

MEMORANDUM

TO: Melanie Symons, Chief Legal Counsel , and Kate Talley, Legal Counsel,
Montana Public Retirement Administration

FROM: Mary Beth Braitman, Tiffany A. Sharpley, and Malaika K. Caldwell, Ice
Miller LLP

DATE: September __, 2014

RE: Montana PERS Compliance With Respect to *U.S. v. Windsor*

This Memorandum focuses on our analysis of the impact of the U.S. Supreme Court's *United States v. Windsor*, 570 U.S. 12 (2013), 133 S. Ct. 2675 ("*Windsor*") decision and Rev. Rul. 2013-17, subsequently issued by the Internal Revenue Service ("IRS") on the Montana Public Employees Retirement System (the "MPERS").

BACKGROUND ON WINDSOR

In *Windsor*, the Supreme Court ruled that section 3 of the Defense of Marriage Act ("DOMA") was unconstitutional. The holding by the Supreme Court and the IRS guidance provide that same-sex spouses who were married in a state that recognizes same-sex marriage must receive the same treatment as opposite-sex spouses for purposes of federal law in all states. The primary effect of this decision for the MPERS is that for federal tax purposes, a same-sex spouse must be treated the same as an opposite-sex spouse. The Supreme Court did not address section 2 of DOMA, which allows a state to decline to recognize the validity of same-sex marriages legally performed in other states for state purposes. This means that Montana can continue to distinguish same-sex spouses from opposite-sex spouses for certain benefit design purposes. In Rev. Ruling 2013-17, the IRS has taken the position that for federal tax purposes, the terms "husband and wife," "husband," "wife," "spouse," and "marriage," wherever used in the Internal Revenue Code ("Code") must be interpreted to include both same-sex spouses and same-sex marriages. In its ruling, the IRS adopted a "place of celebration" test for determining the validity of same-sex marriage for federal tax purposes.

We were asked to consider how the federal tax rules have changed in ways which impact the MPERS. The MPERS is required to follow federal tax law in order to maintain its status as a qualified governmental plan.

MPERS' TAX QUALIFICATION

The primary advantages in MPERS retaining its tax qualification status under Code Section 401(a) are that:

- employer contributions are not taxable to members as they are made (or even vested); taxation only occurs when plan distributions occur;
- earnings and income are not taxed to the trust of the member (until distribution);
- certain favorable tax treatment may be available to members when they receive plan distributions, e.g., ability to rollover eligible distributions; and
- employers and members do not pay employment taxes (even if the positions are Social Security covered) when contributions are made or when benefits are paid.
- the MPERS is currently exempt from many costly and cumbersome Employee Retirement Income Security Act of 1974 ("ERISA") nondiscrimination testing requirements;
- the MPERS may "pick up" employee contributions so that they are pre-tax when made; and
- the MPERS has favorable grandfathering and transitional rules under significant IRS guidance.

BASIS FOR OUR WINDSOR REPORT

We prepared our Report and analysis using the following listed below:

- Montana Constitution, Article XIII, Section 7;
- Montana Code Annotated ("MCA") Chapters 19-2 and 19-3; and
- Montana Administrative Rules § 2.43.

This Report entails an analysis of the impact of *Windsor* on the following the MPERS provisions. Each of the following provisions involved situations where Montana law provides for certain benefits or rights for spouses of members of the MPERS. In each case, we were looking for scenarios in which the provision could remain as it is currently, versus when it was affected by federal tax law and thus by the *Windsor* decision and subsequent IRS guidance. If you know of additional scenarios that may not be clear from the statute and administrative rules, please let us know:

- Beneficiary Designation Rules,
- Plan Rollovers,
- Benefit Limitations under Code Section 415,

- Record Confidentiality,
- Survivor & Death Benefits,
- Qualified Domestic Relations Orders (QDROs), and
- Required Minimum Distributions (RMDs).

