

DATE: January 18, 1990

TO: D. Cruz Gonzalez, Risk Management Director,
via Jack McGrory, Assistant City Manager
FROM: City Attorney
SUBJECT: Disposition of Excess Employer Matching
Contributions to the Supplemental Pension
Savings Plans

In a Memorandum of Law dated April 19, 1989, this office confirmed The Wyatt Company's conclusion that Internal Revenue Code (IRC) section 414(s) prevented monies contributed by a City employee to a section 457 deferred compensation account from being treated as compensation for the purposes of calculating benefits under the Supplemental Pension Savings Plans (SPSP and SPSP-M). That advice was based on an amendment to IRC section 414 which changed the definition of compensation for pension plan tax qualification purposes. That change also affected the calculation of the maximum limitation of benefits for individuals participating in both a defined benefit plan and a defined contribution plan (provided by the same employer) as described in IRC section 415(e). As a result of that advice, the Risk Management Department identified employees who had made excess contributions to their SPSP accounts based on amounts contributed to the section 457 deferred compensation plan. In order to maintain the tax qualification status of SPSP and SPSP-M, it was agreed that the excess employee contributions were to be refunded directly to the employee and that the corresponding excess employer matching contributions would be removed from the individual SPSP account and held in another fund pending a final decision as to its disposition. You have now asked this office the following additional questions concerning this matter.

1. Could the City's match be distributed directly to the employees from whose accounts the funds were recovered?
2. Could the City's match be distributed to employees in general as cash?
3. Could the City's match be left in the SPSP fund in any form?
4. Could the City's match be reclaimed by the City and used for any legitimate purpose?
5. Is there a requirement or need for the City to negotiate with the labor groups regarding the disposition of the City's match?

We note initially that neither the SPSP nor SPSP-M Plan Documents specifically address the disposition of excess employer

matching contributions under these circumstances. However, both Plan Documents provide that excess matching contributions resulting from a failure to pass the nondiscrimination test are to be placed in the forfeiture reserve account to reduce future excess employer matching contributions. Both Plan Documents also state that in the case of contributions which are made by the City by a mistake of fact, such contributions may be returned to the City within one year after they are contributed to the Plan. The Plan Documents do not require such contributions to be placed in the forfeiture reserve account but there is nothing prohibiting such disposition. In addition, both Plan Documents provide that if the Plans are disqualified as a result of an improper plan amendment, the City's contributions conditioned upon such qualification may be returned to the City within one year after the date the Plan's qualification is denied. It is therefore apparent that both Plan Documents contemplate two types of distributions for excess employer matching contributions. The first is to place such contributions in the forfeiture reserve account and the other is to return it directly to the City. Sound accounting procedures would dictate that under the latter circumstances, the return of excess matching contributions should be made to the fund which made the excess contributions.

In response to your first question, we do not believe it to be legally possible to distribute the excess employer matching contributions directly back to the individual employee. As indicated above, the Plan Documents do not contemplate such a distribution under any circumstances. In addition, if the City exceeds the maximum limitation on benefits set forth in IRC section 415(e), the SPSP Plans could be disqualified pursuant to the rules set forth at 26 C.F.R. 1.415-9(3). It can also be argued with authority that any distribution of excess employer matching contributions directly to the employee from whom the funds were recovered is in effect a premature distribution of trust assets in violation of the Code and the Plan Documents. Permitting such a procedure jeopardizes the tax qualification

status of the Plans because the City cannot do indirectly that which is prohibited directly by changing or altering a method of payment under the Plan. *Fentron Industries v. Nat. Shopmen Pension Fund*, 674 F.2d 1300 (1982). The excess employer matching contributions should therefore be returned to either the forfeiture reserve account or to the original funding source. If the City returns the excess matching contributions to the forfeiture reserve account or the original funding source, we believe the maximum limitation on benefit rule set forth in IRC section 415(e) would not be violated. It is therefore strongly

recommended that those procedures be followed.

You next asked if the excess employer matching contributions could be distributed to employees in general as cash. As indicated above, the excess employer matching contributions could be returned to either the original funding source or the forfeiture reserve account. Funds returned to the original funding source can be used for any authorized purpose including the funding of employee salaries and benefits in accordance with the provisions of the Annual Salary Ordinance. Funds deposited in the forfeiture reserve account may only be used to offset future City contributions.

Your third question asked if the excess employer matching contributions could be left in the SPSP trust fund in any form. As indicated above, we believe that these contributions can be placed in the forfeiture reserve account.

Your fourth question has already been answered. If the excess employer matching contributions have been returned to the original funding source, they may be used by The City of San Diego for any authorized purpose.

Your last question concerns the possibility of a requirement for the City to negotiate with the recognized employee organizations regarding the disposition of the excess employer matching contribution funds. If The City of San Diego uses the excess employer matching contributions in any way that affects or changes wages, hours and working conditions of the employees of The City of San Diego, that matter is certainly a mandatory subject for the meet and confer process. On the other hand, if the amounts returned to the original funding source are spent in a manner that does not directly affect or have an impact on wages, hours or working conditions, there is no need to meet and confer on that issue. A transfer to the forfeiture reserve

account clearly does not have such an affect and the City would therefore not be required to meet and confer over such a distribution.

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By

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