



ITEM 7

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For Agenda of:
March 15, 2017

March 10, 2017

TO: President and Members
Board of Retirement

FROM: Robert L. Gaumer
General Counsel

SUBJECT: Adoption of Resolution to Amend Model Regulations

Recommendation:

That the Board adopt the attached Resolution to insure compliance with the Internal Revenue Services' conditional requirement placed on SCERS' most recent favorable Determination Letter.

Introduction

In October 2016 Sacramento County Employees' Retirement System's (SCERS) received its current Internal Revenue Service (IRS) Tax Determination Letter (TDL). As a condition to the effectiveness of the TDL, the IRS is requiring that SCERS amend one of its Board regulations. Staff requests that the Board adopt the attached resolution making the required change.

Historical Background

The following historical summary is provided for the benefit of Board members that may be unfamiliar with SCERS' efforts to secure an IRS Tax Determination Letter. A TDL is a document that attests to SCERS' compliance with federal laws and its tax qualification status.

In 2011, in preparation for submitting an application for a TDL, SCERS spent the better part of a year conducting an audit of its internal procedures evaluating whether these procedures were in compliance with federal tax law and regulations. This included working with outside tax counsel, gathering documents that represent the Plan Document (essentially the contents of the County Employees' Retirement Law (CERL)),¹ reviewing operational procedures versus the federal requirements and participating with the State Association of County Retirement Systems (SACRS) Task Force.

The SACRS Task Force was an association of CERL systems and outside counsel that worked directly with the IRS through the early submission of a Tax Determination Letter application from Orange County (OCERS) on behalf of the group. The IRS worked with outside counsel and OCERS, identifying areas where the CERL was lacking compliance with the Internal Revenue Code (Code). Where noncompliance (or Failures – as the IRS refers to them) was found, outside counsel proposed statutory changes to the CERL and achieved concurrence from the IRS that, where statutory amendments were inefficient, systems could adopt Model Regulations which memorialized system operations and became part of the system Plan Document.

In January 2011, SCERS submitted a Determination Letter application and a Voluntary Correction Program submission. Benefiting from the efforts of the Task Force and OCERS, in December 2013, SCERS received a favorable determination from the IRS.

In addition, SCERS received a Compliance Statement in response to the Voluntary Correction Program submission. In the Compliance Statement, the IRS noted eleven Failures that needed to be addressed. As mentioned, the remedies to the Failures that the Task Force and the IRS agreed to were statutory changes to the CERL and adoption of Model Regulations.

In October 2014, the Board adopted seven Model Regulations that comprised the administrative corrections required by the IRS. One of those regulations addressed SCERS implementation of Code §415 setting forth comprehensive requirements for identifying and calculating annual benefit limits.

Discussion

In 2016, in compliance with the then IRS requirement that public pension plans apply for an updated TDL every five years, SCERS submitted its updated TDL application. In October 2016, SCERS received a conditional TDL from the IRS. The sole condition identified in the newly issued TDL was that the IRS required a clarification to the 415(c) regulation. Despite approving the regulations adopted by the SCERS Board in 2014 the IRS has asked CERL plans to augment the 415(c) Model Regulation to include a definition

¹ Governmental plans do not typically have a traditional Plan Document as is seen in an ERISA plan. In the government arena the plan document tends to be a body of law, regulations, or a city charter. For SCERS the plan document is the general provisions of the CERL, the specific county option provisions that have been adopted by the BOS and BOR and Board resolutions establishing or defining benefits.

for compensation that provides that "differential wage payments" will be determined as provided for in section 105(b) of the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act").

As part of the 2016 TDL application, outside tax counsel submitted a draft resolution to the IRS that allows the Board to amend its current regulations. The IRS reviewed the resolution and approved it as a proper amendment to SCERS' Plan Document. A copy of the resolution is attached as Exhibit A. Attached as Exhibit B is a red-lined version of SCERS current 415(c) regulation with the proposed amendment included.

Conclusion

Staff requests that the Board adopt the attached resolution to amend SCERS' Code §415(c) regulation in compliance with the condition that the IRS placed on issuing SCERS' it 2016 TDL.

