LEGISLATIVE RESEARCH COMMISSION

REPORT
TO THE

1979

GENERAL ASSEMBLY OF NORTH CAROLINA

TAX SHELTERED RETIREMENT

RALEIGH, NORTH CAROLINA

A LIMITED NUMBER OF COPIES OF THIS REPORT ARE AVAILABLE FOR DISTRIBUTION THROUGH THE LEGISLATIVE LIBRARY:

ROOM 2126
STATE LEGISLATIVE BUILDING
RALEIGH, N. C. 27611
PHONE: (919) 733-7778

STATE OF NORTH CAROLINA

LEGISLATIVE RESEARCH COMMISSION

STATE LEGISLATIVE BUILDING

RALEIGH 27611

February 15, 1979

TO THE MEMBERS OF THE 1979 GENERAL ASSEMBLY

Transmitted herewith is the report prepared by the Committee to Study the Feasibility of Providing a Tax Shelter for Employee Contributions to the Various State Administered Retirement Systems. The study was conducted pursuant to Senate Joint Resolution 830 (ratified Resolution 120) of the 1977 General Assembly (Second Session 1978), and this report is submitted to the members of the General Assembly for their consideration.

Respectfully submitted,

Carl J. Stewart, Jr.

W. Craig Lawing

Co-Chairmen

LEGISLATIVE RESEARCH COMMISSION

TABLE OF CONTENTS

APPENDICES

PREFACE

The Legislative Research Commission, authorized by Article 6B of Chapter 120 of the General Statutes, is a general-purpose study group. The Commission is co-chaired by the Speaker of the House and the President Pro Tempore of the Senate and has five additional members appointed from each house of the General Assembly. Among the Commission's duties is that of making or causing to be made, upon the directions of the General Assembly, "such studies of and investigations into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner" (G.S. 120-30.17(6)).

At the direction of the 1977 General Assembly (Second Session, 1978), the Legislative Research Commission has undertaken studies of various matters. The Co-Chairmen of the Legislative Research Commission, under the authority of General Statutes 120-30.10(b) and (c), have appointed committees to conduct the studies, the committees consisting of members of the General Assembly and of the public. Each member of the Legislative Research Commission is responsible for coordinating the activities of two or more committees and serving as liaison between those committees and the Commission. Each committee is co-chaired by one member of the Senate and one member of the House of Representatives.

The study of the feasibility of providing a tax shelter for employee contributions was directed by Senate Joint Resolution 830 (Ratified Resolution 120) of the 1977 General Assembly (Second Session, 1978). The Resolution, in directing the Legislative Research Commission to study the feasibility of providing a tax shelter for employee contributions, directed that the committee investigate the revenue laws of the United States and North Carolina relating to the various State administered retirement systems and the advantages and disadvantages of the adoption of a tax sheltering plan.

A membership list of the Legislative Research Commission, a membership list of the committee on Tax Shelter for Employee Contributions, and a copy of Senate Joint Resolution 830 (Ratified Resolution 120) may be found in Appendix A.

COMMITTEE PROCEEDINGS

The Committee on Tax Shelter for Employee Contributions devoted five meetings to the study of the possibility of tax sheltered retirement for State administered retirement systems. These meetings spanned a five month period during the interim between the 1978 Adjourned Session of the 1977 General Assembly and February 5, 1979. A list of the witnesses who appeared before the committee is attached as Appendix B.

The committee began its study on October 30, 1978, at which time the Honorable Harlan E. Boyles, State Treasurer, addressed the committee and shared several areas of concern which could guide the committee in its study. Mr. Boyles stated these concerns as: 1) the problem of the General Assembly's viewpoint in dealing with fringe benefits for State employees and the increased costs, 2) the report on cost and impact on the funding of the Retirement System (See Appendix C), 3) the administrative problems in connection with bookkeeping and record keeping. Mr. Boyles agreed to provide the committee with any information at his disposal and the aid and assistance of the Retirement System.

The Department of Revenue, represented by Mr. B. E. Dail, provided the committee with information concerning the income tax consequences of a State pick-up of the employee's portion of the retirement contribution. (See Appendix D). The revenue loss to the State of such a program in lieu of a salary increase for State employees would be approximately $6,500,000.

The committee discussed the effect of Internal Revenue Service Revenue Ruling 77-462 which allows states to "pick up" an employees percentage of contribution to a retirement plan under Section 414(h)(2). The committee received a report from the Staff explaining the provisions which allow tax deferral on the portion of the retirement contribution paid by the employer on behalf of the employee. Several states are presently operating such programs. See Appendix E.

Representative Ellis stated that the committee should keep in mind three questions:

1. Whether in the future the State can afford a fully-funded retirement system or a five per cent (5%) salary increase for State employees. There could be serious problems with the Retirement System if it were not fully-funded.
2. If the State takes over the employees' contributions, would not the State have total control over the System and State employees lose their influence in the System?
3. The committee must look at the total picture - where are the funds going to come from to meet the growing needs of the State and to fund additional fringe benefits for State employees?

The committee, at its second meeting on November 16, 1978, received a report from Mr. Marvin K. Dorman, Jr., of the Division of State Budget, on the proceedings of the Department of Administration's study, mandated by the General Assembly, on the feasibility of the State paying Social Security for State employees and the State paying employees' retirement contributions. This study committee had voted to recommend to the Governor that the State pay each employee's Social Security contribution, but not the retirement contribution. This recommendation had been made due to the great number of unanswered questions on the tax consequences of the retirement "pick-up". Mr. Dorman also stated that the retirement pick-up proposal would not affect as many State employees as a salary increase since not all State employees are members of the Retirement System, for example, some college professors.

The Director of the Retirement System, Mr. Edwin T. Barnes, presented information from George B. Buck Consulting Actuaries, (See Appendix C) which indicated that an assumption of the retirement contribution by the State would lead to a reduction in retirement benefits due to the effect of a lost salary increase on average final compensation. The compounding effect of this lost wage increase would damage the benefits of older, long term employees, especially women, due to their longer life expectancy. The Actuary stated that this reduction in benefits could be offset by an increase in the retirement formula from the present 1.55% of average final compensation.

The remaining three meetings of the committee were devoted to presentations by proponents and opponents of the proposal. The proponents were represented by Dr. Robert J. Hursey, Associate Professor of Mathematics, East Carolina University, and Ms. Virginia Ryan, State Director of the North Carolina Federation of Teachers. The opponents were represented by Mr. Lloyd Isaacs, Executive Secretary of the North Carolina Association of Educators. See Appendices F and G for Ms. Ryan's and Dr. Hursey's presentations and Appendix H for Mr. Isaacs' remarks.

Ms. Ryan's and Dr. Hursey's position was that the proposal to assume the employees' portion of the retirement contribution would save the State money as compared to a general salary increase and would provide employees with a six percent salary increase with no additional tax burden. Dr. Hursey provided many examples of benefits to employees over a long period of time which would offset any reduction in retirement benefits due to the loss of a wage increase. Dr. Hursey also stated that an increase in the retirement formula from 1.55% to 1.6% would guarantee that no employee would lose retirement benefits under the "pick-up" proposal. The committee determined that such an increase in the formula would require approximately $26,000,000 during one biennium.

Mr. Lloyd Isaacs presented an opposing viewpoint on behalf of the North Carolina Association of Educators. Mr. Isaacs identified several problem areas, most notably the loss of retirement benefits to a large number of teachers and State employees. Mr. Isaacs stated that approximately 65% of the State employees make less than $13,000 per year and that these employees would not be benefitted to the same extent as higher salaried employees. He was also concerned about the General Assembly's continued funding of 15.12% of each employee's salary to the Retirement System and the loss of employee influence in the Retirement System. Mr. Isaacs also pointed out that under the proposal a retired individual would have to pay federal income taxes of the total retirement benefit, since no taxes would have been paid on the contribution made on the retiree's behalf by the State. Mr. Isaacs also noted that employees making less than the Social Security maximum salary would have even greater reduced benefits under the proposed plan. This is due to the lower salary on which Social Security benefits would be based.

The committee, at its final meeting, discussed all of the information provided by the witnesses, and, after a lengthy discussion, decided that the subject area was very technical and required a more in-depth study to determine the benefits and liabilities to State employees. The committee had received a wealth of information, both technical and explanatory, which, in the short period of time available to the committee, could not be properly studied. The committee decided that in light of this fact no findings could be made at this time. The committee, therefore, directed the Staff to prepare a report to the Legislative Research Commission with the recommendation that the study be continued.

RECOMMENDATION

1. <u>The Study of the Feasibility of Providing a Tax Shelter for Employee Contributions to the various State-Administered Retirement Systems be continued and a report be made to the 1980 Adjourned Session of the General Assembly.</u>

The committee has determined that the subject matter of this study was more technical and more far-reaching in its impact than originally thought, and that additional time should be devoted to the study. The committee also recommends that the committee begin its study by reviewing the work already done.

APPENDIX A

1977-1979

LEGISLATIVE RESEARCH COMMISSION MEMBERSHIP

House Speaker Carl J. Stewart, Jr. Chairman	Senate President Pro Tempore W. Craig Lawing, Chairman
Representative Chris S. Barker, Jr.	Senator Dallas L. Alford, Jr.
Representative John R. Gamble, Jr.	Senator Russell Walker
Representative A. Hartwell Campbell	Senator Cecil J. Hill
Representative H. Parks Helms	Senator Robert B. Jordan, III
Representative Lura S. Tally	Senator Vernon E. White

LEGISLATIVE RESEARCH COMMISSION

Study Committee on

TAX SHELTER FOR EMPLOYEE CONTRIBUTIONS

Senator Robert B. Jordan, III, LRC Member

Senator Rachel G. Gray, Co-Chairman

Representative Thomas W. Ellis, Jr., Co-Chairman

Mr. Cecil Banks

Mr. Peter S. Gilchrist, III

Mr. Troy Kenneth Green

Ms. Norma Harrell

Mr. Ernest McCracken

Ms. Linda Rader

Mr. James P. Senter

GENERAL ASSEMBLY OF NORTH CAROLINA

1977 SESSION (2nd SESSION, 1978)

RATIFIED BILL

RESOLUTION 120

SENATE JOINT RESOLUTION 830

A JOINT RESOLUTION DIRECTING THE LEGISLATIVE RESEARCH COMMISSION TO MAKE A STUDY TO DETERMINE THE FEASIBILITY OF PROVIDING A TAX SHELTER FOR EMPLOYEE CONTRIBUTIONS TO THE VARIOUS STATE-ADMINISTERED RETIREMENT SYSTEMS.

Whereas, teachers, State, and local governmental employees presently contribute a portion of their salaries to one of the various State-administered retirement systems which contributions are fully taxable for State and federal income tax purposes; and

Whereas, if a means of deferring the receipt of such income can be devised, the effect of such deferral will be to increase the "take-home" income of such employees and to defer the income tax thereon until its actual receipt, usually after the retirement of the employee, thereby further offsetting the effects of inflation upon such salaries;

Now, therefore, be it resolved by the Senate, the House of Representatives concurring:

Section 1. The Legislative Research Commission is hereby directed to make a study to determine the feasibility of providing a tax shelter for employee contributions to the Teachers' and State Employees' Retirement System of North Carolina, the Law Enforcement Officers' Benefit and Retirement Fund, the Local Governmental Employees' Retirement System, the

Uniform Clerks of Superior Court Retirement System, the Uniform Judicial Retirement System, and the Uniform Solicitorial Retirement System, and to any other retirement plans in which State employees participate and to make recommendations with respect thereto. The commission shall make a thorough and comprehensive study and review of the revenue laws of the State and of the United States and of the laws relating to these retirement systems as they relate to the feasibility of providing a means of sheltering employee contributions to these retirement systems; shall weigh the advantages and disadvantages to employees and to the State inherent in the adoption of such a plan and, if found feasible, shall make recommendations with respect to whether the plan should be optional or mandatory.

Sec. 2. The State Auditor, the State Treasurer and the Secretary of Revenue shall cooperate with the commission in its study and shall insure that their employees and staff provide full and timely assistance to the commission in the execution of its duties. Necessary staff for the commission shall be furnished by the Legislative Services Commission.

Sec. 3. The Legislative Research Commission shall transmit to the 1979 General Assembly a written report by February 15, 1979, summarizing the information obtained in the course of its inquiry, setting forth its findings and conclusions, and recommending such administrative action and legislation as it deems the public interest to require. If legislation is recommended, the commission shall prepare and submit with its report the appropriate bills.

Sec. 4. This resolution shall become effective July 1, 1978.

In the General Assembly read three times and ratified, this the 16th day of June, 1978.

JAMES C. GREEN, SR.

James C. Green

President of the Senate

CARL J. STEWART, JR.

Carl J. Stewart, Jr.

Speaker of the House of Representatives

APPENDIX B

WITNESSES APPEARING

Mr. Harlan E. Boyles
Treasurer
Department of State Treasurer
Raleigh, North Carolina

Mr. William H. Hambleton (Retired)
Director of Retirements and Health Benefits
Department of State Treasurer
Raleigh, North Carolina

Mr. Edwin T. Barnes
Director of Retirements and Health Benefits
Department of State Treasurer
Raleigh, North Carolina

Mr. Dennis Ducker
Assistant Director of Retirements and Health Benefits
Department of State Treasurer
Raleigh, North Carolina

Mr. Marvin K. Dorman, Jr.
Division of State Budget
Department of Administration
Raleigh, North Carolina

Mr. David Crotts
Fiscal Research Division
North Carolina General Assembly
Raleigh, North Carolina

B. E. Dail
Tax Research Division
Department of Revenue
Raleigh, North Carolina

Mr. Herman Gardner
Office of the Governor
Raleigh, North Carolina

Mr. T. P. Brendle
Fiscal Research Division
North Carolina General Assembly
Raleigh, North Carolina

Mr. B. W. Brown
Individual Income Tax Division Director
Department of Revenue
Raleigh, North Carolina

Ms. K. Merry Chambers
Division of Policy Development
Department of Administration
Raleigh, North Carolina

Mr. Ken Flynt
Division of Policy Development
Department of Administration
Raleigh, North Carolina

Mr. Lloyd Isaacs
North Carolina Association of Educators
Raleigh, North Carolina

Mr. Samuel Ranzino
North Carolina Association of Educators
Raleigh, North Carolina

Mr. Chuck Mooney
North Carolina Association of Educators
Raleigh, North Carolina

Ms. Virginia Ryan
State Director
North Carolina Federation of Teachers
454 Monmouth Street
Winston-Salem, North Carolina

Mr. Lynn Wilson
North Carolina State Employees' Association
Raleigh, North Carolina

Mr. Don Jones
North Carolina State Employees' Association
Raleigh, North Carolina

Mr. Emmett Burden
North Carolina State Employees' Association
Raleigh, North Carolina

Mr. Arch Laney
Executive Secretary
North Carolina State Government Employees' Association
Raleigh, North Carolina

Mr. Prem P. Sehgal
East Carolina University
Greenville, North Carolina

Dr. Robert J. Hursey
East Carolina University
Greenville, North Carolina

Dr. Henry C. Ferrell
East Carolina University
Greenville, North Carolina

Mr. John W. Scott, Jr.
University of North Carolina
Chapel Hill, North Carolina

APPENDIX C

COMMENTS CONCERNING STATE ASSUMPTION OF EMPLOYEE CONTRIBUTIONS TO RETIREMENT AND/OR SOCIAL SECURITY: BY THE CONSULTING ACTUARY OF THE STATE'S RETIREMENT SYSTEMS

Questions have been raised concerning the consequences of having employee contributions to the State Retirement System and/or Social Security taxes "picked-up" by the State, in lieu of a regular salary increase as described in Attachment A.

