



Memorandum

TO: HONORABLE MAYOR
AND CITY COUNCIL

FROM: Richard Doyle
City Attorney

SUBJECT: Ordinance To Clarify Provisions
in the Police and Fire
Department Retirement Plan
Related To Internal Revenue
Code Limitations On Pension
Benefit Calculations

DATE: June 18, 2010

RECOMMENDATION

Approve an ordinance amending Parts 1 and 5.5 of Title 3 of Chapter 3.36 of the San José Municipal Code relating to the Police and Fire Department Retirement Plan to add new Sections 3.36.130 and 3.36.140 defining "Limitation Year" and "Plan Year" and revising Section 3.36.730 to clarify provisions related to Internal Revenue Code limitations on pension benefit calculations.

OUTCOME

The proposed ordinance will clarify Police and Fire Department Plan provisions related to the maximum pension benefits that are payable under Section 415 of the Internal Revenue Code.

BACKGROUND

City Charter Section 1506 provides that the City Council may, by ordinance, provide for the conformance of the City's retirement plans with respect to Section 415 of the Internal Revenue Code (IRC) and other applicable provisions of state and federal law. IRC Section 415 limits the pension amounts that can be paid from "qualified" retirement plans. A qualified plan is a plan that complies with applicable IRC provisions, which allows employee contributions to the plan to be made on a pre-tax basis. The limitations of IRC Section 415 on the pensions that are payable under the Police and Fire Department Retirement Plan are currently addressed in Section 3.36.730 of the Municipal Code.

On April 2, 2007, the IRS issued final amendments to the federal tax regulations relating to limitations on benefits and contributions under qualified plans. Included in these regulations was guidance related to how maximum dollar limits established under IRC Section 415 were to be applied to pension plans which have an automatic benefit

adjustment provision, like the annual automatic 3% cost-of-living adjustment ("COLA") that is contained in the Police & Fire Department Retirement Plan.

ANALYSIS

The current (2010) IRC Section 415 dollar limit on the pension amount that is payable by a qualified plan is \$195,000 (the "default limit"). This dollar limit can be adjusted is adjusted by the IRS in increments of \$5,000 to reflect cost of living changes. The limit amounts for the past 5 years were: \$195,000 (2009); \$185,000 (2008); \$180,000 (2007); \$175,000 (2006); \$170,000 (2005).

The default limit is also subject to adjustment (increase) for amounts attributable to employee post tax contribution; adjustment (decrease) for non-public safety employees who retire before age 62¹ and for retirement with less than 10 years of service. The IRC also provides for the use of a "grandfather limit" by governmental plans for employees who first became participants in the retirement plan on or before January 1, 1990, if the grandfather limit is higher than the default limit. The grandfather limit is based on the pension benefit structure that was in place as of October 14, 1987.

The 2007 IRS regulations made it clear that the default limit is also subject to an actuarially based adjustment (decrease) when the pension plan has an automatic benefit adjustment provision, like the annual automatic 3% COLA that is contained in the Police & Fire Department Retirement Plan.² However, the regulation also provides that a plan can have clear language ensuring that the pension is reviewed every year to ensure that the pension, plus automatic benefit adjustment, is under the limit for that year, if the pension exceeds the applicable limit in the initial year of retirement. The proposed ordinance conforms to the IRC Section 415 language in the Police and Fire Department Retirement Plan to the 2007 regulations related to calculation of pension benefit limits where a plan has an automatic benefit adjustment feature. Outside tax counsel for the Police and Fire Department Retirement Plan developed the proposed amendment language.

EVALUATION AND FOLLOW-UP

The proposed ordinance will return to Council for final adoption after the Police and Fire Department Retirement Board has had an opportunity to review the ordinance pursuant to San José Municipal Code Section 3.36.485. The City Attorney's Office will be reviewing the IRC Section 415 language in the Federated Employees Retirement Plan with outside tax counsel for that plan and may be returning to Council with a recommendation for amendment of that Code provisions pertaining to that plan as well.

¹ For example, the 2010 limit for a non-public safety employee who retires at age 55 is \$117,672.

² These rules do not affect how the grandfather limit is calculated, as that calculation is based on the pension benefit structure that was in place as of October 14, 1987. San José did not have an automatic benefit adjustment feature in the Police and Fire Department Retirement Plan until February 1, 2002.

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Subject: Ordinance re P & F Pension Benefit Calculations

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PUBLIC OUTREACH/INTEREST

This memorandum and proposed ordinance are posted on the City's website for the June 22, 2010 City Council Agenda.

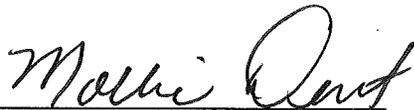
COORDINATION

This memorandum was coordinated with the City Manager's Office, Human Resources and Retirement Services.

CEQA

Not a Project. File No. PP10-068; Municipal Code or Policy (new or revised)

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By 
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