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News

For Immediate Release
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STATE AND IRS REACH PENSION AGREEMENT

Attorney General Deborah T. Poritz and State Treasurer Brian Clymer announced today that the State of New Jersey and the Internal Revenue Service (IRS) have reached agreement in connection with an IRS examination of funding adjustments to the state pension systems in past fiscal years.

Governor Christie Whitman stated that the agreement assures the continued qualified status of the pension systems under the Internal Revenue Code and will have no adverse effect on participating employees or the state's taxpayers.

"No unbudgeted funds will be needed to fulfill the terms of the agreement," the Governor said, adding that the contributions required under the agreement will not exceed the amounts otherwise expected to be contributed to the pensions systems by June 30, 1997.

The primary focus of the IRS examination was the adjustment of contribution rates to the state pension systems for the 1992 fiscal year. The adjustment resulted in the transfer of approximately \$773 million of excess contributions to the state Treasury.

The position of the IRS is that once contributions were deposited into the pension systems, federal qualification standards precluded a transfer of excess contributions out of the systems. The IRS contended that such transfers would have been permissible only under exceptions specified in the federal Employees Retirement Income Securities Act (ERISA).

The state maintained that the transfers of excess contributions resulted from the state's lawful exercise of its authority to establish contribution levels for its pensions systems. The state also contended that ERISA standards are not applicable to the state's pension systems, and that the qualification requirements of the Internal Revenue Code do not bar a state from recovering excess contributions to its pensions systems within the same year for which the contributions are made.

Attorney General Poritz said that a definitive resolution of the legal dispute would have required litigation.

"Both the IRS and the state were willing to enter into the settlement agreement in order to protect participants in the pension systems from the uncertainties and risks associated with litigation," said Attorney General Poritz.

Under the agreement, the IRS agreed to conclude its examination and the state agreed to restore approximately \$1 billion in excess contributions in issue from Fiscal Years 1992 through 1994, plus interest, to the pensions systems by June 30, 1997.

The state also will undertake to add language to its pension statutes to conform with certain requirements under the Internal Revenue Code.

Finally, the state agreed that, if pension contributions are adjusted during any later fiscal year, no contributions that have been transferred to the accounts of the state pension systems will be returned to the state.

The Attorney General said the state's dispute with the IRS did not in any way relate to the level at which the state pension systems are funded. The funding of state pension systems is solely a matter of state law, and the IRS at no time examined or disputed the adequacy of the funding of New Jersey's pension systems.

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Agreement as to Final Determination of
Tax Liability and Specific Matters

Pursuant to section 7121 of the Internal Revenue Code of 1986, as amended (the "Code"), the State of New Jersey (the "State"), the State retirement systems listed below, and the Commissioner of Internal Revenue (the "Commissioner") make the following closing agreement (the "Agreement"):

WHEREAS, pursuant to the provisions of New Jersey law, the State has established and maintains the following six retirement systems (collectively, the "State retirement systems"): (1) the Teachers' Pension and Annuity Fund ("TPAF") (maintained pursuant to New Jersey Statutes Annotated, Title 18A, Chapter 66); (2) the Public Employees' Retirement System ("PERS") (maintained pursuant to New Jersey Statutes Annotated, Title 43, Chapter 15A); (3) the Police and Firemen's Retirement System ("PFRS") (maintained pursuant to New Jersey Statutes Annotated, Title 43, Chapter 16A); (4) the State Police Retirement System ("SPRS") (maintained pursuant to New Jersey Statutes Annotated, Title 53, Chapter 5A); (5) the Consolidated Police and Firemen's Pension Fund ("CPFPPF") (maintained pursuant to New Jersey Statutes Annotated, Title 43, Chapter 16); and (6) the Judicial Retirement System ("JRS") (maintained pursuant to New Jersey Statutes Annotated, Title 43, Chapter 6A);

WHEREAS, the State retirement systems are intended to provide retirement benefits to designated employees of the State and of certain local governments within the State;

WHEREAS, the State retirement systems are intended to satisfy the requirements of Code section 401(a);

