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PENSION TIER CHANGES - CONFLICT WITH IRS REQUIREMENTS

REQUESTED ACTION: Support legislation (HR 205) that would clarify the authority of local governments to propose and implement creative solutions to rising pension costs. At the same time, urge the Internal Revenue Service (IRS) to remove regulatory barriers that prevent local governments from implementing their own local pension reforms.

BACKGROUND: The rising cost of public employee pensions is a growing concern for local governments in California. While a number of counties have proposed their own local solutions to address the issue, a 2006 IRS ruling (Revenue Ruling 2006-43) has proven to be an obstacle to these reforms.

By way of illustration, Orange County and its largest union, the Orange County Employees Association (OCEA), negotiated a new pension package in 2009 in response to mounting pension obligations. The package offered new employees the choice between a traditional defined benefit plan and a new hybrid plan that provides a lower defined benefit in conjunction with participation in a defined contribution plan, similar to that of a 401(k).

In addition, County officials wanted to give existing employees a one-time, irrevocable choice of switching to the hybrid plan. Regrettably, the IRS objected, citing the aforementioned Ruling that outlines the actions required for a local government employer to "pick up" employee pension plan contributions on a tax-deferred basis. Consequently, the loss of "picked up" status could expose all Orange County employees - whether or not they opted into the new plan - to federal taxes on their pension contributions. The County, along with OCEA, approached the IRS in September of 2009 to seek a revision to the rule; however, the Service has yet to announce additional guidance.

Revenue Ruling 2006-43 is a barrier to *any* public agency negotiating similar contracts with its employees. HR 205, sponsored by Representative Loretta Sanchez (D-CA), and cosponsored by Representatives John Campbell (R-CA) and Ed Royce (R-CA), would remove this regulatory roadblock, allowing local governments and their employees to work collaboratively to propose and implement local solutions, without the threat of severe consequences. Such solutions will be more important than ever as counties implement the state's new comprehensive pension reform law.

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