

STATE OF WISCONSIN

APPENDIX TO 2003 SENATE BILL 44

REPORT OF JOINT SURVEY COMMITTEE ON RETIREMENT SYSTEMS

(Introduced by Joint Committee on Finance by request of Governor James Doyle.)

An Act relating to: state finances and appropriations, constituting the executive budget act of the 2003 Legislature.

PROVISIONS OF THE BILL THAT ARE THE SUBJECT OF THIS REPORT

Section 13.50 (6) (a) requires that the Joint Survey Committee on Retirement Systems prepare a report on those provisions of this bill, and any amendments to the bill, that modify the system for, or make any provision for, the retirement of or payment of persons to public officers or employees. The provisions of this bill that are the subject of this report are the following:

1. Modification of the 30-day “break in service” rule that requires a person who retires from employment covered by the Wisconsin Retirement System (WRS) to wait at least 30 days before taking another job that is covered by the WRS. [SECTION 1017 of Senate Bill 44.]

2. Adoption of the provisions of the federal Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16) so that employees under the WRS would be allowed to use “pretax” money from certain sources to purchase any creditable service in the WRS that they are entitled to buy. The bill also makes a number of miscellaneous revisions to the statutes that relate to the purchase of creditable service. These include allowing a person who purchases creditable service to pay 10% of the estimated cost of the creditable service and paying the balance within 90 days from an authorized tax sheltered annuity. In addition, the bill would repeal the requirement that a person may not purchase less than all forfeited creditable service that he or she is entitled to purchase and that a person may not purchase more than 10 years of forfeited or other governmental creditable service. [SECTIONS 1023-1025 of Senate Bill 44.]

These provisions are described below.

1. Modification of the 30-Day “Break In Service” Rule

a. Description

This provision of Senate Bill 44 would reduce the restrictions under current law that require a retired WRS participant who wishes to receive an annuity under the WRS to wait at least 30 days before taking another job with any employer who participates in the WRS. The rationale for this provision, as expressed by the Governor, is that it may encourage some long-term employees to retire from the state service earlier than they otherwise would have, and decrease state payroll costs.

Under **current law**, the WRS is established as a governmental plan and as a qualified plan for federal income tax purposes under the Internal Revenue Code and shall be so maintained and administered. In addition, the statutes provide that the WRS may not be administered in a manner which violates an Internal Revenue Code provision that would cause an otherwise tax-exempt benefit to become taxable under the Internal Revenue Code. [s. 40.015, Stats.]

One requirement of federal law that is imposed on qualified pension plans is that “in service distributions” are prohibited. In other words, a qualified plan may provide an annuity to a person only after he or she retires from service with the employer. There is no provision of the Internal Revenue Code or Income Tax Regulations that clearly define what is an “in service distribution.” Instead, pension law administrators rely on rulings of the Internal Revenue Service and case law to determine what the Internal Revenue Service would consider an “in service distribution.”

Section 40.23 (1) (a) 1., Stats., provides a participant must be continuously separated from all employment with a WRS employer for at least 30 days after the application for retirement is received by the Department of Employee Trust Funds or the date that is 30 days after the individual separates from employment, whichever is later.

Wisconsin Administrative Code s. ETF 10.08 provides detailed rules for determining when an employee is “separated from employment” within the meaning of s. 40.23, Stats. There are two particularly relevant restrictions within this provision of the Administrative Code. First, to be “separated from employment,” a person may not have, within the 30-day period, a contract for future employment with any participating WRS employer. Second, the restriction applies not only to employment with the same employer or, but also to employment with any other employer that participates in the WRS. For example, a person employed by the State of Wisconsin could not, within the 30-day period, take another job or contract to take another job with a local government or a school district that participates in the WRS. [s. ETF 10.08 (2) (b) 3., Wis. Adm. Code.]

SECTION 1017 of Senate Bill 44 would modify the 30-day “break in service” rule as follows:

1. The 30-day requirement would be eliminated for a person who has reached the normal retirement age or who has attained the age and number of years of service that eliminates the actuarial reduction for early retirement.

A person who is classified as a general employee has a normal retirement age of 65 and can receive a normal (without actuarial reduction) retirement annuity at age 57 with at least 30 years of service. A person who is classified as an elected official or a state career executive has a normal retirement age of 62 and can receive a normal retirement annuity at age 57 with at least 30 years of service. A person who is classified as a protective occupation participant has a normal retirement age of 53 if he or she has 25 or more years of creditable service or 54 if he or she has less than 25 years of creditable service.

This revision in the 30-day break in service requirement appears to be consistent with the position of the Internal Revenue Service that the provisions restricting in-service distributions do not apply to distributions made after a person attains normal retirement age.

“In the case of a pension plan, the long-standing position expressed in SECTION 1.401-1 (b) (1) (i) of the Income Tax Regulations would not permit a distribution prior to death, disability, separation from the service, or attainment of normal retirement age. Therefore, in the case of a plan in which the normal

retirement age is 65, a pension plan could not make a distribution at age 59-1/2 to an active participant. If, however, the normal retirement age were 59-1/2, the plan could make such a distribution.” [Internal Revenue Service Private Letter Ruling 7740031.]