WHEREAS, State retirement systems do not incorporate the provisions of Code sections 401(a)(2) and 415;

WHEREAS, no determination letters have been issued with respect to the State retirement systems;

WHEREAS, the State believes that it is in the best interest of the participants in the State retirement systems to disclose this Agreement;

WHEREAS, with respect to the fiscal year of the State ended June 30, 1992 ("fiscal year 1992"):

- (1) Chapter 41 of P.L. 1992, enacted on June 30, 1992, adjusted the level of employer contributions required to be made to the State retirement systems during fiscal year 1992 and directed that employer deposits made during that fiscal year in excess of the adjusted employer contributions required for that fiscal year be returned to the State;

- (2) In accordance with Chapter 41, the following amounts (which included interest) were returned to the State as of June 30, 1992 by the State retirement systems (collectively, the "1992 contributions"): \$373,900,000 (returned by TPAF); \$313,700,000 (returned by PERS); \$52,900,000 (returned by PFRS); \$29,300,000 (returned by SPRS); \$1,500,000 (returned by CPPFP); and \$2,100,000 (returned by JRS);

WHEREAS, with respect to the fiscal year of the State ended June 30, 1993 ("fiscal year 1993");

- (1) Chapter 41 extended by approximately nine months the due date for contributions required to be made to PERS by local government employers during fiscal year 1993;
- (2) Amounts totaling \$49,528,838 (the "1993 contributions"), which certain local government employers had deposited with PERS for fiscal year 1993 without regard to the new due date established by Chapter 41, were returned to those employers shortly after such amounts were deposited;

WHEREAS, with respect to the fiscal year of the State ended June 30, 1994 ("fiscal year 1994");

- (1) Chapter 62 of P.L. 1994, enacted on June 30, 1994, adjusted the level of employer contributions required to be made to the State retirement systems during fiscal year 1994 and directed that employer deposits made during that fiscal year in excess of the adjusted employer contributions required for that fiscal year be returned to the State;
- (2) In accordance with Chapter 62, the following amounts (which did not include interest) were returned to the State as of June 30, 1994 by two of the State retirement systems (collectively, the "1994 contributions"): \$105,000,000 (returned by PERS); and \$75,200,000 (returned by PFRS);

WHEREAS, it is the Commissioner's position that the return by the State retirement systems to the State of the 1992 and 1994 contributions and to the local governments of the 1993 contributions, that were deposited in the State retirement systems, did not satisfy the requirements of Code section 401(a)(2);

WHEREAS, it is the State's position that the 1992, 1993 and 1994 contributions did not constitute "corpus or income" of the State retirement systems within the meaning of Code section 401(a)(2) and that the return of such contributions did satisfy the requirements of Code section 401(a)(2);

WHEREAS, the Commissioner and the State have determined that it is in the best interest of the participants in the State retirement systems and the parties to this Agreement to enter into this Agreement;

NOW, THEREFORE, it is hereby agreed and determined that, for federal tax purposes:

- (1) The above recitations are a material part of this Agreement;
- (2) The State and local governments will repay \$1,002,126,838 (i.e., the amount of the 1992, 1993 and 1994 contributions) to the State retirement systems, no later than June 30, 1997, reduced by the amounts contributed to each retirement system by the State and local governments (except as provided in paragraph (3) below) since June 30, 1992 and before the date of this Agreement. In addition, the State and local governments will repay interest on the respective amounts returned by the State retirement systems (calculated at a 3/4% interest, compounded annually, beginning with the date on which such amounts were returned to the State and local governments and ending on the date of final payment). These computations shall be made as shown in Attachment 2;
- (3) All contributions made to the State retirement systems on or before June 30, 1997, will satisfy paragraph (2) above except those allocated for post-retirement medical benefits or deemed to be employer contributions under Code section 414(h)(2);
- (4) In the event that the level of required employer contributions to any State retirement system is retroactively adjusted in any later fiscal year of the State, the State agrees that employer contributions (and earnings thereon) will not be returned to the State or to any local government employer if such amounts have already been contributed, within the meaning of Code section 401(a)(2), to the related trust in effect for the respective retirement system;
- (5) By June 30, 1997, the State shall amend the statutes governing the State retirement systems to specifically provide that, in accordance with Code

section 401(a)(2), it is impossible, at any time prior to the satisfaction of all liabilities with respect to employees and their beneficiaries under the trust, for any part of the corpus or income to be (within the taxable year or thereafter) used for, or diverted to, purposes other than for the exclusive benefit of the participants in the State retirement systems or their beneficiaries;

