



Pension & Health Benefits Committee

Agenda Item 6a

November 15, 2022

Item Name: Internal Revenue Code Section 415(b) Overview

Program: Retirement Benefit Services Division

Item Type: Information

Executive Summary

The purpose of this item is to provide an overview of the Internal Revenue Code (IRC) section 415(b) requirements, the Replacement Benefit Plan (RBP), and impacts to members.

Strategic Plan

This item supports the CalPERS 2022-27 Strategic Plan Goal: *Member Experience* and the strategic objective of ensuring member satisfaction through accuracy, responsiveness, and timely communication.

Background

IRC section 415(b) limits the annual benefit amount that an individual can receive from an employer's tax-qualified defined benefit plans. These limits are defined for a maximum age of 62 and are generally adjusted downward for benefits paid at an earlier age. The limits may be adjusted by the Internal Revenue Service (IRS) each year to reflect changes in the cost-of-living index and each benefit is retested annually by CalPERS to modify any benefits in excess of the limit for the following calendar year. In accordance with Government Code sections 21750 et seq. and the implementing California Code of Regulations, title 2, sections 589 et seq., CalPERS is the administrator of the RBP for retirees of employers participating in the California Public Employees' Retirement System and the laws and regulations define how we collect the funds from the employer(s) to pay the excess benefits and generally administer the program.

Analysis

The CalPERS RBP currently has a population of approximately 1,700 member participants and 600 employers that are invoiced for the Replacement Benefit Fund (RBF). The replacement benefits are primarily funded from Public Agencies (73%), with State (22%) and Schools (5%) making up the remainder of employer funding. The participants of the plan receive an average monthly check of approximately \$1,800 from the RBF, in addition to their normal CalPERS

retirement benefit. Once a participant is identified as limited by IRC section 415(b), the employer(s) of the participant are billed at four intervals. CalPERS first bills when a member retires and a second bill is issued if an adjustment is processed on a member's account after retirement. Additionally, CalPERS bills on an annual basis (December) after the IRS issues updated IRC section 415(b) limits in November and the participants' benefits are retested against their new personalized limit. Lastly, CalPERS bills for Cost-of-Living-Adjustments (COLAs) in March for those who are eligible.

Once the employer(s) pay their invoices in full, RBF checks are issued and mailed to RBP participants every month. The IRS classifies the income received through the RBP as employer wages, as opposed to a pension, therefore the RBP funds are subject to a one-time FICA tax, which consists of Social Security (OASDI), if applicable, and Medicare taxes. FICA taxes are calculated on the actuarial present value of the lifetime RBP benefit and are taken in whole from the initial RBP payments until they are satisfied.

In accordance with Government Code sections 21750 et seq. and the implementing regulations, CalPERS must charge an administrative fee to maintain the RBP and the costs to administer the program. The RBP administrative fee is applied to each RBP payment a participant receives, is reviewed annually, and may be changed periodically to ensure compliance with applicable State laws and regulations.

Effort to communicate the impacts of the RBP include circular letters issued to employers informing them of the IRC section 415(b) process. In addition, when preparing for retirement, members are informed through educational workshops, publications and in retirement estimates if their benefit approaches the limit. Additionally, RBP participants receive a letter when IRC section 415(b) is applied to their retirement benefit as well as when adjustments or changes occur. An RBP Fact Sheet is also available on our website for general informational purposes.

In addition to CalPERS members, Judges' Retirement System (JRS) I/II and Legislators' Retirement System (LRS) members can also be impacted by the IRC section 415(b) limits. However, current law does not provide for a RBP to pay excess benefits for JRS I/II or LRS members. Therefore, while JRS I/II and LRS benefits are limited in accordance with IRC section 415(b) rules, the process for replacing those benefits does not exist. Stakeholder outreach has occurred to raise awareness of this issue and help seek a resolution.

Budget and Fiscal Impacts

Not Applicable

Benefits and Risks

The statutes and regulations that require CalPERS to be the administrator of the RBF creates the ability to optimize the customer service related to replacements benefits and streamlines the process for the participants in the program. Continually monitoring and adhering to the IRS rules and regulations related to IRC section 415(b) ensures compliance and reduces the risk of concerns with our tax-qualified status.

Attachments

Attachment 1 – IRC415(b) Replacement Benefit Plan Overview PowerPoint

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