STATE "PICKUP" OF EMPLOYEE RETIREMENT CONTRIBUTIONS

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INTRODUCTION

The state Department of Personnel Administration (DPA) is in the process of implementing administratively a federal tax provision allowing the state to "pick up" mandatory employee retirement contributions. Implementation of the pickup program would result in increased take-home pay to state employees--due primarily to reduced federal tax liabilities--at no direct cost to the state.

In this report, we examine the fiscal and policy implications of implementing the pickup program. Chapter I provides background information, including a description of the pickup program and a summary of current retirement costs for state employers and employees. Chapter II discusses the fiscal impact of the program on the affected parties: state employees, the state, and the federal government. Finally, Chapter III examines some related considerations (for instance, the role of collective bargaining).

This report is based on information provided by the Public Employees' Retirement System (PERS), other public retirement systems which have adopted the program, and by the Internal Revenue Service.

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CHAPTER I

BACKGROUND INFORMATION

In this chapter, we provide background information on the federal tax law provision which allows the state to "pick up" its employees' mandatory retirement contributions. Specifically, the chapter describes:

- How the pickup program works;
- The process of implementing the program;
- Other public entities' experience with the program; and
- The state's current retirement costs and contribution rates.

DESCRIPTION OF THE PICKUP PROGRAM

In 1978, Congress enacted Internal Revenue Code Section 414 (h)(2), which authorizes state and local public employers to provide an increase in after-tax income to their employees at no additional direct cost to the employer. Under this program, public employers can "pick up"--that is, pay for--all or a portion of their employees' contributions toward the cost of these employees' retirement benefits.

The pickup program, however, is accomplished not through additional employer expenditures, but by manipulating the employee's salary on paper. In effect, the employer separates the existing salary into two pieces: (1) an amount equal to the employee's retirement contribution (the amount that is being "picked up"), and (2) the remaining salary. The first piece is then deemed to be an employer contribution to the employee's retirement account. As such, this compensation is treated as deferred income, to be taxed later when retirement benefits are received. The second piece becomes the employee's new salary. This has the effect of transforming that portion of the employee's income corresponding to his/her retirement payment from taxable income to income on which taxes are deferred.

Table 1 provides a hypothetical example of how the pickup works. Assume Employee X earns $2,000 a month, from which the tax liabilities and mandatory retirement contributions shown in the "Without Pickup" column are deducted. Under existing law, Employee X's mandatory retirement contribution from after-tax income is $100, leaving $1,642 in take-home pay each month.

Table I-1

How the Pickup Works
Hypothetical Example[a]

Employee X	Without Pickup		With Pickup
Monthly Gross Income	$2,000		$1,900[b]
Less Income Taxes:			
Federal Taxes	-218		-199
State Taxes	-40		-35
Subtotal, Income taxes	(-258)		(-234)
Less Retirement Contributions	-100		-0-
Remaining Monthly Income	$1,642		$1,666
Difference		$24	

a. For this example, we have assumed that the taxpayer is married with two children, files a joint return, has no other income, and takes the standard deduction. In addition, we have used 1983 tax rates.
b. For purposes of social security taxes and pension benefits, the monthly income base is still $2,000, not $1,900.

Under the pickup program, Employee X's salary is "reduced" by $100 and the employer pick up his/her $100 retirement contribution. Without regard to the tax consequences, these two actions offset one another. Because the employee's salary is lower, however, he/she pays less federal and state income taxes. In the hypothetical example illustrated by Table 1, the tax savings is $24 a month. Thus, by shifting a portion of the employee's compensation from a <u>taxable</u> form (a mandatory employee retirement contribution that must be paid from after-tax income) to a tax-deferred form (an employer-paid retirement benefit that is not taxed until received), the pickup program increases the employee's current take-home pay by $24 per month.

As noted above, the pickup does not <u>exempt</u> income from taxation forever; it just defers it to a later time. For most employees, the income would not be taxed until the employee retires and begins receiving retirement benefits. Since most people are in much <u>lower</u> marginal tax brackets during their retirement years, however, the tax deferral also has the effect of <u>lowering</u> the tax liability on that income.

For certain employees, however, the pickup program could result in <u>increased</u> tax liabilities. Employees leaving state service are entitled to a refund of the money in their retirement accounts, which includes employer pickup contributions. Any portion of these funds which has not already been subject to federal and state income taxes is taxable upon receipt. It is possible that all or part of the lump-sum fund would be subject to federal and state taxation at <u>higher</u> marginal tax rates than would have been the case in the absence of the pickup.

While the pickup program affects the employee's wage base for purposes of income taxation, it does not change the wage base for purposes of calculating other benefits. For example, social security taxes would be assessed on wages as if the employer's pickup contribution were still in the employee's wage base. Consequently, neither social security taxes nor benefits would be affected by the pickup program. Similarly, the salary base on which state retirement benefits are determined would not be altered by the pickup program. Benefits would still be calculated as if the employer's pickup contribution were still included in the employee's salary.

IMPLEMENTING THE PICKUP PROGRAM

Under existing law (Government Code Section 20616, as established by Chapter 794, Statutes of 1983), the state and the Regents of the University of California already are authorized to establish pickup programs. Consequently, implementation of such programs can be accomplished administratively, without further legislative action.

The Department of Personnel Administration (DPA) currently is taking steps towards implementing the pickup program for state Public Employees' Retirement System (PERS) members.[1] The department sought and received a "revenue ruling" from the Internal Revenue Service (IRS) in order to assure the state's eligibility for the pickup program, and it is contacting the state employee organizations to obtain approval for this change in employee compensation. Once these tasks are accomplished, the department will contact the IRS and certify that the mandatory employee contributions are,

1. DPA has no authority to implement the pickup program for the Legislator's Retirement System or the Judges' Retirement System.

in fact, being paid by the employer. DPA plans to implement the program for nonrepresented employees (that is, state employees not covered by collective bargaining, such as management personnel) starting with February 1985 paychecks. Implementation for represented employees will begin following union approval.

