

Clearinghouse Rule 11-045

State of Wisconsin
Department of Employee Trust Funds,
Employee Trust Funds Board and Wisconsin Retirement Board

DRAFT REPORT ON CLEARINGHOUSE RULE

RULE to amend ETF 10.01(3i); to create ETF 10.85 and 10.87; and to create ETF 20.0257, 20.38 and 20.39.

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Economic Impact Report.....NONE

Department of Administration s. 227.138 Report..... NONE
Energy Impact Report.....NONE

Agency Person to be Contacted for Questions

Please direct any questions about this rule-making to Mary Alice McGreevy, Compliance Officer, Office of Policy, Privacy and Compliance, Department of Employee Trust Funds, P.O. Box 7931, Madison WI 53707. Telephone: (608) 267-2354. E-mail address: maryalice.mcgreevy@etf.state.wi.us.

Statement Explaining Need for Rule

This rule-making is needed to amend existing rules and create new rules so the written documents required for compliance with the IRC are in place.

Analysis Prepared by the Department of Employee Trust Funds

1. Statutes Interpreted:
40.015, 40.03(1), 40.31, 40.32, relating to maintaining the tax-qualified status of the Wisconsin Retirement System.
2. Statutory Authority:
Sections 40.03 (2) (i), (ig), (ir), (t), and 227.11 (2) (a)(intro), 1. to 3., Stats.
3. Explanation of Agency Authority:
By statute, the ETF Secretary is expressly authorized, with appropriate board approval, to promulgate rules required for the efficient administration of any benefit plan established in ch. 40 of the Wisconsin statutes. Also, each state agency may promulgate rules interpreting the provisions of any statute enforced or administered by the agency if the agency considers it necessary to effectuate the purpose of the statute.

The ETF Secretary is also required by statute to ensure that the WRS maintains compliance with the Internal Revenue Code (IRC) as a qualified plan for tax purposes and each plan is administered in compliance with the IRC. Numerous provisions in Chapter 40 require ETF to comply with the IRC.

4. Related Statute or Rule:
There are no other statutes or rules that are related to WRS tax compliance with the IRC that are not addressed in this rule.
5. Plain Language Analysis:
The changes to the rules are made to clarify how ETF applies and complies with sections 415(b), 415(c) and 401(a)(17) of the IRC. These changes include the following:

- Clarifies that contribution limitations may be adjusted in accordance with changes made by the IRS.
 - Simplifies the readability of the rule by defining “415 limit.”
 - Clarifies that ETF will not violate section 503(b) of the IRC regarding prohibited transactions.
 - Clarifies that the WRS is maintained for the exclusive benefit of participants and their beneficiaries, as required by the IRC.
 - Specifies the factors, adjustments, restrictions and calculations that are used to ensure that benefits and contributions are made in accordance with the limitations of IRC sections 415(b) and (c) and 401(a)(17). This includes clarifying how annuity limitations must be applied, the aggregation of certain plans of the same employer, what benefits are not included when applying the 415(b) and (c).
 - Clarifies how service purchases are made in compliance with IRC section 415(n).
 - Clarifies how eligible rollover distributions are made from the WRS.
6. Summary of, and Comparison with, Existing or Proposed Federal Regulations:
These rules comply with existing federal regulations. The rules are written to ensure continued compliance with these federal tax laws.
7. Comparison with Rules in Adjacent States
- Illinois – The Illinois Pension Code provides comparable provisions regarding compliance of the public employee pension system with the IRC.
 - Iowa - The Iowa Public Employees’ Retirement System is governed by Iowa Code Chapter 97(B) and chapter 495 of the Iowa Administrative Rules, and provides comparable provisions regarding compliance of the public employee pension system with the IRC.
 - Michigan – Chapter 38 of the Michigan Statutes contain some provisions that are comparable regarding the State Employees’ Defined Benefit Pension Plan compliance with the IRC.
 - Minnesota – Chapters 352 to 356A of the Minnesota statutes contain some provisions that are comparable regarding compliance for the Public Employees’ Retirement Association Defined Benefit Pension Plan with the IRC.
8. Summary of Factual Data and Analytical Methodologies:
The proposed rule amendment is intended to make ETF’s rules regarding compliance with federal law clearer.
9. Analysis and Supporting Documents Used to Determine Effect on Small Business or in Preparation of Economic Impact Report:

The rule does not have an effect on small businesses because private employers and their employees do not participate in, and are not covered by, the Wisconsin Retirement System.

