

# Update

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## TEACHER RETIREMENT SYSTEM OF TEXAS

### ***TRS Board work session in Lubbock to be webcast February 15-17***

TRS trustees will hold their annual work session in Lubbock this year. The board holds work sessions once every year for the purpose of taking an in-depth look at the most important issues facing TRS and how best to address them. This year's meeting will take place February 15 through 17 at the Region 17 Education Service Center, 1111 West Loop 289, in Lubbock.

All three days will be webcast live from the TRS website ([www.trs.state.tx.us](http://www.trs.state.tx.us)). After the meetings conclude, recordings of the meeting will be posted on the website for future viewing on demand.

Meeting topics will include a review of TRS investments, discussion of the pension fund and retiree health benefit program sustainability studies now in progress, financial management and budget planning, workforce continuity, the TRS Enterprise Application Modernization (TEAM) Program, and board training and operational matters.

On Thursday morning, Feb. 16, the board will receive a presentation on the status of a pension fund study, which has been required by the Texas Legislature. This presentation will include a panel discussion on pension fund issues and will address the various features of pension funds and the wide range of options being undertaken by public and private pension funds to achieve the purposes for which they were established. **During this discussion on Feb. 16, the board will entertain questions from those at the meeting as well as those viewing the webcast. The TRS website will feature instructions on how to submit questions electronically during the webcast.**

Following the pension study discussion, the board will receive a presentation on another study mandated by the Texas Legislature – this one on ideas for the long-term sustainability of TRS-Care, the TRS retiree health benefit program. As with the pension fund discussion, trustees will accept questions from those attending the meeting as well as anyone viewing the webcast.

Thank you for sharing this information with your employees. For further details, please visit the link on the TRS website at [www.trs.state.tx.us](http://www.trs.state.tx.us).

### ***Important information for employers with qualified retirement plans***

Employers that sponsor qualified retirement plans of their own should be aware that state law establishes the TRS retirement plan as the primary plan when there is more than one plan covering employees. This law is important to the administration of an employer-sponsored plan because it could affect the benefits payable from the employer's qualified defined benefit plan or the annual contributions that may be made to the employer's qualified defined contribution plan.

Contributions made to TRS for service credit purchase *and* made to an employer's qualified defined contribution plan *must be aggregated to determine whether the total annual contributions are within federal tax law limits.* See TRS rule 34 TAC §29.51. The general contribution limit for the Sept. 1, 2011 through Aug. 31, 2012 plan year is \$49,000 or 100% of compensation, whichever is less. If aggregated contributions would exceed the applicable limit, TRS members may be able to use installment payments or rollovers for service purchases to keep aggregated annual contributions within the limits. However, if aggregated contributions exceed the applicable limit, then contributions to the employer plan may need to be reduced.

For employers with defined benefit plans, Section 825.506, Texas Government Code, states that an employer may not provide employee retirement or deferred benefits that, when considered together with TRS benefits as required by federal law, would result in the TRS plan failing to meet federal qualification standards as applied to public pension plans. The benefit limits in Section 415(b) of the Internal Revenue Code are part of the standards that TRS must meet to maintain plan qualification and favorable tax treatment, such as deferral of federal income

tax on salary contributions to TRS until benefits are paid.

Section 415(b) establishes limits on annual benefit payments by qualified defined benefit plans. *When an employee will receive benefits from more than one qualified defined benefit plan covering the same employment, the limits apply to the aggregated benefits.* The Section 415(b) limit is \$195,000 for the 2011-2012 plan year, with lower limits applicable for retirement before age 62.

Because state law establishes the TRS defined benefit plan as primary, TRS compares only a member's TRS benefits to the federal limits to determine whether the benefits will be within the federal benefit limits at and during retirement. If an employer's own defined benefit plan also pays benefits to a retired employee, then under Section 825.506 the employer must take into account the TRS benefits to be sure that the aggregated benefits do not exceed the Section 415(b) limits.

To determine whether an employer's plan is affected by the limits on benefits or annual contributions, the employer should contact the plan administrator or the tax advisor for the plan. TRS maintains no information on employer plans. Also, due to confidentiality requirements, any individual TRS contribution amounts or benefit amounts that an employer's plan administrator may need to consider in comparison to the applicable limits must be obtained directly from the covered employee.

