

Federal Tax Considerations Regarding SB 6668

Potential Merger of LEOFF Plan 1 and TRS Plan 1

Presentation to SCPP

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Goals

- To consider with SCPP the requirements of a merger for purposes of federal tax law and whether the proposed merger under Senate Bill 6668 complies with such requirements.
- To discuss with SCPP members the questions and/or concerns from stakeholders of the proposed merger.



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Clarification

- We have considered the proposed merger reflected in SB 6668 under applicable federal tax law (Internal Revenue Code and Treasury Regulations) for qualified governmental defined benefit plans.
- We are not analyzing whether a proposed merger infringes upon vested rights under Washington State law or would be considered an impairment of contract under Federal or State constitutional law.

Legislature's Authority

- As the body which created LEOFF Plan 1 and TRS Plan 1, the Washington State Legislature is considered the Plan Sponsor.
- Subject to federal tax law, state law and the terms of the Plan, the Legislature maintains the right to amend either (or both) Plans.

Merger

- The actual merger of assets and liabilities of more than one qualified plan into a single plan where the assets and liabilities are available/usable across the spectrum of the merged plans.
- If the assets of one plan remain only available to the members of that plan, then a merger has not occurred.

Federal Tax Law Considerations

- Code § 401(a):

A trust created or organized in the United States and forming part of a . . . pension . . . plan of an employer for the exclusive benefit of his employees or their beneficiaries shall constitute a qualified trust under this section

(2) If under the trust instrument **it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be . . . used for, or diverted to, purposes other than for the exclusive benefit of [the] employees or their beneficiaries.**

(Emphasis added)

Federal Tax Law Considerations (cont'd)

- Although ERISA and ERISA based Code provisions are not applicable to the Plans, ERISA law regarding the analysis of a merger is instructive as to whether a merger is valid for purposes of federal tax law.
- Code § 401(a)(12):

A trust shall not constitute a qualified trust . . . unless the plan of which such trust is a part provides that in the case of any merger or consolidation with, or transfer of assets or liabilities to, any other plan after September 2, 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger . . . which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger. . .

(Emphasis added)

Federal Tax Law Considerations (cont'd)

- Code § 411(d):
 - Establishes special rules regarding minimum vesting standards for a qualified plan where there has been a termination, partial termination or discontinuance of contributions. The accrued benefit of the participant may not be decreased by an amendment of the plan in the case of plan transfers.
- Code § 414(l) – Mergers and Consolidations of Plans or Transfer of Plan Assets:

(1) a trust which forms a part of a plan shall not constitute a qualified trust under § 401 . . . unless in the case of any merger or consolidation of the plan with, or in the case of any transfer of assets or liabilities of such plan to, any other trust plan after September 2, 1974, **each participant in the Plan would (if the plan then terminated) receive a benefit immediately after the merger . . . which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger . . . (if the plan had been terminated).**

(Emphasis added).

Considerations Under SB 6668

- Proposes that the assets and liabilities of TRS Plan 1 and LEOFF Plan 1 be merged.
- The Legislature intends that the merger of assets, liabilities and membership will be accomplished in a way which does not impact benefits provided to members of either plan.
- The assets, liabilities and members of LEOFF Plan 1 are proposed to become assets, liabilities and members of TRS Plan 1.
- Under Section 3, “**each member of each of these plans is entitled to receive benefits immediately after the merger on the effective date of this section that are equal to the benefits the members would have been entitled to receive immediately before the merger in accordance with plan terms.**” (Emphasis added).

Considerations Under SB 6668 (cont'd)

- Under Section 6, LEOFF Plan 1 members (including an active vested members, retirees and survivors) would each be eligible to receive a \$5,000 lump sum.
- Proposal contemplates reduced employer costs for TRS Plan 1 employers (**NOT** distribution of any LEOFF Plan 1 surplus).
- The merger is intended to comply with Code § 401(a) (Section 15).
- Based upon these provisions, we believe the proposed merger also is intended to comply with Code §§ 401(a)(2), 401(a)(12) and 414(l).

IRS Review Approval

- If either:
 - One of the Plans is being terminated as part of the merger; or
 - The two Plans are being merged and a new plan is being created, then the Plans and/or DRS should seek a determination letter from the IRS to confirm that the new structure would be considered qualified under the Code.

IRS Review Approval

- Either the Plans and/or DRS should seek a private letter ruling from the IRS to confirm that the merger/transfer does not result in any tax consequences to any affected members.

QUESTIONS