It must be recognized that the first step in understanding any such proposal is to analyze the impact on employee benefits. Accordingly, a preliminary analysis has been made and, as a result, a number of tenative conclusions have been reached pending clarification of the specific proposals.

Attachment B indicates that any change that causes a reduction in the State's contributions as a result of picking up the employees' Retirement System contributions or Social Security taxes is realized as a result of <u>reduced coverage</u> for employees and teachers under their retirement benefit programs.

The pick-up of an employee's Retirement System contributions by the employer, without an offsetting increase in benefit structure, would reduce his future retirement and death benefits (including social security). The amount of retirement benefit value lost by employees under the State Retirement System depends upon the age, sex and period of State service of the employee in question. Attachment C, "Example of Worst Case", leads to the conclusion that older, long service employees would suffer the greatest lifetime loss in retirement benefits. Women would suffer a greater loss than similarly situated men because of their longer life expectancies.

The pick-up of employee Social Security taxes is less onerous but, nevertheless, would result in reduced social security coverage.

If our understanding of the proposed pick-up legislation is correct, it appears the adoption of such would cause a significant and inequitable impairment of employee benefits. If the proposals under consideration differ from our present understanding, we would appreciate having, for further study, a clear statement of how the changes would be implemented.

COMPARISON OF EMPLOYER PICK-UP" OF EMPLOYEE RETIREMENT SYSTEM CONTRIBUTIONS WITH "PICK-UP" OF EMPLOYEE SOCIAL SECURITY TAX

Pick-up of Employee Retirement System Contributions (Revenue Ruling 77-462)

- Employer can pay all or part of employee's mandatory contributions to a retirement system.

- Amount is not included in gross income

- Amount is not subject to Social Security Tax

- Amount is not considered as employee contribution

(In effect, the Retirement System would become non-contributory for future service with no refund available for those years. The compensation basis for retirement and death benefits would exclude the amount picked up, resulting in lower retirement and death benefits than would otherwise have been payable. Social Security benefits would also be lower.)

Pick-up of Employee Social Security Taxes

- Amount is included in gross income

- Amount is not subject to Social Security tax

- Amount is subject to income tax

(In effect, employee saves FICA tax on FICA tax picked up by employer. The compensation for employer provided retirement and death benefits could include the amount picked up provided any necessary definitional changes are made. Social Security benefits would be lower.)

ATTACHMENT B

COMPARISON OF VARIOUS ALTERNATIVES

Item	Now	AFTER EMPLOYER ALTERNATIVES: Regular 6% Raise	Pick-up of Retirement System Contributions	Pick-up of Employee FICA tax
W-2 Compensation	$10,000	$ 10,600	$ 10,000	$ 10,600
S.S. (6%)	600	636	600	0
Ret. System (6%)	600	636	0	636
Fed. Tax (Est.)	600	720	600	720
Net Take-Home Pay	$ 8,200	$ 8,608	$ 8,800	$ 8,644
Increase in Take-Home Pay		$ 408	$ 600	$ 444
Salary Basis for:				
State Retirement System		$ 10,600	$ 10,000	$ 10,600*
Social Security		10,600	10,000	10,000

COMMENTS

- The regular raise results in the lowest take home pay increase ($408) but employer provided retirement and death benefits and Social Security are all based on $10,600.
- The pick-up of Retirement System contributions results in the largest take home pay increase ($600) but all benefits (including Social Security) are based on only $10,000 of compensation.
- The pick-up of employee FICA taxes results in a net take home pay increase of $444 because the employee does not pay FICA tax on FICA tax ($600) paid by employer.
- Employee Social Security tax rate used as 6%.
- The employees marginal federal income tax bracket was assumed to be 20% (joint return).

*Assumes "compensation" under Retirement System will be amended, if necessary, to include FICA taxes paid by employer.

EXAMPLE OF WORST CASE

A FEMALE TEACHER AGE 58, WITH PRESENT ANNUAL COMPENSATION OF $10,000 RECEIVES 6% ANNUAL SALARY INCREASES OVER HER LAST FOUR YEARS UNTIL SHE RETIRES AT AGE 62 WITH 34 YEARS OF CREDITED SERVICE.

	AFTER REGULAR 6% RAISES ON $10,000	AFTER EMPLOYER PICKS-UP RETIREMENT SYSTEM CONTRIBUTIONS
AVERAGE FINAL COMPENSATION	$ 11,593*	$ 10,937 **
PROPORTION OF AFC (34 YRS. X .0155)	.527	.527
ANNUAL RETIREMENT BENEFIT	6,110	5,764
REDUCTION IN ANNUAL BENEFIT		346
LIFE ANNUITY FACTOR (AGE 62)		11.33
ESTIMATED LOSS IN ACTUARIAL VALUE UNDER RETIREMENT SYSTEM		$ 3,920

* BASED ON $10,600, $11,236, $11,910 and $12,625

** BASED ON $10,000, $10,600, $11,236 and $11,910

NOTE: IN ADDITION, THIS EMPLOYEE'S SOCIAL SECURITY WOULD BE REDUCED. THE DECREASE IN SOCIAL SECURITY BENEFITS WOULD, OF COURSE, BE GREATER FOR YOUNGER EMPLOYEES.

ANALYSIS OF THE PICK-UP
OF MEMBERS' CONTRIBUTIONS TO
TSERS OR THEIR FICA TAXES
BY THE STATE OF NORTH CAROLINA

January 2, 1979

PICK-UP BY STATE OF MEMBERS' MANDATORY CONTRIBUTIONS TO TSERS

PROPOSAL

The State of North Carolina would pay members' contributions to TSERS in lieu of a raise in salary. The amounts paid by the State would be credited to the individual accounts of members and would be available upon termination of service thereafter.

CONSEQUENCES

Under Revenue Ruling 77-462 the member contribution amounts so paid by the State would be treated as follows:

- Such amounts would not be subject to current income tax but would be taxed as income when received.
- Such amounts would not be subject to FICA taxes.
- While such amounts could be credited to members' individual accounts in the Annuity Savings Fund of TSERS they would need to be distinguished from members' after tax contributions and could not become a part of their cost basis (investment in contract) for tax purposes.
- The foregoing treatment would not jeopardize the qualified status of TSERS under the Internal Revenue Code.

EXAMPLE

The following table shows an example of the effect of the State's pick-up of members' TSERS contributions on members' take home pay, the salary basis for TSERS benefits and Social Security. The pick-up by the State has been treated in two ways. The first is the usual approach under column (c) whereby the member does not make any contribution to the TSERS and has the reduced salary basis for TSERS benefits. The second approach, under column (d), which may be possible without jeopardizing the qualified status of TSERS, would require the member to make a contribution to the TSERS on the amount of the pick-up in order to have it included as covered salary under TSERS.

		AFTER EMPLOYER ALTERNATIVES		
			STATE PICKS UP TSERS CONTRIBUTIONS	
Item	Now (a)	Regular 6% Raise (b)	Member Does Not Contribute On Pick-Up (Usual) (c)	Member Does Contribute On Pick-Up (Possible) (d)
W-2 Compensation	$ 10,000	$10,600	$ 10,000	$ 10,000
S.S. (6.13% for 1979)	613	650	613	613
Ret. System (6%)	600	636	0	36
Fed. Tax (Est.)	600	720	600	600
Net Take Home Pay	$ 8,187	$ 8,594	$ 8,787	$ 8,751
Increase in member's Net Take Home Pay over Column (a)		$ 407	$ 600	$ 564
Salary Basis for:				
State Retirement System		$10,600	$ 10,000	$ 10,600
Social Security		10,600	10,000	10,000
State's Cost:				
Salary	$ 10,000	$10,600	$ 10,000	$ 10,000
Social Security	613	650	613	613
Ret. System:				
For Member	-	-	600	600
As Employer	912	967	912	967
	$ 11,525	$12,217A	$ 12,125B	$ 12,180C
Pick-up Saves State			A-B=92*	A-C=37**

* Consists of FICA tax and Employer TSERS cost on $600 (6.13% + 9.12% = 15.25% x $600 = $92)

** Consists of FICA tax on $600.

COMMENTS ON PICK-UP OF TSERS MEMBER CONTRIBUTIONS

- The regular 6% raise, Column (b), results in the lowest take home pay increase ($407) for the member but employer provided retirement and death benefits are based on the gross salary of $10,600.

- The pick-up of TSERS member contributions under the usual approach, Column (c), results in the largest take home pay increase ($600) for the member but all benefits (including Social Security) are based on only $10,000 of salary. The apparent increase of $193 over Column (b) in take home pay results from a savings of $120 of income tax, $37 of FICA tax and $36 of TSERS contribution, all of which would otherwise have been paid on $600 of regular salary.

- The pick-up of TSERS member contributions under a possible approach, Column (d), which would require the member to pay the TSERS contribution on the amount of the pick-up, 6% of $600 or $36, results in a take home pay increase of $564. On this basis, only the wages for Social Security purposes remain at $10,000.

- If future raises under the pick-up proposal are related to the reduced salary base ($10,000) the member's average final salary under TSERS could be less than would otherwise have been the case.

- There is a reduction in the State's cost under the pick-up proposal resulting from reduced contributions to TSERS (as employer) if the pick-up in contributions is not treated as a salary increase under the system and reduced FICA taxes.

- The pick-up of TSERS contributions on either basis will result in some administrative complications because of the necessity to distinguish these amounts for tax purposes.

WAYS TO COMPENSATE FOR BENEFIT REDUCTIONS

The pick-up of TSERS member contributions by the State could result in reductions in TSERS benefits and, in most cases, will result in some reduction in Social Security benefits.

UNDER TSERS

The usual method of implementing the pick-up, Column (c) of the example, indicates that the TSERS salary for benefit purposes would be $10,000, instead of $10,600. This could be compensated for by using a higher benefit rate of 1.643% (instead of 1.55%). Note that this is based on the assumption that salaries will always be about 6% lower than they would otherwise have been. The use of a benefit rate of 1.643% under the TSERS would increase the employer contribution rate by about 1.18% of payroll, or about $22.3 million for the first year based on a payroll of $1,889 million. Although the total employer contribution rate would increase, the rate would be applied to lower payrolls in the future if this method of pick-up is used.

The alternative method of implementing the pick-up, Column (d) of the example, basically overcomes the problem of the reduction in covered salary by requiring the member to make TSERS contributions on the amount of the pick-up by the State. This would require an amendment to the System which, because of its unique nature, should be submitted to the Internal Revenue Service for approval.

UNDER SOCIAL SECURITY

Social Security benefits would be reduced to the same extent under either method of implementing the pick-up, since only $10,000 of earnings would be covered for FICA purposes, rather than $10,600 as under a regular raise.

In all cases where the salary is under the Social Security maximum wage base, Social Security benefits will be reduced slightly on the basis of the proposal. The extent of the reduction depends upon the number of years of reduced salary included in the determination of the employee's average monthly wage. Reductions in the monthly primary Social Security benefit would generally range from roughly $2 in 1983 (reflecting 4 years of reduction) up to as much as 5% of the benefit otherwise payable (reflecting reductions over a full career of 35 years).

Any employee whose adjusted salary under the proposal always exceeds the maximum wage base will, of course, suffer no reduction in Social Security benefits.

Further comments with respect to reduced Social Security benefits are made in the second part of this analysis which covers the pick-up of FICA taxes.

PICK-UP BY STATE OF EMPLOYEE SOCIAL SECURITY TAX

PROPOSALS (Designated as FICA IIA and IIB)

The State of North Carolina (Employer) would assume the FICA taxes payable by each employee on his rate of compensation after reduction on either a FICA IIA or IIB basis. These proposals take advantage of a provision of the Social Security Act which allows an employer to pay an employee's FICA tax without such payment being considered part of the FICA wage base under the Social Security program.

The FICA IIA and IIB proposals differ in the way in which the employee's reduced salary is determined, as shown in the following example, based on the FICA tax rate of 6.13% applicable to 1979 and 1980:

	FICA IIA	FICA IIB
Current Salary	$ 10,000	$ 10,000
FICA Adjustment	- 613	÷1.0613
New Salary Rate	$ 9,387	$ 9,422

The new salary rates indicated above would become the bases to which the FICA tax rate would be applied in order to determine the total amount of FICA tax to be paid by the employer (including the employee's share). It is expected that the adjustment procedure would take place each year.

CONSEQUENCES

Under either of the FICA II proposals the following comments are applicable:

- The amount of FICA tax picked-up by the Employer is included in gross income and is subject to federal and state income taxes.
- There would be an increase in employees' take home pay and a decrease in the cost to the State for each employee, as indicated in the attached examples.
- Retirement and death benefits under TSERS would be reduced unless there is an amendment requiring contributions at 6% on the amount of FICA tax picked-up by the Employer. This would treat the FICA tax as "compensation" for Retirement System purposes.
- Social Security benefits would be reduced because the amount picked-up by the Employer is not counted as part of the FICA wage base under the Social Security program.

COMMENTS ON PICK-UP OF EMPLOYEE FICA TAX

Assuming that the TSERS benefit reductions would be avoided by requiring employees to contribute to TSERS on the amount picked-up by the employer, what remains is an assessment of how the value of employees' increased take home pay compares with the value of the reductions in their Social Security benefits.

An analysis of the trade-off between increased take-home pay and decreased Social Security benefits has been made on a limited basis by the Social Security administration, the results of which were included in a general memorandum, dated July 24, 1978. This study relates to median income workers and it would seem that the conclusions may be considered generally applicable to those earning less than $13,020 at the present time. It should be noted that 65% of the male members and 84% of the female members of TSERS had annual rates of salary below $13,000 on the basis of the data supplied for the actuarial valuation of TSERS as of December 31, 1977 and although salaries are expected to increase in the future so are the "bend points" under the Social Security Act. Therefore the decrease in Social Security benefit for a member in this group would be at a rate of 32% of the decrease in his average wage for Social Security purposes. The comments in the Social Security study would therefore seem to relate heavily to the TSERS membership.

It should be carefully noted that the Social Security study was made on the basis of the most liberal form of the proposed procedure, whereby the employer receives no gain and all savings are given to the employee in the form of higher take home pay. (FICA IIA and FICA IIB result in savings to the employer.) The following conclusion is taken from the Social Security study.

> "Thus under the assumption that the employee receives the full savings arising from employer payment of the Social Security tax, the conclusion appears to be that for average workers there is a tendency for the value of their increased take-home pay to be the same or somewhat greater than the value of their decreased Social Security benefits. In view of the slight improvement relative to the total value of future earnings and benefits, however, and considering the relative uncertainty attached to calculations of this type, I conclude that most employees would not be either advantaged or disadvantaged to a significant degree by the procedure. On the other hand, if the employer does not give all of the savings of the procedure to the employee, then the employee's Social Security benefits would be reduced still further and he would have only a very small savings in income taxes to accumulate as an offset. Under this form of the procedure, it seems clear that most workers would be at a disadvantage in the long run."

On the basis of the foregoing it would appear that any pick-up of employees' FICA taxes which resulted in a savings to the employer, as in the case of FICA IIA or IIB, would disadvantage a significant proportion of the TSERS membership.

A comparison of the present and proposed pick-up procedures follows. Also included are figures showing the basis on which there would be no savings to the Employer but the largest increase in take home pay.

