

Guidelines for

Insurance Companies Establishing PASS Funds

Pending any other formal rules or regulations by the State Tax Commission, insurance companies located in New York State may establish qualified higher education (PASS) funds with Flexible Premium Deferred Annuity contracts under the following guidelines:

1. A written agreement must be entered into between a New York State resident (Depositor) and the insurance company (Custodian) to establish a qualified higher education fund. Model agreement Form TP-322, Higher Education Custodial Account, has been developed and may be used for this purpose. However, the following provisions should be added under Article IX of this form:
  - (a) All monies transferred, assigned and conveyed from the Depositor to the Custodian pursuant to the custodial account agreement (Form TP-322) shall be applied by the custodian as premiums under the annuity contract issued by the Custodian and applied for by the Depositor for the purpose of establishing a qualified higher education fund.
  - (b) The Depositor will designate himself as the owner of and the annuitant under the annuity contract.
  - (c) The Depositor will designate his estate as the irrevocable beneficiary under the annuity contract.
2. The Depositor must be advised, preferably by a written statement, that the maximum premium that can be paid in any taxable year of the Depositor is \$750 times the number of "eligible beneficiaries" listed in the custodial account agreement (Form TP-322).
3. The annuity contract should state (preferably in a Special Requests Section of the Application for Annuity) that the contract applied for is to establish a higher education custodial account as described in section 612(k)(3) of the New York State Tax Law and section T46-112.0(k)(3) of the Administrative Code of the City of New York.
4. The annuity contract must be modified (under the Settlement Options) to bring the method of distribution of the fund into compliance with the provisions of the PASS legislation. The Settlement Options provisions should require that any proceeds of the annuity contract that may become payable on the Retirement Date will be left with the insurance company until such time as the higher education custodial account terminates. During this period, the Depositor may make withdrawals of the proceeds as well as accrued interest, but such withdrawals shall be limited to that amount required solely for the purpose of defraying educational costs of his "eligible beneficiary."

5. A notice must be furnished to prospective PASS account depositors to make them aware of the possible tax consequences (double taxation to New York State)\* of choosing a periodic payment settlement option. This notice should disclose the following:
  - a) Upon the termination of a PASS fund, any remaining assets withdrawn under a periodic payment option may reduce the Depositor's tax benefits because of the possible Federal income tax treatment of the periodic payment received.
  - b) Any possible unfavorable tax treatment will be completely avoided if all the assets of the PASS fund have been distributed before termination of the fund or if the Depositor selects a lump sum payment of any assets remaining in the fund during the Depositor's taxable year in which the fund terminates.
  - c) If the Depositor has any questions with respect to his PASS fund, he should contact his insurance representative or the New York State Department of Taxation and Finance.
6. The annuity contract must be filed with and approved by the Superintendent of Insurance of New York State.
7. The Custodian must submit a copy of the final annuity contract and modified custodial account agreement (Form TP-322) to the Technical Services Bureau indicating all of the above conditions.

\*Under New York State Tax Law, upon termination of the fund, the Depositor would be required to report the entire proceeds remaining in the fund. By choosing a monthly payment plan, the Depositor may have to report the earned income portion of the annuities on his Federal return in subsequent years. (Under the Internal Revenue Code annuity rules, no Federal tax would have to be paid on the earnings of the fund during the year premiums were being paid.) Since the Depositor will have already reported the earnings of the fund to New York State in the year of termination, and New York State Tax Law has no modification to subtract the earned income from Federal adjusted gross income, the Depositor may be subject to New York tax twice on the same income.