Respectfully submitted,

Concur:

Robert L. Gaumer
General Counsel

Richard Stensrud
Chief Executive Officer

Attachments

Exhibit A

RESOLUTION NO. SCERS 2017-02

**RESOLUTION OF THE BOARD OF RETIREMENT
OF THE SACRAMENTO COUNTY EMPLOYEES' RETIREMENT SYSTEM
AMENDING REGULATIONS FOR
INTERNAL REVENUE CODE SECTION 415 – ANNUAL LIMITS**

WHEREAS, the Board of Retirement for the Sacramento County Employees' Retirement System ("SCERS") administers SCERS for the benefit of its members and their beneficiaries; and

WHEREAS, SCERS is intended to comply with the requirements of the Internal Revenue Code of 1986 (the "Code"), as amended or replaced from time to time and the regulations issued thereunder as applicable; and

WHEREAS, on January 12, 2016, the Board of Retirement submitted to the Internal Revenue Service ("IRS") a request for a favorable determination that SCERS meets the applicable requirements of the Code; and

WHEREAS, the plan documents, including Regulations of SCERS Board of Retirement, were submitted for review with SCERS' determination letter application; and

WHEREAS, items of pay that are included in a member's "Total Compensation" for purposes of Code section 415 is defined in Section III.I.1 of Regulations for IRC Section 415(c), subsections 1.a through 1.f; and

WHEREAS, Section III.I.3 of Regulations for IRC Section 415(c) provides that payments the description of which meet the definition of "differential wage payments" provided in Internal Revenue Code section 3401(h)(2) are included in a member's Total Compensation, even if paid more than 2½ months after severance from employment or after the end of the Limitation Year, if later; and

WHEREAS, the IRS has requested that Regulations for IRC Section 415(c) be clarified to provide that the definition of compensation for purposes of Code section 415 includes "differential wage payments" as defined in Code section 3401(h)(2), pursuant to Section 105(b) of the Heroes Earnings Assistance and Relief Tax Act of 2008 ("HEART Act");

THEREFORE BE IT RESOLVED, that the Board of Retirement hereby amends Section III.I.1 of Regulations for IRC Section 415(c), to add new subsection "g." thereto, to read in its entirety as follows:

"Differential wage payments as defined in Internal Revenue Code section 3401(h)(2)."

Resolution No. SCERS 2017-02

March 15, 2017

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On motion made by Member _____, Seconded by Member _____, the foregoing Resolution was passed and adopted by the Board of the Sacramento County Employees' Retirement System this 15th day of March, 2017, by the following vote:

AYES:

NOES:

ABSTAIN:

ABSENT:

President of the Board of the
Sacramento County Employees'
Retirement System

ATTEST:

Secretary of the Board of the
Sacramento County Employees'
Retirement System

Exhibit B

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REGULATIONS FOR IRC SECTION 415(c)

DEFINED CONTRIBUTION LIMITS

SECTION I. PURPOSE AND SCOPE

In accordance with section 31525 and section 31899 et. seq. of the California Government Code, the regulations set forth herein are effective as of [_____], and reaffirm and clarify the existing practices of the Sacramento County Employees' Retirement System (the "System") with respect to the limits on annual additions under section 415(c) of the Internal Revenue Code (the "Code"). For these regulations, the Code includes Treasury regulations issued under section 415(c). To the extent there is a conflict between these regulations and the Code, the Code governs.

The System may establish reasonable procedures for complying with the limits on annual additions under section 415(c) of the Code that it deems necessary or advisable for complying with applicable tax laws or for administrative purposes.

Capitalized terms used in this Regulation are defined in Section III. Terms defined in the County Employees Retirement Law apply here unless otherwise stated.

SECTION II. ANNUAL ADDITIONS LIMITATION

A. Annual Additions Limit, In General

Notwithstanding anything to the contrary contained in the System, the total Annual Additions allocated to a Member's Account under the System, when added to the Annual Additions allocated to the Member's accounts under all other Aggregated Plans maintained by the Employer or an Affiliate for any Limitation Year, shall not exceed the Maximum Permissible Amount; provided, however, that the limit described in III.G.2 shall not apply to an individual medical benefit account (as defined in section 415(I) of the Code).

SECTION III. DEFINITIONS

Solely for purposes of this regulation, the following definitions shall apply:

A. Account

"Account" means the separate Member account provided under the System for benefits that are separate and apart from the retirement benefits (annuity and pension) otherwise provided under the County Employees Retirement Law.

