

**NCPERS**  
**Public Safety Conference**  
**October 2018**



**Tony Roda**  
**Williams & Jensen PLLC**

# Timely Items

- Social Security Offset  
(Windfall Elimination Provision)
- Pick Up Rule
- Infrastructure Investments

# Windfall Elimination Provision

- Reduces your Social Security benefit if you earn a retirement benefit from non-Social Security covered employment (i.e., no FICA tax)
- SS benefit is based on average monthly earnings and the following calculations:
  - 90% of first \$895 of average monthly earnings
  - 32% of \$896 through \$5,397, plus
  - 15% of remainder

## WEP, cont.

- SS benefit is based on average monthly earnings and the following calculations:
  - 90% of first \$895 (WEP reduces 90% to 40%)
  - 32% of \$896 through \$5,397, plus
  - 15% of remainder
- Without WEP:  $\$895 \times 90\% \times 12 \text{ months} = \$9,666$
- With WEP :  $\$895 \times 40\% \times 12 \text{ months} = \$4,296$
- Difference of \$5,370 annually!

# Government Pension Offset

- Reduces Social Security spousal and survivor benefits if you earn a retirement benefit from non-Social Security covered employment (i.e., no FICA tax)
- GPO reduces your SS benefit by  $\frac{2}{3}$  of your non-covered pension
- Could zero out your SS spousal/survivor benefit

# WEP/GPO Legislation

- S. 915 (Sen. Sherrod Brown, D-OH)
- H.R. 1205 (Rep. Rodney Davis, R-IL)
  - Repeal both WEP/GPO
- H.R. 6933 (Reps. Brady R-TX and Neal D-MA)
  - WEP only
  - Proportional formula (2025)
  - \$100 monthly rebate (2020)

# H.R. 6933

- Controversy over a current exemption to WEP known as the substantial earnings (SE) test
- The WEP penalty phases out beginning with 21 years of SE to a complete exemption at 30 years
- SE = \$23,850 of covered employment (2018)

## Additional SS Issues

- Some have recommended mandatory coverage for all new hires
- Included in menu of options (Congressional Budget Office)
- Also, new focus on FICA replacement plan minimums



# Employer Pick Up

- IRC Section 414(h)(2) allows governmental employers to pick up (i.e., pay for) their employees pension contribution with pre-tax dollars
- Widely used mechanism and key issue in collective bargaining agreements

# Pick Up, cont.

## Background

- No regulations
- Rev. Rul. 2006-43
- No CODAs in pick up situation
- Cash or deferred arrangement = affects take home pay
- Requests to allow existing employees to elect between two benefit formulas with different employee contribution rates

## Tension

- Promoting retention of DB plans through flexibility
- Clear path to erode underlying DB benefits

## Legislation

- H.R. 2187
- H. Rept. 115-792
- H.R. 6757, §110

## H. Rept. 115-792

The Committee recommends that Treasury-IRS “...initiate a review of the existing regulatory guidance in Revenue Ruling 2006-43, and issue a revised revenue ruling that allows state and local pension plan sponsors to give existing plan participants the choice to make certain elections between pension plans or plan tiers without changing the tax treatment of employer contributions...”

# H.R. 6757, Family Savings Act

Amendment to IRC Section 414(h)(2):

...a contribution shall not fail to be treated as picked up by an employing unit merely because the employee may make an irrevocable election between the application of two alternative benefit formulas involving the same or different levels of employee contributions.

# Infrastructure Investments

- H.R. 6276, Strengthening Pensions through Investment in Infrastructure Act
  - Board control (Rev. Rul. 57-128)
  - Arbitrage bonds
- Proposed Treasury-IRS regulations on arbitrage bonds

## Infrastructure, cont.

- Promote acquisition of public infrastructure
- Three approaches:
  - Complete ownership
  - Complete ownership with intent to sell
  - LP or LLC (consortium-type structure)

# Lame-Duck Landscape

- Tax Reform 2.0
- Retirement Enhancement Savings Act +
- Select Committee on Multiemployer Plans

# Oldies, but Goodies

- Unrelated Business Income Tax (UBIT)
- PEPTA
- Rothification
- Annuity Accumulation Plan
- Health-Care Related



# Unrelated Business Income Tax

- In 2017, the original House-passed tax reform bill would have subjected certain income of state and local governmental pension plans to UBIT (private equity/LPs/hedge funds)
  - JCT estimated \$1.1 billion over 10 years in new revenue
- Senate bill was silent
- Conferees ultimately dropped House provision

## UBIT, cont.

Policy tension in tax law:

- IRC Section 511 references 401(a) plans
- However, Section 115 exempts income derived from the exercise of any essential governmental function

# Public Employee Pension Transparency Act

- H.R. 6290 (115<sup>th</sup>), Rep. Devin Nunes (R-CA)
- S. 2381 (114<sup>th</sup>), Puerto Rico Assistance Act, Finance Committee Chairman Orrin Hatch (R-UT)
- State and local reporting on funded status to federal government for first time in history
- Threatens tax-exempt bonding authority of states and localities for compliance failures

## PEPTA, cont.

- Plan sponsor would submit annual reports to U.S. Treasury Department
- Two sets of calculations:
  - 1) Current assumed rate of return
  - 2) Supplemental report based on Treasury obligation spot yield curve

# Rothification

- Full Roth or limited (e.g., catch-up contributions)
- Dave Camp-style 50% rule
- Significant revenue generation in first 10 years

# Annuity Accumulation Plan

- Also contained in S. 2381 (114<sup>th</sup>)
- Purely optional: Sponsor “may” establish an annuity accumulation retirement plan
- However: It’s being positioned as a replacement for DB plans

## Annuity Plan, cont.

- Individual, deferred, fixed-rate annuities (annual)
- Only employer contributions
- Aspirational ceilings of 30% for public safety; 20% for others; higher limits for certain ages

## Annuity Plan, cont.

### Concerns:

- Replacement income (inconsistent contributions)
- No survivor or disability benefits (public safety)
- New costs: (1) aggregation costs (outside provider or sponsor/fund); (2) transition costs (similar to DB to DC); and (3) new determination letter



# Health Care-Related

- Early age Medicare (for public safety)
  - Age 55 optional buy-in
- HELPS II (IRC Section 402(I))
  - Index \$3k, include all public sector employees, survivor benefit, direct payment rule, and make it deduction-based

# Regulatory Issues

- Normal Retirement Age
- Definition of Governmental Plan

# Normal Retirement Age Regulations

- Proposed rules released on 1/27/16
- Apply to plans that permit in-service distributions prior to age 62
- Additional safe harbors proposed for governmental plans
  - Age 60 and 5 years of service; Age 55 and 10 years of service; Rule of 80; 25+ years of service (with max. age)
  - For public safety: Age 50; Rule of 70 or more; 20+ years of service (with max. age)
- Final rules expected

# Definition of Governmental Plan

- ANPRM released on 11/8/2011
- Facts and circumstances test
- Treasury Notice 2015-7 regarding inclusion of charter school employees in governmental plans
- Proposed rules expected

# Contact Information

Tony Roda, Partner  
Williams & Jensen PLLC  
701 8<sup>th</sup> Street, NW, Suite 500  
Washington, DC 20001  
(202) 659-8201  
[ajroda@wms-jen.com](mailto:ajroda@wms-jen.com)