### ***Update on IRS proposal on defining "governmental" retirement plans***

TRS has received inquiries about a proposal by the Internal Revenue Service (IRS) to establish new standards for determining whether a retirement plan is a *governmental* retirement plan. The preliminary proposal is designed to clarify the types of entities and employees that may be covered by a governmental retirement plan.

The proposal, designated as Advance Notice of Proposed Rulemaking ("ANPRM") REG – 157714-06, was issued in November 2011. Through this proposal, the IRS and the U.S. Department of Treasury are soliciting public comment before issuing proposed and then final regulations.

The IRS recently extended its public comment period on this proposal. Comments now are due on June 18, 2012. You can find more information about this ANPRM through the IRS website, [www.irs.gov](http://www.irs.gov).

As a governmental plan, TRS is monitoring the development of these new standards to determine how our membership and covered employers may be affected, in particular those in the charter school community. It is very early in the process, so at this time TRS cannot evaluate the actual impact of this IRS project on our membership. We will provide more information as the IRS moves forward.

### ***Using TRS retirees as substitutes***

TRS service retirees are allowed to work an unlimited number of days as substitutes without forfeiting any monthly annuities. Disability retirees may work up to 90 days as a substitute without forfeiting any monthly annuities. Surcharges that are owed for the employment of retirees who retired September 2005 and after are also avoided because substitutes are not eligible for membership in TRS.

Please note that the definition of a substitute for TRS purposes does not allow a retiree to serve in a vacant position. For purposes of employment after retirement, a substitute is a person who serves on a temporary basis in the place of a *current* employee. ***If the position the retiree is filling is vacant, the retiree cannot be considered a substitute for employment after retirement purposes.***

If the position is vacant and if the retiree retired before January 2011, the retiree is considered a full-time employee but now the retiree can work without limit. The surcharges will apply if the retiree retired September 2005 or after and the position the retiree is filling is eligible for membership in TRS. In other words, if the retiree is working one-half time or more and is expected to work at least 4½ months or more the surcharges will apply.

Based on recent legislative changes, a retiree who retired in January 2011 or after can work in the vacant position for no more than one-half time without forfeiting any annuity payments. If, however, at the time of employment, the retiree has had a 12-full-consecutive-calendar-month break in all employment with any TRS-covered employer, the retiree can work any amount of time in the vacant position without forfeiting any annuity payments. If the retiree has not had a 12-full-consecutive-calendar-month break in all employment with any TRS-covered employer, the retiree can work no more than one-half time without forfeiting any annuity payments. If the retiree exceeds one-half time without having the required 12-month break in service, the retiree will forfeit the annuity payment for each month the retiree exceeds one-half time. Also, applicable surcharges will apply if the retiree is working one-half time or more for a period of 4½ months or more.

The reason the position is vacant does not matter. A retiree cannot be considered a substitute for TRS purposes if the position is vacant.

## ***Independent contractor or third-party entity?***

### **NEW TWIST**

In 2010 TRS became aware of a new twist in the independent contractor versus employee debate. The work arrangement involves a Texas Limited Liability Company that sells shares of its own stock to some TRS retirees and then the retiree in his/her capacity as shareholder of the company enters into a contract for services with a TRS-covered employer. The TRS-covered employer pays the company for the services provided by the retiree and the retiree is paid by the company. Retirees who purchased the shares of stock and entered into agreements with TRS-covered employers in their capacity as shareholders expected that they would be considered independent contractors rather than employees of the TRS-covered entities and thereby avoid the limits on employment after retirement. The TRS-covered employers expected to avoid paying the surcharges on the employment of the TRS retirees/shareholders.

TRS reviewed documents provided by the attorney for the limited liability company, including the company agreement with a shareholder, a sample contract between a shareholder and a TRS-covered employer as well as the attorney's responses to direct questions posed by TRS. Based on the documents and responses, TRS concluded that the company was a *third party entity* for TRS purposes and the retirees were employees of the "third party" entity, *not* independent contractors.

