

HF 4899 (O'Driscoll); SF 5073 Westlin): PERA General Plan and Defined Contribution Plan; Eliminating Participation Elections and Revocations to Comply with Federal Law

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Introduction

Affected Plan(s):	PERA General Employees Retirement Plan (PERA General Plan) Public Employees Defined Contribution Plan (PERA DC Plan)
Laws Amended:	Minnesota Statutes, sections 353.028, 353D.01, and 353D.02
Laws Added:	Uncoded session law
Laws Repealed:	Minnesota Statutes, section 353.028, subdivisions 4 and 5, and section 353D.071
Brief Description:	The bill limits or eliminates the ability of certain employees to elect not to participate in the PERA General Plan or elect to participate in the PERA DC Plan to bring the plans into compliance with federal law.
Amendment:	H4899-1A

Background

Minnesota's pension and retirement plans for public employees are considered "tax-qualified" retirement plans,¹ which means that as employees accrue retirement benefits (i.e., defer compensation) under a pension or retirement plan, they are not currently taxable on those accruals. If the plan is not tax-qualified, an employee's annual accrual, to the extent vested, or the annual allocation to an employee's defined contribution account would be considered taxable income to the employee for the year of the accrual or allocation.

To be tax-qualified, the pension or retirement plan must comply with the many requirements in Internal Revenue Code sections 401(a) through 417. A subset of these requirements apply to governmental plans and include the requirement that lump sum distributions be permitted to be directly rolled over, that

¹ "Tax-qualified" generally refers to a pension or retirement plan's compliance with the requirements of Internal Revenue Code section 401(a) et seq. One of Minnesota's statewide plans, the Minnesota Deferred Compensation Plan, would not be considered "tax-qualified" under this definition because it is a plan that satisfies the requirements of Code section 457(b). This plan, however, provides for the deferral of income tax in the same way as a tax-qualified plan.

distributions begin or be made by the “required beginning date,” that compensation in excess of a dollar limit (\$334,000 for 2024) not be considered for plan purposes, and that plan assets be used exclusively for the benefit of employees or beneficiaries and to defray reasonable plan expenses.

Cash or deferred arrangements (CODAs) are provisions in a defined contribution plan that permit employees to elect to contribute a portion of their pay to a defined contribution plan (“deferred”) or to take that portion as taxable compensation (“cash”). These provisions must comply with Code section 401(k).

Governmental plans are prohibited under Code section 401(k) from including CODA provisions as part of the plan unless the governmental subdivision had adopted the arrangement before May 6, 1986. None of Minnesota’s public pension or retirement plans had adopted a CODA/401(k) arrangement before this date so Minnesota’s public pension and retirement plans are not able to offer a CODA.

The Internal Revenue Service (IRS) has provided guidance on what else might constitute a CODA and would therefore be considered impermissible. Any election to defer salary to a qualified retirement plan is an impermissible CODA unless the election is a one-time, irrevocable election. As further refined by the IRS, the election must be made upon first becoming eligible under the plan or any plan of the employer. The IRS has issued other guidance indicating that transferring from one plan to another, where the plans have different employee contribution rates, is effectively a CODA because it is the employee choice that results in a different employee contribution rate.

Conceptually, this issue came up a few years ago in the context of transfers of employees from MN State’s Higher Education Individual Retirement Account Plan (IRAP) to the Teachers Retirement Association (TRA). Because the employee contribution rates between the two plans were different, when a member transferred from the IRAP to TRA, it was considered a new salary deferral election and, therefore, impermissible. When the employee contribution rates between the two plans were made equal, the election problem was solved.

Applying the IRS guidance to the PERA General and Defined Contribution Plans

The PERA General Plan permits city managers to elect not to participate in the Plan during the first six months of employment. This is an impermissible CODA in that such an election, under the IRS guidance, is to be made when the employee first becomes eligible for the plan. According to IRS guidance, six months to make an election as to whether or not to participate in the PERA General Plan is too long an election period.

The PERA DC Plan permits certain categories of employees to elect to participate in the Plan and start making employee contributions. This ability to elect to participate is an impermissible CODA. The Plan also, for some categories of employees, allows employees to revoke an election to participate in the Plan. Since this reduces employee contributions to \$0, the ability to revoke the election to participate too is an impermissible CODA.

For as long as either plan offers an impermissible CODA, it is technically no longer a qualified plan. The IRS has a program called the Employee Plans Compliance Resolution System (EPCRS) under which a plan can correct errors, including plan document (or statute) errors and restore tax-qualified status. We understand that PERA has been working with legal counsel to comply with the requirements of the EPCRS program and implement correction. Part of that correction is passage of HF 4899.

PERA DC Plan Statistics

The PERA DC Plan, established in 1987, is a defined contribution plan for local government officials, physicians, city managers, public ambulance service personnel, and other categories of employees listed under Chapter 353D. Plan features and statistics, as of 2023:

- Employer and employee contributions are deposited in each member's account and invested by the Minnesota State Board of Investment.
- Accounts are 100% vested.
- Approximate number of participating employers: 1,100
- Number of participants: 8,238
- Accounts are distributed in a lump sum following termination of employment.
- Assets: \$89.7 million

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The bill removes or amends provisions in Chapter 353 and 353D to bring the plan into compliance with federal law prohibiting CODAs for governmental plans, generally as follows:

- Reducing election periods for city managers to elect not to participate in the PERA General Plan and for eligible employees to elect to participate in the DC Plan from six months to 30 days after commencing employment;
- All provisions permitting employees to revoke an election to participate or not to participate are removed.