COMPARISON OF PICK-UP PROCEDURES

ITEM	PRESENT	EMPLOYER PICKS-UP FICA TAX: FICA IIA	FICA IIB	No Savings For Employer
EMPLOYER OUTLAY				
(1) Starting Salary	$10,000	$10,000	$ 10,000	$ 10,000
(2) FICA Adjustment		-613	÷1.0613	*
(3) Adjusted Salary	10,000	9,387	9,422	9,453
(4) Employee FICA tax (pick-up)		575	578	580
(5) Employer FICA tax	613	575	578	580
(6) Employer Outlay	$10,613	$10,537	$ 10,578	$ 10,613
(7) Reduction in Employer Outlay from Present	-	76	35	0
EMPLOYEE TAKE HOME PAY				
(8) TSERS Contributions**(6%)	$ 600	$ 598	$ 600	$ 602
(9) FICA Tax (6.13%)	613	-	-	-
(10) Take-home pay before Federal and State income taxes (3)-(8)-(9)	8,787	8,789	8,822	8,851
(11) Increase in take-home pay before Federal and State income taxes from Present	-	2	35	64

* Employer Outlay = $ 10,613
Total Employer and Employee FICA Tax Rate = 12.26%
Adjusted Salary = $10,613 ÷ 1.1226 = $9,453

** Based on pick-up as covered compensation under TSERS

TABLE 1

THE DISTRIBUTION OF THE NUMBER AND ANNUAL COMPENSATION OF MEMBERS BY AGE AS OF DECEMBER 31,1977

	MEN		WOMEN	
AGE	NUMBER	AMOUNT	NUMBER	AMOUNT
19	86	$ 165,280	132	$ 269,529
20	283	821,194	356	1,056,085
21	455	1,759,782	699	2,522,473
22	652	2,824,516	1,190	5,070,466
23	1,148	5,038,763	2,829	11,798,862
24	1,707	8,997,980	4,114	24,680,298
25	2,084	13,095,002	4,939	33,283,482
26	2,297	15,642,814	5,674	40,427,482
27	2,630	19,292,373	5,547	41,140,222
28	2,621	20,597,847	5,353	39,616,708
29	2,914	24,337,724	5,469	40,331,811
30	3,029	25,975,652	5,373	39,076,454
31	3,184	29,209,376	5,525	40,351,038
32	2,866	27,710,805	4,911	36,001,817
33	2,333	23,176,867	3,943	28,147,970
34	2,269	23,608,300	3,997	29,311,357
35	2,245	24,908,506	4,166	31,173,677
36	2,156	24,413,943	3,850	28,892,722
37	1,903	21,777,936	3,555	27,051,494
38	1,789	21,486,035	3,329	25,833,139
39	1,798	21,626,526	3,174	24,521,609
40	1,729	21,059,279	3,086	24,474,950
41	1,683	20,804,685	3,101	24,596,937
42	1,775	23,091,647	2,913	23,690,270
43	1,754	22,169,471	2,966	24,723,987
44	1,672	21,132,586	2,831	23,525,061
45	1,781	22,926,841	2,632	22,053,991
46	1,734	22,873,893	2,799	23,300,228
47	1,756	23,567,653	2,729	23,309,381
48	1,752	22,869,434	2,674	23,166,586
49	1,711	22,420,139	2,661	23,111,514
50	1,729	22,268,235	2,766	23,518,314
51	1,771	23,259,819	2,624	22,671,953
52	1,629	20,738,529	2,457	21,128,047
53	1,668	21,510,627	2,428	20,799,734
54	1,598	20,498,603	2,296	19,500,735
55	1,539	19,802,425	2,205	18,614,852

TABLE 1

THE DISTRIBUTION OF THE NUMBER AND ANNUAL
COMPENSATION OF MEMBERS BY AGE
AS OF DECEMBER 31,1977

CONTINUED

	MEN		WOMEN	
AGE	NUMBER	AMOUNT	NUMBER	AMOUNT
56	1,589	$ 20,267,851	2,067	$ 17,664,012
57	1,562	20,024,651	2,056	17,657,369
58	1,505	17,942,437	1,931	16,538,295
59	1,319	15,754,808	1,862	15,931,913
60	1,203	14,363,846	1,710	14,676,778
61	1,071	12,824,458	1,467	12,707,000
62	1,020	11,977,426	1,315	11,186,137
63	756	8,950,134	973	8,247,932
64	588	7,010,291	774	6,565,528
65	468	5,586,085	568	4,674,439
66	201	2,130,032	292	2,117,213
67	90	952,771	103	408,959
68	78	793,854	69	243,559
69	50	442,435	44	136,036
70	26	251,900	28	145,792
71	25	285,138	16	60,982
72	64	411,847	21	85,338
TOTAL	79,345	$847,431,091	136,589	$1041,792,517

SUMMARY

TEACHERS	25,482	$353,184,549	74,559	$655,868,998
EMPLOYEES	53,863	$494,246,542	62,030	$385,923,519

TABLE 2

THE DISTRIBUTION OF THE NUMBER AND ANNUAL COMPENSATION OF MEMBERS BY YEARS OF SERVICE AS OF DECEMBER 31,1977

YEARS OF SERVICE	MEN		WOMEN	
	NUMBER	AMOUNT	NUMBER	AMOUNT
1	7,474	$ 30,616,207	15,397	$ 46,377,249
2	6,861	58,188,778	13,264	91,516,280
3	5,278	48,377,369	9,891	71,333,123
4	6,249	57,630,272	12,148	86,897,873
5	5,349	49,583,605	10,425	76,888,400
6	4,474	40,943,496	8,322	59,945,344
7	4,281	43,875,329	7,785	57,564,262
8	4,259	43,709,185	7,797	57,559,582
9	3,794	39,084,459	8,875	57,134,492
10	3,692	37,921,844	5,647	44,940,325
11	3,419	36,172,928	4,726	36,472,104
12	2,771	33,985,644	5,560	42,419,341
13	1,862	25,336,361	2,849	27,910,504
14	1,767	24,094,363	2,522	25,878,198
15	1,658	23,067,774	2,285	24,512,958
16	1,380	18,604,338	1,768	19,075,771
17	1,316	18,521,339	1,836	19,979,155
18	1,155	17,005,728	1,425	16,446,247
19	1,007	14,931,923	1,332	15,610,885
20	990	15,813,227	1,242	14,994,083
21	1,097	17,040,563	1,203	14,573,811
22	1,025	16,124,091	1,211	14,536,870
23	897	14,410,271	1,048	13,010,531
24	813	13,110,963	934	11,599,756
25	678	10,702,124	882	11,193,375
26	703	11,499,750	748	9,551,279
27	654	10,327,068	646	8,374,966
28	634	10,300,341	538	7,025,432
29	635	10,879,184	584	7,708,247
30	662	11,031,602	570	7,609,176
31	590	10,373,937	438	5,943,245
32	559	9,261,078	423	5,714,155
33	373	6,297,632	315	4,167,448
34	232	4,271,750	318	4,423,077
35	204	3,752,435	315	4,282,126

TABLE 2

THE DISTRIBUTION OF THE NUMBER AND ANNUAL COMPENSATION OF MEMBERS BY YEARS OF SERVICE AS OF DECEMBER 31,1977

CONTINUED

YEARS OF SERVICE	MEN NUMBER	MEN AMOUNT	WOMEN NUMBER	WOMEN AMOUNT
36	135	$ 2,391,058	314	$ 4,300,552
37	113	2,084,961	227	3,121,475
38	71	1,285,471	160	2,282,042
39	50	1,007,323	118	1,677,809
40	55	1,082,095	121	1,707,958
41	48	945,413	127	1,855,612
42	32	647,114	90	1,313,642
43	18	394,832	61	874,459
44	16	368,214	47	674,969
45	4	70,862	29	428,521
46	5	155,381	16	245,497
47	4	125,869	7	102,761
48	1	19,016	1	14,478
49	1	6,524	2	23,072
TOTAL	79,345	$847,431,091	136,589	$1041,792,517

SUMMARY

TEACHERS	25,482	$353,184,549	74,559	$655,868,998
EMPLOYEES	53,863	$494,246,542	62,030	$385,923,519

APPENDIX D

(Mr. Dail presented)
10-30-78

JAMES B. HUNT, JR.
GOVERNOR

STATE OF NORTH CAROLINA
DEPARTMENT OF REVENUE
P. O. BOX 25000
RALEIGH, N. C. 27640

MARK G. LYNCH
SECRETARY

JAMES P. SENTER
DEPUTY SECRETARY

October 30, 1978

MEMORANDUM

TO: Winston L. Page, Jr., Committee Counsel, Legislative Commission Research

FROM: B. E. Dail, Assistant Director, Tax Research Division BED

SUBJECT: Estimated Revenue Loss from State Taking Over State Employees' Contributions to Retirement System

This is in response to your request for an estimate of the revenue loss that would result if the State took over the employees' portion of the contributions to the retirement system.

According to the retirement system, state employees' contributions for calendar year 1977 totaled $112,894,000. If these contributions had been exempt from state income tax, we estimate the revenue loss would have been $6,500,000. This estimate is based on the assumption that the average marginal tax rate for state employees is 5.75%.

Local government employees contributed $24,511,000 to their retirement plan in calendar year 1977. If these contributions had been exempt from state income tax, it is estimated that the revenue loss would have been $1,290,000. The average marginal tax rate for these employees was estimated to be 5¼%.

The Tax Research Division has not carried out any research concerning the federal income tax law and the exemption of contributions for employees to state retirement plans. It is our understanding that under Revenue Ruling 77-462 contributions of the required employees' portion by a school district (the employer) to a qualified state plan in behalf of its employees were ruled to be excludable from the employee's wages for withholding purposes and from the employee's gross income until actually distributed or made available to the employee. B. W. Brown, Director of the Individual Income Tax Division, has indicated the Attorney General's office has informally agreed that North Carolina's state government could make such contributions for its employees under this ruling after making appropriate amendments to its statutes. The amendments would have to assure that there could be no "constructive receipt" of the contribution by the employee if the contribution is to be free of federal income tax at the time money is paid into the retirement fund for the employee.

Mr. Brown who has studied this matter in some detail is unable to be here this morning because of a previous commitment, but will be very glad to discuss this question with the committee this afternoon.

I have attached a copy of IRS ruling 77-462 for your information.

BED:cw
attached

APPENDIX E

[¶ 6267] Rev. Rul. 77-462, I. R. B. 1977-50, 20.

[Code Sec. 3401. Also Code Secs. 402 and 414]

Withholding of taxes: Wages subject to: Employers' payment to teacher pension plan.—Contributions of a school district that assumes and pays, or "picks up," the required contributions of its teachers to the qualified state pension plan are employer contributions to the plan that are excludable from employees' wages for purposes of income tax withholding and from gross income until subsequent distribution or availability to the employees. **Back reference:** ¶ 2623.02, 2669Z.20, and 4943.345.

Public school teachers in a state are required by law to participate in and contribute to the state pension plan. The pension plan meets the qualification requirements of section 401(a) of the Internal Revenue Code of 1954, and the employees' trust established under the plan is exempt from Federal income tax under section 501(a).

An employer-school district agreed to "pick up" (assume and pay) the required teachers' contributions to the plan. However, the state still designates these contributions as employee contributions for purposes of determining employee rights under the plan and employee remuneration for services.

Section 414(h) of the Code deals with contributions to state plans involving an employees' trust described in section 401(a). In the instant case, since the plan meets the qualification requirements of section 401(a), the plan is considered "described in" section 401(a) for purposes of section 414(h) of the Code. Section 414(h)(2) provides, in part, that where a governmental employing unit picks up plan contributions otherwise designated as employee contributions, the contributions so picked up shall be treated as employer contributions.

Section 3401(a)(12)(A) of the Code, relating to the Collection of Income Tax at Source on Wages (chapter 24 subtitle C of the Code), excludes from the definition of "wages", remuneration paid on behalf of an employee to a trust described in section 401(a) that is exempt from tax under section 501(a) at the time of such payment. See section 31.3401(a)(12)-1(a) of the Employment Tax Regulations.

Held, The school district's contributions to the plan are excluded from wages for purposes of the Collection of Income Tax at Source on Wages; therefore no withholding is required from the employees' salaries with respect to such pick-up contributions. See *H. R. Rep. No. 93-807*, 93d Cong., 2d Sess. 145 (1974), 1974-3 C. B. Supp. 236, 380.

Held further, the school district's picked-up contributions to the plan are excluded from the employees' gross incomes until such time as they are distributed or made available to the employees. See section 402(a) of the Code.

[¶ 6268] Rev. Rul. 77-463, I. R. B. 1977-50, 21.

[Code Sec. 6081]

Returns: Extension of time for filing.—An application for an extension of time to file a return is not a tax return and may be signed by a member of the bar, certified public accountant, an enrolled agent, or a person standing in close personal or business relationship to the taxpayer, who is unable to sign because of illness, absence or other good cause, without that person having a power of attorney from the taxpayer. **Back reference:** ¶ 5183.0175.

Advice has been requested whether a Form 2350, Application for Extension of Time for Filing U. S. Income Tax Return (For U. S. Citizens Abroad Who Expect to Qualify for Exempt Earned Income), may be signed by (1) a member in good standing of the bar of the highest court of a particular jurisdiction, (2) a certified public accountant duly qualified to practice in a particular jurisdiction, (3) a person enrolled to practice before the Internal Revenue Service, or (4) a person standing in close personal or business relationship to the taxpayer who is unable to sign Form 2350 because of illness, absence, or other good cause, without a power of attorney.

Section 1.911-2(e)(1) of the Income Tax Regulations, applicable to earned income from sources without the United States attributable to services performed after 1962, provides that a taxpayer desiring an extension of time (in addition to the automatic extension of time granted by section 1.6081-2 of the regulations) for filing the return until after the completion of the qualifying period under section 1.911-2(a) or (b) of the regulations shall make application therefor on Form 2350.

Form 2350 requires the signature of a preparer other than the taxpayer, under a penalties of perjury statement, certifying that the preparer is (1) a member in good standing of the bar of the highest court of a particular jurisdiction, (2) a certified public accountant duly qualified to practice in a particular jurisdiction, (3) a person enrolled

HIBIT A
-14-78

service with the employer before such employer was required to contribute to such plan, and

(E) which satisfies such other requirements as the Secretary of Labor may by regulations prescribe.

(2) Special rules.—For purposes of this subsection—

(A) If a plan is a multiemployer plan within the meaning of paragraph (1) for any plan year, subparagraph (C) of paragraph (1) shall be applied by substituting "75 percent" for "50 percent" for each subsequent plan year until the first plan year following a plan year in which the plan had one employer who made contributions of 75 percent or more of the aggregate amount of contributions made under the plan for that plan year by all employers making such contributions.

(B) All corporations which are members of a controlled group of corporations (within the meaning of section 1563(a), determined without regard to section 1563(e)(3)(C)) shall be deemed to be one employer.

(g) Plan administrator.—For purposes of this part, the term "plan administrator" means—

(1) the person specifically so designated by the terms of the instrument under which the plan is operated;

(2) in the absence of a designation referred to in paragraph (1)—

(A) in the case of a plan maintained by a single employer, such employer,

(B) in the case of a plan maintained by two or more employers or jointly by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other similar group of representatives of the parties who maintained the plan, or

(C) in any case to which subparagraph (A) or (B) does not apply, such other person as the Secretary may by regulation, prescribe.

(h) Tax treatment of certain contributions.—

(1) In general.—Effective with respect to taxable years beginning after December 31, 1973, for purposes of this title, any amount contributed—

(A) to an employees' trust described in section 401(a), or

(B) under a plan described in section 403(a) or 405(a), shall not be treated as having been made by the employer if it is designated as an employee contribution.

(2) Designation by units of government.—For purposes of paragraph (1), in the case of any plan established by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing, where the contributions of employing units are designated as employee contributions but where any employing unit picks up the contributions, the contributions so picked up shall be treated as employer contributions.

(i) Defined contribution plan.—For purposes of this part, the term "defined contribution plan" means a plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant's account.

