions for tax-sheltered annuities, or (2) to increase the amount of the tax-sheltered annuity contributions excludable from gross income, would apply to ministers and lay employees of a church, etc. Also, the overall annual limitation on the contributions and for any employee eligible for the special elections would not be less than \$10,000 and would be adjusted for post-1974 cost-of-living increases.

The bill would clarify that (1) certain annuities offered by a church, etc., would qualify as tax-sheltered annuities, even though they are not commercial annuities and that (2) amounts paid by an employer to purchase a tax-sheltered annuity contract are taken into account for the years for which actually contributed.

In addition, the bill would clarify that no amount payable to a beneficiary under a tax-sheltered annuity would be excludable in the beneficiary's income until actually paid.

The provisions of the bill generally would be effective for taxable years beginning after December 31, 1980.



## II. DESCRIPTION OF THE BILL

### A. Computation of the Exclusion Allowance

#### Present Law

Under present law, employers which are tax-exempt organizations (including churches) or public schools may make contributions on behalf of their employees to purchase tax-sheltered annuities (sec. 403(b)). The amount contributed by the employer for a tax-sheltered annuity is excluded from an employee's gross income to the extent of the employee's exclusion allowance. The exclusion allowance is generally equal to 20 percent of the employee's includable compensation from that employer times the number of the employee's years of service with that employer, and is reduced by amounts already contributed by the employer to purchase the annuity.

This formula for fixing an employee's annual exclusion allowance may not reflect the career pattern of a minister or lay employee of a church who moves from one employing organization to another employing organization within the church.

#### Explanation of Provision

The bill would provide that, with respect to a minister or lay employee of a church and associated organizations,<sup>1/</sup> all years of service with the church, etc., would be considered as service with one employer, and all contributions by the church, etc., would be considered to have been contributed by one employer. In addition, for purposes of determining the applicable exclusion allowance, the bill would impute a minimum compensation level related to the Office of Management Budget's nonfarm income poverty level guidelines for an average sized family.

### B. Overall Contribution Limitations

#### Present Law

Employer contributions to purchase a tax-sheltered annuity contract for an employee are subject to the overall limit on contributions to tax-qualified defined contribution plans (e.g., fixed contribution pension plans). Under special rules, a participant who is an employee of an educational institution, hospital, or home health service agency may elect to compute the annual exclusion allowance solely by reference to the maximum annual

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<sup>1/</sup> The definition of a church plan includes a plan maintained by a convention or association of churches or an affiliated organization whose principal purpose or function is the administration or funding of a plan or program to provide retirement or welfare benefits for church employees (sec. 414(e)).



employer contribution which could be made to a defined contribution plan under the overall limits on contributions under qualified plans. The special rules apply to employees of a church hospital, etc., but not to other church employees. Under the overall limits, annual additions<sup>2</sup> to tax-sheltered annuities and other defined contribution arrangements may not exceed the lesser of (1) \$25,000 adjusted for post-1974 cost-of-living increases (\$45,425 in 1982) or (2) 25 percent of the participant's compensation from the employer for the year. There is no provision allowing de minimis contributions to defined contribution plans.

In addition, to permit lower-paid employees to make catch-up contributions immediately before retirement, present law provides certain special elections (1) to increase these limitations on contributions for tax-sheltered annuities, or (2) to increase the amount of the tax-sheltered annuity contributions excludable from gross income. However, these elections apply to church and non-church employees of educational institutions, hospitals, and home health service agencies, but not to other employees of churches.

The overall limits on contributions and benefits provide a de minimis rule with respect benefits under defined benefit pension plans. The de minimis rule applies only for a participant whose total retirement benefits under all defined benefit plans of the employer do not exceed \$10,000. (This limit is not adjusted for cost-of-living increases). If the de minimis rule is not satisfied, annual benefits under defined benefit plans are limited to the lesser of (1) \$75,000 adjusted for cost-of-living increases since 1974 (\$136,425 in 1982), or (2) 100 percent of average compensation for the high three years of compensation.

#### Explanation of Provision

The bill would extend to church, etc., employees the special elections (1) to apply the overall limitations on contributions to a tax-sheltered annuity without regard to the separate limits for tax-sheltered annuities, and (2) to apply the special catch-up limits on the amount of the tax-sheltered annuity contributions excludable from gross income.

In addition, the bill would permit de minimis annual contributions of \$10,000 without regard to either the overall limitations on contributions or the special catch-up elections. The \$10,000 would be adjusted for post-1974 cost-of-living increases (\$18,190 for 1982).

The bill would also clarify present law to provide that annual contributions to a tax-sheltered annuity contract would be considered annual additions in the year made, rather than in the year when they become nonforfeitable.

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<sup>2</sup>/ Annual additions consist of employer contributions, certain employee contributions, and forfeitures allocated from the accounts of other participants.



C. Qualifying Tax-Sheltered Annuity Contracts

Present Law

Under present law, it is unclear whether tax-sheltered annuity contracts may be issued by organizations that are not insurance companies.

Explanation of Provision

The bill would provide that a tax-sheltered annuity contract may be issued by a church or a convention or association of churches or an associated organization (such as a pension board) whose principal purpose is the administration or funding of a plan or program for the provisions of retirement or welfare benefits for the employees of a church.

D. Constructive Receipt

Present Law

Under present law, amounts under a tax-sheltered annuity are includable in the beneficiary's income if paid or made available to the beneficiary.

Explanation of Provision

The bill would provide that a beneficiary would be taxed on amounts under a tax-sheltered annuity only when amounts are actually paid under the contract. The provisions parallels the income tax rule for tax-qualified plans which was added by the Economic Recovery Tax Act of 1981.

E. Effective Date

In general, the bill would be effective for taxable years beginning after December 31, 1982. The provision permitting the aggregation of all years of service with a church would be applicable to determine the exclusion allowance for taxable years after December 31, 1980. The provision which defines qualifying annuity contracts would be effective with respect to all taxable years (including all past years). The provision which treats all contributions as annual additions in the year made, rather than the year vested, would generally be effective with respect to all taxable years, unless the taxpayer otherwise elects not to have it apply with respect to contributions made prior to January 1, 1981.

