MEMORANDUM OF LAW

DATE: April 17, 1990

TO: Lawrence B. Grissom, Retirement Administrator
FROM: City Attorney
SUBJECT: Internal Revenue Code Section 415

In a Memorandum of Law dated January 29, 1990, we answered several questions concerning the impact of Internal Revenue Code (IRC) section 415 on the City Employees' Retirement System (CERS). In the course of recent discussions on this subject, several additional questions have arisen. You have asked us to address the following issues.

I

Does IRC section 415 have an effect on any or all the "buy back" programs described in San Diego Municipal Code (SDMC) section 24.1001 (purchase of six months probationary period); section 24.1003 (part time service prior to membership); section 24.1006 (officer or employee not previously included within the field of membership) and section 24.1007 (military service)?

The limitations on benefits rule found in IRC section 415 affects all employees who participate in the above described "buy back" programs, but the year of application depends upon the employee's plan participation status during the period of time the "buy back" covers. When an employee makes a contribution to CERS for the purpose of purchasing a period of nonparticipation in CERS, the amount of the contribution allocated to the employee's separate contract account is calculated into the employee's current year safe harbor limitation formula found in IRC section 415(e) as a contribution to a defined contribution plan. When an employee is making a payment for a previous period of participation in which the employee made no contribution to the plan, the amount contributed is applied to the safe harbor limit for the year of participation for which the payment is made.

An employee returning from military service (SDMC section 24.1007) is treated as if the employee was a plan participant during that period pursuant to the provision of the Veterans Readjustment Act, 38 U.S.C. section 2021 et seq., (the Act) which requires an employer to restore an employee returning from military service to the veteran's former position or "to a position of like seniority, status and pay." The purpose of the Act is to ensure that the returning veteran returns with all the benefits of seniority protected by the Act. Credit for years of

creditable service in a retirement system is considered one of the benefits of seniority under the Act. Alabama Power Co. v. Davis, 431 U.S. 581 (1977). The Act does not require the employer to pay the veteran any amount of compensation for the period of time spent on military service. Foster v. Dravo Corp., 420 U.S. 879 (1975). The veteran merely receives whatever retirement benefit the employer would have provided had the veteran never been subject to military service. The requirement that a returning veteran pay the full amount of the unpaid employee contribution plus interest to the plan for years spent in military service has been held to be consistent with the purposes of the Act. Davis v. Alabama Power Co., 383 F. Supp. 880 (1974), aff'd, 431 U.S. 581 (1977). The City is not required to pay any amount into the system on behalf of the veteran because of an IRC section 414(h) "pickup" provision under the salary ordinance. The City "pickup" is authorized in the annual salary ordinance and is part of "annual compensation." It is not a benefit of seniority.

Similar treatment is afforded to an employee purchasing a previously unpaid period of participation due to an approved leave of absence (SDMC section 23.0313) or an employee repurchasing a period of participation after rehire (SDMC sections 24.0208 and 24.0310). Any repurchased amount is applied for the purposes of the IRC section 415(e) formula to the year of participation not the year the repurchase occurs. However, the purchase by employees of any period of nonparticipation in CERS described in SDMC sections 24.1001, 24.1003 and 24.1006 will affect the employee's safe harbor limitation for the year in which the purchase is made and the contributions credited to the employee's separate contract account must be treated as contributions to a defined contribution plan for that year.

II

Must contributions from the Management Benefit Plan (MBP) to CERS also be calculated in the IRC section 415(e) formula as employer contribution?

In previous years, an employee participating in MBP had the option of allocating certain dollar amounts from MBP to offset the employee's current annual contribution to CERS. Such allocations from MBP were in fact employer pre-tax contributions to a defined benefit plan and as such affected the projected annual benefit factor contained in the IRC section 415(e) formula. In other words, they were additional employer "pick ups" which needed to be calculated as employer contributions in the formula pursuant to IRC section 414(h).

III

Must the retirement board of administration take specific action to provide the benefits of IRC section 411 authorizing the repurchase of creditable years in the system?

As indicated in our January 29, 1990, Memorandum of Law, CERS, a qualified governmental plan, is exempt from the mandatory provisions of IRC section 411 that set forth minimum time limits and standards for employees who desire to repurchase creditable years of prior service in private sector defined benefit plans. The purpose of the statute is to prevent the forfeiture of previously earned benefits. Currently, CERS voluntarily offers a similar benefit to rehired City employees. SDMC sections 24.0208 and 24.0310. IRC section 411 mandates a five-year minimum time period for repayment of such distributions by the employee. The Code does not limit the maximum period for repayment except that repayment must be made before normal retirement age. 26 C.F.R. section 1.411(a)-7(d)(2)(ii)(D)(ii). There is no prohibition in the IRC that precludes the City from expanding its provision to employees who received an in-service voluntary withdrawal. There is also no requirement in the IRC for a governmental plan to adopt a specific regulation in order to provide for the repayment of in-service withdrawals by employees. However, the Retirement Board should consider the enactment of such a provision in order to establish consistent rules and procedures.

IV

May employees who took refunds of contributions without a break in service be considered as rehires for the purpose of applying the provision of IRC section 411?

As indicated above, IRC section 411 makes no distinction between repayments as a result of rehire or as a result of a return of voluntary in-service withdrawals.

V

If Congress enacts legislation requiring that any employee of a public entity who does not belong to a defined benefit plan, must belong to Social Security, will those employees continue to be eligible to participate in SPSP/SPSP-M?

We are aware that President Bush has recommended to Congress that Social Security coverage be imposed on all state and local government employees who are not covered under a governmental pension plan. We do not know if the current legislative proposal excludes defined contribution plans such as SPSP/SPSP-M in the definition of governmental pension plans. In any event, specific questions concerning this proposed legislation can only be answered after we have the opportunity to analyse the exact language of the bill. We will then be able to assess the bill's

impact upon SPSP/SPSP-M Plans. The current SPSP/SPSP-M plan documents do provide for plan termination in case the City is required to contribute on behalf of plan participants to the Federal Social Security System but that language does not preclude the adoption of one or more other available options.

JOHN W. WITT, City Attorney
By
John M. Kaheny
Chief Deputy City Attorney

JMK:mrh:352(x043.2)
ML-90-53