In addition to complying with the requirement that employers specifically elect the pickup program, the state must comply with two other IRS provisions before it can implement the pickup program. First, the pickup must be available to all employees of the affected employer (in this case, all PERS members). This antidiscrimination rule is applied by the IRS to many benefits in order to assure participation by employees in all income groups. Second, the employees cannot be given the option of receiving the picked up contributions directly; it must be paid by the employer to the pension plan.

EXPERIENCE WITH THE PICKUP PROGRAM

Although several public agencies and institutions began paying their employee retirement contributions during the late 1970s, the tax implications of this program have not been widely recognized or publicized. In recent years, however, public employers in increasing numbers have begun offering this tax-deferred fringe benefit. To date, the following states have implemented (or are in the process of implementing) this program for some or all of their retirement systems: Alabama, Illinois, Kentucky, Louisiana, Nebraska, Ohio, Oregon, South Carolina, Utah, and Virginia. Court cases (such as University of North Dakota v. USA, U.S. Court of Appeals, 8th Circuit, 1979), as well as numerous rulings by the IRS and state tax agencies, have clarified and reaffirmed the validity and the legality of the tax-deferred nature of this program.

In California, the University of California Retirement System initiated the program for its members (with an equivalent salary reduction) beginning July 1, 1983. (Information regarding the UC Pickup program is provided in Appendix A.) Chapter 794, Statutes of 1983 (AB 1266), authorized the University to extend the program to its employees who are PERS members. In addition, about 530 of the 1,300 local contracting agencies in the PERS currently pick up some or all their employees' retirement contributions.

In 1984, the Legislature passed AB 1265 (Elder), which would have authorized school districts to pick up mandatory teacher retirement under the State Teachers' Retirement System. The bill, however, was vetoed by the Governor. (See Attachment B for the text of AB 1265.)

CURRENT STATE RETIREMENT COSTS AND CONTRIBUTION RATES

The retirement benefits for state employees currently are provided by one of the following state-administered pension systems: the Public Employees' Retirement System (PERS), the Judges' Retirement System (JRS) and the Legislators' Retirement System (LRS). The state actually manages these systems and provides most of the funding for them.

The employer's (state) and employees' contributions to these retirement systems are summarized in Table 2. The table shows that, in 1984-85, state members of the PERS, LRS, and the JRS are expected to contribute $188 million to their respective retirement systems. The state's contribution to these systems in 1984-85 is estimated to total approximately $825 million.

Table I-2

State Retirement Systems
Estimated 1984-85 Contributions for State Employees
(dollars in millions)

		State Employers' Contributions		Employees' Contributions		Total	
Retirement System	Active Membership[a]	Percent of Salary	Amount[b]	Percent of Salary	Amount[b]	Percent of Salary	Amount[b]
Public Employees' Retirement System:							
Miscellaneous	113,244	18.267%	$632.1	5.0% or 6.0[c]	$135.1	23.3% or 24.3	$767.2
Industrial	3,538	19.976	16.2	6.0[d]	3.1	26.0	19.3
Safety	3,309	20.518	17.0	6.0[d]	4.2	26.5	21.2
Peace Officer/ Firefighter	16,465	24.310	100.2	8.0[e]	30.0	32.3	130.2
Patrol	5,419	25.292	41.1	8.0[e]	8.2	33.3	49.3
Legislators' Retirement System	115	18.810	0.7	8.0[f]	0.3	26.8	1.0
Judges' Retirement System	1,223	19.037[g]	17.4	8.0	7.1	27.0	24.5
TOTALS			$824.7		$188.0		$1,012.7

a. As of June 30, 1984. Peace Officer/Firefighter membership is estimated as of October 30, 1984.
b. Based on projected salaries for 1984-85.
c. Rates are 5.0 percent of monthly salary in excess of $513 for those with Social Security and 6.0 percent of monthly salary in excess of $317 for those without Social Security.
d. Applied to monthly salary in excess of $238.
e. Applied to monthly salary in excess of $863.
f. Except those elected prior to 1972, who pay 4.0 percent of salary.
g. Consists of a statutorily required contribution equal to 8.0 percent of salary and over 11 percent in deficiency support.

CHAPTER II

FISCAL CONSEQUENCES

In this chapter, we discuss the fiscal impact resulting from the Department of Personnel Administration's (DPA) implementation of the pickup program for Public Employees' Retirement System (PERS) members. The primary parties affected are: the federal government, the state, and state employees.

IMPACT ON THE FEDERAL GOVERNMENT

As described in Chapter I, the pickup program results in increased take-home pay for employees by shifting the compensation used to pay employees' retirement contributions from a currently taxable form (salary) to a tax-deferred form (an employer's contribution). The main "loser" in this process is the federal government, which experiences a loss of personal income tax revenues in the short-term. These losses are offset, to some extent, by revenue gains in the future.

Short-Term Revenue Losses

We can estimate the general magnitude of the immediate federal revenue loss which will result from DPA's implementation of a full pickup program of state employee contributions. As shown in Table I-2, the pickup program for PERS members will initially reduce federally taxable income by about $180 million annually. Assuming this income would have been subject to an average marginal federal tax rate of 30 percent, the federal revenue loss will be $54 million annually (if a 35 percent average marginal rate is assumed, the loss is $63 million).

These losses will be offset in part by increased revenues due to lower federal deductions for state taxes, as the pickup program will also lower state tax liabilities. This offset will be about $2 million ($3 million, if a 35 percent federal tax rate is assumed). Thus, the net federal revenue loss from state implementation of a full pickup program will be about $52 million annually in the short-run ($60 million, if a 35 percent rate is assumed). Given the uncertainty surrounding these estimates, however, we would characterize this annual federal revenue loss as being in the range of $50-60 million annually.

