

**California Society of Municipal Finance Officers
CSMFO**

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**Important Developments and Trends
Affecting Public Sector Pensions, Benefits
Taxation and Other Employment Benefits**

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THE PUBLIC RETIREMENT JOURNAL
The Inside Stories on Retirement in California



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What Will Be Covered Today:



1. The Real Retirement Crisis
2. Pension Reform!? Status of Secure Choice
3. Quick Update: Municipal Bankruptcies and Pensions; Retiree Health Litigation
4. Pension “De-Risking”; GASB; Legislation; Rate Trends and Risk Mitigation
5. When Labor Negotiations and Benefit Elections Create Tax Problems
6. Retirement Plan Compliance Highlights

The Real Retirement Crisis



- 86% of Americans say our country has a retirement crisis
- California LOWEST ranking state in NIRS “Financial Security Scorecard” due to low retirement income, lack of availability of plans, high retiree costs
- 53% of Americans (43% of Californians) are offered any kind of retirement, down from 61% in 1999. 82% of union employees are offered plans. This creates “pension envy.”
- 68% of all working Americans do not participate in any plan (or aren’t offered one).

Pension Reform!?

Initiatives to Blow Up Vested Benefits – Reed / DeMaio



Measure proposes to:

- No More “California Rule”
- No More DB Plans = 401(k) as default
- No More Enhancements
- No More Than 50%
- Potentially Overrides All Collectively Bargained Compensation
- Death & Disability Benefits Impacted
- No More Protections When Closing A Plan

Pension Reform!?

Not 2016, What Now?

- Polling showed 40%
- They are going wait for Friedrich's case
- Scalia dies – lower court rules
- Severely limits union fund base
 - Needs:
 - Positive Title & Summary.
 - \$3 million for starters – signature gathering
 - \$10 million min for ground campaign
- Nationwide Advocacy Group
 - NY Lieutenant Governor
 - Utah Senator
 - Chicago Finance Director
 - Reed
 - City, county, state, federal



Status of Secure Choice SB 1234 – An Update



Secure Choice Retirement Savings Trust

- Final Recommendations: March 28th
- Reco: 5% of salary into a Roth IRA
- 70-90% Compliance rate – 6.8 million Californians
 - Once study is complete, next steps:
 - Final legislative approval
 - Oversight similar to Secure Choice Board
 - 9 Gov appointees, 2 state officers, 2 legislative reps
 - Run similar to CalPERS

Quick Update on Municipal Bankruptcies and Pensions



- Vallejo and Stockton have emerged from bankruptcy
 - Both raised sales taxes
 - Both dramatically cut retiree health (\$100s of millions)
 - Neither cut pensions (Stockton judge said it was doable)
- San Bernardino is still negotiating its exit
 - In October, S.B. Judge Jury asked for more information about pension costs – wondering if a plan w/o pension cuts will survive
- According to 6/13 CalPERS reports (comparing 2013 and 2020-21):
 - Vallejo: safety % from 57.6 to 72 and misc.% from 32.7 to 41.2
 - Stockton: safety from 45.5 to 58.1 and misc. from 22.4 to 29.5
 - S.B.: safety from 38.8 to 49.3 and misc. from 24.2 to 32

Quick Update on Retiree Health Developments/Litigation



- Vallejo, Stockton and San Bernardino bankruptcies all include \$100s millions in retiree health cuts
- GASB 45 requirements keep reminding us of the unfunded obligation
- State retiree health obligations: \$300 million by 2047?
- See LAO proposal in 2015
- See Governor Brown's reference to unfunded liabilities in 2016 State of the State Address: "...so massive that it is tempting to ignore them."

Retiree Health Vesting: The Evolving Case Law



M&G Polymers USA v. Tackett:

- Last year USSC made an important ruling regarding employee benefits – in an ERISA case
- Held that Yardman doctrine, that retiree health benefits may vest upon retirement, is not correct
- “Vesting” of retiree health benefits must be analyzed based on ordinary contract principles (i.e., an explicit agreement to provide ongoing benefits?)
- “When a contract is silent, a court may not infer that the parties intended those benefits to vest for life”
- This case has already been cited in case involving a Michigan city’s retiree health obligations (Harper Woods)

Pension De-Risking; GASB; Legislation; Rate Trends and Risk Mitigation



- 7.5% discount rate
- Gov. wants 6.5%
- Increases above 4% of target, discount rate goes down
- GASB 75 – retiree health care on the books
- Gov. prefunding retiree health
- Irrevocable trusts for both
- Legislative proposals – we shall see on February 19th
 - JPA formations, PEPRA
 - Lower formulas than PEPRA
 - Other “clean up”
 - Would you use an ERI?

