TRS 3 Member Rate Flexibility

Issue

Should the SCPP recommend legislation to remove Teachers' Retirement System Plan 3 (TRS 3) member rate flexibility?

Background

The Internal Revenue Service (IRS) has re-qualified TRS 3 on the condition that the Legislature removes the statutory provision that allows members to change their rate option every January. The Department of Retirement Systems (DRS) has asked the SCPP to recommend legislation to remove this provision.

Basic Components Of The Plans 3 (TRS 3, SERS 3, PERS 3)

Each of the Plans 3 is made up of two main parts:

- Defined benefit (DB).
- Defined contribution (DC).

The DB portion is a traditional pension where the member receives a benefit that is based on a formula utilizing the member's years of service, and average final salary. For comparison, the DB portion of each plan 3 is the same as plan 2, but half the size.

Only the employer makes contributions toward the DB portion of a plan 3. Contribution rates for the DB portion are recommended by the SCPP, and set by the Pension Funding Council and the Legislature.

The DC portion is similar to a 401(k) in that contributions are made to an individual retirement account. Those contributions are invested, and at retirement the member receives the funds in that account.

Only the member contributes to the DC portion. The contribution rate is selected by the member from a list of options.[1] All Plans 3 members must choose a rate option within 90 days of being hired into an eligible position,[2] or be defaulted into a contribution rate of 5 percent (Option A).

For members of Public Employees' Retirement System Plan 3 (PERS 3) and School Employees' Retirement System Plan 3 (SERS 3) this is a permanent selection, as members can only change rates when they switch employers.

[1] See Attachment A.
[2] See WAC 415-111-220(4).

Only TRS 3 members are able to change their rate option.[3] Specifically, they can change in January of each year by notifying their employer in writing.

Other Options

The Plans 3 contribution rate options are not the only way for members to choose their overall contribution rate. Many members of the state retirement plans also have access to at least two other savings vehicles that allow for rate flexibility: The Deferred Compensation Program and Tax-Sheltered Annuities.

- Deferred Compensation Program (DCP).[4]

  The DCP is a defined contribution plan established under Internal Revenue Code (IRC) 457. The DCP is available for most public employees in Washington, including teachers.

  The DCP is pre-tax, and participants can change their contribution rate at any time. Contributions are subject to a yearly cap, but "catch up provisions" allow members to contribute in excess of the cap if they are over age 55, or within three years of normal retirement age.

- Tax-Sheltered Annuity (TSA).

  TSA's are defined contribution plans established under IRC 403(b). They are available for most teachers in Washington, as well as certain 501(c)(3) organizations and some members of the clergy.

  These plans are pre-tax, and participants can generally determine how much they want to contribute. That said, the structure of TSA's can vary, and certain provisions may be collectively bargained.

Plan Qualification

A plan must be qualified in order to receive favorable tax status under the IRC.[5] At the highest level, qualification requires the plan documents to be compliant with regulations (i.e. on paper), and for the plan to be administered in compliance with regulations (i.e. in practice).

Determination letters are advance statements of the IRS' opinion as to whether or not the plan meets the requirements on paper. Generally, if the employer operates the plan according to the terms of approved plan documents then the plan will be qualified in practice as well.[6]

IRS regulations are too complex to detail here, but generally include things like provisions to protect member contributions and benefits. IRS regulations are also not

[3] See WAC 415-111-220(8).
[4] For more information, please see the DCP website.
[5] Governmental plans are defined in IRC 414(d), and regulated under IRC 401.
[6] For more information, please see "What is a Favorable Determination Letter?" on the IRS website.

the only source of regulations for a plan. Plan administrators must also consider other federal laws (e.g. the Employee Retirement Income Security Act, to the extent it applies to governmental plans) and state laws.

Possible Implications Of Disqualification

Plan disqualification can result in a loss of favorable tax status, but it is difficult to gauge precisely what the full scope of impacts would be.

Based on IRS publications and discussions with DRS, staff has identified three potential impacts from disqualification:

- Both Plan 2 and Plan 3 may be affected.
- Yearly taxation of plan earnings.
- Taxation of plan contributions.

Both Plan 2 And Plan 3 May Be Affected

The IRS considers each Plan 3 to be a DB plan with a DC component. The IRS also considers each Plan 2/3 combination to be a single plan with two benefit tiers. This is because they share a common trust fund, as follows:

- TRS 2 shares a common trust fund with TRS 3 = one plan.
- PERS 2 shares a common trust fund with PERS 3 = one plan.
- SERS 2 shares a common trust fund with SERS 3 = one plan.

Thus, any impact from disqualification may affect both Plan 2 and its companion Plan 3.

Taxation Of Plan Contributions

If the plan were disqualified, all contributions (employer and member) made on behalf of a member would be considered taxable income (i.e. post-tax) and subject to withholding.

Yearly Taxation Of Plan Earnings

If the plan were disqualified, members would be taxed yearly on plan earnings. This generally refers to any investment returns earned on contributions to the plan; both member and employer contributions.

History Of Rate Flexibility Provision

As noted above, all Plans 3 members select a rate option after enrollment, but only TRS 3 members can change that rate option each year. This ability to change rate options was not part of the original Plans 3 design.

When rate flexibility was enacted in statute in 2003[7] it encompassed PERS 3, SERS 3, and TRS 3. The fact that only TRS 3 members can utilize the option is the result of a complicated series of events involving IRS plan qualification.[8]

- In 2000, DRS submitted TRS 3 to the IRS for plan qualification. The submission included a proposal to enact rate flexibility.
- In 2002, the IRS qualified TRS 3. DRS then submitted PERS 3 and SERS 3 for qualification. This submission included the same proposal for rate flexibility.
- In 2003, the Chapter 156, Laws of 2003 amended Plans 3 statutes to include rate flexibility. Not long afterward, the IRS then struck down the rate flexibility provision for PERS 3 and SERS 3. No PERS 3 or SERS 3 members were allowed to utilize the option.
- In 2009, DRS submitted TRS 3 for re-qualification. This submission included the rate flexibility provision in statute.
- In 2013, the IRS re-qualified TRS 3, contingent on legislative removal of member rate flexibility.

