

# MEMORANDUM #24, 2012

Commonwealth of Massachusetts | Public Employee Retirement Administration Commission

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## MEMORANDUM

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Correction of Erroneous Employee Contributions

DATE: February 29, 2012

Questions have been raised as to the appropriate treatment of mistaken, excess member contributions to a retirement system under Chapter 32. These mistaken member contributions may occur for different reasons – erroneous compensation, a mistake in service purchase calculations, membership errors, etc. The Commission has consulted with its federal tax counsel to consider appropriate approaches to correct these mistaken contributions. Among these different approaches, tax counsel has advised that processing payments of mistaken contributions from the retirement system to the member, in the manner described below, would be a reasonable and administerable approach to correct these errors.

The amount of the mistaken contributions would be paid in a lump sum to the member as a "corrective distribution." The corrective distribution would be reported on a separate Form 1099-R for the year in which the corrective distribution is made, as follows:

<b>If the mistaken contributions were pre-tax (i.e., picked-up):</b>	
Box 1	total distribution amount
Box 2a	total distribution amount
Box 2b	blank (both boxes)
Box 4	10% withholding applies to taxable amount unless member elects no withholding
Box 5	blank

Box 6	blank
Box 7	Code E
<b><u>If the mistaken contributions were after-tax:</u></b>	
Box 1	total distribution amount
Box 2a	blank
Box 2b	blank (both boxes)
Box 4	10% withholding applies to taxable amount unless member elects no withholding
Box 5	contributions amount
Box 6	blank
Box 7	Code E

For all of these mistaken employee contribution corrective distributions, the following rules are applicable:

- The 10% early distribution penalty under Code Section 72(t) does not apply.
- The 10% withholding rule under Code Section 3405 applies, unless the member elects no withholding.
- FICA and FUTA do not apply.
- The distribution is not a required distribution.
- The distribution is not eligible for rollover.
- No amount of the distribution is considered a recovery of part of the member's basis.
- If there are both pre-tax and post-tax excess contributions being returned, they may be combined and reported on one Form 1099-R for the year of distribution.

Also, it may be helpful to send a letter to the member explaining that a Form 1099-R is being issued for a return of employee contributions which were not authorized under Massachusetts law, and that Code E was used in Box 7 because the system is following the principles of Revenue Procedure 92-93 in making this corrective distribution.