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Heed Tougher 403(b) Plan Rules

The IRS recently issued final regulations that are significant for not-for-profit organizations with 403(b) retirement plans (also called “tax-sheltered annuities” in some circles.) Essentially, not-for-profits will have to comply with many of the same reporting and auditing requirements that apply to businesses that operate 401(k) plans.

Be prepared. The new regulations are generally effective for tax years beginning after December 31, 2008. Thus, it is likely that they will affect your not-for-profit for the first time this year.

The new regulations indicate that the IRS has become more serious about the operation of 403(b) plans. These plans have previously flown under the radar for much of the time.

Under the final regulations, an employer with 100 or more participants must provide financial statements in conjunction with the revised Form 5500. It has been estimated that this change will affect about 7,000 not-for-profits with 403(b) plans. An employer with fewer than 100 plan participants may qualify for simplified reporting procedures.

Keeping that in mind, here are some of the main elements of the regulations:

Auditing rules: Organizations subject to the Employee Retirement Income Security Act of 1974 are generally required to have their financial statements audited if they have more than 100 eligible participants at the beginning of the plan year. This requirement typically extends to tax-exempt charitable organizations other than churches or government entities.

The audited financial statements must be attached to Form 5500.

Participant records: In furtherance of generally accepted auditing standards, 403(b) plan sponsors must collect participant records showing activities for the year. This is especially important if individuals have been assigned personal account numbers that are not linked by the sponsoring organization.

Plan administration: As a general rule, 403(b) plan sponsors have had minimal responsibilities in this area. Traditionally, the bulk of the responsibilities have been handled by a financial institution. Auditors will need to understand the controls in place, whether or not certain functions are being outsourced.

Financial statements: Under transitional rules, financial information for 2008 must be included in the audited financial statements for 2009. In the past, some not-for-profits sponsoring 403(b) plans did not receive a statement of net assets and activities at the plan level. Therefore, they should promptly contact the 403(b) plan investment custodian to ensure that these requirements are satisfied.

Finally, your organization should be informed about any significant deficiencies in accounting procedures or internal controls that surface. A “significant deficiency” is defined as an item creating a risk of error in financial statements that may reasonably matter to a user of the financial statements.

This is a complex set of regulations. It is strongly recommended that you

seek professional assistance to ensure full compliance with the new rules. Warady & Davis' not-for-profit team is here to help.

IRS Announces New 403(b) Limits

The news is not all bad for not-for-profits with 403(b) plans. Along with other inflation adjustments for qualified retirement plans, the IRS has announced new thresholds applicable to 403(b) plans for the 2009 tax year. In general, the increases are slightly higher than they have been the past few years.

Some of the key changes that may be of interest to plan participants:

- The limit on the tax exclusion for elective deferrals increases from \$15,500 to \$16,500.
- The allowable catch-up contribution for plans with elective deferrals increases from \$5,000 to \$5,500.
- The annual limit on the compensation amount that may be taken into account for these purposes increases from \$230,000 to \$245,000.
- The dollar limit for additions to defined contribution plans increases from \$46,000 to \$49,000.

Thus, participants in 403(b) plans will be able to contribute significantly more to their plans this year than they did last year.

Should You Capture Your Own Insurance?

Obtaining insurance coverage for a not-for-profit organization can be costly. Plus, your not-for-profit is subject to the whims of the marketplace. But an intriguing alternative has been emerging in the not-for-profit sector.

Consider creating your own insurance company. This setup is typically called a “captive” insurance company or insurance plan. As the name implies, your not-for-profit entity becomes self-insured.

The primary benefit of having a captive insurance company is the ability to gain control over losses and minimize costs over the long term. It also increases the availability of insurance coverage for some not-for-profits. But there are several other daunting prospects. The following is a balanced viewpoint of the pluses and minuses of this arrangement.

Advantages of Captive Insurance

Cash flow: Premiums retained within the not-for-profit could pay dividends in the event of positive results. This potential windfall might be increased by investment earnings.

Control over claims: A captive insurance arrangement may help reduce

the number of claims. This is generally caused, at least partially, by programs initiated for safety reasons.

Insurance availability: With a captive insurance plan, policies may be obtained when it is otherwise difficult to obtain coverage. In fact, in certain situations, this may rescue a not-for-profit that has been deemed uninsurable.

Cost stability: A captive insurance plan is generally not affected by significant upswings and downswings periodically experienced in the commercial market. This can provide greater control over your budgeting process.

Customization: It is possible to design the captive insurance plan to meet the particular needs of the not-for-profit’s participants.

Disadvantages of Captive Insurance

Conversely, there are several potential drawbacks to having a captive insurance company. Here are a few points which should be considered:

Initial payment: If your not-for-profit is forming a captive insurance company, it may require a significant

payment up front to capitalize it. Similarly, an initial outlay is required to join a group. It takes time to recoup the investment.

Administrative expenses: The not-for-profit can expect to incur costs in maintaining the plan. Comparable costs may be incurred for joining a group.

Faulty estimates: This type of arrangement may result in low estimates in the amount of reserves needed to cover losses. Ultimately, the not-for-profit may have to pay an unexpected liability.

No tax savings: Regular business operations are able to count on tax benefits when they determine the viability of a captive insurance plan. Unfortunately, not-for-profit entities do not have this same flexibility.

Less competitive rates: When the rates for commercial policies fall, the policies obtained through a captive insurance plan may be more expensive than other available policies.

This idea is not for everybody, so investigate it carefully. Consult with professional advisers who have expertise in this area before proceeding.



New Model Form for Charitable Lead Trusts

The IRS is trying to make it easier for donors to set up charitable lead unitrusts. To facilitate these arrangements, it is providing new model forms to be used by donors.

Brief background: With a charitable lead unitrust, the donor establishes a trust that makes periodic payments to a charity for a specified term of years. Then the remainder typically reverts to the donor’s family. The donor re-

ceives a current tax deduction for the value of the benefit being provided to the charity.

By using the model form approved by the IRS, both donors and charities can rest assured that all the technical requirements in this area are being met. Consult with a tax practitioner concerning the use of charitable trusts.

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