



# *CITY COUNCIL AGENDA REPORT*

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MEETING DATE: March 20, 2007

ITEM NUMBER:

**SUBJECT:** Pre-Tax Payroll Deduction Option for Additional Retirement Service Credit

**DATE:** March 8, 2007

**FROM:** Administrative Services Department

**PRESENTATION BY:** Terri L. Cassidy, Human Resources Manager

**FOR FURTHER INFORMATION CONTACT:** Jim Thyden, Risk Management Analyst 714-754-5228

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## **RECOMMENDED ACTION:**

1. Adopt CalPERS Employer Pickup Resolution, which implements Pre-Tax Payroll Deduction Plan for California Public Employees' Retirement System (CalPERS) Service Credit Purchases under Internal Revenue Code Section 414 (h)(2) for all employee groups.
2. Approve the Finance Department taking the necessary steps to establish this irrevocable plan and follow through with appropriate arrangements per CalPERS procedures.

## **BACKGROUND:**

Government Code Section 20909 allows eligible (i.e. currently employed) members of CalPERS to purchase up to five full years of additional service credit toward retirement for non-governmental service if certain requirements are met.

CalPERS guidelines permit employees to purchase additional service credit using pre-tax payroll deductions in accordance with Internal Revenue Code (IRC) Section 414 (h)(2). Several employees have requested that the City of Costa Mesa permit them to buy additional service credit time using the payroll deduction program that allows them to do so on a pre-tax basis.

According to CalPERS Member Services Division information, the purchase of "Additional Retirement Service Credit" (ARSC) would be cost neutral to the City (employer). However, the employer must follow specific requirements/restrictions in the implementation process to make this irrevocable election comply with IRC rules.

## **ANALYSIS:**

Government Code Section 20909 grants the option of purchasing service credit in increments of one to five whole years under a program entitled ARSC at any time prior to retirement. For purposes of this section, ARSC means time that does not qualify as public

service, military service, leave of absence, or any other time recognized for service credit by the CalPERS retirement system. The program was adopted by statute in 2003.

Employees may currently purchase ARSC with pre-tax or post-tax employee retirement savings account (457) contributions, or they may finance the purchase prospectively with after-tax payroll deductions. However, by filing a Resolution with CalPERS, employers are allowed to extend the pick-up of member contributions under Internal Revenue Code Section 414 (h)(2) provisions for member payments by payroll deductions for service credit purchases. This would permit employees who elect to participate with the benefit of deferring income tax liability on member service credit purchases.

According to Karl Klun, Manager, CalPERS Member Services Division, the employer would not be adversely impacted by implementation of this program. This option would be voluntary for employees, however, once the Plan Resolution is adopted, it is irrevocable. The cost of the service credit is calculated on the employee's current salary and agency plan and the employee is responsible for paying both the employee and employer share of the time purchased, as well as any interest or administrative costs. The employer is responsible for the payroll reporting only.

#### **ALTERNATIVES CONSIDERED:**

The alternative is to continue the status quo – employees pay prospectively for additional service credit using after-tax payroll deductions.

#### **FISCAL REVIEW:**

Implementation of this program was discussed with the Finance Director. The only possible adverse result would be in the unlikely event that all employees who elect this pre-tax program add significant amounts of service credit and outlive their actuarially predicted lives. In that extreme case, a small increase in the actuarial valuation cost to the employer might ultimately result. It is also possible that a small decrease may result if participants do not live to their actuarially predicted lives. However, the proposed option does not impact this actuarial valuation.

#### **LEGAL REVIEW:**

No legal review was requested as this is permissible under the California Public Employees' Retirement Law and Internal Revenue Code.

#### **CONCLUSION:**

Staff recommends implementing this cost neutral measure to permit employees to purchase service credit, at their cost, on a tax-deferred basis.

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ATTACHMENT: I. [CalPERS Employer Pickup Resolution](#)