(j) Defined benefit plan.—For purposes of this part, the term "defined benefit plan" means any plan which is not a defined contribution plan.

(k) Certain plans.—A defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant shall—

(1) for purposes of section 410 (relating to minimum participation standards), be treated as a defined contribution plan,

(2) for purposes of sections 411(a)(7)(A) (relating to minimum vesting standards) and 415 (relating to limitations on benefits and contributions under qualified plans), be treated as consisting of a defined contribution plan to the extent benefits are based on the separate account of a participant and as a defined benefit plan with respect to the remaining portion of benefits under the plan, and

(3) for purposes of section 4975 (relating to tax on prohibited transactions), be treated as a defined benefit plan.

(*l*) Mergers and consolidations of plans or transfers of plan assets.—A trust which forms a part of a plan shall not constitute a qualified trust under section 401 and a plan shall be treated as not described in section 403(a) or 405 unless in the case of any merger or consolidation of the plan with, or in the case of any transfer of assets or liabilities of such plan to, any other trust plan after September 2, 1974, each participant in the plan would (if the plan then terminated) receive a benefit immediately after the merger, consolidation, or transfer which is equal to or greater than the benefit he would have been entitled to receive immediately before the merger, consolidation, or transfer (if the plan had then terminated). This

E-2

APPENDIX F

ecember 27, 1978

o: Members of the Legislative Research Commission — Committee to Study the Tax Sheltering of Employee Retirement Contributions

rom: R. J. Hursey, Jr., Assoc. Professor of Mathematics, ECU, Greenville, N. C.

e: Effects of adoption of the proposal upon the State and its employees

(A) The Proposal: That the State henceforth assume, pick up, and pay, in lieu of 6% of the raise to be granted State employees this year, employee contributions to retirement and not report this deferred income as gross taxable income to the Internal Revenue Service. (All employees who will retire within five or fewer years should be exempted from the proposal.)

(B) Assumptions: That salaries will rise (at least on the average) by 6% per annum; that the present average salary of State employees is $11,000 per annum; and that there are presently 167,000 State employees. Additional assumptions are stated throughout the report as they appear in the cited examples.

(C) Conclusions: Adoption of the recommended proposal affords that rare opportunity for both employee and employer to reap substantial benefits from the tax sheltering of employee retirement contributions and lower salaries (not lower compensation). Assuming adoption of the proposal, the State will each year (from the adoptive year forward) save approximately .6972% of the total payroll of the State, and the employee whose salary is the present average salary of $11,000 per annum will enjoy increased take-home pay of $250 in the adoptive year alone (equivalent to more than a 9% increase in salary), this increased take-home pay growing larger each year as salaries continue to rise in the future.

(D) The proposal does not, in the legal sense, request that the various retirement programs available to State employees become non-contributory pension plans: each employee will continue to contribute toward his retirement by relinquishing in the adoptive year a raise in pay and all subsequent monies which, when compounded by future pay raises, would have accrued to said relinquished raise. As in the past, it will be possible to distinguish employee from employer retirement contributions. Employees will, by adoption of the proposal, in no way be relinquishing ownership in their respective retirement programs.

(E) Example 1: A State employee whose present salary is (the average) $11,000/yr.:

We further assume that said employee is married, files jointly for federal tax purposes, claims the standard deductions and 4 exemptions, and that the spouse is not gainfully employed.

(1) EMPLOYEE BENEFITS:

without adoption(6%raise)	Deductions	with adoption
$11,660 (salary)		$11,000
700	Retirement	0
711	Social Sec. (6.13%)	674
760	Fed. tax	627
358	State tax	318
$2529	Total Deductions	$1619
$9131	Take-Home Pay	$9381

Result: Adoption of the recommended proposal, in lieu of a 6% salary raise, increases the take-home pay of the cited employee by $250 in the adoptive year. In order that said employee receive take-home pay of $9381 (if the proposal is not adopted), the State must actually raise his salary by more than 9%. Adoption of the proposal, therefore, makes a 6% allocation of funds act as if it were at least 9%.

(2) STATE BENEFITS:

without adoption	Costs	with adoption
$11,660	Salary	$11,000
1,060	Retirement	1,663
711	Soc. Security	674
194	Longevity ($\frac{2}{3}$(.025)(Salary))	183
-358	Less State Tax	-318
$13,270	Total Cost	$13,202

Result: Thus, on the average, the State saves $68 per employee by adoption of the recommended proposal. For all employees, adoption of the proposal, in lieu of a 6% salary raise, saves the State $11,356,000 in the adoptive year (with the magnitude of those annual savings increasing as salaries trend higher in the future).

(F) Example 2: Here, we examine the effects of adoption of the recommended proposal upon the State and an employee who begins work at an annual salary of $8,000, works 30 years (receiving 30 pay raises), and receives annual salary increments of 6%. We further assume an average Social Security rate of 7% and an average longevity pay rate of 2.5%. Finally, said hypothetical employee is assumed married, files jointly for federal tax purposes, and claims 4 exemptions and the standard deductions.

(1) Average final compensation without adoption: $42,193.
(2) Average final compensation with adoption: $39,804.
(3) (maximum) retirement allowance (TSERS) without adoption: $19,620.
(4) (maximum) retirement allowance (TSERS) with adoption: $18,509.

Adoption of the proposal, therefore, results in a decline in annual (TSERS) retirement income of $1,111 per year, a decline of 5.66% from the larger allowance afforded by non-adoption. We have, however, only examined the situation after retirement.

(5) Average salary of employee (over 30 years) : $21,884 (per annum).
Let us now consider the (average) effects of adoption of the proposal:

(6) EMPLOYEE BENEFITS:

without adoption (6% raise)		with adoption
$23,197	Salary	$21,884
1,392	Retirement	0
1624	Soc. Sec.(7%)	1532
3353	Fed. Tax	2999
1145	State Tax	1053
$7514	Total Deductions	$5584
$15683	Take-Home Pay	$16300

Result: Employee take-home pay is increased (on the average) by $617 per year by adoption of the proposal. Over 30 years of work, adoption returns to the employee $18,510 as disposable income. If the annual average savings of $617 were deposited in a savings account earning 6% interest, then the employee would upon retirement have an account worth approximately $48,800; if only half of the annual savings were so deposited, the employee would have an account worth approximately $24,400 at the time of retirement.

In either case, adoption of the proposal affords the employee the financial opportunity to accumulate a substantial personal sum of money which easily compensates for the lower retirement benefits (See F, 3 and 4) accruing to the proposal. Indeed, assuming that the employee had invested only half of his annual savings afforded by adoption of the proposal, those accumulated savings (used as an annuity over 19 years of expected life at age 65, to supplement his TSERS pension) would provide a total annual retirement benefit of $20,572, exceeding the maximum allowable annual (TSERS) pension of $19,804 had the proposal not been adopted; and the employee would still have enjoyed $9255 of additional disposable income to be spent as he saw fit over his 30 working years.

(7) STATE BENEFITS:

without adoption	Costs	with adoption
$23,197	Salary	$21,884
2116	Retirement	3309
1624	Soc. Sec. (7%)	1532
580	Longevity(2.5%)	547
$27,517	Total Cost	$27,272

Result: Adoption of the proposal saves the State (on the average) each year $245. Subtracting away the average loss in State revenue from State income tax of $92, the net savings to the State from adoption from this one employee is $153 per year (or $4,590 over the 30 working years).

(8) Additional note on employee benefits: If our hypothetical employee elected to invest half ($309) of his annual savings accruing to him through adoption and were to deposit those savings in a tax deferred annuity, he could further reduce his income to $21,575, reducing his federal and State tax liability and increasing his average annual take-home pay to $16,379, thereby making adoption of the proposal worth an average of $714 per annum in increased take-home pay.

(9) Now let us, keeping our same hypothetical employee and previous assumptions (except for Soc. Security, whose rate now increases to 7.15), move ahead in time 10 years: the salary of our employee has now advanced through 6% salary increments to $34,334 without adoption, or $32,391 with adoption. We again consider the effects of adoption of the proposal:

(9-a) EMPLOYEE BENEFITS:

without adoption		with adoption
$34,334	Salary	$32,391
2060	Retirement	0
2455	Soc. Sec. (7.15%)	2316
6969	Fed. Tax	6263
1924	State Tax	1788
$13,408	Total Deductions	$10,367
$20,926	Take-Home Pay	$22,024

Result: Adoption of the proposal increases, in this particular year and employee's case, take-home pay by $1098.

(9-b) STATE BENEFITS: Similarily, one can show that adoption of the proposal saves the State $306 in the case of this particular year and this particular employee.

This demonstrates the fact that the magnitudes of the benefits accruing to the State and to the employee grow larger as salaries rise.

(9-c) Additional note on Employee Benefits: If we assume that our employee (in 9-a) can now claim only 2, rather than 4, exemptions for tax purposes, then one can easily show that adoption of the proposal increases his take-home pay by $1533 (rather than $1098) in the cited year. Thus, as exemptions for tax purposes decline, the benefits of the proposal to the employee increase; i.e., increased tax liabilities are, with adoption of the proposal, accompanied by increased employee benefits in the form of increased take-home pay.

(G) Computation of State Income Tax: For an employee whose annual salary is S dollars where S is assumed to be at least $13,700 per year, and who claims 4 exemptions and the standard deduction, the State income tax payable by said employee is

$$((.07)S - 479) \text{ (dollars).}$$

(H) Effects Upon the State by Adoption of the Proposal:

Here, we assume that the annual salary of a State employee is presently S dollars. We continue to assume that the salary of said employee will grow at the rate of 6% per annum. Thus, n years from now, the salary of the cited employee will be: $(1.06)^nS$ without adoption, or $(1.06)^{n-1}S$ with adoption. We now analyze the effects of adoption of the proposal upon the State by assuming that $(1.06)^{n-1}S$ is at least $13,700:

COST TO THE STATE

without adoption	Cost	with adoption
$(1)(1.06)^nS$	Salary	$(1)(1.06)^{n-1}S$
$(.0912)(1.06)^nS$	Retirement	$(.1512)(1.06)^{n-1}S$
$(.07)(1.06)^nS$	Soc. Sec.(7%)	$(.07)(1.06)^{n-1}S$ (understated)
$(.025)(1.06)^nS$	Longevity(2.5%)	$(.025)(1.06)^{n-1}S$
$-(.07)(1.06)^nS + 479$	Less State Tax	$-(.07)(1.06)^{n-1}S + 479$
$(1.1162)(1.06)^nS + 479$	Total Cost	$(1.1762)(1.06)^{n-1}S + 479$

DIFFERENCE = (Cost without adoption) − (Cost with adoption) = $(1.06)^{n-1}S(.006972)$ dollars in the n-th year. Thus, adoption of the proposal saves the State (in the case of the cited employee whose salary is $(1.06)^{n-1}S$ dollars per year n years from now) $(1.06)^{n-1}S(.006972)$ dollars, or .6972% of the salary of the employee. In general, if the average annual salary paid State employees n years from now is at least $13,700, adoption of the proposal, in lieu of one 6% raise, saves the State .6972 % of the State payroll (each and every year after adoption).

(I) Effects Upon Retirement Income:

As has been earlier noted (SeeF, 3 and 4), adoption of the recommended proposal, in lieu of a 6% salary increment, results in a diminution of maximum possible annual retirement benefits from TSERS of approximately 5.66% (or, in the case of an earlier example, $1,111 per year). To prevent this decline in retirement benefits from occurring, it has been suggested that the multiplier inherent to the retirement formula used by TSERS be raised from 1.55 to 1.65 and further estimated that the cost of this adjustment is approximately 1.25% of the annual State payroll.

Recall that adoption of the proposal saves the State approximately .6972% of the annual payroll, which is 55.8% of the needed 1.25% to adjust 1.55 to 1.65. If, therefore, the State were to take its annual savings generated by adoption of the proposal and apply the totality of those savings toward employee retirement (raising to 9.8172 the present contribution rate of 9.12), then the difference between annual retirement benefits (See F, 3 and 4) would shrink from $1,111 to $491 per annum (or $41 per month), a reduction in annual retirement benefits (from Tsers) of only 2.57%.

Let us once again consider the hypothetical employee of Example 2, F, of this report: in particular, let us restrict our attention to that employee in his last 6 years of employment: Said employee's average annual salary over these last 6 years is, assuming adoption of the proposal, $37,657, or $39,916 without adoption. We continue to assume (probably unrealistically) that the employee claims 4 exemptions for tax purposes.

Last 6 Working Years

without adoption		with adoption
$39,916	Salary	$37,657
2395	Retirement	0
2854	Soc. Sec. (7%)	2692
9205	Fed. Tax	8275
2315	State Tax	2157
$16,769	Total Deductions	$13,124
$23,147	Take-Home Pay	$24,533

Result: Adoption of the proposal increases, on the average, the take-home pay of the employee in his last 6 working years by (at least) $1,386 per year. If the employee deposits these savings annually in a savings account earning 6% interest then upon retirement that employee would have accumulated at least $9668 in said account. If this amount is now treated as an annuity to be depleted after 19 years (life expectancy at age 65 is 19 years), then the employee will receive from his aforementioned savings account an additional, supplemental retirement allowance of $817 per year, raising his annual retirement allowance (including that from TSERS) to $19,326, which is only $294 per year less than the annual retirement allowance afforded by non-adoption.

Moreover, if the State were to invest toward employee retirement only half its annual savings accruing to adoption of the proposal, namely .3486% of the State payroll (thereby raising the present 9.12% rate to 9.4686%), then the $18,509 employee retirement allowance accruing to adoption of the proposal could be raised to $18,819 per year. Adding to this allowance the $817 per annum from the employees' aforementioned savings account, our hypothetical employee could then enjoy an annual retirement benefit of $19,636 — an amount actually exceeding the expected retirement benefit available from TSERS had the proposal not been adopted. Adoption of the proposal is, therefore, imminently and unquestionably "fair" to the employee, provided that all employees within 5 or fewer years of retirement are exempted from the proposal. If each employee is given the choice of enrollment in the tax sheltering proposal, there should be no problem with the proposal.

Adotion of the proposal is good for the State, saving the State approximately .3486% of the annual payroll (assuming that the State retains only <u>half</u> of the savings accruing to adoption of the proposal). It should also be noted that when Social Security rates reach their <u>present</u> projected peak of 7.15% in 1986, adoption of the proposal will slightly increase the savings accruing to the State to approximately .3531% of the State payroll (each year).

(J) <u>RECOMMENDATIONS</u>: (1)That the State adopt the recommended proposal to henceforth assume, pick up , and pay employee retirement contributions in lieu of the raise to be granted State employees this year and not to report this deferred income to the Internal Revenue Service as taxable income; (2) That employees who plan to retire within 5 or fewer years from the adoptive date be exempted from participation in this proposal, being granted instead a pay increase of 6%; (3) That the State should invest <u>half</u> of its annual savings accruing to adoption of the proposal toward employee retirement, raising its current rate of 9.12% to 9.4686% (and similarly increasing its contribution rate to all retirement programs into which State monies are being paid).

Respectfully submitted,

R J Hursey, Jr.

Robert J. Hursey, Jr.

Dr. Hursey
E.C.U. 12/14/78

(A) PROPOSAL: That the State assume full liability for employee contributions to retirement (6% of gross salaries) and (by the authority granted by the Pension Reform Act of 1974, Section 414 (h) 2 of the Internal Revenue Code) not to report this deferred income as gross taxable income to the Internal Revenue Service.

(B) ASSUMPTIONS: There are approximately 167,000 State employees, having an annual salary of approximately $11,000.

(C) (1) The Legislature decides to raise salaries by 5.5%.