10. Effect on small business:

There is no effect on small business.

11. Agency contact person:

Mary Alice McGreevy, Compliance Officer, Department of Employee Trust Funds, 801 W Badger Rd, Madison, WI 53713-7931, P.O. Box 7931 (use ZIP Code 53707 for PO Box); Phone: 608-267- 2354; E-mail: maryalice.mcgreevy@etf.state.wi.us

12. Proposed Effective Date:

This rule shall take effect on the first day of the month following publication in the Wisconsin Administrative Register as provided by s. 227.22 (2) (intro.), Stats.

13. Fiscal Estimate:

The rule will not have any fiscal effect on the administration of the Wisconsin Retirement System, nor will it have any fiscal effect on the private sector, the state or on any county, city, village, town, school district, technical college district, or sewerage districts.

14. Free Copies of Proposed Rule:

Copies of the proposed rule are available without cost from the Office of the Secretary, Department of Employee Trust Funds, P.O. Box 7931, Madison, WI 53707-7931. The telephone number is: (608) 266-1071.

Text of Rule

SECTION 1. ETF 10.01 (3i) is amended to read:

10.01(3i) "Maximum voluntary contribution" means the total amount eligible under section 415 (c) of the internal revenue code, as adjusted pursuant to section 415(d) of the internal revenue code, and the regulations thereunder, to be contributed to the Wisconsin retirement system in a calendar year by or on behalf of a participating employee, less all ~~benefit adjustment contributions~~ and required and participating employer-paid additional contributions which are includable in the limits of section 415 (c) of the internal revenue code, as determined by the Department.

SECTION 2. ETF 10.01 (9) is created to read:

"415 limit" means the limit set forth in section 415(b) or (c) of the internal revenue code

SECTION 3. ETF 10.85 and 10.86 are created to read:

10.85 Compliance with code section 503 (b) for prohibited transactions.

Effective January 1, 1989, the Department shall not engage in a transaction prohibited by section 503 (b) of the internal revenue code.

10.86 General code compliance. (1) The Wisconsin retirement system is maintained for the exclusive benefit of participants and their beneficiaries.

(2) No funds may revert, and no contributions shall be permitted to be returned, to a participating employer, except as permitted by Revenue Ruling 91-4.

SECTION 4: ETF 20.0257 is created to read:

20.0257 Compliance with internal revenue code section 415 limitations on

contributions and benefits. (1) CONTRIBUTION AND BENEFIT LIMITATIONS. Notwithstanding any other provisions of the laws governing the Wisconsin retirement system to the contrary, participating employee contributions paid to, and retirement benefits paid from the plan shall be limited to the extent necessary to conform to the requirements of section 415 of the internal revenue code for a qualified pension plan.

(2) PARTICIPATION IN OTHER QUALIFIED PLANS: AGGREGATION OF LIMITS.

(a) The 415(b) limit with respect to any participating employee who at any time has

been a participating employee in any other defined benefit plan as defined in section 414 (j) of the internal revenue code that is maintained by a participating employer in the Wisconsin retirement system shall apply as if the total benefits payable under all such defined benefit plans in which the participating employee has been a participating employee were payable from one plan.

(b) The 415 (c) limit with respect to any participating employee who at any time has been a participating employee in any other defined contribution plan as defined in section 414 (i) of the internal revenue code that is maintained by a participating employer in the Wisconsin retirement system shall apply as if the total annual additions under all such defined contribution plans in which the participating employee has been a participating employee were payable from a single plan.

(3) BASIC 415 (b) LIMITATION.

(a) Before January 1, 1995, an annuitant may not receive an annual benefit that exceeds the limits specified in section 415 (b) of the internal revenue code, subject to the applicable adjustments in that section. On and after January 1, 1995, an annuitant may not receive an annual benefit that exceeds the dollar amount specified in section 415 (b) (1) (A) of the internal revenue code, subject to the applicable adjustments in section 415 (b) of the internal revenue code and subject to any additional limits that may be specified in the laws governing the Wisconsin retirement system. In no event shall an annuitant's benefit payable under the Wisconsin retirement system in any limitation year be greater than the limit applicable at the annuity starting date, as increased in subsequent years pursuant to section 415 (d) of the internal revenue code and the regulations thereunder.

