

Chapter 5: Tax-Favored Savings Plans

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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 nor should it be relied upon when making important decisions relative to these plans. As the laws on these subjects are quite technical and subject to change, 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/403(b) Plans

5.205: Eligibility

Tax-sheltered annuities (TSAs or 403(b) plans) are retirement plans available only for 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 adopting and maintaining a defined contribution retirement plan, which, both in form and operation, satisfies the requirements under Section 403(b) of the Internal Revenue Code. The plan must continue 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. The employee instructs the employer how much to contribute to an account maintained for the benefit of the 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 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 employee (in other words, within 15 days of the last payday of the month).

5.210: Funding

Typically, in churches, you will find employee 403(b) accounts funded primarily through salary reduction agreements. Each employee chooses whether 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' 403(b) accounts 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 2024, based on taxable earnings, generally cannot exceed \$23,000 (indexed annually for inflation).

For age 50 and older, an additional contribution of \$7,500 (subject to inflation adjustments) may be made in 2024.

In 2024, the maximum contribution for combined employer contributions and employee elective deferrals is the lesser of 100% of includible compensation and \$69,000 (indexed annually for inflation). With respect to ministers, housing allowances are not counted in determining includible compensation for the maximum contribution limit.

The employer is 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 an employer-sponsored 403(b) tax-advantaged savings plan administered by Concordia Plan Services through Fidelity and its affiliates. The CRSP employer contribution is voluntary. Employees may elect to contribute to the CRSP on a pre-tax or Roth basis. The CRSP offers carefully selected low fee investments with the opportunity for the participant to receive a managed investment service. Please refer to concordiaplans.org for additional information.

5.220: Tax Aspects

TSA contributions to a 403(b) plan are tax-deferred (i.e., excluded from the employee's gross income in the year earned; and not becoming taxable until withdrawn). Employee pre-tax elective deferrals are shown on Form W-2 in Box 12, Coded E, but not as income in Box 1. Employer's contributions, if any, are not reported on Form W-2.

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 individual'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 individual (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 (\$4,000 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 be in writing. In the absence of a written defined contribution plan describing all the provisions of how 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 compensation eligibility, distribution, timing and 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, the 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 prepare 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 its availability 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.

Some plans may permit participants to borrow 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 plan loan information (if any).

All plans however require that contributions must eventually begin to be distributed, giving IRS its long-awaited source of tax revenue. This event is termed “required beginning date.” Distribution must begin by the April 1 following the calendar year in which an individual retires (or reaches age 73 if you reach age 72 after 12/31/2022.)

5.250:

Plan Reporting to IRS

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

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 \$7,000 through 2024. 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 Publications* 590-A, Contributions to Individual Retirement Arrangements, and 590-B Distributions from 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. 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 qualified 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 72.

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 the 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 qualified 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. 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.

5.620: Qualified Tuition Program/529 Education Savings Account

A 529 Plan is a tax-advantaged investment account for qualified education expenses. Earnings on contributions made to 529 plans grow tax-free, and withdrawals can be made tax-free for qualified education expenses. Depending on the account owner's state of residence and the 529 plan selected, there may be state-tax advantages, as well. There are no annual contribution limits on 529 plans, but account balance limits apply and vary depending on state. Withdrawals from a 529 plan can be used for college expenses, K-12 tuition, certain apprenticeship costs, and student loan repayments. Any parent, grandparent, other family member, friend and the child him/herself can make contributions to the 529 plan account. Beneficiaries of the 529 plan account are transferrable among family members. Starting in 2024, unused 529 funds in certain accounts can be rolled over into a Roth IRA retirement

plan for the beneficiary, up to annual and lifetime limits. For more information, see *IRS publication 970*, Chapter 7: Qualified Tuition Program.

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 HSAs 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. Funds withdrawn for non-qualified medical expenses before age 65 are subject to an additional 20% tax penalty. There is no additional tax on distributions made after the date you are disabled, reach age 65, or die. Individuals own their own HSAs.

If the worker makes the contributions to the HSA under an employer's \$125 Cafeteria Plan, he/she elects how much to contribute each year up to the IRS maximum. That HSA amount is divided by the number of paychecks issued throughout the year and then that amount can be automatically deducted from each paycheck by the employer, before taxes, and placed into the worker's HSA account.

Employer contributions (includes employee's elected 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 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 roll over from year to year and can be used in future years when the worker may have medical expenses.
- High-deductible health plans have lower health plan rates (or premiums), which allows the employer to share the savings with the worker through a salary increase or contributions to the HSA.
- An HSA is portable. The HSA is owned by the worker and travels with him/her from job to job.
- An HSA may earn investment income if investment options are offered. 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.

- HSA 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.
- No required minimum distributions.

Employers in the Concordia Health Plan can provide their workers the opportunity to participate in an HSA through HealthEquity or Kaiser Permanente (for some options). HSAs can also be set up through banks, investment firms and some insurance companies. The Lutheran Church Extension Fund offers HSAs, too (see 19.200). For more information about HSAs, refer to *IRS Publication 969*.