Long-Term Revenue Increases

The pickup program does not exempt income from taxation; it merely defers taxation of this income until a later date. Thus, part of the federal government's revenue loss will be offset by revenue gains in future years. These gains will be realized when state employees receive, in the form of retirement benefits or refunded contributions, the amounts picked up by the state.

In most cases, however, this deferred income will be taxed at lower marginal tax rates than would have been the case in the absence of a pickup program. This is due primarily to the fact that, for most people, retirement income is much less than their income while working. Consequently, the subsequent revenue gains to the federal government will be much less than the immediate revenue losses. Furthermore, even the revenue increases that accrue in subsequent years are not "worth" as much as they would be if received today.

There are, however, certain instances where the federal government will realize higher tax revenues due to the implementation of the pickup program. For instance, some retirees will be in higher marginal tax brackets than they were while working, due to higher income (for example, capital gain income) and/or lower deductions (for example, reduced mortgage interest deductions). In addition, those employees leaving state service will have to pay taxes on refunded accumulated contributions picked up by the employer for the employee. Because these contributions are returned to employees in a lump-sum amount, this income could be subject to a higher tax rate than it would have been if the income had been "spread out" over several years, as it is currently.[1]

We do not know the net effect of these short-term revenue reductions and long-term revenue gains on the federal government.

IMPACT ON THE STATE

Revenue Effects

The effects of the pickup program on California personal income tax revenues will be similar to the effect on federal tax revenues described in the preceding section. The magnitude of these effects, however, will be much smaller, as state marginal tax rates are significantly lower than their federal counterparts.

In estimating the short-term state revenue loss from the pickup, we assumed average marginal state rates (6 percent and 8 percent) which correspond to the federal rates assumed above (30 percent and 35 percent). Accordingly, we estimate the state short-term revenue loss at $11-14 million annually or, more generally, in the $10-15 million range.

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1. It is our understanding, however, that this tax liability can be deferred further by "rolling over" the accumulated contributions into an Individual Retirement Account or "Keogh" plan.

Here again, we are unable to estimate the longer-term revenue gains to and the net revenue impact on the state as a result of the pickup program.

Administrative Costs

Implementation of the pickup program by the state will result in certain administrative costs. The most significant of these costs would be those associated with the development of a separate computerized accounting system to track the employer-paid employee contributions--as required by federal and state tax laws. The PERS, however, developed such a system several years ago, when some of its contracting local agencies elected to implement the program. Development costs of about $300,000 were paid by the Public Employees' Retirement Fund and are being funded over a three-year period by assessing user agencies for their proportionate use of the system. Consequently, the state will incur only moderate administrative costs when it implements the program.

In addition, the State Controller will incur moderate data processing costs for implementation, and minor annual costs for the ongoing administration of the program.

IMPACT ON STATE EMPLOYEES

Income Tax Effects

The impact of the pickup program on state employees' federal and state income tax liabilities has, in effect, been described in the prior two sections. To summarize:

- Short-Term Reductions. State employees will realize net federal tax savings of approximately $50-60 million and state tax savings of about $10-15 million, for total income tax reductions of between $60-75 million annually.

- <u>Long-Term Tax Increases</u>. Some of these short-term savings will be offset by tax increases in later years, when income deferred by the pickup program is finally taxed (that is, when members realize this income in the form of retirement benefits or refunded contributions). We cannot estimate either the magnitude or timing of these tax increases, which also means we cannot estimate the <u>net</u> impact of the pickup program on state revenues.

These estimates, however, reflect only the <u>aggregate</u> effect on all state employees. In Table II-1, we show the impact of the pickup program on employees in different income groups. The table shows that an employee making $10,000 will have his/her annual take-home pay increased by $26, or approximately .3 percent of income, under a pickup program, while an employee making $60,000 will realize an increase of $1,372, or 2.3 percent of gross income.

The tax savings increase with income because--given the progressive federal and state income tax rate structures--the reduction in income provided by the pickup program is of greater value to those in higher marginal tax brackets.

It must be stressed that Table II-1 shows only <u>hypothetical</u> examples of federal and state tax liabilities under a pickup program. These examples assume that the employee has <u>no</u> other income. For an employee who makes $20,000 and whose spouse also makes $20,000, the tax savings would be $687, not $148. This is because actual tax savings would be based on the marginal tax rate applied to taxable <u>family</u> income, not just to the state employee's income.

Table II-1

Impact of Pickup on Take-Home Pay
of State Employees
Hypothetical Examples[a]

Annual Gross Income	Employees' Contribution	Tax Liability Without Pickup			Tax Liability With Full Pickup			Additional Take-Home Pay	
		Federal	State	Total	Federal	State	Total	Amount	Percent of Income
$10,000	$192	$299	--	$299	$273	--	$273	$26	.3%
20,000	692	1,851	$256	2,107	1,731	$228	1,959	148	.7
30,000	1,192	4,027	748	4,775	3,715	676	4,391	384	1.3
40,000	1,692	6,913	1,455	8,368	6,362	1,319	7,681	687	1.7
50,000	2,192	10,414	2,377	12,791	9,637	2,157	11,794	997	2.0
60,000	2,692	14,414	3,465	17,879	13,337	3,172	16,509	1,370	2.3

a. Assumptions: (1) 1983 tax rates; (2) employees are state miscellaneous members of the PERS who are coordinated with Social Security; and (3) employee is married, with two children, files jointly, has no other income, and takes the standard deduction.