AREAS OF ACTION NEEDED FOR COMPLIANCE

During our review of these areas, we grouped provisions into three categories: (i) pure federal law; (ii) pure Montana state law; and (iii) a combination of both federal and state law. We identified a number of common administrative areas that are impacted by *Windsor* that the MPERS may want to consider revising. These include potential review of the tax notices, retirement and survivor forms, QDRO forms, as well as handbooks and descriptions as discussed in the Addendum. However, as you are aware, there are court cases pending in all circuits that raise certain issues that we will not address here, because these issues have not been decided by the U.S. Supreme Court. There are areas described in our review that may need to be revisited depending on the outcome of those pending litigation cases. These are not discussed further in this memorandum. Our preliminary recommendations identify only those areas for the MPERS to consider at this time for action of some nature.

A. Rollovers

1. Basic Federal Law

Federal tax law gives rollover rights to recipients of lump sum distributions in qualified plans. Those rights allow non-spouse beneficiaries to rollover only to inherited IRAs. The rights for spouse beneficiaries, include rollovers to other qualified plans, 403(b) tax sheltered annuities, 457(b) deferred compensation plans, and regular IRAs. *Windsor* requires those broad rollover rights to be made available to same-sex spouses (as well as opposite-sex spouses) as of the effective date of the *Windsor* decision. (June 26, 2013).

2. Montana Law

- MCA 19-2-303(21) and (24); MCA 19-2-1011

3. Ice Miller Recommendations

- a. Rollover Forms – The MPERS forms must be reviewed to confirm that all rollover, death benefit, tax forms, and notices reflect the uniform spousal rollover language for both same-sex and opposite-sex spouses.

- b. Operational Procedures – The MPERS should review its operational rollover procedures to ensure that both same-sex and opposite-sex spouses are offered the spousal rollover treatment in accordance with Code Section 408 and Rev. Ruling 2013-17.

B. Required Minimum Distributions

1. Basic Federal Law

The minimum distribution rules under federal tax law requires distributions from a qualified plan to commence at certain times, and for options to conform to certain incidental death benefit rules. Those times vary depending on whether the benefit is payable to a spouse or non-spouse. *Windsor* requires that all spouses (both same-sex and opposite-sex spouses) be treated the same for these timing and form of benefit rules.

2. Montana Law

- MCA 19-2-908; MCA 19-2-1007

3. Ice Miller Recommendation

5-Year RMD Rule – For RMD timing purposes, MPERS must operationally treat both same-sex and opposite-sex spouses uniformly.

C. Benefit Limitations

1. Basic Federal Law

The Internal Revenue Code contains certain benefit limits that qualified plans must observe. In applying those IRS limits, spousal benefits are treated more favorably than other beneficiary benefits. This more favorable federal tax limit must be applied to all spouses who would otherwise be affected by the IRS benefit limit. This does not change the calculation of the benefit itself, it simply requires that the IRS benefit limitations be administered to treat all spouses the same for purposes of applying these federal tax limits.

2. Montana Law

- MCA 19-2-1001

3. Ice Miller Recommendations

- a. Code Section 415 Limits – The MPERS should confirm that proper protocols are in place to send benefit calculations to actuary (if that is who does ultimate IRC test) once benefit limits are hit.
- b. System Structure – The MPERS should confirm whether age-reduced limits are built into system.
- c. Actuarial Notice – The MPERS should advise actuary running limits, that all spouses (same-sex spouses and opposite-sex spouses) are treated the same.

D. QDROs

1. Federal tax law allows a qualified plan to honor "qualified domestic relations orders" and dictates the federal tax results of these orders.
2. Montana Law
 - MCA 19-2-907; MCA 19-2-909; MCA 40-5-201(13); and Montana Administrative Rules §§ 2.43.3001, 2.43.3008, and 2.43.3009
3. Ice Miller Recommendation

QDRO Taxation – The MPERS should follow federal taxation rules for reporting valid QDROs issued by courts. In addition, the MPERS should review QDRO procedures to ensure that administratively, QDROs received from out-of-state courts for both same-sex and opposite-sex spouses are processed according to established federal taxation rules for spouses.

We look forward to reviewing these materials with you.