Recent IRS Determination Letter

In February 2013, the IRS re-qualified TRS 3. However, this qualification was contingent on the Legislative removal of the statutory provision that allows TRS 3 members to change their rate options every January.

The most recent IRS determination letter included the following timetable:[9]

- A law must be passed and signed in 2014 legislative session.
- DRS must complete the related rulemaking within 91 days of session.
- The final rate selection option for members is January 2015.

Committee Activity

Following the July 23, 2013, SCPP meeting, the Executive Committee scheduled a work session with possible executive action.

Additional Materials

- Rate data.
- DRS materials.

[7] Chapter 156, Laws of 2003
[8] See Attachment B.
[9] The timetable was incorporated by reference to an amendment plan submitted by counsel to the IRS. See Attachment B.

Staff Contact

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Attachment A

Rate Options

Rate Option		Total Rate
Option A (Default)		5.0%
Option B		
	Until age 35	5.0%
	Age 35 to 44	6.0%
	Age 45 and up	7.5%
Option C		
	Until age 35	6.0%
	Age 35 to 44	7.5%
	Age 45 and up	8.5%
Option D		7.0%
Option E		10.0%
Option F		15.0%

Rate Selection Options for PERS 3, SERS 3, and TRS 3

Plan 3 Contribution Rate Selected For Current Members

Data as of March 22, 2013

Contribution Rate Selected	PERS 3		SERS 3		TRS 3		Grand Total	
	Count	Percent	Count	Percent	Count	Percent	Count	Percent
A – 5%	17,169	61%	19,718	63%	21,024	39%	57,912	51%
B – 5%, 6%, 7.5%	3,199	11%	2,612	8%	6,730	12%	12,541	11%
C – 6%, 7.5%, 8.5%	2,385	8%	1,634	5%	7,598	14%	11,617	10%
D – 7%	1,784	6%	2,577	8%	6,090	11%	10,451	9%
E – 10%	2,243	8%	3,065	10%	7,008	13%	12,316	11%
F – 15%	1,503	5%	1,845	6%	5,603	10%	8,951	8%
Grand Total	**28,283**	**100%**	**31,451**	**100%**	**54,053**	**100%**	**113,789**	**100%**

Notes: A "current Plan 3 member" means a member in a Plan 3 who does not have a separation date reported. Data provided by the Department of Retirement Systems. Participants in Option A may have selected that option or defaulted. Default can occur actively or passively.

Rate Choice Data

TRS 3 Contribution Rate Changes			
Data As Of January 23, 2013			
Year of Rate Change	**Contribution Rate Decreased**	**Contribution Rate Increased**	**Total Changes**
2004	1,138	3,135	4,273
2005	602	1,069	1,671
2006	654	1,245	1,899
2007	565	1,341	1,906
2008	585	1,348	1,933
2009	1,074	1,057	2,131
2010	729	1,038	1,767
2011	715	1,136	1,851
2012	659	934	1,593
2013	551	1,201	1,752
Grand Total	**7,272**	**13,504**	**20,776**
Percentages	**35%**	**65%**	

Notes: The counts are for employment periods (EMSPs) that have more than one rate code. The counts do not include members who separated and changed their contribution rate upon reemployment.

INTERNAL REVENUE SERVICE
P. O. BOX 2508
CINCINNATI, OH 45201

DEPARTMENT OF THE TREASURY

RECEIVED FEB 19 2013

Date: FEB 15 2013

Employer Identification Number:
91-6001129
DLN:
17007026052029
Person to Contact:
SYLVAN OPPENHEIMER
Contact Telephone Number:
(410) 962-9479
Plan Name:
WASHINGTON STATE TEACHERS
RETIREMENT SYSTEM 2-3
Plan Number: 002

ID# 52729

STATE OF WASHINGTON
C/O ICE MILLER LLP
TERRY A M MUMFORD
ONE AMERICAN SQUARE STE 2900
INDIANAPOLIS, IN 46282-0200

Dear Applicant:

We have made a favorable determination on the plan identified above based on the information you have supplied. Please keep this letter, the application forms submitted to request this letter and all correspondence with the Internal Revenue Service regarding your application for a determination letter in your permanent records. You must retain this information to preserve your reliance on this letter.

Continued qualification of the plan under its present form will depend on its effect in operation. See section 1.401-1(b)(3) of the Income Tax Regulations. We will review the status of the plan in operation periodically.

The enclosed Publication 794 explains the significance and the scope of this favorable determination letter based on the determination requests selected on your application forms. Publication 794 describes the information that must be retained to have reliance on this favorable determination letter. The publication also provides examples of the effect of a plan's operation on its qualified status and discusses the reporting requirements for qualified plans. Please read Publication 794.

This letter relates only to the status of your plan under the Internal Revenue Code. It is not a determination regarding the effect of other federal or local statutes.

This determination letter gives no reliance for any qualification change that becomes effective, any guidance published, or any statutes enacted, after the issuance of the Cumulative List (unless the item has been identified in the Cumulative List) for the cycle under which this application was submitted.

This letter may not be relied on after the end of the plan's first five-year remedial amendment cycle that ends more than 12 months after the application was received. This letter expires on January 31, 2014. This letter considered the 2007 Cumulative List of Changes in Plan Qualification Requirements.