Similarly, the examples in the table assume that everyone claims the standard deduction. In fact, most higher-income taxpayers itemize deductions, which can result in widely disparate tax liabilities for individuals with the same gross income. The level of itemized deductions would also affect the distribution of tax benefits shown in the last column of Table II-1. As itemizers would lose some of their federal tax savings due to reduced state income tax deductions from adjusted gross income on their federal return, the increased take-home pay as a percent of income would actually be lower for many higher-income employees.

Impact on Salary-Driven Benefits

As noted in Chapter I, implementation of a pickup program does not affect other salary-driven benefits. For instance, social security taxes and benefits, PERS pension benefits, and workers' compensation and disability payments--all of which are salary-driven--will not be altered in any way. This is because the definition of income for these programs is not affected by the pickup provision of federal law.

CHAPTER III

OTHER CONSIDERATIONS

In this chapter, we discuss three other issues related to the implementation of the pickup program. They are:

- o The implications of collective bargaining for the program;
- o The impact of the pickup program on the PERS' new "Two-Tier" retirement program; and
- o The application of the pickup program to other state retirement systems.

COLLECTIVE BARGAINING AND THE PICKUP PROGRAM

As described in Chapter I, Department of Personnel Administration (DPA) has acted administratively to implement the pickup program. The department did not consent to the program as a result of collective bargaining negotiations; instead, it simply took unilateral action to give Public Employees' Retirement System (PERS) members an increase in take-home pay by extending to them the short-term savings available under the pickup program.

We believe the pickup program makes sense from the state's standpoint. It allows state employees to receive an increase in take-home pay without a corresponding increase in state costs. Nevertheless, the pickup program results in an annual revenue loss to the state that is not insignificant (we estimate the loss to be $10-15 million). Consequently, in terms of its net effect on the budget, the DPA's action amounts to a unilateral decision to spend $10-15 million to enhance employee compensation.

SECOND-TIER PERS BENEFITS AND THE PICKUP PROGRAM

The pickup program may have a potentially significant effect on the recently established "Two-Tier" program available to PERS members. Under this program, a state employee can choose to receive lower retirement benefits and in return be relieved of his or her obligation to contribute toward these benefits. Choosing between the two "tiers" is a complex matter, and requires a detailed analysis of one's personal financial situation.

Since, however, the pickup program generates tax savings only for members of <u>contributory</u> retirement plans (that is, Tier One), implementation of the program will cause some employees who otherwise would have elected Tier Two <u>not</u> to do so. Potentially more important than this change in incentives is the change in <u>perceptions</u> about Tier One that the pickup program <u>may</u> bring about. Because all state employees will receive paychecks showing <u>no</u> retirement contribution, the pickup program may induce some employees to look upon Tier One as a <u>noncontributory</u> program as well. Such a perception, however, would be incorrect, since the contribution pickup program under Tier One is offset by an equivalent reduction in salary.

For both of these reasons, the number of employees choosing Tier Two (lower benefits; no employee contribution) may fall significantly short of the level anticipated by DPA and PERS, thereby reducing the projected future savings from implementation of the second-tier program.

APPLICATION TO OTHER STATE SYSTEMS

Legislators' Retirement System and Judges' Retirement System

The DPA is able to implement the pickup program only for PERS members. This is because Government Code Section 20616 does not specifically authorize pickup for members of the Legislators' Retirement System (LRS) and the Judges' Retirement System (JRS). Consequently, PERS staff, who administer these two retirement systems, believe that the pickup program cannot be implemented for LRS and JRS members until enabling legislation is enacted.

State Teachers' Retirement System

As noted in Chapter I, the Legislature in 1984 passed AB 1265, which would have authorized the pickup program under the State Teachers' Retirement System (STRS). The Governor, however, vetoed the bill.

If local districts were given this option, the state would be vulnerable to a potentially major revenue loss. In fact, if all local districts elected to pick up the entire teacher contribution (8 percent of salary), the short-term loss to the state would be in the $35-50 million range.

Extending the Benefits of Pickup to Other State Systems

We see no reason to deny the tax benefits of the pickup program to any members of state retirement systems. Accordingly, the Legislature may want to consider providing statutory authority for the LRS, JRS, and STRS to implement the pickup program for their members.

The Legislature, however, should consider each system individually, as it may want to implement pickup in different ways. In the case of the JRS, for example, the Legislature may want to provide this benefit in the context of overall reform of this financially troubled system.

In the case of STRS, the Legislature may want to address the state revenue loss issue. The Legislature could allow local districts to pick up these contributions--thereby providing teachers with the same tax savings available to PERS members--while at the same time protecting the state's revenue base. One way this could be accomplished is by reducing the school apportionment aid provided to any school district electing to participate in the program, in order to offset the approximate state income tax loss. The school districts, in turn, could then make a corresponding adjustment in teacher compensation to offset the reduction in apportionment aid. Thus, there would be no net impact on either state or school district revenues. Despite the reduction in their compensation, teachers would experience an increase in their take-home pay, at the expense only of the federal government.

APPENDIX A

UNIVERSITY OF CALIFORNIA

PICKUP PROGRAM

Benefits

University of California
Benefit Programs

June, 1983

ANNOUNCING THE UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM TAX-SAVINGS PLAN (UCRS TSP)

For Tax Deferral of Required UCRS Member Contributions

EFFECTIVE WITH JULY 1, 1983 EARNINGS, YOUR REQUIRED CONTRIBUTIONS TO UCRS WILL BE TAKEN FROM GROSS PAY* BEFORE TAXES ARE WITHHELD. BECAUSE YOUR CONTRIBUTIONS WILL BE MADE ON A PRE-TAX BASIS, FEDERAL AND STATE INCOME TAX WITHHOLDING FROM YOUR PAY CAN BE LESS. THE NEW UCRS TAX-SAVINGS PLAN (UCRS TSP) WILL AUTOMATICALLY APPLY TO ALL MEMBERS WHO HAVE REQUIRED CONTRIBUTIONS.