### **OLD HISTORY**

Since May, 2003 retirees employed by a third party entity and providing services to a TRS-covered employer are considered employees of the TRS-covered employer for the purposes of administering employment after retirement. A third party entity is an entity retained by a TRS-covered employer to provide personnel that perform duties or provide services that employees of the TRS-covered employer would otherwise perform. If a TRS retiree is employed by a third-party entity but working at a TRS-covered employer, the retiree must comply with the TRS plan terms regarding employment after retirement and must be reported to TRS on the *Employment of Retired Members Report*. Retirees who were first employed by the third party entity prior to May 24, 2003 and are working for the third party entity at a TRS-covered employer are not considered employees of the TRS-covered employer and may work without limit and without jeopardizing any monthly annuity.

### **RECENT CHANGES**

Recent legislative changes opened the door for retirees who retired prior to January, 2011 to work without limit for a TRS-covered employer. Retirees who retire January 2011 and after may work without limit for a TRS-covered employer only if they have a 12-full-consecutive-calendar-month break in service from any type of employment with all TRS-covered employers. Performing services for a TRS-covered employer through a third-party entity is considered employment with the TRS-covered employer and does not count toward this required break in service. Without this 12 month break in service, retirees who retired January 2011 and after may work as substitutes, one-half time, or a combination of substitute work and one-half time employment without forfeiting a monthly annuity payment. The six-month exception for full-time employment is no longer available.

### **SO, WHAT'S THE CATCH?**

It is true that an independent contractor is not an employee of the TRS-covered employer. As an independent contractor

- any annuity payments are not forfeited by the retiree;
- the months of work are counted toward the required 12-full-consecutive-calendar-month break in service (required for a retiree who retired January 2011 or after); and
- no surcharges are owed by the TRS-covered employer

However, being an independent contractor involves much more than just purchasing shares of stock in a company that includes the words "independent contractor" in its name. TRS recommends that the reporting entity and the retiree consult with their own attorneys about the requirements for independent contractor status and understand all aspects of the arrangement, including tax consequences, before deciding to contract for the services of the retiree as an independent contractor or shareholder. If you have questions regarding the agreement, contact TRS. State law gives TRS the authority to determine if the retiree is an employee of the TRS-covered employer or an

independent contractor. Don't risk the unexpected loss of retirement benefits that the retiree worked so hard to earn.

### ***More information about the standardized school year***

House Bill 2561, 82nd Leg., R.S. (2011), amended the definition of a "school year" for TRS purposes to mean a 12-month period beginning September 1 and ending August 31 of the next calendar year. This bill applies beginning with the 2012-13 school year. The change in the definition of school year will impact two factors in the calculation of benefits: compensation and service credit.

The TRS Board of Trustees recently adopted changes in the TRS rules that detail how TRS will apply the new definition of school year in determining the amount of annual compensation credited to a member. The change in the definition of school year will most likely affect 11- and 12-month employees whose contracts begin on July 1st or August 1st of each year. To implement the change in the law TRS will determine annual compensation for the 2012-13 and earlier school years either according to a 12-month period based on the member's "qualified" contract or work agreement, or on a September 1 through August 31 basis, whichever is most advantageous for a member with either an August through July contract period or a July through June period. In either case, no more than 12 months of compensation will be credited in one school year. Based on this information, **the MD40, Contract and Position Record will be required one more year (the 2012-2013 school year.)**

Annual compensation for the 2013-14 school year and later years will be credited on a September 1 through August 31 basis for all members.

TRS has received a number of inquiries regarding the need for 11- and 12-month employees to change their contracts to a standard year contract. TRS does not require the contracts to be changed. However, members who retire after August, 2013 should consider the most advantageous month for retiring to ensure that in the last school year (September 1st through August 31st) they receive credit for 12 months of compensation if that last year would be included in the final average salary. A member who has a non-standard contract and retires after August 31, 2013, will not have 12 months of compensation in the final year of employment if the member retires at the end of the contract period, i.e., June 30 or July 31.

**Please note that the above information applies ONLY to applying annual compensation. For the purpose of determining a year of service credit, the standard school year of September 1 through August 31 will apply beginning with the 2012-2013 school year. This means that one year of service credit will be earned for 90 days of service (in an eligible position) from September 1st through August 31st each year. In the last school year of service before retirement, a member serving in an eligible position who worked or received paid leave for less than 90 days in the school year but worked or received paid leave for a full fall semester in accordance with the employer's calendar will receive a year of service credit.**