

Federal and State Law Considerations Regarding SB 6668

Initial Analysis

Anne Hall, Senior Counsel & Assistant Attorney General
Staff Counsel to the SCPP

Study Ordered by the Legislature

- ▶ § 106 of 2016 Operating Budget
- ▶ SCPP to study the implications of SB 6668
- ▶ Merges LEOFF 1 into TRS 1

- ▶ Legislature specifically asked the SCPP to study:
 - ▶ Tax
 - ▶ Legal
 - ▶ Fiscal
 - ▶ Policy
 - ▶ Administrative
- Implications of SB 6668

SB 6668:

- ▶ Merges LEOFF 1 with TRS 1
- ▶ All assets and liabilities of LEOFF 1 are merged with the assets and liabilities of TRS 1
- ▶ Makes LEOFF 1 a tier of TRS 1

SB 6668

- ▶ Appears to merge only the assets and liabilities of the two plans. SB 6668 does not merge the provisions of the two plans.

Limited Waiver of the Attorney-Client Privilege

- ▶ To the extent my remarks are governed by the attorney-client privilege in my role as the SCPP's assigned assistant attorney general, I understand that the SCPP waives that privilege solely as to my remarks made here today. The SCPP does not waive the privilege as to any underlying communications, analysis, or written work upon which my remarks may be based that are the same as or related to the subject matter of this presentation.

Federal Tax Law Considerations

- ▶ Both LEOFF 1 and TRS 1 are tax-qualified plans under federal law
- ▶ 26 U.S.C. 401(a): Impossible “for any part of the corpus or income to be . . . used for . . . purposes other than for the exclusive benefit of the employees or their beneficiaries.”

- ▶ Only tax qualified plans can be merged
- ▶ The funded status of any plan does not affect the ability to merge.
- ▶ Once qualified plans are merged, it is important to determine whether the resulting merged plan continues to meet tax qualified status

To achieve tax qualified status:

- ▶ The merger must ensure that each participant of the plan must be entitled to benefits after the merger that are equal to or better than the benefits they were entitled to before the merger.

Amendment to the plan

- ▶ Any merger must be reflected in the terms of each plan
- ▶ Terms of the plan: the statutes and rules
- ▶ LEOFF 1 - RCW 41.26
- ▶ TRS 1 - RCW 41.32

Private Letter Ruling

- ▶ Issued by the IRS
- ▶ Purpose is to ensure that the IRS does not believe the merger creates a taxable event for the members.

Determination Letter

- ▶ Issued by the IRS
- ▶ Review the new structure of the merged plans in order to ensure the new plan remains a tax qualified plan

Questions by Stakeholders

- ▶ Q: What will happen to the surplus in LEOFF 1?
- ▶ A: Unless the plan terms specify otherwise, the ER(s) sponsoring the plan generally own the surplus.

Q: May a merger be temporary?

- ▶ A: No. Under federal law a merger may not be temporary.

Q: Will a merger affect the taxes now collected on benefits?

- ▶ A: No. A merger would not change the tax treatment of any benefits to members of either plan.

Q: What would be the impact of an unfavorable determination letter?

- ▶ The IRS would require the Legislature to stop the merger
- ▶ The IRS would require the Legislature to amend the statutes to make needed changes
- ▶ The IRS would disqualify either or both plans or disqualify the merged plans

Q: Can you charge separate contribution rates for the different tiers of the plan?

- ▶ A: Yes, under federal law different tiers may have different contribution rates.

Q: Can excess assets be distributed every few years?

- ▶ A: It is up to the Legislature to determine how excess assets are distributed, but no excess assets may be distributed before all liabilities are met.

Q: Will the merger require a vote of all members and beneficiaries before the plans can be merged?

- ▶ A: No. Unless LEOFF 1 and TRS 1 statutes specifically require a vote, no vote is required.

Q: Do the plan terms prevent a merger?

- ▶ No. As a matter of federal tax law, the plans' terms do not prevent a merger.

Summary

- ▶ Federal tax law allows mergers of two tax qualified plans such as LEOFF 1 and TRS 1 as long as members are entitled to the same or better benefits after the merger that they were entitled to before the merger.

AND

- ▶ As long as the exclusive benefit rule is observed
- ▶ Strongly recommended: seek a PLR and a Determination Letter

State Law

- ▶ Members of the Washington State public pension systems have certain pension rights that are contractual in nature.
- ▶ *Bakenhus v. City of Seattle*, 48 Wn.2d 695 (1956)

To determine what rights are contractual:

- ▶ Statutes of the public pension plans
- ▶ Rules governing the plans
- ▶ Cases interpreting the statutes and rules

To determine if contractual right is impaired

- ▶ First, determine if a contractual relationship exists
- ▶ Second, determine if the challenged legislation substantially impairs the contractual relationship
- ▶ Third, determine if the impairment was reasonable and necessary to serve a legitimate public purpose.

- ▶ The purpose of LEOFF 1 is to provide for an actuarial reserve system for the payment of death, disability, and retirement benefits to law enforcement officers and fire fighters and to pay benefits for their beneficiaries.

RCW 41.26.020

SB 6668

- ▶ The merger legislation specifically provides that the benefits the members receive after the merger must be equal to the benefits the member was entitled to before the merger.
- ▶ DRS must administer the merger legislation to ensure the members' benefits remain the same.
- ▶ Section 3 of SB 6668

Right to systematic funding of the retirement plan to maintain actuarial soundness.

- ▶ *Weaver v. Evans*, 80 Wn. 2d 461 (1972)
- ▶ Establishes that members of the public pension plans have a contractual right to the systematic funding of their retirement plan to maintain actuarial soundness.

RPEC V. Charles, 148 Wn.2d 602 (2003)

- ▶ “If the Retirees’ and Employees’ rights are in the funding process of an actuarially and fiscally sound retirement system, then EHB 2487 cannot be said to alter the terms of the contract since there is no indication the lowered contribution rates render the system actuarially unsound.”

Two Cautions

- ▶ 1. Under federal law, both merged plans must be amended to provide for the merger.
- ▶ 2. While SB 6668 merges the assets and liabilities of the two plans, its provisions should be clearer about the Legislature’s intent regarding the non-merger of benefit provisions.