Cost of 5.5% raise:	$101,035,000
EXTRA COSTS TRIGGERED BY ACTUALLY RAISING SALARIES BY 5.5% ($605 per annum on the average)	
(1) Retirement:	$9,214,392
(2) Social Security:	$6,153,032
(3) Longevity Pay:	$1,683,912
Sub-total of extra costs:	$17,051,336
Total Cost of 5.5% Raise:	$118,086,336
LESS TAX RE-TAKE :	$5,051,750
NET COST of 5.5% RAISE:	$113,034,486

(2) The Legislature decides to adopt the recommended proposal.

Cost of said proposal is a flat 6% (with no extra incurred costs) of the current pay roll, that is, $110,220,000.

(D) RESULT: Adoption of the recommended proposal SAVES the State $2,814,586 in the adoptive year and will continue to save State money in all ensuing years. Adoption of the proposal also returns to the average State employee a FULL 6% of his current gross salary, acting as if an actual raise in pay of 9% had occurred.

(E) Adoption of the recommended proposal will result in a diminution of retirement benefits from TSERS of approximately 3% on the average and some diminution in Social Security benefits. The decline in retirement benefits from TSERS can be eliminated by raising the "multiplier" in the formula for retirement from the present 1.55 value to 1.6 .

(F) Adoption of the Grimsley proposal to assume employee Social Security contributions and to diminish employee salaries by the assumed amount will result in at least a 6.09% reduction in retirement benefits. It will also result in a correspondingly larger reduction in Social Security benefits and longevity pay. If, of course, the Legislature elected to tax shelter the Grimsley plan (and, thereby, not reduce employee salaries by the assumed amount, leaving salaries constant), then such an amended scheme would be even more beneficial than the recommended proposal to tax shelter retirement contributions. Without the aforementioned amendment, however, the Grimsley plan does not even begin to compete with the recommended proposal in terms of employee benefits.

EAST CAROLINA UNIVERSITY

GREENVILLE, NORTH CAROLINA 27834

~~April~~ May 3, 1978

College of Arts and Sciences

Department of Mathematics

Honorable Carl J. Stewart, Jr., Speaker
The N. C. House of Representatives
The Legislative Building
Raleigh, N. C.

Dear Mr. Speaker:

Thank you for your gracious letter of 3/2/78. I realize how demanding your schedule must be, and we deeply appreciate the attention which you have allowed the professorate. Dr. Daniels has passed your letter of 4/27/78 to me. In said letter, you requested that I submit, in bill form, a copy of the proposal to tax shelter the various State retirement programs. I am not certain that I fully appreciate the concept of the requested form, so, if you will bear with me, I shall outline below the details of the proposal. I shall also take this opportunity to address some of the inequities which have resulted from differences between various State employment acts (covering SPA, EPA, and Public School Teachers). You may recall that I spoke to this issue at the Legislative Conference in Burlington.

<u>THE PROPOSAL:</u> Said proposal recommends that, in lieu of 6% of the raise to be granted State employees, the State assume henceforth all employee retirement contributions and to tax shelter the various retirement programs administered by the State.

This proposal will prove to be of immense benefit to virtually all State employees and only those employees within (approximately) six years of retirement need to be exempted (since the number of remaining working years is too few to offset the effects of a slightly higher retirement pension). Moreover, <u>all</u> employees can be benefically accommodated by this proposal by merely adjusting the current retirement formula used by TSERS (in order to compensate for the slightly lower AFC which accrues to this proposal) and by increasing slightly retirement contributions to State employees in all other retirement programs.

If this proposal is adopted, then the money appropriated for raises would not be put in an employee's pay check but, rather, would be deposited in his retirement account for him. This simple tactic would now return to each employee that money which has been deducted for retirement. Consequently, employee take-home pay would rise a full 6% of gross monthly salary which is roughly equivalent to an actual 9% raise in pay, yet salaries would (if the legislature appropriates funds sufficient for a 6% salary increment) remain constant. The proposal, therefore, seeks to shield the employee (and the STATE) from the unfortunate costs of higher payroll deductions for taxes, Social Security, and retirement which accompany any actual raise in pay.

An example is helpful: Consider the case of a State employee who works for the State 30 years with an initial salary of $8,000 per annum and annual salary raises of 3% each year. After 30 years, the salary of the employee would rise to $18,853 per annum with an average annual salary of $12,687. His maximum retirement benefit from TSERS is (approximately) $8,120 per annum. If this proposal is adopted, then the maximum retirement benefit from TSERS is (approximately) $7,884 per annum, a reduction in annual benefits of $236. This appears unfavorable, but we have only considered the effects of the proposal after retirement! Recall that the average annual salary of the cited employee is $12,687. Adoption of this proposal would return (on the average) $761 each and every year of employment to be spent or saved as one saw fit. Over the 30 working years, adoption of this proposal would return to the cited employee an additional $22,736 of disposable income. Moreover, if the employee were to invest his $761/yr. at 6% during his working years, he would upon retirement have accumulated an amount in excess of $56,000.

One should further observe that life expectancy at age 65 is 19 years: if the proposal is not adopted, then probabilities suggest that our hypothetical employee will receive as a consequence of a slightly higher retirement pension an additional $4,500 in retirement benefits (over the remaining years of his life); however, that same employee would have captured -- had the proposal been adopted -- an additional $22,836 (at least) over his working years -- a net difference of $18,000 in favor of adoption. Moreover, if the proposal is not adopted, then our cited employee must live an additional 97 years (after reaching age 65) to accumulate from his slightly higher retirement pension the $22,836 which would have accrued to him had the proposal been adopted.

Let us now examine the benefits which accrue to the State from this proposal: If the State actually raises salaries, it must necessarily increase its contributions to Social Security (which is constantly rising) and retirement on behalf of its employees. Assuming 157,000 State employees with an annual salary (average) of $11,000, the extra costs of actually raising salaries by 6% is approximately $15,500,000 (beyond the actual cost of the 6% increment). Of course, the State will recover some of the funds distributed for raises through higher taxes, but only approximately 6%. For the 157,000 employees, the State would recover approximately $6,217,000 through taxes. But the proposal saves the State $15,500,000 -- a net savings to the State of $9,283,000 in favor of adoption and without subjecting its employees to higher taxes. The proposal does, therefore, seem to afford that rare opportunity for all to win and none to lose. Another benefit of the proposal is that it tends to dampen out the recent precipitious escalation of salaries which tends to produce losses in TSERS. The proposal would, therefore, tend to make TSERS even more solvent.

New figure: 176,000 State employees.

S. Security will rise Jan 1. to 6.05% from 5.85%; Also, increases in longevity pay Not accounted for.

Finally, this proposal has already won the enthusiastic support of many of the professorate. If passage of this proposal proves impossible in this legislative session, then I beseech you to work for the passage of Senate Bill 830 which mandates the creation of task force to study the feasability of tax sheltering the retirement programs of the State. This resolution (Senate Bill 830) should be amended to include all State employees and not only those who are members of TSERS.

II. INEQUITIES:

If the professorate suffers as great a financial hardship as I have earlier indicated, then how is our plight different from and quantitatively greater than that suffered by all other State employees?

The professorate (and, in general, all EPA employees) have been denied certain benefits and incentives accorded SPA employees: In particular, the professorate has historically not been appropriated funds which accrue to guaranteed salary schedules which provide for (merit) step increments; to reclassifications; or to longevity. These aforementioned benefits amounted last year to 3.45% of the total SPA salary base. Denial of these benefits through the years has now been compounded into a dollar equivalence of considerable proportions and explains in large part why the purchasing power of the professorate has declined more precipitiously than that of the average State employee; it also helps to explain why professors with many years of experience at our institutions are making substantially less than those recently hired! (See the enclosed salary study.) Please note that 3.5% compounded annually over just 10 years is itself sufficient to raise salaries by 41%, and we, the professorate, have been denied the effects of this compounding by being denied the aforementioned benefits and incentives. Is it, therefore, any wonder that my colleagues have felt the sting of inflation even more acutely than the average State employee under SPA provisions?

I do, therefore, entreat you to take steps to provide for equitable treatment of all State employees and to help the professorate recoup its losses. We desperately need minimal guarantees with respect to professorial rank, promotions, and longevity in order to make our financial future less uncertain.

I thank you for your kind attention and stand ready to assist you in any way that I can. Please do not hesitate to call upon me.

Sincerely,

R J Hursey, Jr.

R. J. Hursey, Jr., Chair
Committee Z of the NC Conference of AAUP

P. S.:

I should like to call your attention to the March edition of the <u>AAUP Bulletin</u> (Vol. 64, No. 1), pp.19 - 25 and pp. 26 -30. Herein, the two basic types of salary systems in public education are compared — the single salary schedule vs. the contract salary system. The conclusion is that the SSS is the more equitable of the two types of systems, and we do not employ this type of system in this State(for the professorate).

North Carolina
Department of Administration
116 West Jones Street Raleigh 27603

James B. Hunt, Jr., Governor
Joseph W. Grimsley, Secretary

Division of State Budget and Management
John A. Williams, Jr., State Budget Officer
(919) 733-7061

January 3, 1978

Professor R. J. Hursey, Jr.
East Carolina University
Greenville, North Carolina 27834

Dear Professor Hursey:

Your letter of December 12, 1977 to Governor Hunt requesting that the State assume full liability for employee contributions for retirement was passed on to me for further consideration and action. A member of my staff has pursued your proposal with Mr. W. H. Hambleton, Director of the Retirement and Health Benefits Division in the Department of the State Treasurer, and he is of the opinion that although the proposal appears on the surface to benefit State employees, that the disadvantages of a proposal of this type far outweigh the advantages and has listed his objections to this proposal as follows:

(1) If a plan were adopted whereby, in lieu of a general salary increase, the State would underwrite the mandatory employee contribution for retirement, the effect would be to decrease the employee's salary level for Average Final Compensation purposes for all affected employees who are approaching retirement. This would have a significant downward effect on the employee's retirement benefit.

(2) For all employees earning less than the maximum taxable for Social Security, the average salary for Social Security purposes would fail to increase as it would if a general salary increase were granted. Therefore, these employees would be eligible for a lesser Social Security benefit upon retirement.

(3) Although there would be some immediate income tax advantage to an employee, we believe that this might be more than offset after retirement by reason of the fact that the employees retirement benefit would become fully reportable as taxable income which under the present arrangement his contribution is not.

(4) Since approximately one-third of the retirement trust fund now represents employee contributions and interest, the proposal would eliminate the employee's ownership share in the trust fund and might easily result in the employee having less voice in any changes affecting employee retirement benefits.

(5) Since the inception of the Retirement System, the employees have contributed a substantial portion of the cost for providing benefits. If we were to now eliminate the employees contribution, there would be a moral and equitable problem of arriving at some means to compensate employees who have contributed in the past. The solution could take the form of an immediate refund of excess contributions or of additional benefits at retirement, either of which would be very costly.

(6) The proponent of this proposal, when calculating the cost savings to the State, did not take into account the fact that a certain amount of a general salary increase is returned to the State in the form of income tax revenue.

(7) The proposal would not increase the take-home pay of those employees who are not members of the Teachers' and State Employees' Retirement System.

In summary, we believe that the adoption of this proposal would result in a disservice to State employees and teachers and we would hope that the General Assembly would not depart from the conventional approach to salary increases. In addition, we feel that the proposal would be a manipulation of the retirement trust funds which would circumvent the purposes of the Retirement System and is not a direct approach to the problem of funding salary increases.

Mr. Hambleton indicated that he would be pleased to discuss this matter more fully at your convenience.

If I can be of further service to you in this matter please write me.

Sincerely,

John A. Williams, Jr.
State Budget Officer

FAT/jfj

cc: Governor Jim Hunt

EAST CAROLINA UNIVERSITY

GREENVILLE, NORTH CAROLINA 27834

January 16, 1978

College of Arts and Sciences

Department of Mathematics

Mr. John A. Williams, Jr.
State Budget Officer
North Carolina Department of Administration
Raleigh, N. C. 27603

Dear Mr. Williams:

Thank you for your letter of January 3, 1978. I deeply appreciate the time and attention which you have given this matter. I also appreciate the careful detail contained within your letter, revealing the reservations held by Mr. Hambleton regarding the proposal. I must, however, candidly admit that I do not agree with Mr. Hambleton's assessments after giving those assessments long and careful consideration. I beg your indulgence so that I might rebut said objections. I do this because I believe this issue is of tremendous importance to both State and employees, not because of blind obstinancy. I agree that proposals of this nature must receive careful study, but I also believe in progress; I maintain that here is an opportunity to make progress and improve upon a system which shall benefit all parties concerned. Such opportunities are rare indeed and should be seized whenever possible.

Let me now refer to your letter of January 3, point-by-point (1 - 7):

(1) In my first letter to Governor Hunt, materials were included which specifically stated that certain employees are so near to retirement that they should be exempted from participation in the recommended proposal (since their remaining years of employment are too few to offset the benefits of a higher retirement). A rough calculation leads me to believe that all employees within six (6) years of retirement should be exempted, and I certainly request that this matter be studied in order to determine a more accurate date.

(2) Item 2 is part and parcel of item (1). I suggest that one should not be blinded by the exceptions to the rule, for exceptions are virtually destined to occur. For the vast majority of State employees, I maintain that the proposal

is of great and enduring benefit and that said proposal simultaneously proves beneficial to the State. I see few ways that employees can be afforded the opportunity to tax-shelter a portion of their income, yet this proposal affords such an opportunity. I further assert that tax-sheltering is highly desirable! To illustrate, let us consider an example: Consider an employee who begins working for the State at a salary of $8,000 per annum and assume said employee works for 30 years with annual salary increments of 3% per annum. After 30 years, his salary will rise to $18,853 per annum. His maximum retirement from TSERS is approximately $8,120 per annum.

If the suggested proposal were adopted, then the maximum retirement of the employee would be $7,884, a reduction in annual benefits of $236 per annum. This appears unfavorable, but we have only considered the effect of the proposal after retirement.

The employee has an average salary over his 30 working years of $12,687 per annum. Adoption of the proposal would return (on the average) $761.22 each and every year to the employee to be spent or saved as he saw fit. Over the 30 years of his employment, the proposal would return to said employee $22,836 as disposable income! Moreover, if the employee were to invest his $761.22 at 6% during his working career, he would upon retirement have an account worth in excess of $56,000.

It should also be noted that life expectancy at age 65 is 19 years. If the proposal is not adopted, then probabilities suggest that the employee will receive an additional $4,500 in retirement benefits as a consequence of higher retirement benefits; on the other hand, if the proposal had been adopted, that same employee would have captured an additional $22,836 over his working years — a net difference of $18,000 in favor of adoption! Moreover, if the proposal is not adopted, then the cited employee must live an additional 97 years after reaching age 65 to accumulate from his higher retirement benefits the $22,836 which would have accrued to him had the proposal been adopted.

(3) I am totally confused by this assertion; said assertion is tantamount to the claim that a tax-shelter is undesirable! I assert that I am most willing to expose myself to taxes when my income has dropped to a lower level, and that is exactly what happens when one retires. In general, one of the major reasons for making the proposal is to take advantage of the tax-shelter both now and in the future.

Also, at 65 there is an additional "age 65" exemption.

(4) I do not agree that the proposed scheme eliminates the employee ownership in the trust fund. The proposal merely requests the State to make my contribution for me using my raise money to make said contribution, in lieu of actually putting that raise money into my check and thereby exposing me to higher deductions; i.e., do not put the raise money into my check -- put it in my retirement for me! This tactic benefits both State and employee. I am, in essence, asking that the State distribute raise money in a very special, beneficial way. I will still be contributing towards my retirement, and the only thing that changes is the way my money is deposited in my account.

