

MEMORANDUM OF LAW

DATE: April 28, 1993

TO: Larry Grissom, Retirement Administrator

FROM: City Attorney

SUBJECT: Internal Revenue Service Direct Rollover Rules

In a memorandum dated February 22, 1993, you asked us to review and comment upon procedures implemented in December of 1992 by the San Diego City Employees' Retirement System ("SDCERS" or "Plan") for the purpose of complying with the new Internal Revenue Service ("IRS") direct rollover regulations.

BACKGROUND

On January 1, 1993, every tax qualified retirement plan was required to satisfy new IRS rules allowing members to elect a direct rollover of covered benefit payments to an Individual Retirement Account ("IRA") or a qualified defined contribution plan. If the member does not elect a direct rollover, there is an automatic 20% tax withholding on these distributions.

Essentially, the IRS regulations require SDCERS to provide a notice to persons eligible to receive a payment from the Plan which qualifies for a direct rollover. The notice must provide information about the payee's option to accept the payment or roll it over, and the resultant tax consequences of these actions. SDCERS is obligated to report all qualifying payments to the IRS, to establish procedures for distribution of the payments in accordance with the desire of the payee and to process those payments accordingly.

Failure to comply with the new regulations could have serious consequences. SDCERS is a tax qualified plan within the meaning of Internal Revenue Code ("IRC") section 401(a) and thus enjoys a privileged tax qualified status. To maintain this tax status and avoid disqualification by the IRS, the Plan must adhere to the new IRS rollover regulations. The IRS also has the power to impose a penalty of up to \$5,000 per year for failure to comply with these regulations.

The balance of this memorandum is broken down into two parts. Part 1 categorizes payments from the Plan which are subject to the new IRS rollover regulations. Part 2 discusses the IRS noticing, election and reporting requirements.

PART 1. PAYMENTS SUBJECT TO THE IRS ROLLOVER REGULATIONS

The following SDCERS payments are subject to IRS rollover requirements and therefore the payee must be given the opportunity to elect to rollover the taxable portion of the payment into an IRA or qualified defined contribution plan.

- a. The taxable portion of a refund of contributions to a member who has separated from service with the City. (San Diego Municipal Code ("SDMC") section 24.0308.)
- b. The taxable portion of a refund of spousal survivor contributions. (SDMC section 24.0521.)
- c. The amount in excess of the first \$5,000 of the taxable portion of a Basic Death Benefit payable to the member's spouse or former spouse, when distribution of the benefit is in the form of a lump sum. (SDMC section 24.0703.)
- d. The amount in excess of the first \$5,000 of the taxable portion of a lump sum survivor benefit payment to a spouse or a former spouse who is named as a beneficiary in connection with an Option 1 settlement. (SDMC section 24.0603.)
- e. The accrued service retirement or disability retirement allowance payable at death to a spouse or former spouse who qualifies as a beneficiary to receive such payment.
- f. The amount in excess of the first \$5,000 of the taxable portion of a special death benefit payable in a lump sum to a remarried widow. (SDMC section 24.0709.)

The following SDCERS payments are not subject to IRS rollover requirements and therefore the payee must not be given the opportunity to elect to rollover any portion of the payment into an IRA or qualified defined contribution plan.

- a. Disability retirement allowance payments. (SDMC sections 24.0501 et seq.)
- b. Service retirement allowance payments. (SDMC sections 24.0401 et seq.)
- c. Thirteenth Check payments. (SDMC section 24.0404.)
- d. Survivor benefit payments in the form of a monthly allowance to a beneficiary for the lifetime of the beneficiary. (SDMC sections 24.0521, 24.0604(a)(1), (2), 24.0605, 24.0606.)
- e. Retiree Death Benefit payment. (SDMC section 24.0714.2.)

- f. Basic Death Benefit payment(s), when the recipient is not the member's spouse or former spouse. (SDMC sections 24.0701 et seq.)
- g. Basic Death Benefit payments to the member's spouse or former spouse, when distribution of the benefit is in the optional form of equal monthly installments for the life of the beneficiary. (SDMC section 24.0704.)
- h. Death While Eligible Benefit payments to any beneficiary entitled to receive that benefit. (SDMC sections 24.0704, 24.0704.2.)
- i. Special Death Benefit payment(s), with the exception of a lump sum distribution to a widow who remarries. (SDMC sections 24.0705, 24.0706.)

PART 2. NOTICE, ELECTION AND REPORTING REQUIREMENTS

Notice Requirements

Any person eligible to receive a payment which qualifies for rollover from SDCERS must be given a "Special Tax Notice" in a 60 day window period; no less than thirty (30) days unless waived by executing a written election form, and no more than ninety (90) days before the date the payment is distributed. A notice is not required if the qualifying payment amounts to less than \$200, after aggregating all plan distributions to the member within the calendar year.

Presently, SDCERS is utilizing a model notice issued by the IRS which is intended to apply to all qualified plans, public and private. We suggest that this notice be slightly modified and tailored to remove certain language which is not meaningful to public pension plans in general, including SDCERS, and thus could result in some confusion to the reader (i.e., reference to "Alternate Payee"). We would be happy to work with you on revising this notice.

Election Requirements

The IRS requires SDCERS to do some minimal screening to ensure the legitimacy of the transaction when a member, spouse of a member, or former spouse of a member elects to rollover a qualifying payment into an IRA or a qualified defined contribution plan. On the election form, SDCERS is required to solicit adequate information to ensure that, at least facially, the transaction appears legitimate.

In order to satisfy this requirement, we suggest that the election form presently being used by SDCERS be upgraded to require more information about the IRA or defined contribution plan designated to receive the rollover payment. Also, the election form should reflect a representation from the member that the plan designated to receive the rollover is an "eligible

retirement plan qualified to receive a direct rollover." Lastly, although a member withdrawing contributions is currently required to execute a separate waiver form, we recommend that language be incorporated into this form to advise the member that by electing to rollover or take the distribution, they are waiving all future benefits from SDCERS. Again, we would be happy to work with you on revising this form.

Reporting Requirements

Every payment from the Plan which is eligible for direct rollover and every direct rollover that is made by SDCERS must be reported to the IRS on IRS Form 1099R.

If you need further assistance, please let us know.

JOHN W. WITT, City Attorney

By

Richard A. Duvernay

Deputy City Attorney

RAD:mrh:352(x043.2)

cc Mary Ford

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