MEMORANDUM #37, 2007

Commonwealth of Massachusetts | Public Employee Retirement Administration Commission
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M E M O R A N D U M

TO: All Retirement Boards

FROM: Joseph E. Connarton, Executive Director

RE: Exclusion from Gross Income of Payments for Health Insurance Premiums and Other Provisions of the Pension Protection Act of 2006

DATE: September 25, 2007

The provisions of the **Pension Protection Act of 2006** ("PPA") include several sections of special interest to public retirement plans. The section that has generated the most interest is § 845 of the Act, which adds a new subsection to the Internal Revenue Code [26 USCA § 402(l)]. This provision allows eligible retired public safety officers to exclude from their gross income an amount up to $3,000 that is deducted from a taxable retirement allowance for health insurance premiums or long term care insurance contracts.

EXCLUSION FROM GROSS INCOME OF PREMIUMS WITHHELD AND PAID TO HEALTH INSURANCE CARRIERS

Which retirees are eligible for this exclusion?
Public safety officers who retired for disability or who retired after having attained "normal retirement age." The term "normal retirement age" means the age that a member can retire with an unreduced benefit. Normal retirement age for Group 4 members is age 55, while for Group 1 it would be 65.

What is the definition of "public safety officer"?
The definition of "public safety officer" is not necessarily consistent with the provisions of G.L. c. 32 or any provision of the Massachusetts General Laws, but is specifically governed by the PPA. The PPA adopts the definition contained in the Omnibus Crime Control and Safe Streets Act of 1986 [42USCA § 3796b(9)(A)]. Under this definition, a "public safety officer" is an individual serving a public agency in an official capacity, with or without compensation, as a law enforcement officer, as a firefighter, as a chaplain, or as a member of a rescue squad or ambulance crew.

What premiums can be excluded from gross income?
Distributions withheld from the taxable portion of a retirement allowance that are withheld from an eligible retiree's allowance and paid directly from a retirement system to a health insurance provider or to a long-term care insurance provider.

How much can be excluded from taxable income?
The maximum exclusion is the lesser of the actual premiums paid by the Board or $3,000. If a Board withholds premiums for more than one insurance carrier, the total aggregate amount excludable is $3,000. Members cannot exclude premiums that they pay directly to an insurance carrier.

How will retirees claim the exclusion?
The most recent information from the IRS indicates that the member will be required to report the exclusion on his or her IRS Form 1040. The excludable amount will not be reflected separately on the 1099R issued to the retiree. The instructions for the 2007 1040 are not available at this time. As soon as they are developed, further information will be provided.

Is a survivor of an eligible retiree eligible for the exclusion?
The exclusion is only available to eligible retirees.

What is the Retirement Board's responsibility to its members regarding the exclusion?
Retirement Boards have no mandated role in the implementation of this section of the PPA, but will be expected to assist members who are entitled to the exclusion by advising them of the amount that has been deducted from their allowance and paid to a health insurance provider or to a long-term care insurance provider.

Retirees with questions should be directed to their personal tax advisor for individualized advice about the exclusion.

OTHER RELEVANT PROVISIONS OF THE PENSION PROTECTION ACT OF 2006

Section 829 of the PPA adds non-spouse beneficiaries to the individuals who can make a direct trust-to-trust rollover without income tax withholding. The trust to which the distribution is transferred must identify the deceased member and the beneficiary. The example used in the IRS Notice 2007-7 is "Tom Smith as beneficiary of John Smith." Boards are not required to offer a direct rollover to non-spouse beneficiaries, but if such rollovers are offered, they must be offered to all non-spouse beneficiaries.

Section 822 of the PPA allows defined benefit plans to accept direct rollovers of after tax dollars from qualified retirement plans. The after-tax dollars and interest accrued on these funds must be accounted for separately. The current regulations do not allow for this sort of rollover, so until such time as the regulations are amended, Retirement Systems can only accept pre-tax rollovers.

The Pension Protection Act is more fully discussed in IRS Notice 2007-7 http://www.irs.gov/irb/2007-05_IRB/ar11.html#d0e2107. When the 2007 1040 Form Instructions are available, more information will be provided.

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