(b) For purposes of applying section 415(b) of the internal revenue code, the "annual benefit" means a benefit payable annually in the form of a straight life annuity with no ancillary benefits, without regard to:

1. The benefit attributable, as determined in accordance with Treasury Regulations, to after-tax employee contributions except as provided by section 415 (n) of the internal revenue code; and

2. Rollover contributions as defined in section 415(b)(2)(A) of the internal revenue code.

(4) ADJUSTMENTS TO BASIC 415(b) LIMITATION FOR FORM OF BENEFIT. If the benefit under the Wisconsin retirement system is other than the form specified in par. (3)(b), then the benefit

shall be adjusted so that it is the equivalent of the annual benefit, using factors prescribed in Treasury Regulations.

(a) If the form of benefit without regard to an automatic benefit increase feature is not a straight life annuity or a qualified joint and survivor annuity, the preceding sentence is applied by either reducing the 415(b) internal revenue code limit applicable at the annuity starting date or adjusting the form of benefit to an actuarially equivalent amount (determined using the assumptions specified in Treasury Regulation section 1.415(b)-1(c)(2)(ii)), that takes into account the additional benefits under the form of benefit as follows:

(b) For a benefit paid as a monthly annuity to which section 417(e)(3) of the internal revenue code does not apply, the actuarially equivalent straight life annuity benefit that is the greater of, or the reduced limit applicable at the annuity starting date which is the "lesser of" when adjusted in accordance with the following assumptions:

1. The annual amount of the straight life annuity, if any, payable to the annuitant under the Wisconsin retirement system commencing at the same annuity starting date as the form of benefit to the annuitant; or

2. The annual amount of the straight life annuity commencing at the same annuity starting date that has the same actuarial present value as the form of benefit payable to the participating employee, computed using a 5% interest assumption or the applicable statutory interest assumption; and

i. For years prior to January 1, 2009, the applicable mortality tables described in Treasury Regulation section 1.417(e)-1(d)(2) (Revenue Ruling 2001-62 or any subsequent Revenue Ruling modifying the applicable provisions of Revenue Rulings 2001-62); and

ii. For years after December 31, 2008, the applicable mortality tables described in section 417(e)(3)(B) of the internal revenue code (Notice 2008-85 or any subsequent Internal Revenue Service guidance implementing section 417(e)(3)(B) of the internal revenue code).

(c) For a lump sum benefit paid in a form to which section 417(e)(3) of the internal revenue code applies, the actuarially equivalent straight life annuity benefit that is the greatest of (or the reduced section 415(b) internal revenue code limit applicable at the annuity starting date which is the "least of" when adjusted in accordance with the following assumptions):

1. The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using the interest rate and mortality table, or tabular factor, specified by the Wisconsin retirement system for actuarial experience;

2. The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable, computed using a 5.5% interest assumption or the applicable statutory interest assumption; and

a. For years prior to January 1, 2009, the applicable mortality table for the distribution under Treasury Regulation section 1.417(e)-1(d)(2), the mortality table specified in Revenue Ruling 2001-62 or any subsequent Revenue Ruling modifying the applicable provisions of Revenue Ruling 2001-62; or

b. For years after December 31, 2008, the applicable mortality tables described in section 417(e)(3)(B) of the internal revenue code (Notice 2008-85 or any subsequent Internal Revenue Service guidance implementing section 417(e)(3)(B) of the internal revenue code).

3. The annual amount of the straight life annuity commencing at the annuity starting date that has the same actuarial present value as the particular form of benefit payable computed using the applicable interest rate for the distribution under Treasury Regulation section 1.417(e)-1(d)(3), the 30-year Treasury rate, prior to January 1, 2007, using the rate in effect for the month prior to retirement, and on and after January 1, 2007, using the rate in effect for the first day of the plan year with a one-year stabilization period:

a. For years prior to January 1, 2009, the applicable mortality rate for the distribution under Treasury Regulation section 1.417(e)-1(d)(2), the mortality table specified in Revenue Ruling 2001-62 or any subsequent Revenue Ruling modifying the applicable provisions of Revenue Ruling 2001-62.

b. For years after December 31, 2008, the applicable mortality tables described in section 417(e)(3)(B) of the internal revenue code, Notice 2008-85 or any subsequent Internal Revenue Service guidance implementing section 417(e)(3)(B) of the internal revenue code, divided by 1.05.

