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ARIZONA ATTORNEY GENERAL

Opinion No. 64-27-L
R-126
July 13, 1964

REQUESTED BY: A. N. GANDRUD, Executive Secretary-Treasurer
Arizona School Boards Association

OPINION BY: ROBERT W. PICKRELL
The Attorney General

QUESTION: What is the maximum excludable allowance
available to participants in the Federal
Tax Sheltered Annuity Plan?

CONCLUSION: See formula in body of opinion.

Your question was prompted in order to clarify the statement in Attorney General Opinion #63-28, wherein the statement was made: "The Internal Revenue Code provides that not more than 20% of an employee's income or includible compensation may be excluded as an annuity premium. * * *" The Internal Revenue Code speaks of a 20% limitation and prescribes a formula to be followed.

The formula and the manner of determining the amount which may be excluded is set forth in Title 26, U.S.C.A. Section 403(b)(2)(3)(4)(5) and (6):

"(2) Exclusion allowance. - For purposes of this subsection, the exclusion allowance for any employee for the taxable year is an amount equal to the excess, if any, of-

(A) the amount determined by multiplying (i) 20 per cent of his includible compensation, by (ii) the number of years of service, over

(B) the aggregate of the amounts contributed by the employer for annuity contracts and excludable from the gross income of the employee for any prior taxable year.

"(3) Includible compensation. - For purposes of this subsection, the term "includible compensation" means, in the case of any employee, the amount of compensation which is received from the employer described in paragraph (1) (A), and which is includible in gross income (computed without regard to sections 105(d) and 911)

for the most recent period (ending not later than the close of the taxable year) which under paragraph (4) may be counted as one year of service. Such term does not include any amount contributed by the employer for any annuity contract to which this subsection applies.

"(4) Years of service. - In determining the number of years of service for purposes of this subsection, there shall be included-

(A) one year for each full year during which the individual was a full-time employee of the organization purchasing the annuity for him, and

(B) a fraction of a year (determined in accordance with regulations prescribed by the Secretary or his delegate) for each full year during which such individual was a part-time employee of such organization and for each part of a year during which such individual was a full-time employee of such organization.

In no case shall the number of years of service be less than one.

"(5) Application to more than one annuity contract. - If for any taxable year of the employee this subsection applies to 2 or more annuity contracts purchased by the employer, such contracts shall be treated as one contract.

"(6) Forfeitable rights which become nonforfeitable. - For purposes of this subsection and section 72(f) (relating to special rules for computing employees' contributions to annuity contracts), if rights of the employee under an annuity contract described in subparagraphs (A) and (B) of paragraph (1) change from forfeitable to nonforfeitable rights, then the amount (determined without regard to this subsection) includible in gross income by reason of such change shall be treated as an amount contributed by the employer for such annuity contract as of the time such rights

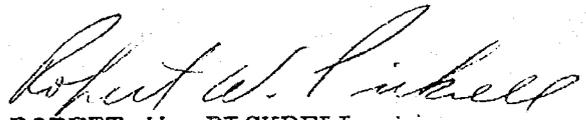
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become nonforfeitable."

In simpler language, the exclusion allowance may be defined as follows:

The employees' "exclusion allowance" for a particular taxation year is equal to 20 per cent of the "includable compensation" for that year, multiplied by the number of years of service and reduced by the total of the tax-free premiums paid in prior years for him by the employer.

It should be noted that where the premium is a diversion of a part of the existing salary, the exclusion allowance is determined on the net salary after the reduction in salary for the premium has been applied. When we apply this rule, we find that 20 per cent of the net salary is 16.66 per cent of the existing salary. Thus the exclusion allowance when there is no past service, is 16.66 per cent of the salary existing prior to the diversion. If any problems are encountered in computing the amount to be excluded in a particular case the school board should consult its local county attorney.


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The Attorney General

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