This determination letter is applicable for the amendment(s) executed

Letter 2002 (DO/CG)

STATE OF WASHINGTON

on January 25, 2013.

This determination letter is based solely on your assertion that the plan is entitled to be treated as a Governmental plan under section 414(d) of the Internal Revenue Code.

This determination letter is applicable to the plan and related documents submitted in conjunction with your application filed during the remedial amendment cycle ending January 31, 2009.

The information on the enclosed addendum is an integral part of this determination. Please be sure to read and keep it with this letter.

We have sent a copy of this letter to your representative as indicated in the Form 2848 Power of Attorney or appointee as indicated by the Form 8821 Tax Information Authorization.

If you have questions concerning this matter, please contact the person whose name and telephone number are shown above.

Sincerely,

Andrew E. Zuckerman
Director, EP Rulings & Agreements

Enclosures:
Publication 794
Addendum

Letter 2002 (DO/CG)

STATE OF WASHINGTON

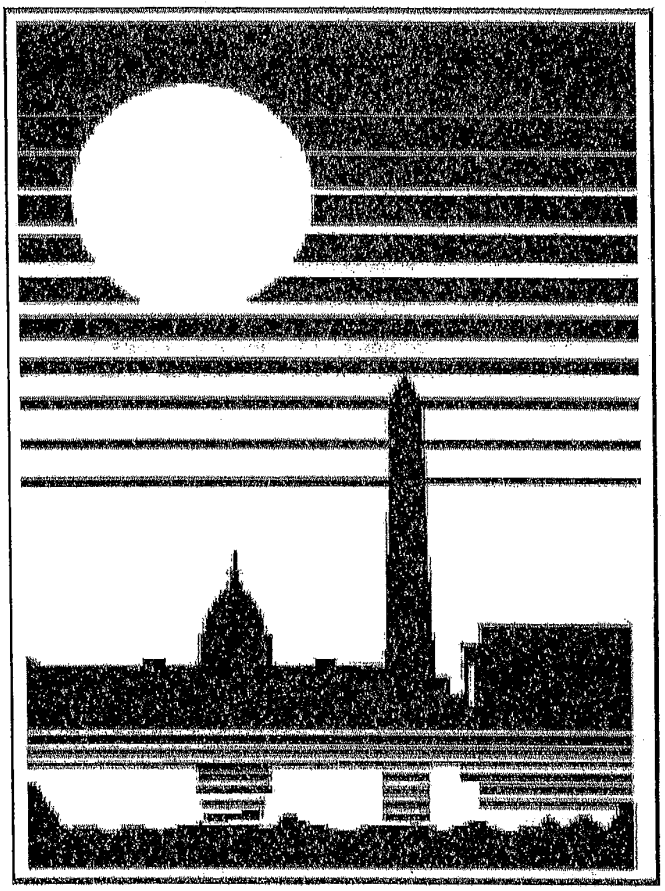
Although an amendment was required to the pick up section of the plan in order to achieve compliance with IRC Sections 401(a) & 401(k), we reiterate that the letter does not express an opinion on whether contributions made to a plan treated as a governmental plan defined in IRC Section 414(d) constitute employer contributions under IRC Section 414(h)(2). If you wish for a ruling on the pick up provisions, a private letter ruling will need to be submitted in accordance with Revenue Procedure 2013-4.

Letter 2002 (DO/CG)

Department of the Treasury Internal Revenue Service

Publication 794
(Rev. October 2010)
Catalog Number 20630M

Favorable Determination Letter



Introduction

This publication explains the significance of your favorable determination letter, points out some features that may affect the qualified status of your employee retirement plan and nullify your determination letter without specific notice from us, and provides general information on the reporting requirements for your plan.

Significance of a Favorable Determination Letter

An employee retirement plan qualified under Internal Revenue Code (IRC) section 401(a) (qualified plan) is entitled to favorable tax treatment. For example, contributions made in accordance with the plan document are generally currently deductible. However, participants will not include these contributions in income until the time they receive a distribution from the plan, at which time special income averaging rates for lump sum distributions may serve to reduce the tax liability. In some cases, taxation may be further deferred by rollover to another qualified plan or individual retirement arrangement. (See Publication 575, Pension and Annuity Income, for further details.) Finally, plan earnings may accumulate tax free. Employee retirement plans that fail to satisfy the requirements under IRC section 401(a) are not entitled to favorable tax treatment. Therefore, many employers desire advance assurance that the terms of their plans satisfy the qualification requirements.

The Internal Revenue Service provides such advance assurance through the determination letter program. A favorable determination letter indicates that, in the opinion of the IRS, the terms of the plan conform to the requirements of IRC section 401(a). A favorable determination letter expresses the IRS's opinion regarding the form of the plan document. However, to be a qualified plan under IRC section 401(a) entitled to favorable tax treatment, a plan must satisfy, in both form and operation, the requirements of IRC section 401(a), including nondiscrimination and coverage requirements. A favorable determination letter may also provide assurance, on the basis of information and demonstrations provided in your application, that the plan satisfies certain of these nondiscrimination and coverage requirements in form or operation. See the following topic, Limitations and Scope of a Favorable Determination Letter, for more details.

Limitations and Scope of a Favorable Determination Letter

A favorable determination letter is limited in scope. A determination letter generally applies to qualification requirements regarding the form of the plan. A determination letter may also apply to certain operational (non-form) requirements.

Generally, a favorable determination letter does not consider, and may not be relied on with regard to:
- certain requirements under IRC section 401(a)(4), including the requirement that the plan be nondiscriminatory in the amounts of contributions or benefits for highly compensated and nonhighly compensated employees;
- the coverage requirements under IRC sections 410(b) and 401(a)(26); and
- the definition of compensation under IRC section 414(s).