(A separate, optional tax-savings plan, described in the other brochure you have received, will also be effective this July 1 and will apply to employee-paid health, dental, and other insurance premiums; be sure to read that brochure also.)

How The UCRS TSP Works

The Internal Revenue Code, and similar tax laws for the states of California and New Mexico, now make it possible for the University to subtract your required UCRS retirement contributions from gross pay* before federal and state taxes are withheld. For employees working in states other than California and New Mexico, UCRS contributions can be taken from gross pay before federal income tax withholding only.

In the past, federal and state taxes were figured on your gross pay, and your UCRS contribution was deducted from the balance remaining after tax withholding. With the new UCRS TSP, your UCRS contribution will be subtracted from gross pay first, beginning with contributions taken from July, 1983, earnings. (See separate brochure: employee premiums for health, dental, and insurance plans will also be subtracted from gross pay starting with July, 1983 earnings.) Federal and state tax withholding will be calculated on the remaining reduced taxable income amount.

*NOTE: If you now make tax-deferred contributions to the UCRS Additional Retirement Programs, taxes are based on your gross pay minus the amount you contribute to these programs.

The new plan provides a reduction in your taxable University income equal to the amount of your required UCRS contribution. Federal and state income tax withholding may therefore be lower, and the amount of annual earnings reported by the University on your W-2 form to IRS and the state may be lower than your actual annual gross salary. If you also pay net health, dental, and insurance plan premiums under the tax-savings plan explained in the separate brochure, your taxable income will be further reduced.

If you pay Social Security (FICA) taxes, your monthly Social Security deduction will continue to be based on total gross pay so future Social Security benefits will not be reduced.

Pre-Tax Purchase of UCRS Service Credit

Under the UCRS TSP, you will be able to make payroll deduction payments to establish or reestablish UCRS service credit on a pre-tax basis (UCRS booklets available in your department or from your local Benefits Representative explain circumstances under which service credit may be purchased). In other words, your payments to purchase UCRS service credit will be subtracted from gross pay before tax withholding, just as your required UCRS contributions, further reducing your taxable income. Pre-tax purchase of service credit will be available only if your payments are made by payroll deduction.

Future Taxability of Your Pre-Tax Contributions

Taxes on the UCRS contributions that you make under the UCRS TSP will be deferred until you receive your contributions in a refund or begin receiving benefits. The same will be true for any pre-tax payments you make to establish or reestablish UCRS service credit. When you do receive monthly UCRS benefits or a refund of your contributions, your pre-tax contributions will be fully subject to federal and state income taxes at the ordinary tax rates in effect at that time.

What Your Tax-Savings Will Be

The amount of your tax-savings with the UCRS TSP will depend on your gross pay, your required UCRS contribution, and your income tax rates based on marital status and number of withholding exemptions claimed on your W-4 form.

(Keep in mind that you will also have tax-savings under the optional tax-savings plan for net health, dental, and other insurance plan premiums, explained in the separate brochure, unless you file the withdrawal form for that plan).

Here's an example showing the total tax-savings for an employee under the UCRS TSP and the optional tax-savings plan (see separate brochure) combined. The employee is in UCRS coordinated with Social Security, earns $2,500 a month gross pay, is married with four tax withholding exemptions, is age 40, and makes pre-tax premium payments under the optional tax-savings plan (see separate brochure) for family health plan coverage and $45,000 of life insurance.

OLD AFTER - TAX METHOD		
GROSS PAY (TAXABLE INCOME)		$2,500.00
Federal Income Tax:	$339	
California State Income Tax:	$61	
Total Income Tax Deductions		– $ 400.00

NEW TAX - SAVINGS (PRE - TAX) PLAN		
Gross Pay		$2,500.00
Required UCRS Contribution (Based on Gross Pay)		– $ 56.00
Employee's Net Health Premium		– $ 71.00
Life Premium for $45,000 of Coverage		– $ 12.60
REMAINDER (TAXABLE INCOME)		$2,360.40
Federal Income Tax:	$290	
California State Income Tax:	$51	
Total Income Tax Deductions		– $ 341.00
TAX-SAVINGS = $59		

Tax amounts are based on withholding tables effective July 1, 1983, and are rounded off. UCRS contributions are based on total gross pay and the rate effective July 1, 1983, for members of UCRS coordinated with Social Security is used here. The health plan and life insurance premiums are based on rates for August, 1983 coverage (see separate brochure).

NOTE: The one-year up-to-$50 reduction in required UCRS member contributions is expected to stop this June 30. Your tax-savings under the UCRS TSP (and tax-savings based on health, dental, and insurance plans, explained in the separate brochure) may not be large enough to cover the loss of the up-to-$50 reduction. Some UCRS members may see a reduction in net pay, even with the TSP plans; however, that reduction would be smaller than it would be without the tax-savings plans.

How the UCRS TSP Will Affect:

•YOUR SALARY-RELATED PAYROLL DEDUCTIONS & BENEFITS - Except for tax-deferred contributions to the UCRS Additional Retirement Programs (see below), all salary-related payroll deductions for University benefits will continue to be based on your total gross pay (before pre-tax required UCRS contributions are subtracted). This includes the amount of your pre-tax UCRS contribution.

Likewise, salary-related University benefits you may receive (monthly UCRS and Social Security benefits, NDI-A or NDI-B, STD, personal life insurance, Workers' Compensation, and Unemployment Insurance) will continue to be based on total gross pay up to plan limits.

Remember that your pre-tax UCRS contributions will be fully subject to income taxes when you receive them as a refund or begin receiving UCRS benefits.

•SALARY INCREASES - The UCRS TSP will not affect annual range adjustments (cost-of-living increases), salary merit increases, and other salary-related personnel actions such as promotions.