(5) BENEFITS NOT TAKEN INTO ACCOUNT FOR 415(b) LIMITATION. For purposes of this section, the Department shall not take the following benefits into account when applying 415(b) limits:

(a) Any ancillary benefit which is not directly related to retirement income benefits;

(b) That portion of any joint and survivor annuity that constitutes a qualified joint and survivor annuity;

(c) Any other benefit not required under section 415(b)(2) of the internal revenue code and Treasury Regulations thereunder to be taken into account for purposes of the limitation of section 415(b)(1) of the internal revenue code.

(6) OTHER ADJUSTMENTS IN 415(b) LIMITATION.

(a) In the event the participating employee's retirement benefits become payable before age 62, the limit prescribed by this section shall be reduced in accordance with Treasury Regulations pursuant to the provisions of section 415(b) of the internal revenue code, so that such limit, as reduced, equals an annual straight life benefit when such retirement income benefit begins which is equivalent to a \$160,000, as adjusted, annual benefit beginning at age 62.

(b) In the event the participating employee's benefit is based on at least 15 years of service as a full-time employee of any police or fire department, as defined by federal law, or on 15 years of military service, the adjustments provided for in par. (a) do not apply.

(c) The reductions provided for in par. (a) are not applicable to pre-retirement disability benefits or pre-retirement death benefits.

(d) In the event the participating employee's retirement benefit becomes payable after age 65, and is payable as a money purchase annuity pursuant to s. 40.23, Stats. for purposes of determining whether this benefit meets the limitation set forth in sub. (3), such benefit shall be adjusted so that it is actuarially equivalent to the benefit beginning at age 65. This adjustment shall be made using an assumed interest rate of 5% and shall be made in accordance with regulations promulgated by the secretary of the treasury or his delegate.

(7) FEWER THAN 10 YEARS OF SERVICE ADJUSTMENT FOR 415(b) LIMITATIONS. The maximum retirement benefits payable to any participating employee who has completed fewer than 10 years of service is the amount determined under sub. (3) multiplied by a fraction, the numerator of which is the number of the participating employee's years of service and the denominator of which is 10. The reduction provided by this subsection cannot reduce the

maximum benefit below 10%. The reduction provided for in this subsection is not applicable to pre-retirement disability benefits or pre-retirement death benefits.

(8) TEN THOUSAND DOLLAR LIMIT. Notwithstanding the limitations set forth in this section, the retirement benefit payable with respect to a participating employee shall be deemed not to exceed the 415 limit if the benefits payable, with respect to such participating employee under the Wisconsin retirement system and under all other qualified defined benefit pension plans to which the participating employer contributes, do not exceed \$10,000 for the applicable limitation year and for any prior limitation year and the participating employer has not at any time maintained a qualified defined contribution plan in which the participating employee participated.

(9) EFFECT OF CERTAIN POST-RETIREMENT BENEFIT ADJUSTMENTS WITHOUT A LUMP SUM COMPONENT ON 415(b) TESTING. Effective on and after January 1, 2009, for purposes of applying the 415(b) limit of the internal revenue code to an annuitant without a lump sum benefit, the Department shall apply the following standards:

(a) An annuitant's applicable 415(b) limit shall be applied to the annual benefit in the annuitant's first limitation year without regard to any post-retirement benefit adjustments under ss. 40.27 and 40.28;

(b) To the extent that the annuitant's annual benefit equals or exceeds the 415(b) limit, the annuitant shall no longer be eligible for benefit increases until such time as the benefit plus the accumulated increases are less than the 415(b) limit; and

(c) Thereafter, in any subsequent limitation year, an annuitant's annual benefit, including any post-retirement benefit increases under ss. 40.27 and 40.28, Stats., shall be tested under the then applicable 415(b) limit including any adjustment to section 415(b)(1)(A) of the internal revenue code dollar limit under section 415(d) of the internal revenue code, and the regulations thereunder.