In addition, a favorable determination letter may not be relied on for any qualification changes that becomes effective, any guidance published, or any statutes enacted, after the issuance of the applicable Cumulative List of Changes in Plan Qualification Requirements (Cumulative List) unless the item has been identified in that Cumulative List for the cycle under which the application was submitted. See section 4 of Revenue Procedure (Rev. Proc.) 2007-44, 2007-28 I.R.B. 54.

However, if you requested one or more of the optional nondiscrimination and coverage determinations offered on the determination letter application forms (Form 5300, Form 5307, Schedule Q), your favorable determination letter considers, and may be relied on, with regard to the specific determination(s) you requested, provided you satisfy the following requirement: you must retain copies of the application forms, any required demonstrations, and all correspondence with the IRS Revenue Service related to the application for a favorable determination letter. **A favorable determination letter cannot be relied on with regard to any optional determination request unless all of the required information is retained.**

In addition, the following apply generally to all determination letters:

- If you maintain two or more retirement plans, some of which were either not submitted to the IRS for determination or not disclosed on each application, certain limitations and requirements will not have been considered on an aggregate basis. Therefore, you may not rely on the determination letter regarding the plans when considered as a total package.

- A determination letter for a defined benefit plan may be relied on regarding the requirements of IRC section 401(a)(26) if the application requested a determination regarding section 410(b).

- A determination letter does not consider the special requirements relating to: (a) affiliated service groups, (b) leased employees, or (c) plan assets or liabilities involved in a merger, consolidation, spin-off or transfer of assets with another plan unless the letter includes a statement that the requirements of IRC section 414(m) (affiliated service groups), or 414(n) (leased employees) has been considered.

- No determination letter may be relied on with respect to the effective availability of benefits, rights, or features under the plan. (See section 1.401(a)(4)-4(c) of the Income Tax Regulations.) Reliance on whether benefits, rights, or features are currently available to a non-discriminatory group of employees is provided to the extent requested in the application.

- A determination letter does not consider whether actuarial assumptions are reasonable for funding or deduction purposes or whether a specific contribution is deductible.

- A determination letter does not consider, and may not be relied on with respect to, certain other matters described in section 5 of Rev. Proc. 2009-6, 2009-1 I.R.B. 189 (i.e., whether a plan amendment is part of a pattern of amendments that significantly discriminates in favor of highly compensated employees; the use of the substantiation guidelines contained in Rev. Proc. 93-42, 1993-31 I.R.B. 32; and certain qualified separate lines of business requirements of IRC section 414(r)).

- The determination letter applies only to the employer and its participants on whose behalf the determination letter was issued.

- A determination letter does not express an opinion whether disability benefits or medical care benefits are acceptable as accident or health plan benefits deductible under IRC section 105 or 106.

- A determination letter does not express an opinion on whether the plan is a governmental plan defined in IRC section 414(d).

- A determination letter does not express an opinion on whether contributions made to a plan treated as a governmental plan defined in IRC section 414(d) constitute employer contributions under IRC section 414(h)(2), nor on whether a governmental excess benefit arrangement satisfies the requirements of IRC section 415(m).

You should become familiar with the terms of the determination letter. Please call the contact person listed on the determination letter if you do not understand any terms in your determination letter.

Retention of information. Whether a plan meets the qualification requirements is determined from the information in the written plan document, the application form and the supporting information submitted by the employer. **Therefore, you must retain copies of any demonstrations or other information submitted with your application. Such demonstrations determine the extent of reliance provided by your determination letter. Failure to retain such information may limit the scope of reliance on issues for which demonstrations were provided.**

Other conditions for reliance. We have not verified the information submitted with your application. The determination letter will not provide reliance if:

(1) there has been a mistatement or omission of material facts, (for example, the application indicated that the plan was a governmental plan and it was not a governmental plan);

(2) the facts subsequently developed are materially different than the facts on

which the determination was made; or

(3) there is a change in applicable law.

Law changes affecting the plan. A determination issued to an adopting employer of an individually designed plan will be based on the most recent Cumulative List published prior to the one year period starting February 1st and ending January 31st in which the determination letter application was filed. The Cumulative List is a list published annually by the IRS that identifies on a year-by-year basis all changes in the qualification requirements resulting from statute changes, regulations, or other guidance published in the Internal Revenue Bulletin that are required to be taken into account in the written plan document. See sections 4, 13, and 14 of Rev. Proc. 2007-44 for further details. Generally, a determination letter issued to an adopting employer of a pre-approved plan (i.e., Master & Prototype (M&P) plan or volume submitter (VS) plan) will be based on the Cumulative List used by the IRS in reviewing the pre-approved plan. However, see section 19 of Rev. Proc. 2007-44 for exceptions to this rule. For terminating plans, a determination letter is based on the law in effect at the time of the plan's proposed date termination. See Section 8 of Rev. Proc. 2007-44.

Amendments to the plan. A favorable determination letter issued to an individually designed plan will provide reliance up to and including the expiration date identified on the determination letter. This reliance is conditioned upon the timely adoption of any necessary interim amendments as required by section 5.04 of Rev. Proc.2007-44. A favorable determination letter issued to an adopting employer of a preapproved plan will provide reliance up to and including the last day of the six-year cycle following the six-year remedial amendment cycle in which the determination letter application was filed. The reliance is conditioned upon the timely adoption of any necessary interim amendments as required by section 5.04 of Rev. Proc. 2007-44. Also see Rev. Proc. 2005-16, 2005-10 I.R.B. 674 sections 5.01 and 15.05 and Announcement 2005-37, 2005-21 I.R.B. 1096.

Plan Must Qualify in Operation

Generally, a plan qualifies in operation if it continues to satisfy the coverage and nondiscrimination requirements and is maintained according to the terms on which the favorable determination letter was issued. Changes in facts and other basis on which the determination letter was issued may mean that the determination letter may no longer be relied upon.

