

LEGAL MEMORANDUM

To: AURORA POLICE MONEY PURCHASE PENSION PLAN TRUSTEES

From: MCNALLY AND BOWERS, P.C.

Re: PURCHASE OF PAST SERVICE CREDITS IN FPPA DEFINED
BENEFIT PLAN

Date: 4-25-05

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The Plan has provided us several questions of law regarding the purchase of FPPA past service credits under CRS Section 31-31-410 and Section 415(n) of the Internal Revenue Code of 1986 (hereinafter the "Code").

Code Section 415(n) provides generally as follows:

1. If an employee makes one or more contributions to a defined benefit governmental plan to purchase permissive service credit under such plan, such contributions are subject to the defined benefit plan limit under Code Section 415(b), determined by treating the accrued benefit derived from all of the employee's contributions to purchase such past service credit, so long as the employee voluntarily contributes to the plan an amount (as actuarially determined by the plan) that does not exceed the amount necessary to fund the benefit.

2. A plan fails to meet the requirements of Code Section 415(n) if either (a) more than five years of past service credit attributable to "nonqualified service" are taken into account, or (b) any past service credit attributable to nonqualified service is taken into account before the employee has "at least five years of participation under the plan."

3. "Nonqualified service" is service other than (a) service for a governmental employer, (b) service as an employee of an educational organization, (c) service as an employee of an association of governmental employees, or (d) military service (other than Code Section 414(u) military service).

4. Service for a governmental employer, an educational organization or an association of governmental service will be considered nonqualified if "recognition of such service would cause a participant to receive a retirement benefit for the same service under more than one plan."

CRS Section 31-31-410 contains provisions somewhat similar to Code Section 415(n), as follows:

5. CRS Section 31-31-410(1) provides that a member may *purchase* service credit or be *granted* service credit upon the "qualified roll over of distributions" from another plan for other public employment within the U.S. not covered by the statewide defined benefit plan (the "FPPA DB Plan"), subject to the following:

a. The member must have "at least one year of continuous service credit with the same employer covered by the statewide defined benefit plan."

b. The member must verify that he will not receive a benefit from any retirement plan covering such employment and that the service credit to be granted "has not vested with that plan, except to the extent required by federal law."

c. The member must "pay or transfer" to FPPA "the cost of such service credit", as calculated by the FPPA board on an actuarially equivalent basis.

6. CRS Section 31-31-410(2) allows a member to *purchase* up to five years of service credit of periods of active duty in the military, subject to the same one year requirement of CRS Section 410(1) set forth in paragraph 5a above, the same non-duplicative benefit requirement set forth in paragraph 5b above, and a similar requirement as set forth in paragraph 5c above, except that the member must "pay" to FPPA the cost (not "pay or transfer", as CRS Section 410(1) requires).

7. CRS Section 31-31-410(2.5) provides that a member may *purchase* up to five years of service credit or be *granted* up to five years of service credit upon the "qualified roll over of distributions" from another plan for private employment in the U.S., subject to the exact same requirements as in CRS Section 410(1) set forth in paragraph 5 above.

8. CRS Section 31-31-410(3) provides that "any service credit purchased under this section must cover a period of one year or longer."

The first question posed to this firm asks whether each of the subsections under CRS Section 31-31-410 requires some period of service with the employer *after the conversion* by the employer to the FPPA DB Plan before a participant is eligible to purchase service credit under the FPPA DB Plan. More particularly, we've been asked if that one year of service after the conversion is required before eligibility to purchase credit for prior governmental service or prior military service and five years of service after the conversion is required before eligibility to purchase credit for prior private employer service.

It is our opinion that such subsections are problematic for the FPPA DB Plan under Code Section 415. However, we believe that such subsections require either one year or five years, as the case may be, of continuous service with the City of Aurora before eligibility to purchase service credits, which continuous period of service can be either *before or after* the date of conversion to the FPPA DB Plan. Unlike Code Section 415(n), there is no language in the FPPA state statutes that indicates that such period of

service with the employer covered by the FPPA DB Plan must be *after* the date of conversion. Code Section 415(n), for example, provides expressly at Section 415(n)(3)(B)(ii) that no nonqualified service may be taken into account until the employee has at least five years of "participation" under the plan. We therefore believe that the FPPA state statutes allow such one year or five year period of continuous employment to be either before or after the conversion to the statewide DB Plan.

Our position set forth in the above paragraph, however, logically leads us to the opinion that the provisions of the FPPA state statute are contrary to the Code Section 415(n) requirements with regard to nonqualified service (i.e., past service for private employers or for past government or military service that has become "nonqualified" under Code Section 415(n) because of receipt by a participant of a retirement benefit for the same service under more than one plan). The Code clearly requires five years of "participation" in the defined benefit plan that is granting the prior service credit before eligibility to purchase such prior service credit. The FPPA state statutes appear to allow purchase of such prior service credit for prior private employment after five continuous years of service *either before or after conversion*. Therefore, any purchase of nonqualified past service credit under the FPPA state statutes prior to the participant having participated in the FPPA DB Plan for five or more years would result in the FPPA DB Plan's violating Code Section 415, which would be a potentially disqualifying Plan violation

The Plan has also questioned what it believes to be the position of FPPA representative Lory Floyd, that a participant may purchase past service credit in order to satisfy the one year or five year continuous service requirement under CRS Section 31-31-410 (i.e., a participant may purchase past service credit to satisfy the eligibility requirements to purchase past service credit). There clearly is no express language in the Colorado statutes that indicates that the one year or five year eligibility service requirements may be satisfied by the purchase of past service credits prior to the satisfaction of such eligibility requirements. In addition, it is even more clear that such practice would violate the provisions of Code Section 415(n)(3)(B)(ii) that expressly require five years of *participation* in the statewide DB Plan before eligibility to purchase nonqualified past service credit. We believe that an argument that the purchase of five years of past service credits would in some manner satisfy the Code's five year participation requirement is totally unsupportable under even the most strained of statutory interpretations.