(10) EFFECT OF POST-RETIREMENT BENEFIT ADJUSTMENT WITH A LUMP SUM COMPONENT ON 415(b) TESTING. On and after January 1, 2009, with respect to an annuitant who receives a portion of the annuitant's annual benefit in a lump sum, the annuitant's applicable 415(b) limit shall be applied taking into consideration post-retirement benefit adjustments as required by section 415(b) of the internal revenue code and applicable Treasury Regulations.

(11) SECTION 415(c) LIMITATIONS ON CONTRIBUTIONS AND OTHER ADDITIONS. After-tax contributions by a participating employee or other annual additions with respect to a

participating employee may not exceed the lesser of \$40,000 as adjusted pursuant to section 415(d) of the internal revenue code or 100% of the participating employee's compensation.

(a) Annual additions are the sum, for any year, of contributions by a participating employer to a defined contribution plan, contributions by a participating employee to such a plan, and forfeitures credited to the individual account of a participating employee. Contributions made by a participating employee are determined without regard to rollover contributions and to picked-up employee contributions under section 414(h)(2) of the internal revenue code that are paid to a defined benefit plan.

(b) Except as otherwise provided in this subsection, for purposes of applying section 415(c) of the internal revenue code and for no other purpose, the definition of compensation, where applicable, used by the Department is compensation actually paid or made available during a limitation year, except as noted in this subsection and as permitted by Treasury Regulation section 1.415(c)-2, or successor regulation; provided, however, that contributions by participating employees that are picked up under section 414(h) of the internal revenue code shall not be treated as compensation. For these purposes, compensation is defined as wages within the meaning of section 3401(a) of the internal revenue code and all other payments of compensation to a participating employee by a participating employer for which the participating employer is required to furnish the employee a written statement under sections 6041(d), 6051(a)(3) and 6052 of the internal revenue code and shall be determined without regard to any rules under section 3401(a) of the internal revenue code that limit the remuneration included in wages based on the nature or location of the employment or the services performed, such as the exception for agricultural labor in section 3401(a)(2) of the internal revenue code.

1. For limitation years beginning after December 31, 1997, compensation also includes amounts that would otherwise be included in compensation but for an election under section 125(a), 402(e)(3), 402(h)(1)(B), 402(k), or 457(b) of the internal revenue code. For limitation years beginning after December 31, 2000, compensation also includes any elective amounts that are not includible in the gross income of the participating employee by reason of section 132(f)(4) of the internal revenue code.

2. For limitation years beginning on and after January 1, 2009, compensation for the limitation year also includes compensation paid by the later of 2½ months after a

participating employee's termination of employment or the end of the limitation year that includes the date of the participating employee's termination of employment if:

a. The payment is regular compensation for services during the participating employee's regular working hours, or normal compensation for services outside the participating employee's regular working hours such as overtime or shift differential, commissions, bonuses or other similar payments, and, absent a termination of employment, the payments would have been paid to the participating employee while the participating employee continued in employment with the participating employer;

b. The payment is for unused accrued bona fide sick, vacation or other leave that the participating employee would have been able to use if employment had continued; or

c. Payments pursuant to a nonqualified unfunded deferred compensation plan, but only if the payments would have been paid to the participating employee at the same time if the participating employee had continued employment with the participating employer and only to the extent that the payment is includible in the participating employee's gross income.

3. Any payments not described in subd. 2 are not considered compensation if paid after termination of employment, even if they are paid within 2½ months following termination of employment, except for payments to a participating employee who does not currently perform services for the participating employer by reason of qualified military service within the meaning of section 414(u)(1) of the internal revenue code to the extent these payments do not exceed the amounts the individual would have received if the individual had continued to perform services for the participating employer rather than entering qualified military service.

4. A participating employee who is in qualified military service within the meaning of section 414(u)(1) of the internal revenue code shall be treated as receiving compensation from the participating employer during such period of qualified military service equal to:

(a) The compensation the participating employee would have received during such period if the participating employee were not in qualified military service, determined based on the rate of pay the participating employee would

have received from the participating employer but for the absence during the period of qualified military service; or

b. If the compensation the employee would have received during such period was not reasonably certain, the employee's average compensation from the participating employer during the 12 month period immediately preceding the qualified military service, or, if shorter, the period of employment immediately preceding the qualified military service.