Some examples of the effect of a plan's operation on a favorable determination are:

Not meeting nondiscrimination in amount requirement. If the determination letter application requested a determination that the plan satisfies the nondiscrimination in amount requirement of section 1.401(a)(4)-1(b)(2) of the regulations on the basis of a design-based safe harbor, the plan will generally continue to satisfy this requirement in operation if the plan is maintained according to its terms. If the determination letter application requested a determination that the plan satisfies the nondiscrimination in amount requirement on the basis of a nondesign-based safe harbor or a general test, and the plan subsequently fails to meet this requirement in operation, the favorable determination letter may no longer be relied upon with respect to this requirement.

Not meeting minimum coverage requirements. If the determination letter application includes a request for a determination regarding the ratio percentage test of IRC section 410(b) and the plan subsequently fails to satisfy the ratio percentage test in operation, the letter may no longer be relied upon with respect to the coverage requirements. Likewise, if the determination letter application requests a determination regarding the average benefit test, the letter may no longer be relied on with respect to the coverage requirements once the plan fails to satisfy the average benefit test in operation.

Changes in testing methods. If the determination letter is based in part on a demonstration that a coverage or nondiscrimination requirement is satisfied, and, in the operation of the plan, the method used to test that this requirement continues to be satisfied is changed (or is required to be changed because the facts have changed) from the method employed in the demonstration, the letter may no longer be relied upon with respect to this requirement.

Contributions or benefits in excess of the limitations under IRC section 415. A retirement plan may not provide retirement benefits or, in the case of a defined contribution plan, contributions and other additions, that exceed the limitations specified in IRC section 415. Your plan contains provisions designed to provide benefits within these limitations. Please become familiar with these limitations, for your plan will be disqualified if these limitations are exceeded.

Top-heavy minimums. If this plan primarily benefits employees who are key employees, it may be a top-heavy plan and must provide certain minimum benefits and vesting for non-key employees. If your plan provides the accelerated benefits and vesting only for years during which the plan is top-heavy, failure to identify such years and to provide the accelerated vesting and benefits will disqualify the plan.

Actual deferral percentage or contribution percentage tests. If this plan provides for cash or deferred arrangements, employer matching contributions, or employee contributions, the determination letter does not consider whether special discrimination tests described in IRC section 401(k)(3) or 401(m)(2) have been satisfied in operation. However, the letter considers whether the terms of the plan satisfy the section 401(k)(3) or 401(m)(2) requirements specified in IRC section 401(k)(3) or 401(m)(2).

Reporting Requirements

Most plan administrators or employers who maintain an employee benefit plan must file an annual return/report. The following is a general discussion of the forms to be used for this purpose. See the instructions to each form for specific information:

Form 5500-EZ Annual Return of One-Participant (Owners and their Spouses) Pension Benefit Plans - generally for a "one-participant" plan, which is a plan that covers only:

(1) an individual, or an individual and his or her spouse who wholly own a business, whether incorporated or not; or
(2) partner(s) in a partnership or the partner(s) and the partner's spouse.

If Form 5500-EZ cannot be used, the one-participant plan should use Form 5500, Annual Return/Report of Employee Benefit Plan.

See Instructions to Form 5500-EZ for specific rules.

Note: A "one-participant" plan that has no more than $250,000 in assets at the end of the plan year is not required to file a return. However, Form 5500-EZ must be filed for any subsequent year in which plan assets exceed $250,000. If two or more one-participant plans have more than $250,000 in assets, a separate Form 5500-EZ must be filed for each plan.

Instead of filing the paper Form 5500-EZ, plan administrators or employers may choose to file electronically using Form 5500-SF. Detailed information for electronic filing is available in the 2009 Instructions for Form 5500-EZ or at www.efast.dol.gov.

A "Final" Form 5500-EZ must be filed if the plan is terminated.

Form 5500, Annual Return/Report of Employee Benefit Plan – for a pension benefit plan that is not eligible to file Form 5500-EZ.

Note. Keogh (H.R. 10) plans having over $250,000 in assets are required to file an annual return even if the only participants are owner-employees. The term "owner- employee" includes a partner who owns more than 10% interest in either the capital or profits of the partnership. This applies to both defined contribution and defined benefit plans.

Form 5330 for prohibited transactions. Transactions between a plan and someone having a relationship to the plan (disqualified person) are prohibited, unless specifically exempted from this requirement. A few examples are loans, sales and exchanges of property, leasing of property, furnishing goods or services, and use of plan assets by the disqualified person. Disqualified persons who engage in a prohibited transaction for which there is no exception must file Form 5330 by the last day of the seventh month after the end of the tax year of the disqualified person.

Form 5330 for tax on nondeductible employer contributions to qualified plans - If contributions are made to this plan in excess of the amount deductible, a tax may be imposed upon the excess contribution. Form 5330 must be filed by the last day of the seventh month after the end of the employer's tax year.

Form 5330 for tax on excess contributions to cash or deferred arrangements or excess employee contributions or employer matching contributions - If a plan includes a cash or deferred arrangement (IRC section 401(k)) or provides for employee contributions or employer matching contributions (IRC section 401(m)), then excess contributions that would cause the plan to fail the actual deferral percentage or the actual contribution percentage test are subject to a tax unless the excess is eliminated within 2½ months after the end of the plan year. Form 5330 must be filed by the due date of the employer's tax return for the plan year in which the tax was incurred.

Form 5330 for tax on reversions of plan assets - Under IRC section 4980, a tax is payable on the amount of almost any employer reversion of plan assets. Form 5330 must be filed by the last day of the month following the month in which the reversion occurred.