•UCRS ADDITIONAL RETIREMENT PROGRAM CONTRIBUTIONS -

Tax-deferred contributions: You may contribute up to 20% of your salary (your maximum exclusion allowance) to the programs on a tax-deferred basis each calendar year. Complete details about calculating the maximum exclusion allowance are in IRS Publication 571, and you can obtain it by contacting the IRS office listed in your public phone directory.

If you want to contribute this maximum amount, you should not use your total gross salary to calculate the exclusion allowance. Instead, use your new reduced taxable income explained above (gross salary MINUS pre-tax UCRS contributions, and pre-tax health, dental and insurance plan premiums, explained in the separate brochure). You are responsible for staying within the limits of your exclusion allowance. You should read IRS Publication 571 for rules on alternative methods of figuring your allowance.

If you have been making tax-deferred contributions at your maximum limit this year, you might go over your 1983 maximum exclusion allowance since it will be lower starting with July earnings. If this is the case, and you have not made a change in the amount of your tax-deferred contributions in 1983, you can reduce the amount of your contributions for the rest of the year. If this is the first year you have made tax-deferred contributions, or if you have already made a change in the amount of contributions this year, you may have to cancel contributions before the end of the year to avoid going over your exclusion allowance. You would be able to resume contributions starting in January, 1984. You should check into this before the end of October -- ask your department or local Benefits Representative for contribution change/cancellation forms and assistance. Even though your maximum tax-deferred contributions to the Additional Retirement Programs may be lower, those contributions plus pre-tax UCRS contributions and premiums under the two tax-savings plans should result in a higher total tax-sheltered amount.

After-tax contributions: The maximum amount of after-tax contributions you can make to the Additional Retirement Programs will continue to be 10% of annual gross pay.

•PAID LEAVES - While on sabbatical or other paid leave, your UCRS tax-savings plan will continue. Your taxable income will be gross leave pay minus your pre-tax UCRS contributions, and pre-tax health, dental, and insurance premiums (see separate brochure).

The UCRS TSP Is Not Optional

The UCRS TSP will be required for all UCRS members who contribute to the UCRS basic plan, effective July 1, 1983. Pre-tax payment of UCRS contributions will be reflected starting with August paychecks for members paid monthly, or with July paychecks for members paid bi-weekly. Your check stub will continue to show your UCRS contribution as in the past, and will show your new taxable income as well as total gross income.

The UCRS Tax-Savings Plan is subject to the provisions of Internal Revenue Code Section 414(h) and comparable California and New Mexico state laws, and may be modified or terminated if applicable laws change in the future. Official University provisions for the plan are approved by The Regents and will govern if there are any differences in this brochure. The official provisions are available through the University Benefit Programs office in Berkeley--contact your Benefits Representative for additional information.

University of California
Benefit Programs
2120 University Avenue
Berkeley, CA 94720

June, 1983 75M

AB 1265, 1983-84 SESSION

STATE TEACHERS' RETIREMENT SYSTEM:

AUTHORIZATION FOR PICKUP PROGRAM

AMENDED IN CONFERENCE
ASSEMBLY AUGUST 31, 1984; SENATE AUGUST 31, 1984

AMENDED IN SENATE MARCH 21, 1984

AMENDED IN ASSEMBLY JANUARY 17, 1984

AMENDED IN ASSEMBLY JANUARY 3, 1984

CALIFORNIA LEGISLATURE—1983–84 REGULAR SESSION

ASSEMBLY BILL No. 1265

Introduced by Assemblyman Elder

March 2, 1983

An act to amend Sections 22101, 22114, 22800, 23100, and 23801 of, and to add Sections 22804.5 and 23414 to, the Education Code, and to amend Section 3543.2 of the Government Code, relating to public employees, *and* making an appropriation therefor~~, and declaring the urgency thereof, to take effect immediately~~.

LEGISLATIVE COUNSEL'S DIGEST

AB 1265, as amended, Elder. Public school employees: STRS—employer payment of member contributions.

(1) Existing law provides for collective bargaining between public school employers and public school employees on matters relating to wages, hours of employment, specified health and welfare benefits, leave and transfer policies, and similar matters.

This bill would also specifically include within the scope of representation, the subject of employer payment to the State Teachers' Retirement System (STRS) of member contributions, as herein authorized.

(2) The existing State Teachers' Retirement Law (STRL): prescribes the rights and benefits of members of the State Teachers' Retirement System; defines, for retirement

purposes, the term "compensation" and other terms which utilize that term; requires employers and members to each pay a contribution at a rate of 8% on the member's compensation; requires crediting of member contributions to the member's individual account; requires employer contributions and state contributions to be held in the reserves of the system, as specified; provides for the crediting of interest to the member's individual account, as specified; provides for payment of the accumulated member contribution and credited interest, upon specific employment termination, to the member and, upon death of a member under specified conditions, to the beneficiary; and does not authorize employer payment of member contributions.

This bill would: (a) authorize employers to pay to STRS all or a portion of the member contribution in lieu of payment by the member, subject to specified conditions, including ~~payment to~~ *reimbursement of* the county superintendent of schools for ~~resulting~~ *actual additional* costs incurred by the superintendent, *as specified;* (b) include within the definition of "compensation" any member contributions paid by the employer and make related changes; (c) require the amount of employer-paid member contributions to be included, solely and exclusively for the purposes of the STRL, in the compensation of the member and require that employer and member contributions be paid on all resulting increases in that compensation; (d) require member contributions paid by the employer to be credited to the individual account of the member; (e) require separate reporting of employer-paid and member-paid member contributions; (f) require related implementation costs and information system modification costs to be repaid by employers electing to pay member contributions; (g) express that the purpose hereof is to defer taxes but disclaim responsibility of the system for the tax status of member contributions paid by the employer and provide that the system shall not incur any liability whatsoever with respect to related tax rulings, as specified; and (h) make other conforming, technical, and clarifying changes. This new authorization would impose state-mandated costs since its exercise would be subject to negotiation under existing law

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relating to public school employer-employee relations.