5. Back pay, within the meaning of Treasury Regulation section 1.415(c)-2(g)(8), shall be treated as compensation for the limitation year to which the back pay relates to the extent the back pay represents wages and compensation that would otherwise be included under this definition.

(c) For limitation years beginning on or after January 1, 2009, a participating employee's compensation for purposes of sub. (11) may not exceed the annual limit under section 401(a)(17) of the internal revenue code.

(12) SERVICE PURCHASES UNDER SECTION 415(n). (a) For permissive service credit contributions made in limitation years beginning after December 31, 1997, if a participating employee makes one or more contributions to purchase permissive service credit under the Wisconsin retirement system, then the requirements of Section 415(n) of the internal revenue code shall be treated as met only if:

1. The requirements of Section 415(b) of the internal revenue code are met, determined by treating the accrued benefit derived from all such contributions as an annual benefit for purposes of Section 415(b) of the internal revenue code, or

2. The requirements of Section 415(c) of the internal revenue code are met, determined by treating all such contributions as annual additions for purposes of Section 415(c) of the internal revenue code.

(b) For purposes of applying this section, the system shall not fail to meet the reduced limit under Section 415(b)(2)(C) of the internal revenue code solely by reason of this paragraph and shall not fail to meet the percentage limitation under Section 415(c)(1)(B) of the internal revenue code solely by reason of this section.

(c) For purposes of this section the term "permissive service credit" means service credit:

1. Recognized by the Wisconsin retirement system for purposes of calculating a member's benefit under the system;

2. Which such member has not received under the system; and

3. Which such member may receive only by making a voluntary additional contribution, in an amount determined under the system, which does not exceed the amount necessary to fund the benefit attributable to such service credit. Effective for permissive service credit contributions made in limitation years beginning after December 31, 1997, such term may include service credit for periods for which there is no performance of service, and, notwithstanding subparagraph (B) of this paragraph, may include service credited in order to provide an increased benefit for service credit which a member is receiving under the system.

(d) The Wisconsin retirement system shall fail to meet the requirements of this section if:

1. More than 5 years of nonqualified service credit are taken into account for purposes of this subsection; or
2. Any nonqualified service credit is taken into account under this subsection before the participating employee has at least 5 years of participation under the system.

(e) For purposes of par.(d) of this subsection, effective for permissive service credit contributions made in limitation years beginning after December 31, 1997, the term "nonqualified service credit" means permissive service credit other than that allowed with respect to:

1. Service, including, without limitation, parental, medical, sabbatical, and similar leave, as an employee of the Government of the United States, any State or political subdivision thereof, or any agency or instrumentality of any of the foregoing, other than military service or service for credit which was obtained as a result of a repayment described in Section 415(k)(3) of the internal revenue code;
2. Service, including, without limitation, parental, medical, sabbatical, and similar leave, as an employee, other than as an employee described in subd. 1, of an education organization described in Section 170(b)(1)(A)(ii) of the internal revenue code which is a public, private, or sectarian school which provides elementary or secondary education through grade 12, or a comparable level of education, as determined under the applicable law of the jurisdiction in which the service was performed;
3. Service as an employee of an association of employees who are described in subd. 1; or
4. Military service, other than qualified military service under Section 414(u) of the internal revenue code, recognized by the system.

(f) In the case of service described in subdivisions 1, 2 and 3 of paragraph (e) of this subsection, such service shall be nonqualified service if recognition of such service would cause an annuitant to receive a retirement benefit for the same service under more than one plan.

(g) In the case of a trustee-to-trustee transfer after December 31, 2001, to which Section 403(b)(13)(A) of the internal revenue code or Section 457(e)(17)(A) of the internal revenue code applies without regard to whether the transfer is made between plans maintained by the same employer:

1. The limitations of paragraph (4) of this subsection shall not apply in determining whether the transfer is for the purchase of permissive service credit, and

2. The distribution rules applicable under federal law to the system shall apply to such amounts and any benefits attributable to such amounts.

