MEMORANDUM

To: Senate Judiciary Committee

From: Alan D. Conroy, Executive Director

Date: February 14, 2025

Subject: Informational Testimony on Senate Bill 237

Senate Bill 237 proposes using retirement accounts for child support payments in certain circumstances. As a qualified 401(a) governmental defined benefit retirement plan, SB 237 includes KPERS contribution accounts. While we understand and appreciate the intent of ensuring financial support for children, the bill presents legal challenges for the Retirement System.

Internal Revenue Code Issues

KPERS is a qualified 401(a) plan under the Internal Revenue Code. As a qualified plan, KPERS must adhere to the IRS rules and regulations governing governmental defined benefit plans to maintain its tax deferral status. Failure to comply with the federal tax law requirements for tax-qualified plans can jeopardize the Plan's qualified status, leaving the entire Plan in jeopardy. SB 237 has three policies that appear to contradict the Internal Revenue Code.

1. **Making in-service distributions without a distributable event.** Under federal law, and only if the plan provisions allow it, plan members may take money out of their retirement accounts while still working if they have reached normal retirement age or are at least 59½ years old.

   The Kansas Legislature has the power to amend the Retirement Act to allow early withdrawals at these ages, even if the person is still employed. However, Senate Bill 237 does not follow these rules. Instead, it requires retirement plans to dip into retirement accounts to make direct child support payments through the Kansas Payment Center at any time, without considering the usual age or employment restrictions.

   Distributions to members who have not reached normal retirement age or 59½ are not permissible under federal tax law.

2. **Taxability of payments.** For permissible distributions under a court order that KPERS may honor pursuant to federal tax law and the Plan's terms, the

distribution would be included in the member's gross income.

3. **No early withdrawal penalties.** Section 1(b)(2) in SB 237 states that these distributions are not subject to early withdrawal penalties.

   The early withdrawal penalty is found in IRC § 72(t), which also lists exceptions to the penalty. The distributions in SB 237, if otherwise permissible, must be subject to the early withdrawal penalty under federal tax law. <u>This is required reporting for KPERS</u>.

Actuarial Funding Implications
SB 237 permits the withdrawal of funds from a member's retirement account without altering the member's benefit entitlement. As a result, KPERS remains responsible for paying the full amount of any future benefits owed to the member, regardless of the withdrawals made for child support obligations.

This creates a funding gap, as KPERS would be required to absorb the cost of these distributions, effectively shifting the financial burden of the member's child support obligations onto the pension fund.

A potential solution would be for KPERS to process child support orders in a similar way to the current processing of Qualified Domestic Relations Orders (QDROs), which is to reduce a member's future benefit by an actuarial amount when payments are ordered to another party. If a similar mechanism were applied to garnished contributions, SB 237's approach could be more financially sustainable.

Courts in several states, including Florida, Illinois, Indiana, Iowa, Maryland, Missouri North Carolina, Ohio and Pennsylvania, have recognized QDROs to enforce one-time payments of past-due child support. However, KPERS' tax and compliance counsel, Ice Miller, is not aware of any court authorizing a child support orders due to income loss or child support orders for continuing monthly payments as proposed in SB 237.

Further study is required to ensure that a child support order could be applied in these situations.

I would be pleased to respond to any questions the Committee may have.