B. Affiliate

Solely to the extent provided in the Code with respect to public agencies, the term "Affiliate" means all members of a controlled group of an Employer.

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C. Aggregated Plan

“Aggregated Plan” means any defined contribution plan which is aggregated with the System pursuant to Section III of this regulation.

D. Annual Additions

“Annual Additions” means the sum of the following amounts credited to a Member's Accounts under the System and any Aggregated Plans for the Limitation Year:

1. Employer contributions allocated to the Member's Account that is separate and apart from any pension or annuity benefits provided under the County Employees Retirement Law;
2. Employee contributions (after-tax), including mandatory contributions (as defined in section 411(c)(2)(C) of the Code and Treasury regulations issued thereunder), as well as voluntary employee contributions used to purchase permissive service credit (as defined in Code section 415(n)(3)), to the extent such service credit purchase is not prohibited under PEPR, if an election is made to treat those amounts as Annual Additions in the year contributed pursuant to Code section 415(n)(1).
3. Forfeitures;
4. Amounts allocated to the Member's individual medical account (within the meaning of section 415(l)(2) of the Code), which is part of a pension or annuity plan maintained by the Employer or Affiliate, except that such amounts are not included in Annual Additions for purposes of applying the 100% of compensation limit.

The term “Annual Additions” excludes:

1. Repayments of cash-outs as described in Code section 415(k)(3) (for example, to purchase restoration of an accrued benefit that was lost when employee contributions were previously cashed out) for the limitation year in which the restoration occurs;
2. Catch-up contributions made in accordance with Code section 414(v);
3. Restorative payment described in Treasury regulations section 1.415(c)-1(b)(2)(ii)(C);
4. Excess deferrals that are distributed in accordance with Treasury regulations section 1.402(g)-1(e)(2) or (3);
5. Rollover contributions (as described in Sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d) and 457(e)(16) of the Code);
6. Loan repayments;

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7. Employee contributions to a qualified cost-of-living arrangement described in Code section 415(k)(2)(B);
8. Employee contributions picked up by the Employer under Code section 414(h)(2);
9. Make-up contributions attributable to a period of qualified military service, as defined in Code section 414(u), with respect to the year in which the contribution is made (but not with respect to the year to which the contribution relates); and
10. Employee contributions to purchase permissive service credit (as defined in Code section 415(n)(3)) to the extent such service credit purchase is allowed under PEPRA and if an election is made to treat the accrued benefit derived from all such contributions as an annual benefit subject to the limits of Code section 415(b).

E. Employer

“Employer” means the participating County or District that participates in the System and employs the Member.

F. Limitation Year

“Limitation Year” means the calendar year.

G. Maximum Permissible Amount

“Maximum Permissible Amount” means the lesser of:

1. \$52,000 (for 2014), as adjusted for increases in the cost-of-living under section 415(d) of the Code; or
2. 100 percent of the Member’s Total Compensation for the Limitation Year.

H. Severance From Employment

“Severance From Employment” means the Member ceases to be an employee of the Employer. A Member does not have a Severance From Employment if, in connection with a change of employment, the Member’s new employer maintains the System with respect to the Member.

I. Total Compensation

“Total Compensation” means all items of remuneration described in paragraph (1) and excludes all items of remuneration described in paragraph (2), below.

1. Items Included

Total Compensation includes all of the following items of remuneration for services:

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- a. A Member's wages, salaries, fees for professional services, and other amounts received (without regard to whether or not an amount is paid in cash) for personal services actually rendered in the course of employment with the Employer and any Affiliate to the extent that the amounts are includible in gross income (or to the extent that the amounts would have been includible in gross income but for an election under Code section 125(a), 132(f)(4), 402(e)(3), 402(h)(1)(B), 402(k), or 457(b)). These amounts include, but are not limited to, bonuses, fringe benefits, and reimbursements, or other expense allowances under a non-accountable plan, as described in Treasury regulations section 1.62-2(c);
- b. Amounts described in Code section 104(a)(3), 105(a), or 105(h), but only to the extent that these amounts are includible in the gross income of the Member;
- c. Amounts paid or reimbursed by the Employer or an Affiliate for moving expenses incurred by a Member, but only to the extent that at the time of the payment it is reasonable to believe that these amounts are not deductible by the Member under Code section 217;
- d. The amount includible in the gross income of an Member upon making the election described in Code section 83(b);
- e. Amounts that are includible in the gross income of a Member under the rules of Code section 409A or Code section 457(f)(1)(A), or because the amounts are constructively received by the Member; and
- f. An amount that is excludable under Code section 106 that is not available to a Member in cash in lieu of group health coverage because the Member is unable to certify that he or she has other health coverage; provided, however, that the Employer does not request or collect information regarding the Member's other health coverage as part of the enrollment process for the health plan.
- g. Differential wage payments as defined in Internal Revenue Code section 3401(h)(2).

