ACT 183

S.B. NO. 2878

A Bill for an Act Relating to the Federal Tax Limit on Compensation Applicable to the Employees' Retirement System.

Be It Enacted by the Legislature of the State of Hawaii:

SECTION 1. The employees' retirement system of the State of Hawaii (ERS) is intended to be a tax-qualified retirement plan under section 401(a) of the Internal Revenue Code of 1986, as amended (Code). Section 401(a)(17) of the Code limits the annual compensation that may be taken into account in determining benefit accruals under the ERS. Section 401(a)(17) was first effective with respect to the ERS on July 1, 1996. Currently, there is no provision in chapter 88, Hawaii Revised Statutes, applying the section 401(a)(17) limits. The legislature finds that chapter 88, Hawaii Revised Statutes, should be amended to apply the federal tax limit on compensation in accordance with federal tax law.

Under article XVI, section 2, of the Constitution of the State of Hawaii, membership in the ERS is a "contractual relationship"; a member's "accrued benefit" may not be "diminished" or "impaired." The legislature finds that the Constitution of the State of Hawaii limits what the legislature may do to bring the ERS into retroactive compliance with federal tax law. If the "accrued benefits" cannot be provided under a tax-qualified plan, they must be provided under a nontax-qualified plan.

This Act amends chapter 88, Hawaii Revised Statutes, to apply the federal tax limits on pension compensation effective July 1, 1996, and adds a nontax-qualified arrangement to protect benefits accrued in excess of the federal tax limits for the period July 1, 1996, through June 30, 2004. This Act also appropriates funds to pay the nontax-qualified benefits.

SECTION 2. Chapter 88, Hawaii Revised Statutes, is amended by adding a new section to be appropriately designated and to read as follows:

"§88- **Federal tax limits on annual compensation.** (a) Effective July 1, 1996, compensation used to determine "average final compensation" under section 88-81 and employee contributions picked up by the employer under section 88-46, shall be subject to the annual limit set forth in section 401(a)(17) of the Internal Revenue Code of 1986, as amended.

(b) Notwithstanding subsection (a), any member who accrued a benefit prior to July 1, 2004, based on annual compensation in excess of the limit set forth in section 401(a)(17) of the Internal Revenue Code of 1986, as amended, shall receive a nontax-qualified benefit equal to the difference between:

(1) The pension benefit that would be payable at the earliest age the member could retire with an unreduced benefit, based on the member's years of credited service and the member's average final compensation as of June 30, 2004, without regard to the limit under section 401(a)(17); and

(2) The tax-qualified pension benefit that would be payable at the earliest age the member could retire with an unreduced benefit, based on the member's years of credited service as of June 30, 2004, and the member's average final compensation as limited by section 401(a)(17) as of the earliest age the member could retire with an unreduced benefit, or, upon the member's termination of service, if earlier.

(c) The nontax-qualified benefit under subsection (b) shall be determined and paid in a single lump sum within the time required to meet federal tax withholding and reporting obligations for the first year the benefit is taxable. The lump sum shall be the actuarial equivalent of a single-life annuity payable at the earliest age the member could retire with an unreduced benefit, assuming that the compensation limit in effect under section 401(a)(17) at the time the benefit is taxable will increase two per cent annually. The actuarial equivalent of the single-life annuity shall be calculated on the following assumptions:

(1) An eight per cent discount rate;

(2) The 1994 Group Annuity Mortality Static Table (Males and Females), published in the Transactions of the Society of Actuaries 1995, vol. 47 (table 18), using a blended mortality table that is a fifty per cent-fifty per cent blend of the 1994 Group Annuity Mortality table for males set back two years and the 1994 Group Annuity Mortality table for females set back one year; and

(3) A two and one-half per cent simple interest cost of living adjustment to the original annuity.

(d) At the earliest age the member could retire with an unreduced benefit, or, upon the member's termination of service, if earlier, the member shall be entitled to an additional payment if the actual compensation limit then in effect under section 401(a)(17) is less than the limit that was assumed to be in effect under subsection (c) as of the date that was assumed to be the member's unreduced retirement age. Such additional payment, if any, shall be the difference between:

(1) The benefit that would have been paid under subsection (c) if the member's unreduced retirement age and the actual section 401(a)(17) limit in effect at the earlier of the member's unreduced retirement age or termination of service had been known and used; and

(2) The benefit that was paid under subsection (c).

The amount of any additional payment shall be adjusted for interest at eight per cent from the date of payment under subsection (c) to the date of payment under this subsection.

(e) The nontax-qualified benefit shall be administered by the board of trustees; provided that:

(1) State members shall be paid with funds appropriated from the State's general revenues; provided that the University of Hawaii and the departments and agencies subject to section 88-125 shall reimburse the State for the respective amounts payable on account of the employees of the University of Hawaii or in such departments and agencies; and

(2) County members shall be paid by the respective counties pursuant to assessments made and received by the system.

(f) Section 88-91 shall apply to the nontax-qualified benefit."

SECTION 3. There is appropriated out of the general revenues of the State of Hawaii the sum of $369,350 or so much thereof as may be necessary for fiscal year 2004-2005 to carry out the purposes of this Act, including pension payments and administrative expenses.

The sum appropriated shall be expended by the employees' retirement system of the State of Hawaii for the purposes of this Act.

SECTION 4. New statutory material is underscored.[1]

SECTION 5. This Act shall take effect on July 1, 2004; provided that Section 2 shall take effect retroactive to July 1, 1996.

(Approved July 7, 2004.)

Note

1. Edited pursuant to HRS §23G-16.5.