The Plan's last request for guidance involves the flush language at the end of Code Section 415(n) that provides that service for a governmental employer, an educational organization or an association of governmental service, which is otherwise "qualified" service, will be considered nonqualified if "recognition of such service would cause a participant to receive a retirement benefit for the same service under more than one plan." There is similar language in each of CRS subsections 31-31-410(1), (2) and (2.5), that sets forth the following condition: the member must verify that the member "will not receive a benefit from any retirement plan covering such employment and that the service credit to be granted has not vested with that plan."

We understand that one could take the position that such language means that past service credit can only be purchased for past service that was not covered by a retirement plan. We believe that such argument would be without merit. The applicable language of Code Section 415(n) does not *prohibit* the purchase of past service credit if a participant receives a retirement benefit for the same service under more than one plan, but rather in such event the Code simply requires the conversion of such otherwise qualified past service into nonqualified past service. This means that in such event a participant is limited to a purchase of no more than five years of such nonqualified service credit and must participate in the FPPA DB Plan for five years before any such purchase.

Likewise, CRS subsections 31-31-410(1) and (2.5) both provide for the purchase of past service credit by a member's "roll over of distributions from an eligible plan." Therefore, the FPPA state statute clearly contemplates the purchase of past service credit with funds from a prior employer's eligible retirement plan.

In addition on this issue, though the applicable language of both the Code and the Colorado FPPA statutes is not clearly written, we believe that a participant's purchase of past service credits under the FPPA DB Plan with funds rolled over into such Plan from another qualified retirement plan does not constitute a prohibited "receipt of a benefit" under both plans for the same service. We believe the stronger argument is that by rolling such funds into the FPPA DB Plan, and then using such funds to purchase past service credit, a participant is not "receiving a benefit" under the prior employer's plan, because the participant does not *receive* such funds for his or her personal use and benefit. Rather, as the legislative history of the applicable Code provisions suggests, such funds are being used merely to facilitate "portability" of pension benefits *from one plan to another*. In other words, the participant is giving up his or her benefits under the prior plan in exchange for the increased benefits under the FPPA DB Plan that the purchase of past service credit provides, in an amount actuarially equivalent to the benefits given up.

Note that if a member of the FPPA DB Plan were to contribute his or her own money into such Plan to purchase past service credit, rather than using a rollover of distributions from a prior employer's plan, then very clearly there would be duplication of benefits for the same service if the member received retirement benefits for such past service under a retirement plan of the prior employer that covered such member. However, it is our opinion that the provisions of CRS Section 31-31-410 would not allow such to occur. Each of subsections 31-31-410(1), (2) and (2.5) contains the requirement that a participant must verify that he will not receive a benefit from the prior employer's plan for the same service being purchased under the FPPA DB Plan.

It is **very important** to note further that both the Code and the FPPA state statutes require that the amount contributed to the FPPA DB Plan to purchase the past service credit may not exceed the amount necessary to fund the benefit attributable to the past service credit being purchased. CRS Section 31-31-410 provides that such amount is to

be calculated by the FPPA Board on an actuarially equivalent basis. This requirement leads to a possible scenario where the purchase of past service credits may not be available to a participant, as follows:

Assume a participant in the Aurora Police Money Purchase Pension Plan (the "MPPP") has performed ten years of service with the Police Department of the City of Aurora and has an account balance under such MPPP of \$100,000.00 at the date of the MPPP's conversion into the FPPA DB Plan. Assume further that the FPPA Board actuarially calculates that for such participant to purchase ten years of past service credit under the FPPA DB Plan for such prior service with the City, the cost would be only \$75,000.00, because of the actuarial factors used by FPPA. In such event, the participant may roll over into the FPPA DB Plan only the \$75,000.00 necessary to purchase the ten years of past service credit. The participant would then have \$25,000.00 still in his/her account under the MPPP that would be distributable to the participant. This appears to be a case where the participant will be receiving a benefit under both plans for the same service (i.e., he/she receives a full ten years of service credit under the FPPA DB Plan, but he/she is also receiving a \$25,000.00 distribution from the MPPP that is received for the same service).

Under Code Section 415(n), the above scenario in which the participant receives benefits from two plans for the same service would convert the participant's prior "qualified" service into "nonqualified" service. That means that the participant would be limited to a purchase of only five years of past service credit and only after being a participant in the FPPA DB Plan for five years. However, under CRS Section 31-31-410 it appears that the participant would not be allowed to purchase *any* past service credit because the member would not be able to verify that he/she "will not receive a benefit from any retirement plan covering such employment and that the service credit to be granted has not vested with that plan (i.e., the MPPP)." There appears to be no manner in which the participant under this scenario could somehow bring himself/herself within the "non-duplicative benefits" requirements set forth in CRS 31-31-410. If the participant purchases *fewer* years of past service credit, then he/she contributes less money into the FPPA DB Plan for such purchase, resulting in an even larger benefit being distributable to him/her from the MPPP for the same service for the City of Aurora. Alternatively, the participant is not allowed to use the extra \$25,000.00 in the MPPP (after the purchase of ten years of past service credit) to purchase additional service credit under the FPPA DB Plan. It was clearly not the intent of the drafters of either the Code provisions or the CRS FPPA provisions to allow a participant to purchase past service credit for years in excess of the actual number years in which past service was performed. Therefore, under this scenario, the participant is receiving benefits from both plans for the same service, which prohibits him/her under CRS Section 31-31-410 from purchasing *any* past service credits.