Form 5310-A for certain transactions - Under IRC section 6058(b), an actuarial statement is required at least 30 days before a merger, consolidation, or transfer (including spin-off) of assets to another plan. This statement is required for all plans. However, penalties for non-filing will not apply to defined contribution plans for which:

(1) The sum of the account balances in each plan equals the fair market value of all plan assets,
(2) The assets of each plan are combined to form the assets of the plan as merged,
(3) Immediately after a merger, the account balance of each participant is equal to the sum of the account balances of the participant immediately before the merger, and
(4) The plans must not have an unamortized waiver or unallocated suspense account.

Penalties will also not apply if the assets transferred are less than three percent of the assets of the plan involved in the transfer (spinoff), and the transaction is not one of a series of two or more transfers (spinoff transactions) that are, in substance, one transaction.

The purpose of the above discussions is to illustrate some of the principal filing requirements that apply to pension plans. This is not an exclusive listing of all returns and schedules that must be filed.

GPO U.S. GOVERNMENT PRINTING OFFICE: 2010—647-607

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January 25, 2012

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VIA FACSIMILE (513) 263-3255

Mr. Jeff Nelson
Internal Revenue Service
550 Main Street
Room 2023
Cincinnati, OH 45202

RE: Washington TRS Plan 2-3 Annual Rate Flexibility
EIN: 91-6001129; PN: 002
DLN: 17007-026-05202-9

Washington PERS Plan 2-3
EIN: 91-6001058; PN: 003
DLN: 17007-026-05200-9

Washington SERS Plan 2-3
EIN: 91-2030361; PN: 004
DLN: 17007-026-05201-9

Dear Mr. Nelson:

This letter address the TRS Plan 2-3 annual rate flexibility issue that you recently discussed with Mary Beth and the determination letters for all three Washington State Plans that are still pending -- TRS Plan 2-3, PERS Plan 2-3, and SERS Plan 2-3.

I. TRS 2-3 Annual Rate Flexibility

Pursuant to our conversation, we have enclosed an updated timeline for curtailment of the rate flexibility in TRS Plan 3. We have kept the same action items that we had in our May 6, 2011 package. However, we have moved the dates, assuming a final issuance of the IRS determination letter on or before April 1, 2013. As you will see, under Rev. Proc. 2009-36, this means that the last election will occur January 2015.

The contribution flexibility issue is only applicable to TRS 2-3. It is not a feature that is available in PERS 2-3 or SERS 2-3.

We have also enclosed the proposed amendments that would be adopted as part of this process. Both legislative and regulatory changes are required.

II. Determination Letters

We have checked our files and we wish to provide you with the following information to assist you in preparing the "caveat" for each determination letter and also to provide you with information about supplements that were provided.

A. TRS 2-3

Caveats. Proposed amendments were submitted as follows with respect to TRS 2-3:

- With the original submission dated January 21, 2009; and
- With an additional submission dated October 15, 2010.

The determination letter for TRS 2-3 may be caveated for these proposed amendments. However, we can report to you that they have been adopted.

In addition, the TRS 2-3 determination letter would contain a caveat for the proposed amendment related to contribution flexibility. We would also ask that the caveat reflect the timetable enclosed with this submission.

Supplements. The TRS 2-3 filing was supplemented four times on the following dates with final amendments to the plan document. We wanted to list those supplements here so that you would be able to determine whether the file that you have is complete:

- October 15, 2010 (providing final amendments to the plan document and answering specific questions presented by IRS);
- December 16, 2010 (describing 2010 second special session legislation);
- July 7, 2011 (describing 2011 legislative changes); and
- February 7, 2012 (permanent rule changes).

B. PERS 2-3

Caveats. Proposed amendments were submitted as follows with respect to TRS 2-3:

- With the original submission dated January 21, 2009; and
- With an additional submission dated October 15, 2010.

The determination letter for PERS 2-3 may be caveated for these proposed amendments. However, we can report to you that they have been adopted.

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Supplements. The PERS 2-3 filing was supplemented four times on the following dates with final amendments to the plan document. We wanted to list those supplements here so that you would be able to determine whether the file that you have is complete:

- October 15, 2010 (providing final amendments to the plan document and answering specific questions presented by IRS);
- December 16, 2010 (describing 2010 second special session legislation);
- July 7, 2011 (describing 2011 legislative changes); and
- February 7, 2012 (permanent rule changes).

C. SERS 2-3

Caveats. Proposed amendments were submitted as follows with respect to SERS 2-3:

- With the original submission dated January 21, 2009; and
- With an additional submission dated October 15, 2010.

The determination letter for SERS 2-3 may be caveated for these proposed amendments. However, we can report to you that they have been adopted.

Supplements. The SERS 2-3 filing was supplemented three times on the following dates with final amendments to the plan document. We wanted to list those supplements here so that you would be able to determine whether the file that you have is complete:

- October 15, 2010 (providing final amendments to the plan document and answering specific questions presented by IRS);
- July 7, 2011 (describing 2011 legislative changes); and
- February 7, 2012 (permanent rule changes).

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Please let us know if you have any questions.

Very truly yours,

ICE MILLER LLP

Mary Beth Braitman

Mary Beth Braitman

Terry A.M. Mumford

Terry A.M. Mumford

MBB/TAMM/mlf
Attachment: Timeline; Amendments

cc *(via e-mail)*: Anne Hall
Sarah Blocki
Marcie Frost
David Nelsen

I/3051019.4

PLAN TO AMEND TRS PLAN 2-3 ANNUAL RATE FLEXIBILITY

BACKGROUND

The Internal Revenue Service ("IRS") intends to issue a favorable determination letter for TRS Plan 2-3 contingent on the adoption of amendments to RCW 41.34.040 and WAC 415-111-220(8) to remove the annual rate flexibility. TRS 2-3 is a governmental pension plan. Therefore, under Rev. Proc. 2009-36, the plan amendment must be adopted no later than 91 days after the close of the legislative session that begins 120 days after the issuance of the letter.

