

## **Impact on MERS From Pension Reforms Made by the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”)**

Effective January 1, 2002, federal tax law has been significantly changed by EGTRRA. This law permits participants in pension plans under Internal Revenue Code sections 401, 403, 408 (“traditional IRA”) or 457 the right to move retirement assets from one plan into another plan. Previously, section 401 assets could only be “rolled over” to another 401 plan, 403 assets to another 403 plan, and 457 assets to another 457 plan. These limitations are generally removed by EGTRRA. In general, you must “separate” from service under the prior plan and be eligible to take a distribution from that plan in order to “roll over” assets to another plan which has agreed to receive the distribution (a receiving plan *may, but is not required* by EGTRRA, to receive a rollover distribution). You may make an eligible rollover distribution by a direct transfer (no taxes withheld) or through an indirect rollover (taxes withheld), as further described below.

### **What types of plans are covered under the various Code sections mentioned?**

- Section 401 plans include defined benefit plans (such as MERS traditional benefit programs); defined contribution plans (MERS Defined Contribution Benefit Program, where ICMA-RC is MERS’ third-party administrator); and section 401(k) plans (available in the public sector if adopted before May 6, 1986, and for certain municipal hospitals).
- Section 403 covers tax sheltered annuity plans, and 403(b) plans are tax-sheltered annuity (“TSA”) plans for section 501(c)(3) corporations including a public school.
- Section 408 IRA is a “traditional” Individual Retirement Account (section 408(a)) or Annuity (section 408(b)), but not an inherited IRA, a Roth IRA or SIMPLE IRA or a Coverdell Education Savings Account (formerly known as an education IRA).
- Section 457 plans are deferred compensation plans of state and local government and non-profit tax-exempt organizations.

### **How does this apply to MERS?**

MERS’ defined benefit plan provides a fixed lifetime benefit amount to the MERS member (and beneficiary where applicable). Thus, in most cases there are no “retirement assets” in the form of an account balance (such as a lump sum) to be moved from MERS to another plan. The prime exception would be a member who terminates without vested future MERS benefits, who may wish to transfer accumulated member contributions, if any, to another plan.

**However, there is an important new provision in EGTRRA (section 647) that applies only to governmental defined benefit plans such as MERS. EGTRRA permits a direct trustee-to-trustee transfer from one plan (as stated above) to a governmental defined benefit plan under which the member is currently covered (such as MERS) to purchase service credit or to repay a prior refund of contributions that the current member has taken previously, without the requirement for a separation from service.** This means that if a member is presently covered as a MERS defined benefit plan member and also participates in a defined contribution plan (or a 457 plan) for that same governmental employer, those plan assets may now be directly transferred to MERS by the trustee of the other plan while you continue your MERS employment. Such 457 in-service transfers may only come from a governmental 457 plan (and not a non-profit, nongovernmental plan). Also, assets from a TSA under section 403(b) may similarly be transferred in-service to a governmental defined benefit plan for purchase of service or to repay a refund. If you participate in another plan because of prior employment, then those assets are also available for these purposes, either through a direct transfer (trustee-to-trustee) or by an indirect rollover.

MERS defined contribution benefit program third party administrator, ICMA-RC, permits such in-service transfers from its 401 plan to MERS; ICMA-RC recently amended its section 457 Deferred Compensation Plan and Trust Document to permit direct trustee-to-trustee (MERS) transfers, effective January 1, 2002.

Such transfers may include any after-tax contributions that the member had in the distributing plan. MERS will separately account for such after-tax amounts, similar to how MERS has historically handled employee after-tax contributions or service purchases.

Each governmental defined benefit plan has the authority to decide whether it will allow such transfers. **Consistent with its existing practices, MERS will permit such transfers effective January 1, 2002 under the terms described below.**

### What are MERS' requirements for service credit purchases and repayment of refunds?

**MERS will permit direct trustee-to-trustee transfers for a service credit purchase or to repay a refund, limited to the MERS-determined amount needed to finance the purchase or repayment.** All MERS' requirements under the Plan Document for a service credit purchase apply. This includes MERS' determination of actuarial cost, and approval of the governing body of the member's current MERS employer and for repayment of a refund.

There are several other limitations on such transfers into MERS for these purposes.

