WRITTEN ONLY

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE HOUSE COMMITTEE ON OCEAN MARINE RESOURCES, AND HAWAIIAN AFFAIRS AND THE COMMITTEE ON WATER AND LAND
ON
HOUSE BILL 638, H.D. 1

February 8, 2013

RELATING TO THE OFFICE OF HAWAIIAN AFFAIRS

House Bill No. 638, H.D. 1, excludes officers and employees of the Office of Hawaiian Affairs (OHA) who are hired after December 31, 2013 from benefit programs that are applicable to officers and employees of the State. This bill amends sections 88-21 and 88-54.5, Hawaii Revised Statues (HRS), to exclude prospectively OHA officers and employees from membership in the Employees' Retirement System (ERS). This bill also amends section 88-43, HRS, by allowing current OHA employees and officers who are members of the ERS to make an election to terminate their membership and to be paid the total of their accumulated contributions.

The Department of Budget and Finance strongly opposes this bill because any legislation that permits a current Contributory or Hybrid member of the ERS to "opt out" of the ERS and receive a distribution of accumulated contributions while still employed creates a tax-qualification issue. More specifically, such an allowance for current and then continuing employees would not conform to the provisions for a tax-exempt retirement pension system. The ERS has submitted testimony on this measure that provides more detailed information regarding these specific concerns.

We defer to the Office of Information Practices in regards to the provision to subject all employees of the OHA to the Uniform Information Practices Act.

TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE COMMITTEE ON OCEAN, MARINE RESOURCES, AND HAWAIIAN AFFAIRS
AND THE COMMITTEE ON WATER AND LAND
ON
HOUSE BILL NO. 638, H.D.1

FEBRAURY 8, 2013

RELATING TO THE OFFICE OF HAWAIIAN AFFAIRS

Chair Hanohano, Chair Evans and Members of the Committees:

H.B. 638, H.D.1, excludes officers and employees of the Office of Hawaiian Affairs (OHA) hired after December 31, 2013, from benefit programs generally applicable to officers and employees of the State. As these benefit programs include membership in the Employees' Retirement System (ERS), this bill amends ERS sections 88-21 and 88-54.5 to exclude OHA employees and trustees from membership in the system. In addition, this proposal seeks to amend section 88-43 by allowing current OHA employees and officers who are members of the ERS to elect to terminate their membership in the System and to be paid the total of their accumulated contributions.

The ERS Board of Trustees opposes this bill as it would jeopardize the tax qualification of the ERS.

The ERS is a tax-qualified retirement plan under section 401(a) of the Internal Revenue Code of 1986, as amended (Code). Section 414(h)(2) of the Code provides for favorable tax treatment for employee contributions "picked up" (made by the employer on behalf of the employee) to a tax-qualified retirement plan established by the state or county. Should the ERS lose its tax-exempt status, the federal tax consequences would be extremely harmful to its members. Contributions received from employee members would no longer have favorable pre-tax treatment; instead, employees' contributions to the ERS would be entirely subject to federal tax at the time of contribution. In addition, all members would be taxed on the value of their total accrued retirement benefits at the time they vest rather than when they receive their retirement benefits.

Any legislation that permits a current Contributory or Hybrid member to “opt out” of the ERS (and receive a distribution of accumulated contributions while still employed) creates a tax-qualification issue. This bill violates the rule in Revenue Ruling 2006-43 that prohibits 401(k)-type elections in government pick-up plans. In addition, if in service distributions are permitted, this legislation also violates the long-standing rule that prohibits such distributions from defined benefit pension plans like the ERS.

The ERS Board is committed to preserving the tax-qualified status of the ERS, and therefore strongly opposes the passage of this bill.

Thank you for the opportunity to testify on this important measure.