(5) This item still maintains that employee contributions are eliminated by adoption of the proposal: this is not true, and the objection is tainted by a false hypothesis. Adoption of the proposal would mean that the rapid escalation in salaries would be (temporarily) halted. Salaries would stand still for the year in which the proposal were adopted, yet take-home pay would leap by an amount equivalent to a 9% (approximately) pay raise. Average salary would remain constant; average compensation rises by a full 6% with little pressure being exerted to scale upward minimal starting salaries and creating a fantastic fringe benefit for all State employees. In addition to all this, the proposal makes it possible to have a 6% allocation of funds act as if it were a 9% raise, and it saves the State money!

In general, the salaries (and, hence, various salary schedules) would remain constant for one year, resulting in savings in the following years.

Under no circumstances should this proposal be considered on a one year or temporary basis: to adopt said proposal and to then revoke it at a later date is equivalent to granting a pay increase and to later take it back!! Pay raises granted are compounded by later pay raises. This fact again underscores yet another reason why this proposal is advantageous to the State. If the State actually raises my salary, then it is immediately subjected to higher contributions on my behalf to Social Security and retirement. When the State next raises my salary, it will then compound its obligations on my behalf. At the same time, of course, I shall be subjected to higher taxes. The proposal will, moreover, not only save the State (and the employee) money for one year, but for each year that ensues.

I do not understand the claim that there should be any need (moral, or otherwise) to refund monies to employees who have contributed towards their retirements. Employees will continue to contribute towards their retirements; only the method of contributing will change. I am giving up an increase in my salary in order to have the fringe benefit proposed.

(6) Assuming 157,000 State employees with an average annual salary of $11,000, the extra costs of actually raising employee salaries by 6% is approximately $15,500,000 (above and beyond the actual cost of the 6% raise). These costs are triggered by the State's rising obligations to Social Security and retirement.

It is indeed true that, by raising salaries, the State will, through higher taxes (YUK!), get back part of the money distributed through raises. But only part, namely approximately 6%. For the average employee, his salary would rise $660 per annum, and the State would recover $39.60. For all 157,000 State employees, the return to the State would approximate $6,217,200. But the proposal saves the State $15, 500,000, a net difference of $9,283,000 in favor of adoption of the proposal and without exposing the employees to higher taxes.

(7) I am again totally confused by this assertion; the proposal is meant to apply to all State employees, independent of the retirement system to which any employee belongs.

Finally, I should like to address a remark as pertains to the application of the proposal to future employees of the State: I do not find it unreasonable to suggest that all new employees be required to contribute (as is presently done) towards their retirements for the first five (5) years of their employment.Beginning their sixth year of employment and thereafter, the State shall, in lieu of 6% of the raise to be granted, make the employee's contribution for the employee as proposed.

I thank you for your time and consideration.

Sincerely,

R J Hursey Jr.

R. J. Hursey, Jr., Assoc. Prof.
Dept. of Mathematics

APPENDIX G

EXHIBIT B

Presentation to Legislative Research Commission's Committee on Tax Shelter for Employee Contributions, December 14th, 1978 by Virginia Ryan, State Director, North Carolina Federation of Teachers

We are living, as you are all aware, in a time of rapidly increasing inflation. We are also living in a time when we want to do something about inflation and yet not penalize the workers in our State. The North Carolina Federation of Teachers feels, at this time, that its proposal is even more appropriate now, than ever before. The N.C. Federation of Teachers, with the support of the N.C. AFL-CIO, wholeheartedly support the concept that I am about to explain which will keep North Carolina within the President's guidelines and yet provide tremendous benefits to the State Employees of North Carolina.

Not only are teachers and other state employees concerned with actual salary increases, but they are also concerned with actual disposable income. We all realize the basic concept that when a salary increase is provided, additional taxes, retirement and social security are paid. When the cost to the State is computed, the additional costs beyond the actual salary increase will also amount to a great deal of money. The savings of our proposal to the employer, the State of North Carolina, will be explained by Dr. Hursey at the conclusion of my presentation.

The actual proposal of the NCFT is for the State of North Carolina to amend all retirement programs to become tax sheltered; and in lieu of part of the next salary increase, the employer assume henceforth and forever the full liability for employee retirement contributions. This proposal, therefore, increases the employee take-home pay without paying additional taxes since the employee is presently paying taxes on his/her gross income. Tax sheltering forces the taxes to come due when one's income is generally lower and when the age 65 exemption has become available, reducing the magnitude of said taxes.

The adoption of this proposal does not, strictly speaking, result in a non-contributory retirement plan, for the employee has relinguished that percentage of an actual pay raise which the employer has inturn agreed to deposit in the employee's retirement account. The second part of this proposal, therefore, directs that the raise to be accorded the employee be distributed in a special way- a way which proves to be mutually beneficial. Monies which had been deducted for retirement from monthly checks would no longer be deducted, returning to each employee that full percentage of his gross monthly income which would have been taken for retirement and upon which taxes have already been paid. Part two, therefore, directs that a portion of employee salary raises be deposited in employee tax sheltered retirement accounts but not in employee pay checks (which, otherwise, would necessarily trigger greater deductions for retirement, social security and other taxes).

To better appreciate the effects of the proposal, consider the hypothetical case of state employee X whose current annual salary is $16,000 ($1,333 per month) and whose non-tax sheltered retirement plan demands a contribution of 6% of gross annual salary ($80 per month). Adoption of the proposal in lieu of 6 percent of the next salary raise would return a full 6 percent of gross salary, $80 per month, to state employee X as disposable income. If the 6 percent appropriation had been applied so as to actually increase the state employee's annual salary to $16,960, there is no way (as a result to increased deductions for taxes, social security, and retirement) that he could have received the full $80 per month increment. Without the benefits of the proposal, state employee X's salary must be increased slightly more than 9 percent in order to enjoy an increase in monthly take-home pay of $80. Thus, by adopting the recommended proposal, it is possible to make 6 act as if it were 9. If we further continue this example by assuming that $16,000 as the average annual salary of state employee X, over a career of 30 years, then adoption of the proposal would return to state employee X approximately $28,800 of additional disposable income over his 30 working years.

Indeed, if state employee X can financially afford to open a personal, supplemental, tax sheltered account (for himself or spouse) yielding 6 percent, and annually deposits the $960 (or portion thereof) which the proposal on the average returns, then upon retirement he will have amassed in said account a sum, whose maximum worth would exceed $75,000. The state employee will also have used, once again, the magic of tax sheltering by reducing his taxable income by an average of $960 per annum, saving an additional $23 per month (through lower state and federal taxes) and increasing his maximum monthly take-home pay by $103, $80 from adoption of the proposal plus the additional $23. To enjoy an increase in monthly take-home pay of this magnitude would require an actual salary increase of nearly 12 percent.

I would like to address some concerns that people have expressed in regards to this proposal. Last year, when the NCFT presented this proposal to the Board of Trustees of the TSERS there appeared, afterwards, misquotes on what I actually presented. Let me now explain that the following points of information are clarifications on questions regarding this proposal. I would hope that the educated people sitting in this room, here today, will take this presentation as a sum total of its parts.

I. It has been said that with this proposal the State would receive less tax revenue. This is true, since you will not be raising the salaries 6% to provide the added income to be taxed. What we must compare is the savings to the State in providing this benefit in relation to the tax revenue to be lost. The State of North Carolina will be saving more money than it will lose. At the same time the State will be providing more take-home pay for its employees.

II. Because an employee's retirement income is based on actual salaries, it has been said, that the employees close to retirement would not benefit. This is a consideration which must be addressed when this proposal is adopted. One way to solve this problem is that when an employee is to retire and the 79-80 salary is to be used in the formula, that the salary used reflect a 6% salary increase in the computation. This is really not a significant problem since the solution can be addressed when the actual computation takes place, therefore, no one would be penalized.

III. Employees, under this proposal, would have to pay taxes once they began receiving their retirement income. This is an integral part of the tax shelter program and why it is beneficial. Employees, presently, are paying taxes on a higher income and therefore, would benefit by deferring the taxes when their annual income is lower.

IV. This proposal has been ridiculed regarding the fact that employees would actually receive less money upon retirement.

To understand this, one must look at the overall increase of disposable income over the working years. Again, let us look at a hypothetical state employee.

Suppose an employee begins working for the State at a salary of $8,000 per annum and that said employee works 30 years with annual salary increments of 3% per annum. After 30 years, his salary will rise to $18,853. His maximum retirement in TSERS would be approximately $8,120 per annum.

If the suggested proposal were adopted, then the employee's maximum retirement, from TSERS, would decline to $7,884 per annum. This is a reduction, in annual benefits, of $236 per annum. This appears unfavorable, but we have only considered the effect of the proposal <u>after retirement</u>.

The employee's average salary over his 30 working years is $12,687 per annum. Adoption of the proposal would return (on the average) $761.22 each and every year to the employee as disposable income. Over the 30 years, the proposal would return $22,836 to the employee to be spent (or saved) as he/she saw fit. Moreover, if the employee were to invest (in a savings account at 6% per annum) this $761.22 each year over the 30 years he/she would, upon retirement have an account worth in excess of $56,000.

It should also be noted, that the life expectancy at age 65 is 19 years. If the proposal is not adopted, then probabilities suggest that the employee will receive an additional $4,500 (approximately) in retirement benefits. However, if the proposal had been adopted, then that same employee would have captured an additional $22,836 over his/her 30 working years. This amounts to a net difference of $18,000 (at least) in favor of adoption. Moreover, if the proposal is not adopted, then said employee must live 97 years (after reaching age 65) to accumulate the $22,836 which would have been returned, had the proposal been adopted.

These figures do not take into consideration the added benefit of putting this money into an additional tax shelter program, as I explained earlier.

V. This proposal will not punish those employees who have contributed their money in the past. Employees, under this proposal, will continue to contribute toward their retirement. It is only the method of contribution that changes. This proposal reflects change, progress and improvement in our retirement system. This same progress can be observed in the increase of salaries that has been made over the past 10-15 years.

VI. The State Employees of N.C. do not relinguish their ownership in the trust fund. The NCFT does not propose any changes in the make-up of the Board of Trustees and therefore, does not expect any changes to be made.

VII. This proposal will not prohibit any State Employee from receiving their accumulated retirement money, if they choose to leave the system.

We, in the North Carolina Federation of Teachers, feel that this proposal would be of great benefit to State Employees and the State of North Carolina. We urge you to take this information and study it carefully. We are sure that you will arrive at the same conclusions that we have.

Thank you again, for providing the opportunity to speak on this matter. Now, if you wouldn't mind, I would like to present Dr. Hursey from East Carolina University, we will share more valuable information with you. At the conclusion of his presentation I am sure we will be able to answer any of your questions.

APPENDIX H

An Assessment of the Proposal for
the State's Assumption of Employee Contributions
to the Retirement System
Presented to the Committee on Tax Shelter for Employees' Contributions
by Lloyd Isaacs, Executive Secretary,
The North Carolina Association of Educators

The North Carolina Association of Educators opposes any change in the method of financing the retirement systems of the state unless the Average Final Compensation formula in the Teachers' and State Employees' System is increased to .0175 percent. The proposed changes calling for decreasing or eliminating employee contributions are not in the best interest of most members of the retirement systems. The members who will benefit most are the highest paid, at the top of their schedules. The groups who would suffer most are the lower paid employees and females.

The Teachers' and State Employees' Retirement System began in 1941 on the fundamental concept of a partnership between the individual employee and the state. That partnership has continued and strengthened.

The cooperative roles of the member and the state centered on (1) money and (2) governance. The state contributes and the members contribute. The voices of the members are as strong as the state government's voice. The retirement system's strength stems from the contributions of the state and the members in hard, cold cash.

Funds contributed by a member are held in trust for that person. The funds will be returned if the member dies, if the member terminates employment, or upon retirement.

The contribution rate for members is set by law at 6 percent of compensation. The state currently contributes 9.12 percent. If the state assumes the members' 6 percent, there are grave doubts that the total of 15.12 percent will continue. Employees fear the contributions will shrink in the near future because the economy is expected to tighten and because Social Security contributions will increase. The fears are well founded, for a precedent was set recently when the General Assembly failed to appropriate the amount deemed necessary by the TSERS's actuary and by that system's board of trustees.

The most significant recent development is that the special committee studying Social Security issues made an in-depth study of the state pick-up of employee retirement contributions -- and flatly turned the proposal down. This action was taken although the proposal was projected to save the state almost $3,000,000 annually.

Other studies have been made from time to time. The most important took place in 1969. At that time, the North Carolina Association of Educators considered the state pick-up of retirement contributions. The state assumption of all employee contributions appeared to be a windfall tax shelter. But careful study proved this tax shelter more an illusion than a reality.

Every serious study has found that the decreases in service and disability benefits for retirement, Social Security benefits, and death benefits outweigh any current pocket funds. Who may most profit from tax sheltering? The higher paid college professors, department heads and administrators would. The average teacher, with a salary of $12,000, would save less than half as much, percentage-wise, in tax deferring as would a higher paid department head, administrator, or college professor at $25,000. The Federal taxable income of the teacher with three dependents would be about $5,800 at a rate of 19 percent, for a tax of $962. The $25,000 employee with two dependents has a taxable income of about $19,550 at a rate of 28 percent, for a tax of $4,254. The top of the $25,000 may be taxed as high as 40 percent, so the tax savings on such sheltering is large.

Some of the contentions put forth to this committee deserve a closer look:

First, for an employee to forego one 6 percent salary increase will eliminate all increases on the amount of that increase for his or her career. Assuming 6 percent increases for 40 years, the employee foregoing one $720 increase (6 percent x $12,000) watches the compounding steal away $7,401 the last year of service. Think of the cumulative loss for 40 years -- a fortune. And, the effect on retirement AFC and Social Security will be devastating.

Second, the decreased retirement and Social Security benefits for employees and/or dependents -- when such loss will be sorely felt -- is almost enough to offset gains in current take-home pay for the average employee. This is enticing for higher paid employees, but we should look out for the bulk of the employees of our schools and agencies. The lowest paid employees stand to lose most. And, since females outlive males about 20 percent in years after retirement, the females will lose more than males.

Third, who, in light of our galloping inflation, can safely predict that taxes in retirement will not continue to increase?

Fourth, any employee who withdraws his funds, especially the employee who does not vest, i.e., achieve five years membership in the retirement system, will suffer most in a lump-sum distribution because of higher taxes. Again (more on this later) we should speak for those who need the most protection -- the lowest paid.

Fifth, a program of tax sheltered annuities is now available to educators and state employees. Thousands are participating in an effort to supplement retirement. They are counting on a tax-free corridor of two or three years after retirement when they can convert these annuities and save many tax dollars. The corridor is tax free only because the employees paid taxes during working careers on their contributions to the retirement systems. It will be a great injustice to these persons to change the rules so they become doubly hit by the disappearance of a tax sheltering plus a tax take after retirement which they did not anticipate.

Sixth, educators and state employees can now enjoy tax sheltering through the annuities programs set out in the above paragraph. The Internal Revenue Service rules governing the annuities operate on a very strict percentage of compensation which can be placed in any qualified plan of deferred compensation. Tampering with the qualified contributions may bring IRS regulation changes to the detriment of employees.

Now, direct comments on contentions presented to this committee:

I. There will be some savings to the state, but from the employees' pockets, because the state will simply deposit less in the retirement system and less in the Social Security system. Who hurts most -- the high paid employee earning more than the Social Security maximum, or the lower paid individuals? The high paid won't have their Social Security benefits reduced by the retirement contribution pick-up. And the lower paid suffer.

