

SAFE HARBOR AND PENSION TAXABILITY

We receive many questions on how a member's pension taxability is determined, particularly with regard to the "Safe-Harbor" portion of their benefit. In our January issue we provided a table showing a breakdown on taxability of pension benefits. All normal retirement pensions are considered taxable, except for the portion that falls under this "Safe-Harbor" calculation. But what exactly is this?

IRS rules state that pension payments from a tax-qualified plan are generally considered ordinary income and as such are taxed in that manner. However, there may be a portion that is excluded from tax. This portion is derived from any contributions received by the plan from the employee on an after-tax basis.

For members in our plans, contributions that were made prior to July 1, 2000 were made with after tax dollars, meaning that their pension contributions were calculated after the member's state and federal taxes has been deducted from their regular paychecks. As a result, these contributions are considered non-taxable when the member begins receiving benefits from the plan. How much of their monthly benefit is considered non-taxable is derived by dividing a retiree's total amount of non-taxable contributions (investment in contract) by their expected number of monthly payments (which is set by the IRS). The number of monthly payments is based on the member's age at retirement. The following table is what is set forth by the IRS:



Pension Payable for Single Life		Pension Payable for More than One Life	
Age of Retiree	Expected Number of Payments	Combined Ages of Retiree and Beneficiary	Expected Number of Payments
55 and under	360	110 and under	410
56-60	310	111-120	360
61-65	260	121-130	310
66-70	210	131-140	260
71 and over	160	141 and over	210

Let's take an example: Let's assume a member is age 50 at retirement and has a calculated monthly pension of \$3,000. During their career, they have made a total of \$20,000 of non-taxable contributions. The "Safe Harbor" portion of their monthly benefit would calculate as follows:

$$\begin{aligned} \text{"Safe Harbor" portion} &= \frac{\text{Retiree's total of non-taxable contributions}}{\text{Expected number of payments}} \\ \text{"Safe Harbor" portion} &= \frac{\$20,000}{360} \\ \text{"Safe Harbor" portion} &= \$55.56 \end{aligned}$$

So as you can see in this example, this member's non-taxable portion of their monthly benefit calculates to be \$55.56 per month for the next 360 monthly payments. Once a member exhausts their 360th payment, then their entire benefit is considered taxable because at that point they would have recovered all of their non-taxable contributions.

This calculation is also the reason why members who exit DROP receive a portion of their DROP funds directly. This portion is the non-taxable portion of their monthly benefit they would have received if they were truly retired. In the above example, if this member entered DROP and participated for the full 60 months, then they would have received a non-taxable check in the amount of \$3,333.60 upon their exit from DROP.

DID YOU KNOW?

Our partners at the Arizona Peace Officer Standards and Training (AZPOST) Board provided us with the following information. If you have any POST certified retirees considering returning to work in a POST certified position, then you might want to provide them with this information:

PEACE OFFICER CERTIFICATION

Peace Officers who are planning to, or who have recently retired should familiarize themselves with their peace officer certification status when they leave an employer. The day you leave employment, your peace officer certification is classified as INACTIVE. Unless subsequently employed as a peace officer, your certification is INACTIVE for three (3) years then it is reclassified as LAPSED. There are different requirements to return your certification to an ACTIVE status from both the INACTIVE and LAPSED categories. If you feel you may desire to ever serve as a peace officer in the future you should familiarize yourself with this process. Information is available through the AZPOST website link at www.azpost.gov or by calling AZPOST at 602-223-2514 and ask for a Compliance Specialist.

NOTES FROM THE BENEFITS DEPARTMENT

If your board or supporting staff is contacted regarding a death of one of your retirees, and they were receiving pension payments via direct deposit, please suggest to the family that they leave the bank account open until the final pension check is deposited. As many of you may already know, pension benefits are paid on the last business day of each month so if a member passes anytime in that month, the pension benefit is still payable on the last day of that month.

Asking the families to hold off on closing or removing the deceased member from the bank account will help prevent the bank from rejected those funds. If this happens, we can only reissue the pension funds with a paper check made payable to the deceased member or "To the Estate of the deceased member" which may cause payment negotiating problems for that family.

UPCOMING TRAINING:

April 7, 2010

9:30am to 11:30am

Topic: Disability Retirement and Determining PSPRS Membership

Location: Chino Valley Fire District 1133 W Road 3 North, Chino Valley, AZ 86323

Space is limited! To sign up please email Freida Huff: cvfd@chinoazfire.com or call 928-636-8857.

April 7, 2010

1:30pm to 3:30 pm

Topic: DROP, Service Purchases and Health Insurance Options (trainings for PSPRS members)

Location: Chino Valley Fire District 1133 W Road 3 North, Chino Valley, AZ 86323

Space is limited! To sign up please email Freida Huff: cvfd@chinoazfire.com or call 928-636-8857.

L'IL RONNIE'S CORNER

"Employer shortfalls"

I am always getting calls from members with a variety of questions like:

- Are we getting a COLA this year?
- Can we make improvements to DROP like 5 years to 7 years?
- Can we get more money for retiree health care?
- Will DROP still be around when I want to use it?
- What compensation counts toward my high 3-year average pay?



The latest question and concern is, "Can my employer make me take a cut in pay or take away a benefit?" That answer has to be made on a case-by-case basis. Arizona is a right to work state and only a few employers allow or acknowledge employee organizations. Even fewer allow them to negotiate for wages and benefits, and then placing them into an official "Agreement". So my response to you will be referring you to your agreement if you have one.

The current economy has really impacted our employers. These difficult times are finding employers' funding sources diminishing. The money they thought they would have to pay bills (your salary) is getting harder to come by. That being said, employers are going to employees and employee organizations asking them to take cuts in pay and benefits. The answer to the question, can my employer reduce my pay and benefits is "yes" in most, if not all cases. If you have a contract or agreement that addresses pay and benefits, all of those issues could be on the negotiations table by the employer as they look for givebacks when your contract is set to expire. On the other hand, the employer would be hard pressed to come in mid contract and arbitrarily reduce your pay or end a benefit.

The good news is that this will come as no surprise to any of you. It is well publicized and this allows you time to prepare. If you are working on your high three and are planning on retirement or entering DROP you may want to reevaluate your "Plan". If a reduced salary means that much to you, the one option you still have is stay a little bit longer and make up the reduced pay with increased percentage. It's just that simple. Personally, I don't know why anyone would want to retire during these difficult times unless they have to as a result of ending their DROP period.

My former employer is in the same boat. Recently the Phoenix Police and Fire labor unions each gave up 1% in wages and 2.2% in benefits for the next 2 years in an effort to save all of the employees facing layoffs. This included almost 400 officers and 200 firefighters.

So if you do end up losing some wages or benefits, you may want to reconsider your retirement plans. Stay employed for as long as you can during these difficult times. Make more money while increasing your percentage and get a bigger pension.

Remember, if you hear any rumors please call me for the facts. Be safe.
L'il Ronnie

Contact Ron at 602-361-0803 or littletonnie@mac.com if you need some help, a visit or training. We are here to serve you.