- (6) By June 30, 1997, the State shall amend the statutes governing the State retirement systems to incorporate the provisions of Code section 415;
- (7) If the State timely enacts the amendments described in paragraphs (5) and (6) above, the Commissioner shall consider the State retirement systems as satisfying section 401(a) of the Code as a matter of form;
- (8) If the State satisfies paragraph (2) above, the Commissioner shall consider the State retirement systems as not failing to satisfy section 401(a) of the Code with respect to the return to the State of the 1992 and 1994 contributions and the return of the 1993 contributions to the local governments;
- (9) This Agreement constitutes a resolution under the Code of the specific matters set forth herein. No inference shall be made with respect to whether this resolution satisfies other federal law or any other tax matter;
- (10) The State has determined that it will release this signed and executed Agreement to the public.

This Agreement is final and conclusive except:

- (i) This Agreement may be reopened in the event of fraud, malfeasance, or misrepresentation of material facts;
- (ii) If the Agreement relates to a tax period ending after the date of this Agreement, it is subject to any law, enacted after the Agreement date, that applies to that tax period;
- (iii) This Agreement is subject to Internal Revenue Code sections that expressly provide that effect be given to their provisions notwithstanding any other law or rule of law except section 7122 of the Code.

By signing this Agreement, the parties certify that they have read and agreed to the terms of this document. The Attorney General certifies that she is specifically authorized to enter into contracts and take all legal actions on behalf of the State and the State retirement systems.

THE STATE OF NEW JERSEY

March 21, 1996
Date

By: Deborah T. Pritz
Attorney General

THE STATE RETIREMENT SYSTEMS

March 21, 1996
Date

By: Deborah T. Pritz
Attorney General

INTERNAL REVENUE SERVICE

March 22, 1996
Date

By: Andrew J. Huff
District Director

ATTACHMENT 1

Attachment I shows the amounts by which the 1992, 1993 and 1994 contributions have been restored to the State retirement systems by subsequent employer contributions made through June 30, 1995.

Public Employees' Retirement System (PERS)

Contributions returned to the State on 6/30/92	\$ 313,700,000
Contributions returned to local governments as of 6/30/92	49,520,831 ¹
Plus interest @ 8 3/4% through 6/30/93	395,011,361
Contributions for FY 6/30/93	(229,481,973) ²
Balance on 6/30/93	168,529,388
Plus interest @ 8 3/4% through 6/30/94	180,013,210
Contributions for FY 6/30/94	(167,720,094) ³
Contributions returned to the State on 6/30/94	105,000,000
Balance on 6/30/94	117,293,116
Plus interest @ 8 3/4% through 6/30/95	127,436,264
Contributions for FY 6/30/95	(65,321,666)
Balance on 6/30/95	62,034,598
Plus interest @ 8 3/4% through 3/31/96	\$ 66,105,618

¹ All 1992 contributions are treated as though returned to local employers on June 30, 1992 (notwithstanding that those contributions were generally returned after that date).

² All contributions to each of the respective State retirement systems are treated as though made on the last day of the respective fiscal year (notwithstanding that local employer contributions are generally due and paid earlier in the fiscal year).

³ The actual contributions for the fiscal year 1994 were \$62,720,094 after adjustment for the \$105,000,000 1994 contributions returned to the State shown in bold. However, for purposes of this schedule, the unadjusted deposits and the amounts returned to the State are shown separately.

