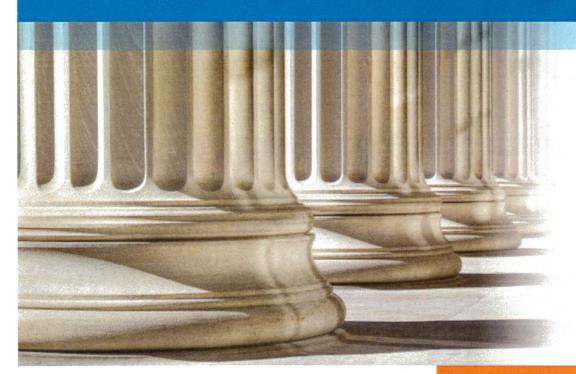
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Deferred Compensation and Final Average Salary



Presented by:

Alan Conroy, Executive Director

Phone: 785-296-6880

Email: aconroy@kpers.org

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Final Average Salary

Discussion topics

- "457(f)" deferred compensation
- IRS limits on annual contributions
- IRS limits on annual benefits



Final Average Salary

Compensation, salary and final average salary

Pension benefits are based on the formula

Final Average Salary X Years of Service X Multiplier =
Annual retirement benefit

- Final average salary is based on average of three to five years of "compensation" or "salary"
 - Depends on member's plan (e.g., KPERS or KP&F), tier, and membership date
 - Somewhat different statutory definitions of "compensation" and "salary"
 - Both "compensation" and "salary" definitions include all salary and wages payable to a member for personal services performed for a participating employer



Definitions

Treatment of tax-deferred benefits

- Statutory definitions of "compensation" and "salary" specifically include deferred compensation
 - Compensation is defined in K.S.A. 74-4902(9) to include amounts under sections 403(b) and 457 of the federal internal revenue code
 - Salary is defined in K.S.A. 74-4902(33) to include any amounts for tax sheltered annuities or deferred compensation plans and amounts under sections 403(b) and 457 of the federal internal revenue code
- 403(b) and 457 plans are voluntary personal savings vehicles offered by governmental and school employers on a tax-deferred basis



Deferred Compensation

457 plans

- A 457(b) plan offered by a governmental employer typically covers most, if not all employees
 - Any individual receiving a state paycheck is eligible for the KPERS 457 plan
 - Local employers may offer a 457(b) plan
- A 457(f) plan is used by employers to retain certain employees
 - Usually limited to particular key employees
 - The employer establishes and funds the plan in a contract with the employee
 - The employee does not receive any income until the end of the contract period



Deferred Compensation

457(f) plans

- Under KPERS' statutory definition of compensation and salary, 457(f) funds received at the end of the contract period are included
- Use is extremely rare out of about 90,000 retirements in the past 20 years, KPERS is aware of a maximum of 3 times in which 457(f) benefits were included in final average salary
- "Cap law" limits the effect of the 457(f) benefits on final average salary
 - If a member's compensation used in calculating his or her final average salary is more than 15% higher than the preceding year, the amount which exceeds the 15% is not included in compensation (7.5% for KPERS 2 members)
 - Therefore, the increase in a member's final average salary due to 457(f) benefits would be capped at 15% for KPERS 1 members and 7.5% for KPERS 2 members



Deferred Compensation

457(f) plans

- 457(f) benefits would have smaller impact on KPERS 3 cash balance plan benefits
 - KPERS 3 benefits are calculated based on account balances, rather than final average salary
 - KPERS 3 accounts reflect compensation earned throughout career – not the highest three to five years
 - Contributions on 457(f) benefits paid at or near retirement would earn interest for very limited period of time



Salary Limitations

IRS limits compensation subject to contributions

- The IRS sets a contribution limit based on annual earnings and membership date
 - Caps earnings on which contributions are made
 - Does not cap actual earnings
 - Higher limit if membership date is before July 1, 1996
- The IRS sets the limits for each calendar year
- Kansas has adopted the IRS limitation levels by statute



Salary Limitations

IRS limits compensation subject to contributions

Year	Membership date on or after July 1, 1996	Membership date before July 1, 1996
2015	\$265,000	\$395,000
2014	\$260,000	\$385,000
2013	\$255,000	\$380,000
2012	\$250,000	\$375,000
2011	\$245,000	\$360,000
2010	\$245,000	\$360,000
2009	\$245,000	\$360,000
2008	\$230,000	\$345,000
2007	\$225,000	\$335,000
2006	\$220,000	\$325,000
2005	\$210,000	\$315,000
2004	\$205,000	\$305,000
2003	\$200,000	\$300,000
2002	\$200,000	\$295,000
2001	\$170,000	\$285,000
2000	\$170,000	\$275,000



Benefit Limitations

IRS limitation on benefits

- The IRS also sets a maximum limitation on the gross annual <u>benefit</u> amount for a member
- The 2015 limit is \$210,000
- This does not include a lump sum payment as it is based on the single life annuity maximum