- (1) You must be a MERS member as of the time the transfer is received by MERS.
- (2) MERS will accept amounts equal to: the member's portion of the MERS-calculated "actuarial cost" of the service purchase amount you must pay as determined by the governing body of your current MERS employer (in the Service Credit Purchase Form); or, in the case of repayment of a prior MERS refund, the amount determined by MERS.
- (3) As to transfers from an IRA, the Internal Revenue Code allows MERS to accept a distribution of taxable amounts only from a "traditional IRA" (including a "conduit IRA," where all IRA amounts are from an earlier rollover from a Section 401(a) qualified plan). See third bullet point, Section 408, in What types of plans are covered at beginning of this article for other restrictions.
- (4) With specific reference to Section 457 deferred compensation plans, a "rollover" of plan assets to purchase MERS defined benefit service credit or to repay a prior MERS refund of contributions must come from a governmental Section 457(e)(1)(A) plan (and not from a non-governmental tax exempt organization). In-service transfers from a TSA under section 403(b) are permitted for the same purposes.
- (5) Under EGTRRA, assets which are "rolled" over from one of the plans described above (or a "traditional IRA") to another plan assume ("takes on") the characteristics of the plan they are being transferred to. After-tax amounts may be transferred, as noted earlier.

### What are the approved transfer methods used to purchase MERS service or repay a refund?

You may take this action by a direct transfer or an indirect rollover. Remember, under EGTRRA, in-service distributions to MERS for the purchase of MERS service credit or to repay MERS a prior refund can only occur by means of a direct trustee-to-trustee transfer.

A “**direct transfer**” means that the distributing plan will transfer your distribution directly to MERS. Most plan participants who move assets to other plans find it more convenient to move the assets in the form of direct trustee-to-trustee transfer as there is no federal tax withholding required. EGTRRA specifies that a direct transfer is the only method for in-service transfers to purchase MERS service or repay a refund. You must satisfy the distributing plan’s requirements for making direct transfer. Such requirements could reasonably include certification of your membership under MERS defined benefit plan, and MERS documents showing the amount and actuarial cost of defined benefit service being purchased (or showing the amount of dollars needed to repay a prior refund). The amount transferred to the MERS defined benefit plan is limited by EGTRRA to the amount necessary to actuarially “pay for” the service, or make the refund repayment. This may include all (or a portion) of available assets in the distributing plan.

An “**indirect rollover**” means that the distributing plan pays the distribution to the member; in turn, the member must deposit the assets with MERS within 60 calendar days from the date payment was received by the member from the distributing plan. In this situation, federal taxes are withheld upon all previously-untaxed amounts—there *may be* a required 10% federal early withdrawal penalty, and a *mandatory* 20% federal withholding tax, and other requirements. For indirect rollovers, the required MERS form that must be completed is Certification of Qualified Fund Rollover to MERS. The distributing plan may have similar requirements to those noted in the prior paragraph, and the distribution paid to you may use up all (or part) of your account. Payment for MERS service purchases and repayment of refunds may occur by indirect rollover, but EGTRRA does not authorize in-service distributions to be made by this method as it does for direct transfers.

Internal Revenue Service guidelines (Code section 402(f) and IRS Notice 2002-3) require the distributing plan to give you a written explanation and a reasonable waiting period to consider your options before payment is made on behalf of the member. IRS Notice 2002-3 (reflecting the EGTRRA changes) requires a written explanation of direct trustee-to-trustee rollover rules, mandatory tax withholding on indirect rollovers, and tax consequences of distributions not rolled over. For example, the rollover transfer waiting period for section 401 and 457 plans is 30 days. However, if a member wishes to have payment made sooner than this, the member may “waive” the waiting period. Upon distribution, the same plan will notify the Internal Revenue Service that a distribution of funds has been made by issuance of a 1099-R for the year in which the distribution was made.

*Please note that these instructions summarize only the federal (not state or local) tax rules that might apply. The rules described above are complex. Some individuals may want to contact a professional tax advisor, depending on the complexity of their situation.*

EGTRRA has made significant changes to the “pension world.” MERS has revised its forms to accommodate the EGTRRA changes discussed in this article. These forms are: Certification of Qualified Fund Rollover to MERS (transfers into MERS); Refund Application (transfers out of MERS), and MERS “Safe Harbor Explanation.” These forms may be found and downloaded at the MERS web site ([www.mersofmich.com](http://www.mersofmich.com); click **Employers**, and then **Forms**; go to **Section II. A**. Please contact MERS for assistance.