Teachers' Pension and Annuity Fund (TPAF)

Contributions returned to the State on 6/30/92	\$ 373,900,000
Plus interest @ 8 3/4% through 6/30/93	406,616,250
Contributions for FY 6/30/93	(154,339,973)
Balance on 6/30/93	252,476,277
Plus interest @ 8 3/4% through 6/30/94	274,567,951
Contributions for FY 6/30/94	(121,751,669)
Balance on 6/30/94	152,816,282
Plus interest @ 8 3/4% through 6/30/95	166,187,707
Contributions for FY 6/30/95	(70,939,953)
Balance on 6/30/95	95,247,754
Plus interest @ 8 3/4% through 3/31/96	\$ 101,498,388

Police and Firemen's Retirement System (PFRA)

Contributions returned to the State on 6/30/92	\$ 52,900,000
Plus interest @ 8 3/4% through 6/30/93	57,528,750
Contributions for FY 6/30/93	(206,350,471)
Balance on 6/30/93	- 0 -
Plus interest @ 8 3/4% through 6/30/94	- 0 -
Contributions for FY 6/30/94	- 0 -
Contributions returned to the State on 6/30/94	75,200,000
Balance on 6/30/94	75,200,000
Plus interest @ 8 3/4% through 6/30/95	81,780,000
Contributions for FY 6/30/95	(204,992,587)
Balance on 6/30/95	- 0 -

The actual contributions for fiscal year 1994 were \$154,677,413 after adjustment for the \$75,200,000 1994 contributions returned to the State shown in bold. That is, for purposes of this schedule, the \$75,200,000 1994 contributions returned to the State are treated as a separate transaction to be restored out of subsequent contributions rather than as an adjustment to fiscal year 1994 contributions.

State Police Retirement System (SPRS)

Contributions returned to the State on 6/30/92	\$ 29,300,000
Plus interest @ 8 3/4% through 6/30/93	31,863,750
Contributions for FY 6/30/93	- 0 -
Balance on 6/30/93	31,863,750
Plus interest @ 8 3/4% through 6/30/94	34,651,828
Contributions for FY 6/30/94	(14,807,268)
Balance on 6/30/94	19,844,570
Plus interest @ 8 3/4% through 6/30/95	21,580,970
Contributions FY 6/30/95	(27,962,034)
Balance on 6/30/95	- 0 -

Judicial Retirement System (JRS)

Contributions returned to the State on 6/30/92	\$ 2,100,000
Plus interest @ 8 3/4% through 6/30/93	2,283,750
Contributions for FY 6/30/93	(9,286,000)
Balance on 6/30/93	- 0 -

Consolidated Police and Firemen's Pension Fund (CPFPPF)

Contributions returned to the State on 6/30/92	\$ 1,500,000
Plus interest @ 8 3/4% through 6/30/93	1,631,250
Contributions for FY 6/30/93	(6,810,554)
Balance on 6/30/93	- 0 -

**PROPOSED DISCUSSION POINTS
PRESS CONFERENCE
MARCH 22, 1996**

1. **Reasons for Settlement**

The State believed throughout this matter and continues to believe that there is substantial merit to its legal position that the 1992 and 1994 transfers did not violate the applicable provisions of the Internal Revenue Code. The IRS has continued to maintain otherwise. Thus, litigation would have been necessary to resolve the merit of the State's legal position. The risks and uncertainties associated with litigation are always substantial. This matter would have gone to court only after the IRS issued a formal notice of "disqualification" of the State pension systems. The effect of such a disqualification, if upheld, would be to tax all vested contributions made on behalf of participating employees. The tax would occur immediately. It was the State's determination that the risk of putting participating employees through the uncertainties and anxiety of a determination of disqualification by the IRS was not something we would permit to happen. Accordingly, this resolution avoids such a draconian result in a way that is perfectly satisfactory to the State and to the IRS.

2. **Summary of Proposed Settlement Structure**

The settlement requires that the amounts transferred to the State General Treasury in 1992 (\$773 million) and in 1994 (\$180 million), plus monies returned to the local governments due to early payment in 1993 (\$49 million), plus interest at the systems' assumed rate of 8 and 3/4 percent, be repaid to the systems not earlier than June 30, 1997. For purposes of this repayment, subject to certain exceptions, all of the State and local contributions made in Fiscal Year 1993 and thereafter would effectively be treated as repayments for this purpose.