The 2013 legislative session began January 15, 2013. Therefore, the required plan amendments must be adopted 91 days after the close of the next legislative session, which begins in 2014. That legislative session will begin mid-January 2014 and is a 60 day session. This means that the amendment to RCW 41.34.040 would be adopted in the 2014 session and the amendment to WAC 415-111-220(8) would be adopted no later than 91 days after the end of that session. With the adoption of the legislative amendment in the 2014 session and the adoption of the regulatory amendment 91 days later, the both amendments should be adopted in June 2014. This would mean that the final election would occur in January 2015.

TIMELINE FOR PLAN TO AMEND TRS PLAN 3 ANNUAL RATE FLEXIBILITY

The following is the proposed draft timeline of the Department to effect the IRS required change.

When	Action
Post-2013 Session	Work with Select Committee on Pension Policy and necessary stakeholders to obtain their approval of the legislative amendment and their recommendation for adoption.
January-March 2014	Introduce legislation and move amendment through the legislative process
Post-2104 Session	Obtain Governor's signature of legislative amendment
April-August 2014	Develop communications to go in stakeholder newsletters, quarterly statements, employer-provided communications, etc.
May 2014	File WAC amendment. The process to adopt changes to rules is governed by the Revised Code of Washington and the Washington Administrative Code, and includes certain requirements and mandatory timelines for elements of rule adoption.

- This process requires advance filing times, mandatory wait periods at various stages of the process, and public hearing and comment.

- The amending of rules about rate flexibility would be complex, and require coordination with legal advisers and stakeholders, prior to public hearing.

August-November 2014

Deliver stakeholder/employer communications about upcoming change.

There are more than 50,000 members in the TRS Plan 2-3. Effective communication about the removal of the annual rate flexibility and the implementation of a final, irrevocable rate choice would require the following:

- Notification via the TRS Plan2-3 Quarterly Statements

- Posting of information on the DRS Website

- Tailored communication to employers for distribution to TRS Plan 3 employees

October-December 2014

Deliver message of change at stakeholder meetings, DRS training events for employers and members, etc.

- Coordination with the Washington Education Association (WEA) and the American Federation of Teachers (AFT) to include articles in their newsletters regarding the change

- Presentations at WEA and AFT meetings, as well as employer-sponsored events

January 2015

Final rate choice window. The rate structure chosen by existing Plan 3 members will be irrevocable. The rate structure chosen by new members at hire will also be irrevocable.

Proposed Amendment 1/25/2013

RCW 41.34.040 Contributions — Rate structures — Annual option.

(1) A member shall contribute from his or her compensation according to one of the following rate structures in addition to the mandatory minimum five percent:

	Contribution Rate
Option A	
All Ages	0.0% fixed
Option B	
Up to Age 35	0.0%
Age 35 to 44	1.0%
Age 45 and above	2.5%
Option C	
Up to Age 35	1.0%
Age 35 to 44	2.5%
Age 45 and above	3.5%
Option D	
All Ages	2.0%
Option E	
All Ages	5.0%
Option F	
All Ages	10.0%

(2) The department shall have the right to offer contribution rate options in addition to those listed in subsection (1) of this section, provided that no significant additional administrative costs are created. All options offered by the department shall conform to the requirements stated in subsections (3) and (5) of this section.

(3)(a) For members of the teachers' retirement system entering plan 3 under RCW 41.32.835 or members of the school employees' retirement system entering plan 3 under RCW 41.35.610, within ninety days of becoming a member he or she has an option to choose one of the above contribution rate structures. If the member does not select an option within the ninety-day period, he or she shall be assigned option A.

(b) For members of the public employees' retirement system entering plan 3 under RCW 41.40.785, within the ninety days described in RCW 41.40.785 an employee who irrevocably chooses plan 3 shall select one of the above contribution rate structures. If the member does not select an option within the ninety-day period, he or she shall be assigned option A.

(c) For members of the teachers' retirement system transferring to plan 3 under RCW 41.32.817, members of the school employees' retirement system transferring to plan 3 under RCW 41.35.510, or members of the public employees' retirement system transferring to plan 3 under RCW 41.40.795, upon election to plan 3 he or she must choose one of the above contribution rate structures.

(d) Within ninety days of the date that an employee changes employers, he or she has an option to choose one of the above contribution rate structures. If the member does not select an option within this ninety-day period, he or she shall be assigned option A.

(4) Each year, through January of 2015, members of plan 3 of the teachers' retirement system may change their contribution rate option by notifying their employer in writing during the month of January. After January of 2015, a member of plan 3 of the teachers' retirement system may only change their contribution rate option under the provisions of paragraph 3(b) of this section. The termination of this annual contribution rate change option in January 2015 is required to meet plan qualification requirements in section 401(a) of the Internal Revenue Code. Consistent with plan qualification requirements in the Internal Revenue Code, this annual contribution rate change option has never been available to plan 3 members of the public employees' retirement system and the school employees' retirement system.

(5) Contributions shall begin the first day of the pay cycle in which the rate option is made, or the first day of the pay cycle in which the end of the ninety-day period occurs.