2. The 30-day break in service requirement would be eliminated for a person who retires and then takes a job with a **different employer** who participates in the WRS. According to legal counsel at the Department of Employee Trust Funds, the Internal Revenue Service in-service distribution prohibition only applies to distributions from the same employer. Therefore, eliminating the 30-day break in service rule for a person who takes a job with another employer who is covered by the WRS would not violate the in-service distribution prohibition.

b. Actuarial Effect

This provision would have no material actuarial effect on the WRS.

c. Probable Costs

This provision may reduce state and local government payroll costs if it encourages long-term employees to retire earlier than they otherwise would have. If these long-term employees return to employment as rehired annuitants or otherwise work in positions for which retirement and other fringe benefits are not paid by the employer, payroll costs may be lower. However, it is not possible to determine to what extent this will occur.

d. Public Policy

The Joint Survey Committee on Retirement Systems recommends that the provisions of this bill relating to the 30-day break-in service rule be deleted from Senate Bill 44 and introduced as separate legislation. While these provisions may represent good public policy, they need further discussion and deliberation that they will receive if introduced as a separate bill rather than being included in Senate Bill 44.

2. Purchase of Creditable Service With Money From Certain Tax-Sheltered Annuity Funds

a. Description

This provision of Senate Bill 44 would authorize WRS employees to pay for any creditable service they are otherwise entitled to purchase with money from certain tax sheltered annuity funds. This use of money from tax-sheltered annuity funds was approved for both federal income tax purposes and state income tax purposes by the federal Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16). (The federal law change also affected Wisconsin income tax treatment of this type of transaction because Wisconsin adjusted gross income is based upon federal adjusted gross income.)

Under current law, WRS employees are authorized to purchase service under the WRS to recover years of service they previously forfeited, periods of service which, at various times in the past, were not credited to their accounts under the WRS and service for other governmental units. The purchase of service under the WRS increases the purchaser's retirement annuity, either by adding years of creditable service to their formula benefit or by increasing their money purchase benefit.

If a person leaves WRS employment prior to retirement and takes a separation benefit (a lump sum withdrawal of employee contributions), he or she **forfeits** the creditable service earned before taking the separation benefit. If the employee later returns to WRS employment, he or she may be able to purchase the forfeited service if:

1. An application to purchase forfeited service is received by the Department of Employee Trust Funds before WRS employment is terminated.
2. The applicant has at least three continuous years of creditable service under the WRS since returning to WRS employment.
3. The person purchases the maximum amount of forfeited service that he or she is entitled to buy.

A person may not purchase more than 10 years of forfeited service and may not purchase a greater number of years of service that he or she earned after returning to WRS employment. The cost of forfeited service is an amount equal to the employee's contribution rate for each year of forfeited service to be purchased, based upon the employee's final average earnings at the time of the application.

In addition, under certain circumstances, a person may purchase creditable service for periods during which they worked in a position covered by the WRS, but did not receive credit for that service. This includes employees who were employed before January 1, 1973 who were required to serve a qualifying period before becoming eligible for WRS benefits; teachers who were employed before July 1, 1957 and were classified as "junior teachers" not eligible for participation in the retirement system until they reach age 25; employees who received a teacher improvement leave of absence from the Board of Regents of the Wisconsin state colleges between January 1, 1964 and August 31, 1967; and persons who were employed after age 62 in an executive retirement plan position prior to May 30, 1988, because no creditable service was given to a person after he or she reached age 62. The cost of purchased service described in this paragraph is computed in a manner similar to that used to determine the cost of forfeited service.

Also, a WRS employee who worked for a non-WRS federal, state, or local employer other than the military may purchase WRS creditable service if:

1. The applicant has at least three continuous years of creditable service under the WRS.
2. The years of service for the non-WRS employer are not used to establish entitlement to any benefit paid by the federal, state, or local government (other than Social Security, disability benefits, or benefits paid for service of the National Guard).

A person may not purchase more than 10 years of service for a non-WRS employer and may not purchase more than the number of years of WRS creditable service in his or her account at the time of the application. The cost of purchasing creditable service based on service for a non-WRS employer is the actuarial cost of the benefit increase that the service will provide.

The purchase of creditable service under the WRS can be paid for with additional voluntary contributions previously made to the WRS by the applicant or with other funds of the applicant.

SECTION 1017 of Senate Bill 44 would allow creditable service to be purchased with funds in s. 403 (b) plans (such as the plan offered to employees at the University of Wisconsin System), s. 457 plans, such as the deferred compensation plan offered to State of Wisconsin employees and private employer's s. 401 (k) plans. As was described above, under the Internal Revenue Code and Wisconsin income tax law, distributions from these funds are not considered taxable income to the employee when used to purchase creditable service under the WRS.

In addition, Senate Bill 44 would authorize participants in the WRS to purchase creditable service by paying 10% of the total cost of the creditable service, with the balance provided to the Department of Employee Trust Funds within 90 days by transfer from a tax-sheltered annuity plan described above. This provision of Senate Bill 44 would also repeal the restriction of current law that a person may purchase no more than 10 years of forfeited or other governmental service.

b. Actuarial Effect

This provision would have no material actuarial effect on the WRS.

c. Probable Costs

The amount of creditable service that WRS employees are authorized to purchase is not known. However, the Department of Employee Trust Funds reports that it receives approximately 1,800 requests to estimate the cost of purchasing creditable service annually. In 2002, it received 830 applications to purchase forfeited service, for a total of \$8,011,000; 258 requests to purchase WRS qualified service, for a total of \$321,000; and 13 requests to purchase other governmental service, for a total of \$262,151.

The amount of increased annuity benefits purchased with these moneys is not known.

The bill may allow more persons to purchase the creditable service they are entitled to under current law by allowing them to pay for it with moneys from s. 403 (b) (1), s. 457, or s. 401 (k) accounts, but the extent to which this will occur is not known.

d. Public Policy

The Joint Survey Committee on Retirement Systems finds that the provisions of this bill relating to the purchase of creditable service with money from certain tax-sheltered annuity funds are good public policy.

5/21/03