II. To assure no reduction in future benefits, the state must increase contributions. As a matter of fact, the total contribution by the state would be increased, thereby wiping out most, if not all, of the projected savings.

III. Deferred taxes must be paid. The person getting only a smaller retirement benefit and a smaller Social Security benefit will be burdened by taxes at the worst time of his/her life.

IV. If we could be sure the employee would wisely save and wisely invest those savings, then we could spend our energies seeking a referendum to get out of the Social Security system. Of course, any savings wisely invested could provide an annuity. But the member's contributions are setting one up now. And it is not further taxable. And it provides for greater retirement benefits through a higher AFC. And, most important, it is a sure thing for workers now and in the future. The retirement annuity established by current contributions almost discounts an annuity which might result from tax savings.

V. Although contributions could continue to be credited to the individual's account, any employee separating from service would take a lump-sum settlement and be hit with taxes on all taxable earnings for that year. Taxes would be paid on the sum total of the lump sum withdrawal and all taxable salaries. That would hit the employee a staggering tax blow.

VI. The contention that ownership of the trust fund (actually there are two funds: annuity and pension) would not be relinquished is false because "ownership" would mean, by IRS standards, that the money is the individual's to do with when and as he pleases. If so, there could be no tax sheltering.

VII. The contention that employees can get their contribution out "if they choose to leave the system" is partially correct, but employees cannot "choose to leave the system" unless they terminate employment.

The NCAE would long ago have camped on your doorstep with such a proposal if it was best for the majority of the educators and state employees.

In the words of Hugh Gillespie, actuary, "Women would suffer a greater loss than similarly situated men because of their longer life expectancies." And, "if our understanding of the proposed pick-up legislation is correct, it appears the adoption of such would cause a significant and inequitable impairment of employee benefits."

Put this notion to rest now. It serves only to undermine morale of employees and strike fear in their hearts about their future and the future of their dependents. Employees still have faith in the state retirement systems. Tampering with that trust and faith would be unwise and self-defeating. Tampering with a partnership funding would be a penny-wise and pound-foolish act.

###

1/5/79-e

APPENDIX I

By Dr. Henry
C. Ferrell,
E.C.U. 12/14/7

Statement of Principles on Academic Retirement and Insurance Plans

The Statement which follows was prepared by a joint committee of the American Association of University Professors and the Association of American Colleges. It was adopted by the Council of the American Association of University Professors in May, 1969, and endorsed by the Fifty-fifth Annual Meeting as Association policy.

The purpose of an institution's retirement policy for faculty members and administrators and its program for their insurance benefits and retirement annuities should be to help educators and their families withstand the financial impacts of illness, old age, and death and to increase the educational effectiveness of the college and university. This policy and program should be designed to attract individuals of the highest abilities to educational work, to sustain the morale of the faculty, to permit faculty members to devote their energies with singleness of purpose to the concerns of the institution and the profession, and to provide for the orderly retirement of faculty members and administrators.

The following practices are recommended:

1. The retirement policy and annuity plan of an institution, as well as its insurance plans, should:

   a. Be clearly defined and easily understandable by both the faculty and the administration of the institution. When the age of retirement is fixed, the faculty member or administrator should be reminded of his approaching retirement at least one year prior to the date on which it is to become effective. When the retirement age is flexible, he should be informed of his impending retirement at least six months prior to the date on which it is to occur, except that if he is to be retired as early as age 65, this period should be at least one year.

   b. Take into account the old age, survivor, disability, and medical benefits of federal Social Security and other applicable public programs.

   c. Permit mobility of faculty members and administrators among institutions without loss of accrued retirement benefits and with little or no gap in annuity and insurance plan participation.

   d. Be reviewed periodically by faculty and administration of the institution, with appropriate recommendations to the institution's governing board, to assure that the plans continue to meet the needs, resources, and objectives of the institution and the faculty.

2. Retirement should normally occur at the end of the academic year in which the faculty member or administrator reaches the age specified for retirement by his institution's plan. Each institution should make clear whether, for these purposes, the summer period attaches to the preceding or the forthcoming academic year. Retirement provisions currently in effect at different institutions vary in the age specified for retirement and in the degree of flexibility relating to extensions of active service. Cogent arguments can be advanced in support of a number of these arrangements. Since conditions vary greatly among institutions, however, no universally applicable formula can be prescribed. Plans in which the retirement age falls within the range of 65 to 70 appear to be in conformity with reasonable practice.

   Where the institution has a flexible plan that provides for extension of service beyond its base retirement age, extensions should be by annual appointment and ordinarily should not postpone retirement beyond the end of the academic year in which age 70 is attained. Such extensions should be made upon recommendation of representatives of the faculty and administration through appropriate committee procedures that assure full protection of academic freedom. Representatives of the faculty should be chosen in accordance with procedures adopted by the faculty for committee appointment. (This also applies to the responsibilities noted in 1d, 3, and 4.)

3. Circumstances that may seem to justify a faculty member's retirement before the base retirement age in a flexible plan or the stated age in a fixed plan, or his disassociation from the institution for reasons of disability, should in all cases be considered by representatives of the faculty and administration through appropriate committee procedures. Where issues of tenure are involved in a case

of retirement before the base retirement age in a flexible plan or the stated age in a fixed plan, standard procedures of due process should be available.

4. The retirement age for faculty may differ from the age for retirement from administrative duties. Cessation of administrative duties, however, with assignment of teaching responsibilities only, is not interpreted as a retirement.

5. The recall of faculty members from retired status to full or part-time activity should be by annual appointment upon recommendation of representatives of the faculty and administration through appropriate committee procedures. Such recall should be rare; expected duties should be clearly defined; and full-time service should be arranged only in unusual circumstances.

6. Between the ages of 60 and retirement, faculty members should be permitted to arrange, on their own initiative, reductions in salary and services acceptable both to them and to their institutions. Such reductions in salary and services should occur without loss of tenure, rank, or eligibility for benefit-plan participation.

7. The institution should provide for a plan of retirement annuities. Such a plan should:

a. Require participation after not more than one year of service by all *full-time faculty* members and administrators who have attained a specified age, not later than 30.

b. Be financed by contributions made during each year of service, including leaves of absence with pay, with the institution contributing as much as or more than each participant. Moreover, an institution's retirement plan should be so organized as to permit voluntary annuity contributions from employees on leaves of absence without pay. In order that participants in a contributory plan may have the tax treatment of a noncontributory plan available to them, the individual should have the option to make his required contributions by salary reduction in accordance with relevant tax laws.

c. Maintain contributions at a level considered sufficient to give the long-term participant a retirement income that is appropriately related to his level of income prior to retirement, with provision for continuing more than half of such retirement income to a surviving spouse. The recommended objective for a person who participates in the plan for 35 or more years is an after-tax retirement income including federal Social Security benefits equivalent in purchasing power to approximately two thirds of the yearly disposable income realized from his salary after taxes and other mandatory deductions during his last few years of full-time employment.

d. Ensure that the full accumulations from the individual's and the institution's contributions are fully and immediately vested in the individual, available as a benefit in case of death before annuity payments commence, and with no forfeiture in case of withdrawal or dismissal from the institution.

e. Be such that the individual may withdraw the accumulated funds only in the form of an annuity. To avoid administrative expense, exception might be made for very small accumulations in an inactive account.

8. The institution should help retired faculty members and administrators remain a part of the institution, providing, where possible, such facilities as: a mail address, library privileges, office facilities, faculty club membership, the institution's publications, secretarial help, administration of grants, laboratory rights, faculty dining privileges, and participation in convocations and academic processions. Institutions that confer the emeritus status should do so in accordance with standards determined by the faculty and administration.

9. When a new retirement policy or annuity plan is initiated or an old one changed, reasonable transition provisions, either by special financial arrangements or by the gradual inauguration of the new plan, should be made for those who would otherwise be adversely affected.

10. The institution should maintain a program of group insurance financed in whole or in part by the institution and available to faculty members and administrators as soon as practicable after employment. The program should continue all coverages during leave of absence with pay, and during leave without pay unless equally adequate protection is otherwise provided for the individual. The program should include:

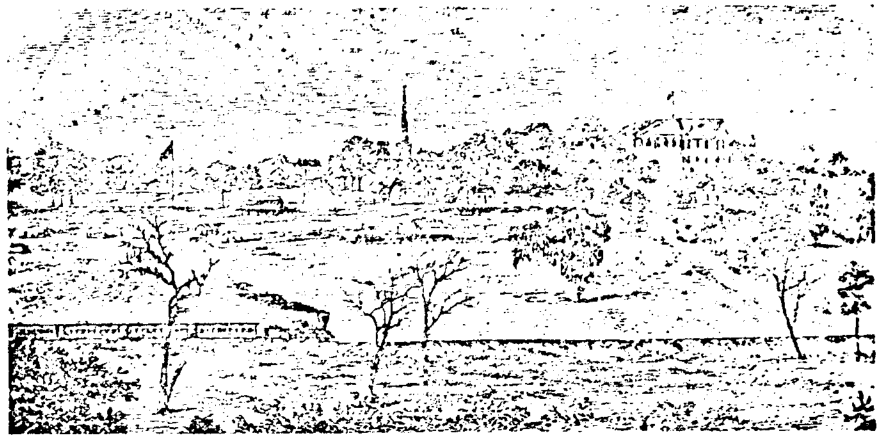
a. Life insurance providing a benefit considered sufficient to sustain the standard of living of the staff member's family for at least one year following his death. Where additional protection is contemplated, the special financial needs of families of younger faculty members should receive particular consideration.

b. Insurance for medical expenses, with emphasis upon protection against the major expenses of illness or injury in preference to minor expenses that cause no serious drain on a family's budget. Such insurance should continue to be available through the institution (1) for the retired staff member and spouse, and (2) for the surviving spouse who does not remarry and dependent children of an active or retired staff member who dies while insured.

c. Insurance providing a monthly income for staff members who remain totally disabled beyond the period normally covered by salary continuation or sick pay. For a person who has been disabled six months or more, the plan should provide an after-tax income including federal Social Security benefits equivalent in purchasing power to approximately two thirds of the income he realized after taxes and mandatory deductions prior to his disability. Such income should continue during total disability for the normal period of employment at the institution, with adequate provision for a continuing income throughout the retirement years.

APPENDIX J

THE FLORIDA RETIREMENT BULLETIN



AUGUST 1974 VOL.1, NO.1

FRS to become Non-Contributory

Members of the Florida Retirement System's regular and special risk classes will soon cease making contributions to their retirement fund. This change takes effect on January 1, 1975, for employees of all state agencies, school districts, and community colleges and on October 1, 1975, for employees of all other governmental units. Committee Substitute for House Bill 3909, passed by the Legislature and signed into law by Governor Askew, requires the employer to assume total contributions for all FRS members other than elected state officers.

What this means for regular members is a 4 percent increase in take-home pay, while the increase for special risk members will be 8 percent. Special risk members are currently contributing only 6 percent of salary to retirement, but effective October 1, 1974, this contribution will go to 8 percent, as discussed later in this bulletin. When the system becomes non-contributory for the employee, the employer's contribution will jump from 4 percent to 9 percent for regular members and from 8 percent to 13 percent of salary for special risk members.

The primary purpose in changing FRS to a non-contributory plan is to help eliminate the unfunded liability documented in past actuarial studies of state retirement systems. In addition to requiring the employer to pay the total retirement contribution for regular and special risk members, Committee Substitute for House Bill 3909 also increased by 1 percent the total contribution currently required for regular and special risk members. Since employers' contributions are not refundable, it will cut down on the amount of refunded contributions which the fund pays to terminating employees. During the last fiscal year, more than $30 million was paid in refunds. Reducing this outflow will do much to stabilize the retirement fund. Upon termination an employee will continue to be entitled to a refund of his contributions made prior to the date the system becomes non-contributory and to a refund of his contributions made after the system becomes non-contributory for past, prior, military, and leave of absence service. Although Governor Askew recommended that the state and other governmental units take over contributions totaling 4 percent of the salary of all members of state administered retirement systems, the Legislature did not include members of the Teachers Retirement System, or any other state administered retirement plan in this bill. However, members of these systems will be given another opportunity to transfer to FRS this fall. (See article on page one for details.) The new law also provides that no member's salary shall be reduced as a result of the Florida Retirement System becoming non-contributory; it also guarantees the legal rights of members to all benefits earned.

CHANGES AFFECTING SPECIAL RISK MEMBERS

On October 1, 1974, all special risk members of the Florida Retirement System will be contributing 8 percent of salary, to be matched by each employer. In return they will receive 3 percent retirement credit per year of service as compared to the present 2 percent credit. Pursuant to an Attorney General's Opinion (AGO 74-196), on January 1, 1975, special risk employees of state agencies, school districts, and community colleges will cease making retirement contributions.

(continued on page 2)

Reopening of FRS

Included in the non-contributory or omnibus retirement act is a provision to reopen the Florida Retirement System to approximately 45,000 members of the state's older retirement systems. Unlike the transfer period in 1972, no retroactive social security will be provided. The enrollment period begins September 1, 1974, and ends November 30, with membership in FRS effective January 1, 1975. Those members of the older existing systems who do not transfer to the Florida Retirement System will continue to participate in their existing system.

The Division of Retirement will provide all agencies with informational material on the reopening of the system. Some of the material will compare the provisions of the older existing retirement systems to the provisions of the Florida Retirement System. In addition, division personnel will be holding group meetings with interested employees to answer questions on the Florida Retirement System.

From the Director

With the publication of this first Florida Retirement Bulletin, we hope to establish an effective channel of communication between you, the members of the Florida Retirement Systems, and the division which serves you. We will apprise you of legislative action which affects your retirement system, of policy decisions made by the division, division organization, growth and functions.

The legislative session just completed was a productive one, and this issue is largely devoted to examining what was accomplished.

Committee Substitute for House Bill 3909, discussed elsewhere in this bulletin, provides that the employing units will in the immediate future begin paying the retirement contributions presently required of the regular and special risk members of the Florida Retirement System, and also pay an additional 1 percent of gross salary for these members. These provisions will improve greatly the actuarial soundness of the Florida Retirement System.

House Bill 3924 provides for a cost-of-living adjustment to the benefits paid to a small group of persons who were not previously eligible for such an adjustment. The cost of implementing this bill is relatively small, and since these benefits are paid from the State's General Revenue Fund, it has no actuarial impact on the Florida Retirement System Trust Fund.

Future county court judges are made mandatory members, and such judges who are on the payroll October 1, 1974, may elect to become members of the Elected State Officers Class under the provisions of House Bill 3020.

Senate Bill 81 increased the required contributions and retirement credit earned by members of the special risk class. Although the interaction the provisions of this bill with Committee Substitute for House Bill 3909 ults in the contributions for special risk members being insufficient to fund the increased benefits, it is hoped this deficiency can be eliminated by subsequent legislative action.

Some significant improvements were made in the cost-of-living provisions by Committee Substitute for House Bill 3909 which had an estimated actuarial cost of approximately $10 million per year. The 3 percent ceiling on the cost-of-living adjustment to retirement benefits was not lifted during the past session, however, due to the significant cost of changing the present limitation. Before this ceiling can be raised it appears that the Legislature will have to provide additional funding since the 1974 Legislature wrote into the law governing the Florida Retirement System their intention that adequate funding, based on sound actuarial data, will be provided for all future benefit increases.

Robert L. Kennedy, Jr.

The Florida Retirement Bulletin
Official Publication of the
Department of Administration
Division of Retirement

Prepared by:
Terry Cappellini   Lew Dennard   Douglas Mann

Artist: Chris Georgiades

This public document was promulgated at a cost of $5,408.00 or $.027 per copy to inform interested persons of the policies and operations of the Florida Retirement System.