The bill includes a session law that allows city managers, local government officials, and public ambulance service personnel who could have elected to participate in the DC Plan or, in the case of city managers, to revoke participation in the PERA General Plan during employment or periods longer than 30 days to make a one-time election during the month of August 2024.

Section- by- Section Summary

Section 1 amends section 353.028, which permits city managers to elect, during the first six months of employment, to be excluded from participation in the PERA General Plan and, if they so elect, to revoke that election later at any time. Specifically, Section 1 adds a definition for "first employed," which is defined to mean a city manager who has not been an employee in any position covered by a PERA plan or a supplemental retirement plan sponsored by the city that employs the manager.

Section 2 amends section 353.028, subdivision 2, which is the process for a city manager to elect to be excluded from the PERA General Plan. Section 2 makes the following changes:

- Instead of allowing any city manager to elect to be excluded from the PERA General Plan, section 2 modifies the requirement to allow only a city manager “first employed” by a city (using the definition added by section 1) to elect to be excluded. A city manager who had previously been an employee with retirement coverage by a PERA plan or a supplemental retirement plan sponsored by the city is not eligible to elect to be excluded from the PERA General Plan.
- The election is a one-time, irrevocable election. Under current law, a city manager who has elected to be excluded from the PERA General Plan can revoke that election.
- The period for making an election is shortened from the first six months of employment to the first 30 days of employment.

Section 3 amends section 353.028, subdivision 3, which permits a city manager that elected to be excluded from the PERA General Plan to enter into an agreement with the city to contribute an amount equal to the employer contribution that would have been made to the PERA General Plan on behalf of the city manager to be contributed to a deferred compensation plan or the PERA DC Plan. A new provision requires the agreement between the city and the city manager to be entered into within the city manager’s first 30 days of employment.

Section 4 amends the eligibility provisions for the PERA DC Plan, at section 353D.01, subdivision 2, to revise the requirement for elected county sheriffs who are receiving a retirement annuity from the PERA Police and Fire Plan. The language currently in the bill contains errors that are corrected in Amendment 1A. As corrected by Amendment 1A, the provision limits participation for these county sheriffs to only those who did not have previous employment with the county for which the sheriff was elected.

Section 5 amends section 353D.02, which describes the categories of employees eligible to elect coverage by the PERA DC Plan:

- Local government officials,
- eligible physicians,
- eligible ambulance service personnel,
- eligible rescue squad personnel,
- St. Paul Port Authority personnel,
- city managers, and
- certain volunteer firefighters.

The clause for each category is amended to require that the election be made within the employee’s first 30 days of employment and that the election be irrevocable.

Section 5 also adds a subdivision that states that an election to participate in the PERA DC Plan is available to eligible participants within the participant’s first 30 days of employment and only if the employee was not previously employed in a position covered by a PERA plan or a deferred compensation plan sponsored by the governmental employer.

Section 6 is a session law that consists of three subdivisions that provide the following:

- Subdivision 1 permits city managers in the PERA General Plan and who were hired within 6 months before the effective date of the bill to elect to be excluded from membership in the PERA General Plan by filing an election with the executive director of PERA during the month of August 2024. The election must be approved by the city's governing body.
- Subdivision 2 permits local government officials elected or appointed within the 6 months before the effective date of the bill to elect to participate in the PERA DC Plan by filing an election with the executive director of PERA during the month of August 2024. The election must be approved by the city's governing body.
- Subdivision 2 permits public ambulance service personnel hired within the 6 months before the effective date of the bill to elect to participate in the PERA DC Plan by filing an election with the executive director of PERA during the month of August 2024.

Section 7 repeals subdivisions in section 353.028 and section 353D.071. The 353.028 section subdivisions are reinstated under Amendment H4899-1A. Section 353D.071 is repealed because it is unnecessary due to similar provisions in Chapter 356.635 that are being updated in a staff technical changes bill to be considered by the Commission later this session.

Effective date. The bill is effective the day following final enactment.

Amendment

Amendment H4899-1A makes the following changes to the bill:

- Two statutes that are being repealed in the bill should not have been repealed and are reinstated and amended by the amendment:
Line 3.13 inserts these two statutes, section 353.028, subdivisions 4 and 5, as new sections 4 and 5:
 - Section 4 amends subdivision 4, which permits city managers to receive a refund of any employee contributions the manager made before an election to be excluded from the PERA General Plan takes effect. Language relating to having that refund be contributed to fund a deferred annuity, which is an employee deferral election, is being deleted.
 - Section 5 amends subdivision 5 to make it clear that if a city manager who has elected to be excluded from the PERA General Plan subsequently accepts employment in another governmental subdivision, the exclusion election is rescinded, through no choice of the employee.
- Lines 4.13 to 4.16 are being amended to correct bad drafting. The provision as corrected will permit an elected county sheriff who is receiving a retirement annuity from the PERA Police and Fire Plan to participate in the DC Plan as long as the sheriff does not have previous employment with the county for which the sheriff was elected.
- The Repealer on line 7.25 of the bill is being amended to remove section 353.028, subdivisions 4 and 5, so these sections will not be repealed.