(3) This bill would also appropriate $200,000 from the Teachers' Retirement Fund to the Teachers' Retirement Board for implementation of this act, as specified.

(4) This bill would provide that the foregoing provisions, except items (1), 2(f), and (3), shall become operative ~~; if this bill is chaptered before May 1, 1984, on July 1, 1985, but, if chaptered thereafter,~~ on July 1, 1986.

(5) Article XIII B of the California Constitution and Sections 2231 and 2234 of the Revenue and Taxation Code require the state to reimburse local agencies and school districts for certain costs mandated by the state. Other provisions require the Department of Finance to review statutes disclaiming those costs and provide, in certain cases, for making claims to the State Board of Control for reimbursement.

This bill would provide that no appropriation is made by this act for the purpose of making reimbursement pursuant to the constitutional mandate or Section 2231 or 2234, for a specified reason.

(6) This bill would provide that notwithstanding Section 2231.5 of the Revenue and Taxation Code, this act does not contain a repealer, as required by that section; therefore, the provisions of the act would remain in effect unless and until they are amended or repealed by a later enacted act.

~~(7) This act would take effect immediately as an urgency statute.~~

Vote: *⅔ majority*. Appropriation: yes. Fiscal committee: yes. State-mandated local program: yes.

The people of the State of California do enact as follows:

SECTION 1. Section 22101 of the Education Code is amended to read:

22101. "Accumulated retirement contributions" means the sum of all member contributions and all member contributions paid by the employer pursuant to Section 22804.5 with credited interest but does not include accumulated annuity deposit contributions and accumulated tax-sheltered annuity contributions.

SEC. 2. Section 22114 of the Education Code is amended to read:

22114. "Compensation" and "salary" mean remuneration in cash payable by the employer to the member, and includes any member contributions paid by the employer pursuant to Section 22804.5, any amount deducted from the member's salary for payment to one other than the member for the purpose of purchasing an annuity contract for the member under an annuity plan which meets the requirements of Section 403(b) of the Internal Revenue Code of 1954 (26 U.S.C. Sec. 403(b)), and any amount deducted from a member's wages for participation in a deferred compensation plan established pursuant to Chapter 8 (commencing with Section 18310) of Part 1 of Division 5 of Title 2, or pursuant to Article 1.1 (commencing with Section 53212) of Chapter 2 of Part 1 of Division 2 of Title 5, of the Government Code.

"Compensation" and "salary" do not mean, and shall not include, any of the following:

(a) Job-related expenses.

(b) Money paid to the employee for overtime service on and after July 1, 1956.

(c) Compensatory damages and money paid to the member in excess of regular salary as a compromise settlement of a dispute arising from termination of a member's employment contract.

(d) Lump-sum payments for accumulated sick leave or accumulated vacation leave.

(e) Money paid for summer school employment.

(f) Money paid as a bonus.

(g) Tax-sheltered annuity contributions which do not result in a reduction of the earned contract salary paid to the employee.

(h) Fringe benefits paid for by the employer in lieu of salary.

(i) Money not available for payment of salaries and which is applied by an employer for the purchase of annuity contracts or for other insurance programs, including those which meet the requirements of Section

403(b) of the Internal Revenue Code of 1954.

Any moneys paid under subdivisions (a) to (i), inclusive, shall not be included as a part of the member's compensation subject to contributions reported to the system.

SEC. 3. Section 22800 of the Education Code is amended to read:

22800. Contributions made by a member and member contributions made by an employer pursuant to Section 22804.5 shall be credited by the board to the individual account of the member.

SEC. 4. Section 22804.5 is added to the Education Code, to read:

22804.5. (a) An employer may pay, in lieu of payment by the member, all or a portion of the member contributions required by Section 22804 for all compensation earned during any school year which commences on or after ~~the operative date of this section~~ *July 1, 1986,* including the additional member contributions specified in paragraph (6) of this subdivision, subject to all of the following conditions:

(1) The member shall not have the option of choosing to receive directly from the employer an amount equivalent to the member contributions payable by the employer, in lieu of having the employer pay the member contributions directly to the system.

(2) The amount of member contributions paid by the employer, in lieu of payment by the member, shall be full percentage increments of the compensation as defined by Section 22114.

(3) The provisions of any written agreement which embody an agreement for the payment of member contributions by an employer, in lieu of payment by the member, shall become effective on a July 1 and shall remain in effect unchanged through the following June 30 and any amendment to those provisions in subsequent years shall become effective on a July 1 and remain in effect unchanged through the following June 30. Any written agreement finalized during a school year shall specify that those provisions shall become effective on

either July 1 of the current school year or on July 1 of the immediately succeeding school year.

(4) An employer who enters into any written agreement which includes an agreement to pay, in lieu of payment by the member, all or a portion of member contributions shall pay the same percent of compensation earned for every employee who is a member of the system.

(5) The member contributions paid, in lieu of payment by the member, by the employer shall be credited to the individual account of the member.

(6) The amount of the member contributions paid by the employer, in lieu of payment by the member, shall be included, solely and exclusively for the purposes of this part, in the compensation of the member, as defined by Section 22114. Both member contributions and employer contributions shall be paid on all resulting increases in that compensation.

(7) The member contributions paid by the employer, in lieu of payment by the member, shall be reported separately from the member contributions paid by the member.