Attachment: Montana PERS Post-*Windsor* Analysis

From: Caldwell Malaika [Malaika.Caldwell@icemiller.com]
Sent: Friday, September 05, 2014 12:05 PM
To: Symons, Melanie; Talley, Kate
Cc: Braitman, Mary Beth; Sharpley, Tiffany; Caldwell Malaika
Subject: Montana PERS - Windsor Chart of Action
Attachments: INDY-#3772857-v2-Montana_PERS_-_Post-Windsor_Chart_of_Action_Items-c.DOCX; INDY-#3779093-v3-Montana_PERS_-_Memo_re_Windsor-c.DOCX

Hi Melanie and Kate,

Attached you will find a post-*Windsor* chart of action that we have prepared for the Montana Public Employees Retirement System ("MPERS"). We have also prepared a memorandum which provides further detail on the background and the impact of the *Windsor* decision on MPERS.

Upon your review, we would like to schedule some time with you to discuss. Thanks.

Mary Beth, Tiffany, and Malaika



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Montana Public Employee Retirement Administration
Table of General Revisions Legislation to be Considered for 2015
 Last update 09/23/2014

Current Code Section	Completed	Proposed Change	Reason	Notes	Responsible Person
15-30-2618(7)(c)	x	Add allowance for DOR to provide income info to us to audit disability earnings statements	Dept of Revenue	Revenue will support but not include in their own bill	Kate
***19-2-405(1)		Enrolled actuary — delete enrolled	Steve's comments to Barb	Do we want to change to a lesser standard? Cannot capitalize member as per legislative standards, Leave as is	Barb
***19-2-405(4)(b)	x	Strike 19-21-203 and replace with 19-21-214	Codification error not caught in 013. Sheri Scurr requests we add to General Revisions bill (we will want to compare with whatever we do with the ORP PCR)		Melanie
19-2-505 19-3-2141		Authority to collect overpayment on DC disabilities	authority to collect if overpayment occurs if account stop dates are not entered correctly	KT moved proposed change from 19-2-505 to 19-3-2141 in 8/11/14 draft	Patty/Kate
19-2-602		Increase amount requiring mandatory distribution to \$1,000 or \$ 5,000	See 3/19/13 PlanSponsor article addressing time, cost and risk to plan for administering accounts of \$5000 or less in ERISA subject accounts – (increased audit risk, resources to track them down and keep sending them annual statements)	is it in the member's best interest. revisit in 2017. Try reaching via annual statements 1st.	2017
19-2-702		Clarify what is required for membership services	confusion with 1st working date vs. pay date starting the membership clock	rule in PERIS to clarify that there should membership service from 1st day of work. ARM 2.43.2101, 2.43.2114. Leave on chart until discussion with core team	Melanie

Current Code Section	Completed	Proposed Change	Reason	Notes	Responsible Person
19-2-801	X ?	1) address process shift away from "membership cards" to forms 2) clarify (3) to indicate the old pre-terminated membership card is only good until they complete a new card upon reinstatement?		2. added 7/10/14 following audit finding – agreement change needed or leave as is?	Kate
19-2-902(2)(a)		Research. It used to say "if < \$5,000", why was it amended in 2009	lump sum v. benefit requirements of the IRS	Research	Melanie/Patty
***19-2-902(3)		Consider whether to stop entire benefit for month of death or to forgive payout of that month's benefit – preferably the former	Too much time and energy spent attempting to recover payouts after death	Melanie to talk to John about steering committee in which this was discussed.	Kate
19-2-903		strengthen ability to collect overpayments following a death	No authority to collect on overpayments	Not ok in General Revision bill per Kate consult with Ginger .	2017
19-2-904		insurance withholding issue	Add contingent annuitants/spouses Retain payment to insurance provider if possible	We pay their premium too, if they are covered by deceased member's employer's insurance <i>Paying carrier directly creates complications w/ getting \$ back and when carrier changes – Paying only ER may eliminate issue. See TRS gen revisions 19-20-1101. - KT</i>	Melanie
19-2-907	?	allow reference to confidential disclosure statement (CDS)	requires FLO to include sensitive info, policy shift to protect individual privacy	909 does not include req for SSN <i>Upon researching issue further determined CDS docs are not required to be filed unless parties are subject to a child support order. Options: (1) leave statute as is and include statement in our FLO packet and templates about ability to redact/file under seal OR (2) add provision to statute requiring parties to file document with Board containing SSNs before FLO will be considered.</i>	Kate