When Labor Negotiations and Benefit Elections Create Tax Problems



Five useful case studies:

- How not to do “cost-sharing”
- Elections and pick-ups; two cases
- “Trading” health for deferred comp.
- CODAs and “one-time elections”
- PTO cash-outs – still a problem

How **not** to do “cost-sharing”

- PEPRA and new economic realities are forcing more cost-sharing of what were employer-provided benefits
- Typical labor negotiations involve “horse-trading” or exchange of one benefit (or compensation) for something else
- Most unions want to preserve EPMC: not taxable, but “PERSable”
- Watch out for AOI where union seems to be “directing” pay from one application to another
- See PLR 201551006

Elections and pick-ups

- Popular way to make employee mandatory contributions “pre-tax” is through IRC 414(h) “pick-up”
- Several municipalities/counties are trying to give employees “choice” to make pre-tax contributions in order to keep another benefit (e.g., a level of retiree health)
- A valid “pick-up” requires:
 - Formal written employer action to “pick up” employee contributions
 - No ability to opt out of pick-up and take cash instead

Elections and pick-ups (continued)

- With respect to the second rule – no cash option – IRS may have confused employers/practitioners with a series of earlier PLRs “suggesting” that employees might be able to make a one-time, irrevocable election whether to participate in a picked-up contribution
- Unfortunately, these rulings never looked closely at the “cash or deferred” rules relating to 401(k) plans. Rules permit a one-time, irrevocable election outside of 401(k) rules if made before employee becomes eligible under any retirement plan
- Most local agencies can’t sponsor 401(k)s

Elections and pick-ups (continued)

- PLR 20161013: City gave certain groups a “window” during which to make an irrevocable election to make additional mandatory contributions (that would be picked up) in order to maintain certain retiree health benefits. IRS held: no election allowed in pick-up situation
- PLR 201532036: County wanted to offer employees one-time election to increase mandatory contribution (to be picked up) in order to preserve benefit formula. IRS held: County could not give employees a choice, but could implement on “mandatory” basis
- Look out for PARS arrangements where choice was given; what about other pick-ups where elections given?

“Trading” health for deferred comp.

- Allowing employees to choose between two or more noncash benefits is one way that cities attempt to save
- Recently, a local city gave employees a choice between having \$\$ used to pay health insurance premiums or go into a 457(b) plan – no cash option
- Although there wasn't any constructive receipt, employees who elected nontaxable health benefits in lieu of 457(b) contributions would be taxable under the AOI doctrine. See PLRs 9104050, 9227035, and 9436051
- This could be done on a unilateral, nonelective basis

PTO cash-outs – still a problem

- Although we've talked about it before, we still see too many MOUs and CBAs that permit PTO cash-outs
- See attached article for more details
- You need to look at all of your clients' CBAs to make sure you and they are not perpetuating a huge tax problem for both employer and employees
- Best options?
 - Eliminate cash-out altogether
 - Require election to cash out in year prior to year earned
 - Severely restrict (or possibly penalize) cash-outs; PLR?

Governmental Plan Compliance Highlights



- IRS audits of governmental 457s; (f), (b) and airtime
- Changes in IRS determination letter rules
- Lump-sums and NRA proposed regulations
- Same-sex marriage guidance
- Multiemployer plans; MPRA

Governmental Plan Compliance Highlights (continued)



IRS audits of governmental 457s; (f), (b) and airtime

- We are now seeing the IRS conducting audits of governmental 457 plans and related transactions
 - Triggered by “excessive” deferrals; box 13
 - Looking for hidden 457(f)s
 - Looking at pre-tax add’l service purchases

Governmental Plan Compliance Highlights (continued)



Changes in IRS Determination Letter Rules

- IRS will no longer be issuing determination letters for individually designed plans, except adoption/termination
 - May “push” more sponsors to use “pre-approved”
 - Places more importance on who provides/updates your plan document
 - May result in more “plan document” problems

Governmental Plan Compliance Highlights (continued)



- Lump-Sum Windows for Retirees (now prohibited):
IRS Notice 2015-49
- Proposed NRA Rules for Govt'l Plans (1/27/16)
- Same-sex marriage guidance – IRS Notice 2015-86

Multiemployer Pensions in Big Trouble



- Plan hidden away in a \$1.01 trillion fed bill
- Allows certain ERISA multi-employer pension plans to reduce benefits to retirees
- Pension Benefit Guaranty Corp (PBGC) insurance program:
 - Federal agency bails out private sector employee plans
 - PBGC deficit is \$42.4 billion, up from \$8 billion last year
 - Provides benefits to more than 10 million actives and retirees
- Public agencies that sign on to Taft-Hartley plan can be subject to significant amounts of “withdrawal liability” – critical to understand and, if possible, avoid this

Questions?

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