3. For an eligible participating employee, the limitation of Section 415(c)(1) of the internal revenue code shall not be applied to reduce the amount of permissive service credit which may be purchased to an amount less than the amount which was allowed to be purchased under the terms of the Wisconsin retirement system as in effect on August 5, 1997. For purposes of this paragraph an eligible participating employee is a participating employee who first became a member in the system before January 1, 1998.

(13) MODIFICATION OF CONTRIBUTIONS FOR 415(c) AND 415(n) PURPOSES. Notwithstanding any other provision of law to the contrary, the Department may modify a request by a participating employee to make a contribution to the Wisconsin retirement system if the amount of the contribution would exceed the 415 limits of the internal revenue code by using the following methods:

(a) If the law requires a lump sum payment for the purchase of service credit, the Department may establish a periodic payment plan for the participating employee to avoid a contribution in excess of the limits under section 415(c) or 415(n) of the internal revenue code.

(b) If payment pursuant to par. (a) will not avoid a contribution in excess of the limits imposed by section 415(c) or 415(n) of the internal revenue code, the Department may either reduce the participating employee's contribution to an amount within the limits of those sections or refuse the participating employee's contribution.

(14) REDUCTION OF BENEFITS PRIORITY. Reduction of benefits and contributions to all retirement plans maintained by the same participating employer, where required, shall be

accomplished by first reducing the participating employee's benefit under any defined benefit plans in which the participating employee participated, such reduction to be made first with respect to the plan in which the participating employee most recently accrued benefits and thereafter in such priority as shall be determined by the Department and the plan administrator of such other plans, and next, by reducing or allocating excess forfeitures for defined contribution plans in which the participating employee participated, such reduction to be made first with respect to the plan in which the participating employee most recently accrued benefits and thereafter in such priority as shall be established by the plan and the plan administrator for such other plans provided, however, that necessary reductions may be made in a different manner and priority pursuant to the agreement of the Department and the plan administrator of all other plans covering such participating employee.

SECTION 5. ETF 20.38 and 20.39 are created to read:

20.38 Eligible rollover distributions. (1) For purposes of s.40.08(14), Stats., and compliance with section 401(a)(31) of the internal revenue code, this section applies notwithstanding any contrary provision or retirement law that would otherwise limit a distributee's election to make a rollover. A distributee may elect, at the time and in the manner prescribed by the Department, to have any portion of an eligible rollover distribution paid directly to an eligible retirement plan specified by the distributee in a direct rollover.

(2) Effective January 1, 2002, the definition of eligible rollover distribution includes a distribution to a surviving spouse, or to a spouse or former spouse who is an alternate payee under a qualified domestic relations order, as defined in section 414(p) of the internal revenue code.

(3) "Eligible rollover distribution" means any distribution of all or any portion of the balance to the credit of the distributee, except that an eligible rollover distribution does not include:

(a) Any distribution that is one of a series of substantially equal periodic payments, not less frequently than annually, made for the life or the life expectancy of the distributee or the joint lives or joint life expectancies of the distributee and the distributee's designated beneficiary, or for a specified period of ten years or more;

(b) Any distribution to the extent such distribution is required under section 401(a)(9) of the internal revenue code;

(c) The portion of any distribution that is not includible in gross income; and

(d) Any other distribution which the Internal Revenue Service does not consider eligible for rollover treatment, such as certain corrective distributions necessary to comply with the provisions of section 415 of the internal revenue code or any distribution that is reasonably expected to total less than \$200 during the year.(3) Effective January 1, 2002, a portion of a distribution will not fail to be an eligible rollover distribution merely because the portion consists of after-tax employee contributions that are not includible in gross income. However, such portion may be transferred only:

1. To an individual retirement account or annuity described in section 408(a) or (b) of the internal revenue code or to a qualified defined contribution plan described in section 401(a) of the internal revenue code;

2. On or after January 1, 2007, to a qualified defined benefit plan described in section 401(a) of the internal revenue code or to an annuity contract described in section 403(b) of the internal revenue code, that agrees to separately account for amounts so transferred and earnings thereon, including separately accounting for the portion of the distribution that is includible in gross income and the portion of the distribution that is not so includible;

3. On or after January 1, 2008, to a Roth IRA described in section 408A of the internal revenue code. Effective January 1, 2002, the definition of eligible rollover distribution also includes a distribution to a surviving spouse, or to a spouse or former spouse who is an alternate payee under a qualified domestic relations order, as defined in section 414(p) of the internal revenue code.