Current Code Section	Completed	Proposed Change	Reason	Notes	Responsible Person
19-3-412/19-3-1106		clarify membership for "member" elected to positions and exceeding 960 hours	discussion @ 05/3/13 leg meeting	Patty to research notes from 5/3/13 meeting, June may have notes from that meeting.	Patty
19-3-412(1)(d)		10 months		talk to Leslie Bergman or Susan Fox to see if they still want the change possibly 6 months instead of 10	Melanie
19-3-412(8)(a)		Determine whether an employee who declined membership in an OME position and who stays in that position and accepts another OME position with a different employer should have an election	Townsend audit	Fallon says 30 day break in service required. Changed law in 2009 to avoid excessive elections	?
19-3-904 (3)	X	double of the member's accumulated contributions not entirely accurate	current process removes service purchases before the amount is doubled	Strike "accumulated contributions" replace with "regular contributions and interest"	Patty, Sheri & Marjorie
19-3-1103		annual or monthly reporting for disabilities recipients	line of business	No change (remove from table)	Patty/Sarah
19-3-1105		Benefit upon 2nd retirement	need concrete calculation assistance for members on a second retirement	We need to determine: (1) if the 2 nd rtmt benefit should be calculated only based on new service credit, new compensation, new factor and added to first retirement benefit; and (2) whether they have to be vested; OR (3) whether we should treat them as a new member based on laws in effect when they go back to work with a distinct 2 nd benefit	Patty
19-3-1106		limits 960 hours - internally we only count hours worked, not hours paid	statute provides for employment not to exceed 960 hours, rule states " does not work more than 960 hours"	Steering committee determined to continue past practice in LOB design but will revisit in future to correct. Legis change necessary?	2017

Current Code Section	Completed	Proposed Change	Reason	Notes	Responsible Person
19-3-1106	?	clarify reporting requirements for elected officials that opt out	need to include them in the NCE reporting.	(5) excludes them from reporting requirement – but still need to be included in NCE (ie. the following members are subject to NCE...but not (3) reporting requirements) Review ARM 2.43.2114(8) <i>Proposed change ok? Will include both elected officials opting out of membership AND retirees over 70.5 on NCE report – which seems to jive with ARM but would be a business process change</i>	Kate
19-3-1204(1)(c),		90 day limit for requesting survivorship benefit	LOB use case 801		Melanie
19-3-1210(3) & rest of systems, 19-2-406(5), 19-2-303	19-5-802; 19-7-?? 19-8-1002;	explain why it doesn't apply to disabilities	if not converted, no deductions from accumulated contributions	definition of ancillary,	Melanie
19-3-1501(5) 19-5-701(5), 19-7-1001(5), 19-8-801(5),		If member dies after retirement and w/in 30 days from the date the member's written application electing/changing an election of an optional retirement is received, then the election is void. Need to require a beneficiary designation.	PERIS review discovered that (5) is internally inconsistent – “after retirement and within 30 days from date of application” Should say "before receiving and accepting their first benefit check” – Ref 19-2-801 and notes in folder.	904JADQ and Research Q.	Melanie

