WRITTEN ONLY

TESTIMONY BY KALBERT K. YOUNG
DIRECTOR, DEPARTMENT OF BUDGET AND FINANCE
STATE OF HAWAII
TO THE SENATE COMMITTEE ON JUDICIARY AND LABOR
ON
HOUSE BILL 805 H.D.1

March 19, 2013

RELATING TO FEDERAL TAX QUALIFICATION OF THE EMPLOYEES' RETIREMENT SYSTEM

House Bill No. 805, House Draft 1, makes technical amendments to Chapter 88, Hawaii Revised Statutes, relating to Pension and Retirement Systems in order to comply with Internal Revenue Code requirements and pre-ERISA vesting rules that are necessary to maintain the Employees' Retirement System's status as a tax-qualified plan.

The Department of Budget and Finance strongly supports this Administration bill because it will enable the Employees' Retirement System (ERS) to complete the favorable determination letter process with the Internal Revenue Service that is a necessary requirement to ensure that the ERS meets the federal tax qualification requirements that are applicable to governmental plans sponsored by state and local governments

TESTIMONY BY WESLEY K. MACHIDA
ADMINISTRATOR, EMPLOYEES' RETIREMENT SYSTEM
STATE OF HAWAII
TO THE SENATE COMMITTEE ON JUDICARY AND LABOR
ON
HOUSE BILL NO. 805, H.D. 1

MARCH 19, 2013

RELATING TO FEDERAL TAX QUALIFICATION OF THE EMPLOYEES' RETIREMENT SYSTEM

Chair Hee, Vice Chair Shimabukuro and Members of the Committee:

H.B. 805, H.D. 1, proposes to amend sections 88-73, 88-83.5, 88-281 and 88-331 of chapter 88, Hawaii Revised Statutes ("HRS") to complete the favorable determination letter process with the Internal Revenue Service.

The Employees' Retirement System of the State of Hawaii (ERS)is a tax-exempt, qualified retirement plan under section 401(a) of the Internal Revenue Code (Code). If the ERS should 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 income 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.

In 2009, the ERS submitted a request to the Internal Revenue Service to review and determine whether the language of the plan (i.e., the language of the statutes and administrative rules governing the ERS) meets the federal tax qualification requirements applicable to governmental pension plans. On March 21, 2012, the Internal Revenue Service issued a favorable determination letter (that the ERS continue as a tax-exempt organization) approving the language of the plan. The determination letter was specifically conditioned on the State's adoption of proposed amendments that the Internal Revenue Service had reviewed and approved as part of the determination letter process. The proposed amendments must be adopted to complete the determination letter process and enable the ERS to maintain its tax-exempt status.

The two proposed amendments are described as follows:

1. The Employees' Retirement System proposed technical amendments to section 88-83.5, Hawaii Revised Statutes, to comply with final regulations under section 415 of the Internal Revenue Code, which were effective with respect to the Employees' Retirement System on January 1, 2009.

   Generally, section 415 of the Internal Revenue Code provides a dollar limit on the annual benefit that may be paid to a member of the Employees' Retirement System. In calendar year 2013, the dollar limit is $205,000 for a member commencing retirement benefits between ages 62 and 65. The dollar limit is adjusted (increased) as the cost of living increases. Subject to certain exceptions for police officers and firefighters, actuarial adjustments are required for members retiring prior to age 62. The Internal Revenue Service approved the proposed amendments to section 88-83.5, Hawaii Revised Statutes, as part of the determination letter process. The proposed amendments must be adopted to complete the determination letter process.

2. The Internal Revenue Service requested amendments to sections 88-73, 88-281, and 88-331, Hawaii Revised Statutes, to meet certain vesting rules that were applicable to tax-qualified retirement plans prior to the enactment of the federal Employee Retirement Income Security Act on September 2, 1974. Those vesting rules require that a member's right to the member's accrued retirement benefit be fully vested (i.e., non-forfeitable) upon the attainment of normal retirement age and the completion of any required years of service and any other reasonable requirements set forth in the plan. In response to the Internal Revenue Service's request for amendments, the Employees' Retirement System proposed amendments to sections 88-73, 88-281, and 88-331, Hawaii Revised Statutes, that were intended to meet the technical requirements of the Internal Revenue Service's request but not change in any way the benefits provided under chapter 88, Hawaii Revised Statutes.

As the Internal Revenue Service has approved the proposed amendments and specifically conditioned the favorable determination letter on the State's adoption of the proposed amendments, the Board of Trustees of the Employees' Retirement System supports the passage this bill.

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