3. **Effect of Settlement for the Various Pension Systems**

With respect to four of the systems (Consolidated Police and Firemen's Pension Fund, Judicial Retirement System, State Police Retirement System, and Police and Firemen's Retirement System), this settlement requires no future contribution commitment by the State. That is, past contributions will have caused CPFPF and JRS to have been fully repaid by Fiscal Year 1993 and SPRS and PFRS to have been fully repaid by Fiscal Year 1995.

With respect to the Teachers' Pension and Annuity Fund, after the crediting of the projected Fiscal Year 1996 contributions there would be an unrestored balance of approximately \$36.7 million. The projected contributions for Fiscal Year 1997 (approximately \$142 million) will fully satisfy the remaining amount to be restored.

With respect to the Public Employers' Retirement System, it is anticipated that it will be fully restored by the close of FY 1996 upon application of anticipated contributions.

4. Key Assumptions

It should be noted that two portions of contributions will not be included in the credit amount for the restoration.

Post retirement medical benefits will not be included in the credit applied in any fiscal year. (These monies only pertain to PERS and TPAP and represent significant amounts of money.)

Also excluded were contributions made pursuant to §414(h)(2). These contributions are employee contributions which the IRS treats as employer contributions. They were not used for purposes of calculating credit for repayment.

Technical Issues

The 401(a)(2) rule speaks to the plan insuring that monies are used exclusively for the benefit of plan participants. We never considered that our plan provide otherwise. In fact, 1994 amendments put in language to specifically underscore this intention in our plans. By this agreement we agree to make even more clear the language in our statutes on this matter.

§415. This section requires that the plans not give benefits that exceed certain levels. There is a good likelihood that benefit levels for our plan participants do not and should not violate the levels that the code requires. By this agreement the IRS has asked for and we have agreed to clarify in the statutes that our plans will preclude such a possibility from happening.

Both of these technical issues were only included only to make our plans' provisions more clear and more explicit.

6. The May 15, 1995 letter listed a number of other technical issues. All other technical issues were taken off the table by mutual agreement of the IRS and the State during our negotiations. Therefore, they are not addressed specifically in this closing agreement. Jaynoe LaVecchia can speak to any of these if necessary.

(1) The chart of post retirement monies that are not being included in this payback:

TPAF 93	\$182m (firm)
94	none (firm)
95	none (firm)
96	\$122.5 (soft)
97	\$142.9 (soft)
ES 93	\$64.9 (firm)
94	\$28 (firm)
95	\$42 (firm)
5	\$55.6 (soft)
7	\$59.8 (soft)

Lynch v. Clymer

In June 1995, Senators Lynch and Kenny requested a copy of the May 15, 1995 letter received by the Treasurer from the IRS in connection with an IRS examination into the effect of the 1992 pension law changes upon the tax-exempt status of the State's pension funds. This request was made under the Right to Know Law and the common law. The Treasurer declined to publicly disclose the text of the letter, because to do so would undermine the State's ability to effectively advance its position before the IRS. The Attorney General did, however provide a summary of the issues being reviewed by the IRS and the status of the matter to the Senators.

The Senators challenged the Treasurer's refusal to disclose the letter all the way to the State Supreme Court, which remanded the issue back to the trial court for further fact-finding. Throughout the numerous court proceedings the Attorney General argued that the ongoing, sensitive negotiations with the IRS would be irrevocably harmed by disclosure of the letter. It was the State's position that a public debate over the merits of the State's views vis-a-vis the views of the IRS would risk hardening the respective positions of the parties, thus precluding a full and fair consideration of the State's arguments to the detriment of its citizens. The Attorney General asserted that it was critical that the negotiation process be allowed to proceed in private, unfettered by the need to simultaneously debate the issue in public.

Judge Carchman on remand adopted the State's arguments and refused to order that the May 15 letter be disclosed to the Senators. The ultimate soundness of the State's arguments and the wisdom of Judge Carchman's ruling has been borne out by the settlement announced today.