(b) The expressed purpose of employer payment of member contributions, in lieu of payment by the member, is to defer payment of taxes on the amount of these member contributions which are paid by the employer. The system shall not be responsible for the tax status of these member contributions paid by the employer, and shall not incur any liability whatsoever with respect to rulings or changes in rulings on the tax status of these member contributions paid by the employer.

~~(c) No employer, other than an employer which makes contribution payments directly to the State Teachers' Retirement System, may make the payments authorized by this section unless the county superintendent of schools approves thereof. As a condition to that approval, the county superintendent of schools may require the employer to reimburse the county superintendent of schools for part or all of the~~

~~resulting costs incurred by the county superintendent of schools.~~

(c) An employer who makes payments authorized by this section and who utilizes the services of the county superintendent of schools in making these payments may be required to reimburse the county superintendent of schools for all or part of the actual additional cost of providing this service over and above the cost of providing current services of a similar nature to the district. Prior to reimbursement, the county superintendent of schools shall provide the district with a detailed accounting of the additional costs.

SEC. 5. Section 23100 of the Education Code is amended to read:

23100. Upon the termination of a member's employment by any cause other than death or retirement there shall be paid to the member, pursuant to this chapter, both of the following:

(a) The accumulated retirement contributions made after June 30, 1935.

(b) The accumulated annuity deposit contributions.

Accumulated contributions include credited interest through the date of payment.

SEC. 6. Section 23414 is added to the Education Code, to read:

23414. The cost of modifying the State Teachers' Retirement System's information system to account for any member contributions paid by the employer pursuant to Section 22804.5 and other implementation costs shall be repaid to the Teachers' Retirement Fund through charges levied by the board against employers who elect to pay all or a portion of the member contributions.

SEC. 7. Section 23801 of the Education Code is amended to read:

23801. Upon receipt of proof of a member's death who has no preretirement option in effect, and who has no eligible survivors for a family allowance, there shall be paid to the beneficiary both of the following:

(a) The accumulated retirement contributions made after June 30, 1935.

(b) The accumulated annuity deposit contributions.

Accumulated contributions include credited interest through the date of payment.

SEC. 8. Section 3543.2 of the Government Code is amended to read:

3543.2. (a) The scope of representation shall be limited to matters relating to wages, hours of employment, and other terms and conditions of employment. "Terms and conditions of employment" mean health and welfare benefits as defined by Section 53200, leave, transfer and reassignment policies, safety conditions of employment, class size, procedures to be used for the evaluation of employees, organizational security pursuant to Section 3546, procedures for processing grievances pursuant to Sections 3548.5, 3548.6, 3548.7, and 3548.8, employer payment of member contributions to the State Teachers' Retirement System pursuant to Section 22804.5 of the Education Code, and the layoff of probationary certificated school district employees, pursuant to Section 44959.5 of the Education Code. In addition, the exclusive representative of certificated personnel has the right to consult on the definition of educational objectives, the determination of the content of courses and curriculum, and the selection of textbooks to the extent such matters are within the discretion of the public school employer under the law. All matters not specifically enumerated are reserved to the public school employer and may not be a subject of meeting and negotiating, provided that nothing herein may be construed to limit the right of the public school employer to consult with any employees or employee organization on any matter outside the scope of representation.

(b) Notwithstanding Section 44944 of the Education Code, the public school employer and the exclusive representative shall, upon request of either party, meet and negotiate regarding causes and procedures for disciplinary action, other than dismissal, including a suspension of pay for up to 15 days, affecting certificated employees. If the public school employer and the exclusive representative do not reach mutual agreement, then the provisions of Section 44944 of the Education Code shall apply.

(c) Notwithstanding Section 44955 of the Education Code, the public school employer and the exclusive representative shall, upon request of either party, meet and negotiate regarding procedures and criteria for the layoff of certificated employees for lack of funds. If the public school employer and the exclusive representative do not reach mutual agreement, then the provisions of Section 44955 of the Education Code shall apply.

(d) Notwithstanding Section 45028 of the Education Code, the public school employer and the exclusive representative shall, upon the request of either party, meet and negotiate regarding the payment of additional compensation based upon criteria other than years of training and years of experience. If the public school employer and the exclusive representative do not reach mutual agreement, then the provisions of Section 45028 of the Education Code shall apply.

SEC. 9. The sum of two hundred thousand dollars ($200,000) is hereby appropriated from the Teachers' Retirement Fund to the Teachers' Retirement Board for expenditure for the design and implementation of all information system modifications necessary to account for member contributions paid by the employer pursuant to this act. The sum hereby appropriated shall be available for encumbrance without regard to fiscal years.

~~SEC. 10. If this bill is chaptered before May 1, 1984, Sections 1, 2, 3, 4, 5, and 7 of this act shall become operative on July 1, 1985, but if this bill is chaptered on or after May 1, 1984,~~

SEC. 10. Sections 1, 2, 3, 4, 5, and 7 of this act shall become operative on July 1, 1986.

SEC. 11. No appropriation is made and no reimbursement is required by this act pursuant to Section 6 of Article XIII B of the California Constitution or Section 2231 or 2234 of the Revenue and Taxation Code because the Legislature finds and declares that there are savings as well as costs in this act which, in the aggregate, do not result in additional net costs.

SEC. 12. Notwithstanding Section 2231.5 of the Revenue and Taxation Code, this act does not contain a repealer, as required by that section; therefore, the provisions of this act shall remain in effect unless and until they are amended or repealed by a later enacted act.

~~SEC. 13. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:~~

~~This act would permit employers, on and after alternative future dates, to pay all or a portion of the member contributions to the State Teachers' Retirement System, in lieu of payment by the member. In order for the State Teachers' Retirement System to perform extensive modification of the computerized information system to account for any member contributions paid by the employer and to complete this work prior to the operative date of the programmatic provisions of this legislation, it is necessary for this act to take effect immediately.~~