Current Code Section	Completed	Proposed Change	Reason	Notes	Responsible Person
19-2-505 19-3-2141	?	Authority to collect overpayment on DC disabilities	authority to collect if overpayment occurs if account stop dates are not entered correctly	KT moved proposed change from 19-2-505 to 19-3-2141 in 8/11/14 draft. CONCERN: if SAVA will not allow strengthened ability to collect overpayments following a death as proposed for 19-2-903, this may not be allowed either... And have started to question the need for it anyway based on existing language..	Patty/Kate
19-5-802(1)	x	Provide for a survivor benefit or death benefit if an inactive judge dies prior to retiring	UC801 – discovered that inactive judges can wait to 60 to retire but nothing in statute addresses payment of inactive judge’s account if they die before retiring	remove the word "active"	Kate
19-7-301(4)	x	rewrite or provide default for when the PERS member doesn’t make an election; use language from 19-13-210(4)(a)	from Baxter case		Kate
19-7-410	x	amend to provide that any SRS member who receives worker's comp, not just deputy sheriffs under 7-32-2113	Over sight from 2005 bill	only applies to deputy sheriff, contact SPOA(Kathy or Jim) for information, add provision like 19-3-504 for other members of SRS?	Kate/Patty
19-7-501, 19-7-502 and 19-7-901		Consider changing 19-7-502 and 19-7-901 age to 50 which is SRS NRA age now Check HPORS too	We amended these statutes in 2013 in both our qualifications bill (nra) and our general revisions bill (changing 19-7-901 to conform with 19-7-502. But there may still be inconsistencies as we were thinking NRA is 60 but it's 50 now under 19-7-501	Have ERF for SRS and they have been implemented. NRA is defined as 50 and 19-7-502 uses age 60	Patty/Melanie
19-8-302(3)	x	rewrite or provide default for when the PERS member doesn't make an election; use language from 19-13-210(4)(a)	from Baxter case		Kate
19-8-1001		Change 25 years of service credit to 20 years; change 2% to 2.5%	Consistency with 19-8-603 and 19-8-701.	The “reduced” death benefit has been in existence all along. Do we really want to change it now?	Patty/Melanie

Current Code Section	Completed	Proposed Change	Reason	Notes	Responsible Person
19-9-301(1)(c)	x	rewrite or provide default for when the PERS member doesn't make an election; use language from 19-13-210(4)(a)	from Baxter case		Kate
19-9-1020		one-time permanent ad-hoc purchasing power adjustment	can we delete? There are still non-GABA police (not covered by 19-9-1013) but they are covered by the annual minimum benefit adjustment in 19-9-1007. Based on the wording in 19-9-1020, I assume we made this one-time ad-hoc purchasing power adjustment in/very shortly after April 2001 and Diane and June verified we are no longer running payments or calculations under § 1020.	repeal notify Jerry Williams	Melanie
19-9-1206					Melanie
19-13-601		Statute can't apply to 3 rd class cities and rural fire districts that join FURS	They get workers comp and VLT so compensation would be 166% of normal salary	Kevin Dorwart from City of Glendive will help with rewrite. Patty to contact Kevin to find out why they don't want the rewrite.	Patty
19-13-1007		Non-GABA elections PPF retirees		Barb to consider and discuss at next meeting. Do by Rule Change instead of statute change.	Kate
19-17-108 and 112		Remove notarization requirement	New system will only require a checkbox certifying that information is correct. Melanie: subscribe and verify doesn't mean notarize does it? No	This could allow for electronic submission of annual certificate. research subscribe and verify regarding notarization - Kris may only need to change rule 2.43.5002 Neither of these statutes require notary - no change?	Barb

Current Code Section	Completed	Proposed Change	Reason	Notes	Responsible Person
19-17-301		proposed increased funding VFCA?		leave on for 2017	2017
19-17-403		VFCA— seems to offer an escape route, allows them to individually submit info to the board prove service upon retirement			Hollie, Kate, Melanie, Barb
19-17-405(4)		survivorship lump sum payment	what if the recipient were to die before the 40 months are up? do we care	We agree that benefit would end at the death of the member. There would not be any other beneficiary to payout to.	
19-2-803; 19-3-1204(3)(b)		With respect to the payment to a minor, in PERS if no one has filed on behalf of the minor, the minor can file upon reaching the “age of majority” (18). See 19-3-1204(3)(b).	No idea why this is only in PERS. Will check w/ IM if there is any reason to not move 19-3-1204(3)(b) to a new subsection (4) in 19-2-803, and add a 5 year (or less) statute of limitations.		
*Indicates suggested revision has been determined and provided to the board					