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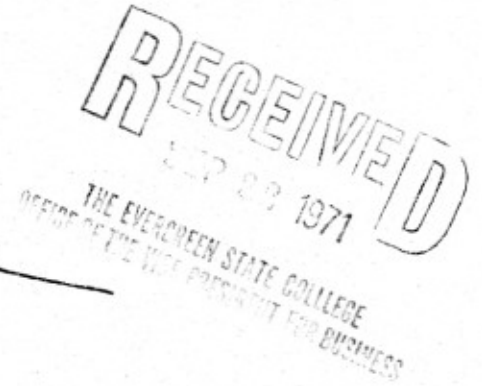
September 20, 1971

MEMORANDUM

TO: All Agencies

FROM: Walter C. Howe, Jr.  
Director

SUBJECT: TAX DEFERRED ANNUITIES



Attached is a copy of the Attorney General's opinion dated September 17, 1971, regarding the discrepancy contained in Chapter 264, Laws of 1971, 1st Extraordinary Session. Your attention is directed specifically to the last paragraph on page 2, and the second paragraph, page 5, of the attachment. These paragraphs indicate that the referenced statute in Chapter 264 should read 403(b) instead of 401(a).

Chapter 264, Laws of 1971, 1st Extraordinary Session, provides in part that:

"Any department, division, or separate agency of the state government, and any county, municipality or other political subdivision of the state acting through its principal supervising official or governing body is authorized to enter into an agreement with any life insurance company, bank trustee, or custodian authorized to do business in the state of Washington to provide deferred annuities in lieu of a portion of salary or wages for all officials and employees of said public entities deemed to be eligible by the agency of the United States Government having jurisdiction of the matter under the provisions under 26 U.S.C., section 401 (a), as amended by Public Law 87-370, 75 Stat. 796 as now or hereafter amended . . . ." (Emphasis supplied). (Note: Referenced section of the U.S. Code should read 403(b) instead of 401(a).

The Internal Revenue Service is the United States agency to determine eligibility of state agencies which may participate in tax deferred annuities. Pertinent portions regarding eligible employers from the I.R.S. Pamphlet "Tax-Sheltered Annuity Plans for Employees of Public Schools and Certain Tax Exempt Organizations," are quoted herewith for information:

#### "QUALIFIED EMPLOYER

The tax-sheltered annuity provisions will apply only if the contributions toward the contract are paid by a qualified employer. There are two types of qualified employers: Public Schools and qualified tax-exempt organizations.

#### PUBLIC SCHOOLS

A State or local government, or an agency or instrumentality of any of the foregoing, may be a qualified employer, but only as to its employees who are performing (or have performed) services, directly or indirectly, for an educational institution.

An education institution means only an educational institution that normally maintains a regular faculty and curriculum and normally has a regularly organized body of students in attendance at the place where its educational activities are carried on.

#### QUALIFIED TAX-EXEMPT ORGANIZATIONS

This is an organization that is tax exempt as being organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. An organization of this type may be in the form of a corporation, any community chest, fund, or foundation.

GOVERNMENT INSTRUMENTALITIES. Generally, organizations (other than Public Schools, described above) that are wholly owned State or municipal instrumentalities are not qualified employers. However, if this organization is a separate entity that has been specifically exempted from Federal taxation as being organized and operated exclusively for the purposes stated in the above paragraph, it is a qualified employer. Thus, a separately organized school, college, university, or hospital may qualify if it is a counterpart of an organization described previously, and is not an activity under a branch or department that is an integral part of a State or municipal government.

These organizations may submit requests to establish a Federal tax exemption by filing Form 1023, Exemption Application, with the District Director of Internal Revenue for the District in which is located the organization's principal place of business or principal office."

In discussions with the Internal Revenue Service, Seattle Office, they stressed the fact that in order for a state agency to qualify under Section 501(c)(3) of the U.S. Code, which section sets forth the qualification for exempt

employers, two conditions must be met in all respects:

- a. That the organization be organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary or educational purposes, etc.
- b. That the agency be a separate corporate entity.

A recent ruling by the Internal Revenue Service further amplifies the above conditions. Applicable sections of that ruling are furnished herewith for information:

"Section 501(c)(3) of the Code provides for the exemption of organizations that are "organized and operated exclusively" for charitable or educational purposes.

In order for an organization to meet the requirements for exemption under section 501(c)(3) of the Code it must be both organized and operated exclusively for one or more of the exempt purposes specified therein. If an organization fails to meet either the organizational or the operational test, it is not exempt. See section 1.501(c)(3)-1 of the Income Tax Regulations.

A state or municipality itself does not qualify as an organization of the type described in section 501(c)(3) since its purposes are clearly not exclusively those described in section 501(c)(3) of the Code. Similarly, an activity constituting an integral part of a state or municipal government cannot so qualify inasmuch as the organization engaged therein would still be the state or municipal government which cannot qualify as an organization described in section 501(c)(3) of the Code. See Revenue Ruling 60-384, C.B. 1960-2, 172."

To the best of our knowledge, the only state agency, outside of educational institutions, which has been designated a qualified employer by the Internal Revenue Service is Northern State Hospital. This designation was received several years ago when the qualifications for tax-exempt status were more liberal.

Considering the above requirements and conditions, any agency Director that believes his agency would qualify for participation in a deferred annuity program should submit a request to establish a Federal tax exemption by filing Form 1023, Exemption Application, with the District Director of Internal Revenue. It is strongly recommended however, that no payroll deductions be allowed for deferred annuities until such Federal tax exemption certification has been received from the Internal Revenue Service. A copy of the exemption should be provided to this office.

All Agency Directors  
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Each agency should minimize administrative costs for this program if it is determined that you are able to participate. It is recommended that upon successfully obtaining an exemption certificate that the annuity program be selected for your employees under competitive bid.

WCII:vb

Attachment