2. Items Excluded

The following items are excluded from Total Compensation:

- a. Employer contributions (other than elective contributions described in Code section 402(e)(3), 408(k)(6), 408(p)(2)(A)(i), or 457(b)) to a deferred compensation plan (including a simplified employee pension described in Code section 408(k) or a simple retirement account described in Code section 408(p), and whether

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or not qualified) to the extent such contributions are not includable in the Member's gross income for the taxable year in which contributed, and any distributions (whether or not includible in gross income when distributed) from a deferred compensation plan (whether or not qualified) other than amounts received during the year by a Member pursuant to a nonqualified unfunded deferred compensation plan to the extent includible in gross income;

- b. Other amounts that receive special tax benefits, such as premiums for group term life insurance (but only to the extent that the premiums are excludible from the gross income of the Member, and are not salary reduction amounts that are described in Code section 125);
- c. Other items of remuneration that are similar to any of the items listed in a and b, above.

3. Timing

- a. In order to be taken into account for a Limitation Year, Total Compensation must be paid or made available (or, if earlier, includible in the gross income of the Member) during the Limitation Year. For this purpose, compensation is treated as paid on a date if it is actually paid on that date or it would have been paid on that date but for an election under Code section 125, 132(f)(4), 401(k), 403(b), 408(k), 408(p)(2)(A)(i), or 457(b)).
- b. In order to be taken into account for a Limitation Year, Total Compensation must be paid or treated as paid to the Member prior to the Member's Severance From Employment with the Employer; provided, however, that Total Compensation includes amounts paid to the Member by the later of 2½ months after Severance From Employment or the end of the Limitation Year if the amounts are regular compensation for services during the Member's regular working hours, compensation for services outside the Member's regular working hours (such as overtime or shift differential), commissions, bonuses, or other similar compensation that absent a Severance From Employment would have been paid to the Member while the Member continued in employment with the Employer.
- c. Total Compensation does not include amounts paid after Severance From Employment that are severance pay, unfunded nonqualified deferred compensation, or any other payment that is not described in the preceding paragraph, even if paid within 2½ months, except for:
 - i. Payments to an individual who does not currently perform services for the Employer by reason of Qualified Military Service to the extent that these payments do not exceed

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the amounts that the individual would have received if the individual had continued to perform services for the Employer rather than entering Qualified Military Service; and

- ii. Payments to a Member who is permanently and totally disabled; provided, however that salary continuation applies to all Members who are permanently and totally disabled for a fixed or determinable period. For this purpose, a Member is permanently and totally disabled only if the Member is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted, or can be expected to last, for a continuous period of not less than 12 months.

4. Limit

A Member's Total Compensation shall not include compensation in excess of the limitation of Code section 401(a)(17) that is in effect for the calendar year in which such Limitation Year begins.

SECTION III. AGGREGATION WITH OTHER DEFINED CONTRIBUTION PLANS

All defined contribution plans (as defined in section 1.415(c)-1(a)(2) of the Treasury regulations and whether or not terminated) maintained by the Employer or an Affiliate shall be aggregated with the System, and all plans so aggregated shall be considered as one plan in applying the limitations of this regulation.

SECTION IV. COORDINATION WITH OTHER DEFINED CONTRIBUTION PLANS

In the event that a Member participates in another defined contribution plan of the Employer or of an Affiliate that is a tax-qualified defined contribution plan, contributions or allocations that would otherwise be made on behalf of the Member to the System shall be reduced to the extent necessary to avoid exceeding the limitations of this regulation when contributions are aggregated as described above.

SECTION V. CORRECTION

Any excess Annual Additions shall be corrected using the methods specified in guidance promulgated by the Secretary of the Treasury describing the procedures for correcting excess Annual Additions under the Employee Plans Compliance Resolution System ("EPCRS") or its successor.