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SOUTH CAROLINA RETIREMENT SYSTEMS

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September 20, 2006

W. Thomas Reeder
Internal Revenue Service
Washington, DC

Hand delivered

Dear Mr. Reeder:

I am writing to you as director of the South Carolina Retirement Systems (Retirement Systems), which administers five defined benefit pension plans for public employees, to seek guidance concerning the Pension Protection Act of 2006 (PPA). The Retirement Systems services more than 200,000 active members and in excess of 100,000 annuitants. Our members are from state government, public schools, institutions of higher education, and local governments. In addition to serving as director of the Retirement Systems, I am a member of the National Association of State Retirement Administrators (NASRA) and the National Council on Teacher Retirement (NCTR). I also serve on the NCTR executive committee.

I am submitting this letter on behalf of the Retirement Systems; however, South Carolina is not alone in facing these issues. Many other pension plans throughout the nation are affected by the provisions of the PPA and are confronted with the same issues.

Section 845 of the PPA allows eligible retired public safety officers to elect to exclude up to \$3,000 from gross income certain distributions made from an eligible retirement plan to pay qualified health insurance premiums. To be eligible for the income exclusion, the premiums must be paid directly to the insurance company by the retirement plan.

By requiring the insurance premiums to be paid by the retirement plan, affected retirement plans will be required to expend significant time and resources to gather membership data, modify existing data systems, and deal with multiple insurance carriers to provide qualified retirees with this advantageous financial benefit.

The Retirement Systems provides benefits to a diverse employee base. Our plans cover many employee groups other than public safety officers. We do not currently identify employees as "public safety officers." Therefore, in order to administer this benefit, we will have to determine the eligibility of retirees for this one benefit. This will require direct individual communication with retirees and employers by the retirement plan in order to identify the eligible retirees and provide guidance to employers and retirees in interpreting the definition of a "public safety officer." This education process is further complicated by other portions of the PPA which provide a different definition of a public safety officer (PPA Section 828).

Retirement plans will need clarification from the IRS concerning the extent of its responsibility for attesting that a retiree meets the IRS definition of a qualified public safety retiree. There are nearly 800 employers in the Retirement Systems' plans. Identifying public safety officers accurately will be difficult and will require heavy reliance upon employer certification. Because many of these members have been retired for years, employers may have difficulty in determining whether or not the member's last position was a public safety officer position. If verification by the Retirement Systems is required, the time and resources required to complete this aspect of the administration will be cumbersome and time consuming and in some cases, the information may not be verifiable.

To implement this provision of the PPA for all public safety employees, the Retirement Systems will need to identify outside insurance companies with whom retirees may have policies and develop reporting and reconciliation requirements with them. Retirement plans will have no control over the relationship between the retiree and the insurance provider; rather, retirement plans will only be a conduit between them. As a result, retirement plans will be in the middle of dealings between the insurance company and the retiree such as cancelled policies, modified policies, refunded premiums, and increased premiums. Tremendous time, effort, and resources will be required if the retirement plans will be responsible for reconciling all of these events and properly reporting amounts on the retirees' 1099s.

Additionally, qualified retirees may participate in more than one eligible retirement plan as defined by the Act (qualified defined benefit trust, 457(b), 403(a), or 403(b) plans). All eligible retirement plans of an employer are to be treated as a single plan under the Act. However, there may be more than one administrator for each of these types of plans. This creates a potential problem related to tracking and reporting the excludible amounts on appropriate tax forms, since it is possible the different plans will track and report the payments separately and not communicate the amounts to the retiree's other plans.¹

¹ Gabriel, Roeder, Smith & Company Research Memorandum, "Pension Protection Act Provisions for State and Local Governments," September 1, 2006, page 5.

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Finally, like the Retirement Systems, many retirement plans cover multiple employment categories, most of which are not included in the definition of "public safety officer." In order for retirement plans to provide this benefit to a small group of members, the retirement plans will be expending assets of the trust fund. This raises some fiduciary concerns for retirement systems administrators.

It is our understanding that the original intent of the United States Congress in requiring pension plans to directly submit the premium payments to the insurance companies was to ensure retirees were able to receive the benefit of the tax deduction during the year rather than waiting until the end of the tax year. While this scenario is true for active employees who cannot reduce their tax withholdings beyond a limit, retirees are free to instruct the pension plans to withhold as much or as little in taxes as they deem necessary. The result is that there is no additional benefit provided to the retiree by requiring the pension plan to submit the premium payments directly to the insurance companies.

The tax benefit provided in the PPA could be provided to public safety retirees by allowing individuals the option of taking the income exclusion for qualified health insurance premiums on their individual annual tax returns. This option provides the benefit granted in the PPA without creating substantial administrative overhead for qualified pension plans. We believe this creates a win/win situation for all affected parties, with a net result of less administrative cost to taxpayers.

I thank you for your time and appreciate your consideration of this issue as a technical correction.

Sincerely,


Peggy G. Boykin, CPA
Director