WAC 415-111-220 How do I choose a defined contribution rate?
(1) **Contribution rates:** If you are a member of the Teachers' Retirement System (TRS) Plan 3, the School Employees' Retirement System (SERS) Plan 3, or the Public Employees' Retirement System (PERS) Plan 3, you are required to contribute from your compensation according to one of the following rate structures:

	Base Rate	Additional Rate	Total Contribution Rate
Option A			
All ages	5.0%	0.0%	5.0%
Option B			
Up to age 35	5.0%	0.0%	5.0%
Age 35 to 44	5.0%	1.0%	6.0%
Age 45 and above	5.0%	2.5%	7.5%
Option C			
Up to age 35	5.0%	1.0%	6.0%
Age 35 to 44	5.0%	2.5%	7.5%
Age 45 and above	5.0%	3.5%	8.5%
Option D			
All ages	5.0%	2.0%	7.0%
Option E			
All ages	5.0%	5.0%	10.0%
Option F			
All ages	5.0%	10.0%	15.0%

(2) **How do I make the choice?** Under WAC 415-111-110, it is your responsibility to complete the correct form for choosing a contribution rate and submitting the form in a timely manner to your employer as directed on the form.

(3) **Where do I get the form to make my choice?** Your employer must provide the appropriate form to choose a contribution rate if you are enrolling in Plan 3 or transferring from Plan 2 to Plan 3.

(4) **When do I have to choose?** You must choose a contribution rate within ninety calendar days from your date of hire in an eligible position. However, if you are transferring from Plan 2 to Plan 3, you must choose a contribution rate at the same time you transfer. The ninety-day period does not apply to a member transferring from Plan 2 to Plan 3.

(5) **When do contributions begin?**

(a) Once you choose a contribution rate, contributions will begin the first day of the pay cycle in which you make the choice.

(b) If the employer advises the department that you should be reported into Plan 3 membership retroactively, the ninety-day period starts from the date it is discovered that you should have been reported. The department will decide which date to use.

(6) **What if I work for more than one employer?** If you are a Plan 3 member working in eligible positions for more than one employer, you may select a different contribution rate with each employer.

(7) **What happens if I do not make a choice?** Under RCW 41.34.040, you will be assigned a base rate of 5% (Option A) if:

(a) You are a new employee or changing your employer, and do not choose a contribution rate within the ninety-day election period described in subsection (4) of this section; or

(b) You are transferring from Plan 2 to Plan 3 and do not choose a contribution rate at the time of transfer. Contributions required under subsection (a) or (b) will begin the first day of the pay cycle in which you are assigned to Option A.

(8) **Can I change my contribution rate?**

(a) If you are a PERS 3 or SERS 3 member, once you choose a contribution rate or are assigned the base rate of 5% (Option A), you cannot change that contribution rate unless you change employers. This rule is required by an IRS decision on the tax qualified status of PERS 2 and 3 and SERS 2 and 3.

(b) Each time you change employers, you must choose a new contribution rate within ninety days or you will be assigned a base rate of 5% (Option A). No contributions will be taken until you choose a rate or until the ninety-day period has elapsed, whichever occurs first.

(c) Each January, through January 2015, TRS Plan 3 members may change their contribution rate option by providing written notification to their employer as described in WAC 415-111-110(1). After January 2015, TRS Plan 3 members may only change their contribution rate option as provided in 8(b) above. The termination of TRS rate flexibility in January 2015 is required to meet plan qualification requirements in the Internal Revenue Code.

February 2010

Dear Plan 3 member,

Thank you for your letter to Director Hill regarding the possibility of an annual opportunity for members of the Public Employees' Retirement System (PERS) and School Employees' Retirement System (SERS) Plan 3 to change their member contribution rates. He has asked me to respond on his behalf.

We understand your desire to bring PERS and SERS Plan 3 into conformity with Teachers' Retirement System (TRS) Plan 3. The question of such "rate flexibility," however, is governed entirely by federal regulation, and the Department of Retirement Systems (DRS) is not in a position to act in a way that is contrary to these regulations.

DRS submitted TRS Plan 3 for plan qualification to the Internal Revenue Service (IRS) in 2000. The request included a proposal to allow TRS members to change their contribution rates once a year. In 2002, the IRS qualified the TRS plan, with the annual rate flexibility option.

TRS was the first Plan 3 fully implemented. In 2000, when it was submitted to the IRS, the SERS plan had been passed by the legislature, but was not yet in effect and PERS Plan 3 had not yet passed the legislature.

In 2002, after receiving the favorable TRS Plan 3 determination, DRS submitted a request for qualification of PERS and SERS Plan 3. The submission included a request to allow PERS and SERS Plan 3 members to change contribution rates in January of each year.

After a lengthy review, the IRS determined that PERS and SERS would not receive federal tax qualified status as defined benefit plans if the annual contribution rate change option was included in the plans. To receive plan qualification, the rate change proposal was removed.

Since the IRS' refusal to approve rate flexibility in PERS and SERS, the IRS has issued guidance underscoring its position on rate flexibility. The IRS, apparently in order to protect the federal tax base, has recently and consistently taken steps to guard against the expansion of a governmental employee's ability to defer taxation on additional income through their government sponsored defined benefit plans by placing limits on changes government employees may make to their contribution rate.

PERS, SERS and TRS must comply with the provisions of IRS code that govern defined benefit retirement plans for governmental employees. If any legislative change to the plan conflicts with IRS code, the plan may be disqualified by the IRS resulting in significant cost to the governmental employers and employees. The favorable plan determination means that PERS, SERS and TRS can continue to operate under the provisions of section 401(a) of the IRS code which includes the ability for members to contribute to Plan 3 on a tax-deferred basis.

All the Washington retirement plans are presently before the IRS for requalification. The Department does not know whether the IRS will continue to qualify TRS Plan 3 with the existing "rate flexibility" feature. We anticipate the IRS review of the plans to be completed in 2010.

DRS has done everything in its authority to work the issue through the IRS. In the process, DRS has kept the best interest of all the members in mind.

Sincerely,

Marcie Frost
Deputy Director