(continued from page 1)

Special risk employees of counties, cities, and special districts must pay the 8 percent contribution until October 1, 1975, when the non-contributory provisions of Committee Substitute for House Bill 3909 take effect for them. The total retirement contribution required for special risk members drops from 16 percent to 13 percent when employers start making the total contributions on January 1 or October 1, 1975.

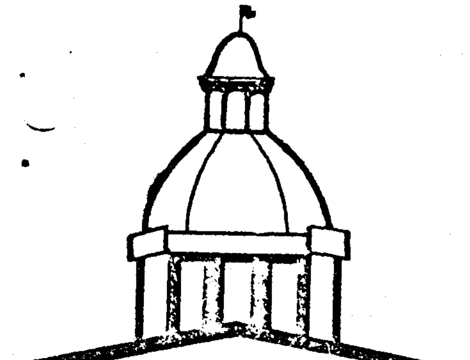
Special risk retirement credit already earned as of October 1, 1974, will remain at the 2 percent level and only special risk service after that date will be at the 3 percent rate. This law also limits the benefit for a special risk member to 100 percent of average final compensation.

INTEREST RATES CHANGED

The Legislature also raised the interest rates on the purchase of past service, prior service, military service, and service credits for authorized leaves of absence. Effective July 1, 1975, the interest charged will be 6.5 percent compounded annually for members of all retirement systems.

To illustrate how this change may affect members who wish to purchase credit for prior service, let's use an example of a teacher who worked in the public school system of Florida from 1960 through 1965 and resigned, receiving a full refund of all the retirement contributions made during that period. If reemployed as a teacher in Florida this year, he or she would have to work for three consecutive years before becoming eligible to purchase retirement credit for prior service. If this teacher chose to purchase this prior service credit, he or she would be required to pay back the full amount of the refunded contributions with interest. This interest would be 4 percent compounded annually from the date of the refund until July 1, 1975, and 6.5 percent compounded annually from July 1, 1975, until full payment was made. This same method of applying interest will be used for the purchase of military service, past service, and retirement credit for authorized leaves of absence.

(continued on page 3)



Legislative News

Nearly 100 separate retirement bills covering almost as many different facets of retirement were introduced during the 1974 Legislature. Unlimited cost-of-living adjustments, 30 years normal retirement at any age, recomputation of benefits based on the five-year average final compensation, credit for military service that has been used for military retirement, and abolition of the elected state officers class are only some of the proposals that were considered and rejected. However, less than ten retirement bills made it through the Legislature to the Governor for signature. Among the w that did pass, the n-contributory or omnibus retirement bill stands out as the single most important retirement law since the creation of the FRS in 1970. If the predictions hold true, this one bill will go far toward putting the retirement system on a sound financial footing.

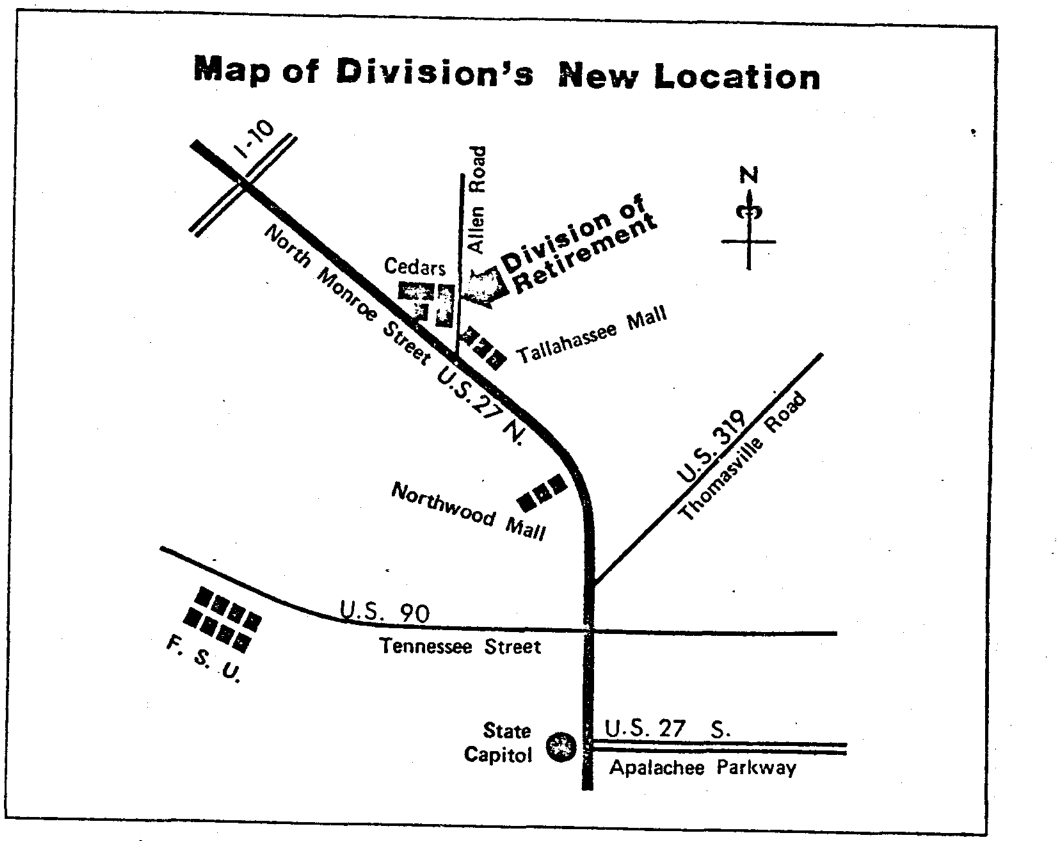
Many of those measures that did not make it were either too costly or impractical, while others failed because they were apparently contrary to the Legislature's current retirement philosophy. The lateness of introduction and the pressure of the last weeks of the session contributed to the failure of other proposals. House Bill 4013 by the House Committee on Retirement, Personnel, and Claims is one of those that, for one reason or another, did not make it. This bill would have created a State Retirement Commission of lay persons appointed by the Governor to hear members' appeals to certain retirement decisions, to make recommendations to the Legislature for improvements in the retirement systems, and to provide advice to the State Retirement Director in developing a sound and 'ern retirement system. Having passed the House by a vote of 99 to 0, House Bill 4013 died in the Senate Ways and Means Committee as time ran out for the 1974 session.

Division Plans Move

In early August the Division of Retirement will move to a new location, the Cedars Executive Office Center, in Tallahassee. The division's new offices are three and a half miles from the present offices in downtown Tallahassee. The map below shows the new location as well as the main highway arteries leading to it.

While the division is physically moving, our telephone numbers and mailing address will remain the same. We hope to be relocated by the first week of August. All correspondence should continue to be addressed to:

DIVISION OF RETIREMENT
CARLTON BUILDING
TALLAHASSEE, FLORIDA 32304



(continued from page 2)

In order to receive credit for prior service earned after FRS becomes non-contributory, it will be necessary only for a regular or special risk member to be reemployed for three years. For example, a member who works from 1976 to 1979 and terminates would not receive a refund since no employee contributions were made. If the person is subsequently reemployed and works for three continuous years, he or she would receive retirement credit for the earlier service at no cost.

REPAYMENT OF CONTRIBUTIONS FOR RETROACTIVE SOCIAL SECURITY

Another change included in the omnibus retirement bill which affects members who transferred to FRS in 1972, is the extension to June 30, 1975, of the date for repayment without penalty of money borrowed from members' retirement contribution accounts to purchase retroactive social security coverage. Earlier notices to affected employees advised that 8 percent interest compounded annually would be added on any amount owed on January 1, 1974. Under this new law no interest will be charged until July 1, 1975.

(continued on page 4)

Frequently asked ?'s

QUESTION: What happens to the contributions I have already paid into the Florida Retirement System when it becomes non-contributory?

ANSWER: *The contributions you have paid will remain in the retirement trust fund. If you terminate your membership in the Florida Retirement System and request a refund you will be refunded all your contributions through January 1, 1975, or October 1, 1975, depending on when the system becomes non-contributory for you. Also, any money contributed for past, prior or military service will be refunded.*

QUESTION: What is acceptable for proof of age?

ANSWER:
1. *Birth Certificate*
2. *Delayed birth certificate*
3. *Census report (First one taken after birthdate of member)*
4. *Life insurance policy issued prior to July 1, 1945.*

QUESTION: Was there a change in interest rates on amounts owed the various retirement systems?

ANSWER: *Yes, the Legislature raised the interest rates to 6.5 percent compounded annually for all retirement systems effective July 1, 1975. This applies to members purchasing past, prior, and military service as well as service credit for authorized leaves of absences.*

QUESTION: When should I make application for retirement and how is the effective date determined?

ANSWER: *A member should make application for retirement benefits at least 90 days prior to his date of termination of employment. Such application will require certification by the employer of the date the member intends to terminate. If all requirements for retirement have been satisfied, benefits will commence on the first day of the month following the last month during which the member was employed. If the member desires to make application for retirement at a later date after termination of employment, benefits will commence on the first day of the month following the month in which application is made.*

EDITOR'S NOTE:

Do you have a question of general interest to our readers? Send to Division of Retirement, Florida Retirement Bulletin, Carlton Building, Tallahassee, Florida 32304.

(continued from page 3)

COST-OF-LIVING

Some minor changes were also made to the cost-of-living formula used to adjust retirement benefits as the cost-of-living changes. The annual 3 percent ceiling on adjustments was retained, but the new omnibus retirement bill provides that once a retiree receives the first cost-of-living adjustment under the old law, all subsequent adjustments will be made by increasing the benefit being paid on each June 30 by the change in the average cost-of-living index, limited to 3 percent. One effect of this change will be to grant cost-of-living increases on top of benefits that have been adjusted in accordance with the $8 minimum benefit law. However, the $8 minimum benefit adjustment must be received for a full year before the retiree will be entitled to the cost-of-living adjustment. A person must still reach age 65 to qualify for cost-of-living adjustments.

Another act by the 1974 Legislature granted cost-of-living adjustments to the several hundred employees retired under Section 112.05, Florida Statutes, the old non-contributory plan for state employees. Elderly incapacitated school teachers who receive a monthly allowance under Section 238.171, Florida Statutes, and widows of Confederate War veterans who receive a monthly benefit will also receive cost-of-living adjustments under this act.

DEATH BENEFITS

An improvement in the death benefits provisions of the Florida Retirement System was enacted this year. Previously, the surviving spouse of a member who died after completing ten years of service had only two options available: to receive a full refund of the member's contributions, or to have a monthly benefit payable for life based on the member's age and service at death. If the member had not achieved normal retirement age, the benefit paid to the surviving spouse would be adjusted for early retirement, frequently resulting in a drastically reduced monthly benefit. Now a third option is made available to the spouse in this situation. He or she may elect to delay receipt of the benefit until some later date when their financial need may be greater. This delayed benefit will be based on the age the deceased member would have attained on the date the benefit starts, resulting in a larger monthly annuity.

APPENDIX K

Panel endorses new Social Security plan

By A.L. MAY
Staff Writer

Over the objections of the state's three public employee organizations, a legislative study committee decided Tuesday to ask the General Assembly next year to change the way the state handles Social Security taxes for its teachers and employees.

Representatives of the three employee groups remained opposed to the plan despite the committee's adopting a "good faith" statement that any loss of Social Security benefits would be made up within state retirement programs or through increased benefits to teachers and employees.

The plan, sponsored chiefly by Joseph W. Grimsley, state administration secretary and a member of the committee, also drew opposition from another member of the study panel — Deputy State Auditor John W. Buchan.

"There are just too many unknowns" Buchan said after the meeting.

One highly-placed source in the administration of Gov James B. Hunt Jr. said the complicated plan probably would die in the legislature unless the employee groups could be persuaded to support it.

Currently, state employees pay Social Security taxes and also contribute, with the state, to public employee retirement plans.

Emmett W. Burden, executive director of the North Carolina State Employees Association and a member of the committee, asked the committee to recommend further study of the proposed changes.

The other two employee group representatives on the committee, Lloyd S. Isaacs, executive director of the N.C. Association of Educators, and J. Arch Laney, executive director of the North Carolina State Government Employees Asssociation, indicated support for Burden's proposal.

Continued from page 33

Grimsley, however, called Burden's proposal "passing the buck," and argued that state employees would lose nothing from the plan but taxpayers could save $210 million over the next nine years.

At Grimsley's urging, the committee approved the plan by a six-to-four vote.

The plan is two-pronged: One part would remove sick pay from the wage base used in figuring Social Security taxes.

A second part would have the state assume the employees' share of the Social Security tax. Half is now paid by the employee and half by the state.

The sick pay proposal is less controversial. Only Burden and Laney voted against it.

Although Social Security benefits would decrease slightly, the employee would share equally with the state in the savings, a total of about $4 million in 1979 and more than $80 million over the next nine years.

The more controversial part of the plan — the state's taking over payment of the Social Security taxes entirely — would benefit the state more than the employees.

Although employees would no longer pay the tax, their gross salaries would be adjusted downward by the amount of the taxes assumed by the state. As the Social Security rates increased, salaries would be adjusted downward and the state would pay the increased tax.

Grimsley's chief consultant on the issue, T.L. Amick of Durham, chief executive officer of Management Improvement Corporation of America, told the committee that both the state and the employees would benefit.

Amick said the state's assumption of the tax now paid by employes would lower a wage base. With other accounting changes, he said, this would save the state about 6 percent of its current Social Security payments — or $3.4 million next year and $143 million over the next nine years.

The take-home pay of an employee actually would be increased slightly by the reduction of his gross income, Amick said, because he would pay less state and federal income taxes.

For example, he said, an employee making $10,000 a year would gain $7.52 in take home-pay in a year and the state would save $75 by taking over the employee's share of the Social Security tax, reducing the wage base.

N&O
December 6, 1978

This is for your information.

WLP, Jr.

APPENDIX L

LEGISLATIVE PROPOSAL I

A JOINT RESOLUTION DIRECTING THE LEGISLATIVE RESEARCH COMMISSION TO CONTINUE THE STUDY OF THE FEASIBILITY OF PROVIDING A TAX SHELTER FOR EMPLOYEE CONTRIBUTIONS TO THE VARIOUS STATE ADMINISTERED RETIREMENT SYSTEMS.

Whereas, the study mandated by Senate Joint Resolution 830, ratified Resolution 120 of the Session Laws of the 1977 General Assembly (Second Session, 1978) entailed the gathering of a large amount of information from many different sources and the receipt of testimony from all affected persons within State Government; and

Whereas, the committee did not have sufficient time to study all the technical information presented and the need for further study of the subject;

Now, therefore, be it resolved by the Senate, the House of Representatives concurring:

Section 1. The Legislative Research Commission is hereby directed to continue the study mandated by ratified Resolution 120, Senate Joint Resolution 830, of the Session Laws of 1977 (Second Session, 1978) of the feasibility of providing a tax shelter for employee contributions to the Teachers' and State Employees' Retirement System of North Carolina, the Law Enforcement Officers' Benefit and Retirement Funds, the Local Governmental Employees' Retirement System, the Uniform Clerks of Superior Court Retirement System, the Uniform Judicial Retirement System, and the Uniform Solicitorial Retirement System and to any other retirement plans in which State employees participate.

Sec. 2. The State Auditor, the State Treasurer and the Secretary of Revenue shall cooperate with the commission in its study and shall and shall insure that their employees and staff provide full and timely assistance to the commission in the execution of its duties. Necessary staff for the commission shall be furnished by the Legislative Services Commission.

Sec. 3. The Legislative Research Commission shall transmit its findings to the 1979 General Assembly, Second Session 1980.

Sec. 4. This resolution shall become effective July 1, 1979.