(4) As used in this section, "eligible retirement plan" means any of the following that accepts the distributee's eligible rollover distribution:

(a) An individual retirement account described in section 408(a) of the internal revenue code;

(b) An individual retirement annuity described in section 408(b) of the internal revenue code;

(c) An annuity plan described in section 403(a) of the internal revenue code;

(d) A qualified trust described in section 401(a) of the internal revenue code;

(e) Effective January 1, 2002, an annuity contract described in section 403(b) of the internal revenue code;

(f) Effective January 1, 2002, a plan eligible under section 457(b) of the internal revenue code that is maintained by a state, political subdivision of a state, or any agency or instrumentality of a state or a political subdivision of a state that agrees to separately account for amounts transferred into that plan from the Wisconsin retirement system; or

(g) Effective January 1, 2008, a Roth IRA described in section 408A of the internal revenue code.

(5) As used in this section, "distributee" means a participating employee or former participating employee. It also includes the participating employee's or former participating employee's surviving spouse and the participating employee's or former participating employee's spouse or former spouse who is the alternate payee under a qualified domestic relations order, as defined in section 414(p) of the internal revenue code. Effective January 1, 2007, a distributee includes a nonspouse beneficiary who is a designated beneficiary as defined by section 401(a)(9)(E) of the internal revenue code. However, a nonspouse beneficiary may only make a direct rollover to an individual retirement account or individual retirement annuity established for the purpose of receiving the distribution, and the account or annuity shall be treated as an "inherited" individual retirement account or annuity.

(6) As used in this section, "direct rollover" means a payment by the plan to the eligible retirement plan specified by the distributee.

20.39 Limits on compensation. The Wisconsin retirement system is subject to the following rules for purposes of determining final average earnings:

(1) Effective with respect to plan years beginning on and after January 1, 1996, and before January 1, 2002, the annual compensation of a participating employee which exceeds \$150,000 as adjusted for cost-of-living increases under section 401(a)(17)(B) of the internal revenue code shall be disregarded for purposes of computing employee and participating employer contributions to or benefits due from the Wisconsin retirement system. Effective only for the 1996 plan year, in determining the compensation of an employee eligible for consideration under this provision, the rules of section 414(g)(6) of the internal revenue code shall apply, except that in applying such rules, the term "family" shall include only the spouse of the participating employee and any lineal descendants of

the employee who have not attained age 19 before the close of the year.

(2) Effective with respect to plan years beginning on and after January 1, 2002, the annual compensation of a plan participating employee which exceeds \$200,000 as adjusted for cost-of-living increases in accordance with section 401(a)(17)(B) of the internal revenue code may not be taken into account in determining benefits or contributions due for any plan year. For the purposes of applying this provision of the internal revenue code, annual compensation means compensation during the plan year or such other consecutive 12-month period over which compensation is otherwise determined under the plan or the determination period. The cost-of-living adjustment in effect for a calendar year applies to annual compensation for the determination period that begins with or within such calendar year. If the determination period consists of fewer than 12 months, the annual compensation limit is an amount equal to the otherwise applicable annual compensation limit multiplied by a fraction, the numerator of which is the number of months in the short determination period, and the denominator of which is 12. If the compensation for any prior determination period is taken into account in determining a plan participating employee's contributions or benefits for the current plan year, the compensation for such prior determination period is subject to the applicable annual compensation limit in effect for that prior period.

3. As used in this section, the term "eligible participating employee" means a person who first became a participating employee of the retirement system prior to the plan year beginning after December 31, 1995. Pursuant to section 13212(d)(3)(A) of Omnibus Budget Reconciliation Act of 1993, and the regulations issued under that section, eligible participating employees are not subject to the limits of section 401(a)(17) of the internal revenue code. The limits referenced in sub. (1) and sub. (2) above apply only to years beginning after December 31, 1995, and only to individuals who first become plan participants in plan years beginning on and after January 1, 1996.