



EMPLOYEE RELATIONS

BULLETIN

November 5, 1986

TO: ALL CITY EMPLOYEES

1986 TAX REFORM ACT-PENSION AND DEFERRED COMPENSATION IMPLICATIONS

The long awaited Tax Reform Act of 1986 has finally been adopted. As you have all no doubt heard by now it is not the tax simplification that was originally promised. The Act, which is hundreds of pages long, contains many provisions that affect the City and its employees. Although it will require months to understand its full implications, in the meantime there are provisions effective January 1, 1987 that could have a major effect on employees planning to retire or leave City employment around the end of this calendar year. If you are planning to do this, you should consider your decision carefully and recognize that there may be tax problems. The following items are the most likely to affect you:

1. Repeal of Three-Year Basis Recovery Rule

As of July 1, 1986 retirees are no longer able to recover on a tax-free basis their own previously taxed contributions during the first three years of benefit payments. Instead, your retirement will consist of two parts: (1) a portion of your contribution, which is not taxed, and (2) the City's contribution, which is taxed. The three-year rule is still in effect for state tax purposes.

Important: The tax reform bill contains a temporary rule for people retiring between 7/2/86 and 12/31/86. This should be considered by those planning to retire near the end of the year. (Contact your retirement system for details.)

2. Refunds of Retirement Contributions Before Age 59 1/2

This provision affects any employee who leaves City service prior to retirement and withdraws his or her own contributions from a retirement plan.

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Currently, all earnings on contributions are taxable. Also employee contributions that have not been taxed are taxable income (contributions to the City Employees' Retirement System after January, 1986 and to the Fire and Police Pension System prior to July, 1982).

After January 1, 1987, these refunds will be subject to a 10% excise tax, in addition to regular taxes, unless paid on account of death or disability. There is a special provision for employees who terminate before January 1, 1987 and receive their refund check by March 15, 1987.

Taxes are a very complicated business and the City cannot give personal tax advice, however, general questions concerning the above may be directed to your retirement plan office: Fire and Police Pension System, Ext. 54493; City Employees' Retirement System, Ext. 52821; Water and Power Retirement System, 481-4159.

Deferred Compensation Plan

The 1986 Tax Reform Act makes no major changes in the City's Deferred Compensation Plan. Employees may still contribute up to \$7500 yearly and defer taxes on those contributions. The plan can be used as a tax deferral alternative for City employees who will no longer be eligible to make tax deductible contributions to an Individual Retirement Account (IRA).

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