*Crosscheck*sm Review

State of Nebraska Public Employees Retirement Systems

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Executive Summary

Groom Law Group, Chartered and Segal were engaged by the Nebraska Public Employees Retirement System (NPERS or the System), to perform an independent review of the administrative operations and practices of their Internal Revenue Code (IRC) §401(a) defined benefit retirement plans, IRC §401(a) defined contribution plans and IRC §457 deferred compensation plan, and the administrative operations and practices of the System and to determine whether it meets standards set forth in the plan documents and to determine the level of compliance with applicable federal laws.

This Executive Summary describes our findings and analysis from the comprehensive compliance review, which includes a review of Plan documents, governance structure and administrative functions, compliance with applicable federal laws and consistency of administration with Plan rules, as well as provides recommendations and suggestions for improvements in Plan administrative functions and operational compliance with federal tax law.

We wish to thank Mr. Randy Gerke and his staff, along with Mr. Orron Hill, for their immense cooperation and support during the project. The System was gracious and candid and provided full access to staff and documents during the review process.

As a result of our compliance review, we conclude that the Plan is substantially in compliance with the requirements under IRC §401(a) and §457(b) and related Treasury Regulations and other applicable federal laws. We have identified a few areas of administration of the Plan that may be of concern to NPERS and could warrant further review and/or modification. Overall, however, it appears that administration of the Plan is generally consistent with Internal Revenue Service (IRS) rules and governing Plan documents. During a compliance review of any plan, we often find operational and compliance issues and areas for improvement to the administrative processes. Retirement plan administration is inherently difficult by nature due to the number of constantly changing regulations required to be followed, and no plan document is free from ambiguity and the need for interpretation. From our review, it is apparent that NPERS administers their Plan pursuant to rigorous and thorough internal control procedures developed for and consistently applied to Plan operations.

Groom Law Group and Segal's compliance review services, known as ***Crosscheck*,** is a comprehensive review of plan operating procedures to determine whether they are in compliance with applicable requirements of the Internal Revenue Code and other federal legislation and regulatory guidance, as well as with the provisions of the Plan documents. The goal of a ***Crosscheck*** review is to:

1. **Assess** the current state of plan administration.
2. **Confirm** that procedures correspond to what the plan documentation states.
3. **Review** operational compliance with the Internal Revenue Code and other federal laws.
4. **Identify** potential risks and penalties associated with noncompliance.

Plan Review and Analysis

Our review and analysis of plan documents and operations included an extensive examination of federal laws and regulations, as described below.

- IRC requirements for qualified §401(a) retirement plans and §457(b) deferred compensation plans, including the following areas:
  - Written plan requirements
  - Trust and exclusive benefit requirements
  - Vesting rules for governmental plans
  - Eligible employers
  - Eligible employees
  - Contributions and deferral elections/limitations
  - Definitely determinable benefit requirements
  - Normal retirement age rules
  - Section 401(a)(8) forfeiture rules
  - Section 401(a)(9) minimum and required distributions
  - Section 401(a)(25) actuarial assumption rules
  - Section 415 limits for governmental plans (including excess benefit arrangements, aggregation of plans and purchase of service rules)
  - Section 401(a)(17) limit on recognized compensation
  - Employee and employer contribution requirements
  - Re-employment rules
  - IRC rollover and direct rollover rules
- Permitted distribution rules
  - Anti-alienation provisions and domestic relations orders
  - Benefit cashouts and lump sum payments
  - Special rules and exemptions for governmental plans
- IRC income tax reporting and withholding requirements
- Age Discrimination in Employment Act (ADEA)
- Veterans' reemployment rights (including USERRA and HEART Act rules)
- Family and Medical Leave Act (FMLA)
- Americans with Disabilities Act (ADA)
- Fiduciaries responsibilities and delegation of duties
- Claims and appeals procedures
- Disclosure to participants and beneficiaries
- Benefit processing, including:
  - Eligibility for and calculation of retirement benefits
  - Disability and survivor benefits
  - Application for benefit payments

- Notices and benefit statements to participants
- Benefit calculation procedures
- Plan distributions, including lump sum payments and optional forms
- Tax withholding requirements and basis recovery methods
- Required minimum distributions

Project Methodology

To understand our findings and recommendations, it is important to describe our process and methodology. As background, our review of NPERS followed our ***Crosscheck*** compliance review and analysis methodology, which was individually tailored for the Plan's specific compliance needs.

Step One: Data Collection

Prior to the on-site visit at the NPERS offices, various Plan documents were requested and collected from NPERS, including Nebraska Revised Statutes (NRS) and official Board policies and procedures. In addition, we reviewed all Plan communications, publications, forms and financial, actuarial and audit reports contained on the Plan's website.

Step Two: Documentation Review and Analysis

A brief familiarity review was performed of the Plan documentation, in order to prepare for on-site interviews with NPERS staff. In addition, Plan documentation was thoroughly analyzed by Groom Law Group and Segal. A ***Crosscheck*** workbook, with questions specific to the type of plan, was used as a guide during the interview process.

Our documentation analysis also reviewed the consistency of Plan documents, including:

- "Fit" of participant communications with governing documents, including recent revisions;
- Consistency of operational processes and procedures, as well as other written materials with governing documents and employee communication materials; and
- Consistency of administrative actions with governing documents and written policies and procedures for Plan administration.

Step Three: On-site Interviews

The on-site visit to the NPERS offices consisted of interviews with the key individuals who are responsible for the day-to-day operation of the Plan over the course of two days (February 19 and 20, 2020). The goal of the interview process is to ensure that Groom Law Group and Segal, as well as those involved with administration of the Plan, understand the rules of the Plan, and that NPERS staff actually administer those rules according to Plan documentation. As indicated above, we covered an extensive array of questions that were designed by Groom Law Group and Segal regarding Plan administration and operational issues. The interviews also provided an educational opportunity for NPERS staff to address questions to our team of compliance experts on matters related to pension administration.

Step Four: Written Report

At the conclusion of our review, we prepared this written report of our findings, which identifies and outlines action items, including identification of areas requiring further inquiry, and recommendations on corrective action, if indicated. Subject to review and approval by NPERS staff, the final report will be presented to the NPERS Board of Trustees.

If NPERS wishes to act on any of the results of the ***Crosscheck*** review, we can assist in developing solutions. The accuracy of the review and the resulting report is a direct function of the quantity and quality of data available for review.

We thank NPERS once again for selecting Groom Law Group and Segal to conduct this compliance review and look forward to discussing our findings and recommendations.

Section 1. Issues Affecting All Plans

This report refers to the five qualified plans administered by the System as the State, County, School, Patrol and Judges Plans, each being referred to as a “Plan”, and collectively as the “Plans”. The defined contribution plans for State and County employees participating on January 1, 2003, who elected to remain members in such defined contribution plans are treated together with the cash balance plans of which they are a part are considered single plans in accordance with IRC §414(k), consistent with how they have been filed with the IRS for determination letters (i.e., there is one State Plan and one County Plan).

The following points are to discuss compliance issues identified from the process above.

A. Cash or Deferred Arrangement Issue on Repayments for All Plans

Overview

Most of the qualified plans of the System (State, County, School, and Patrol), allow members to make payments via irrevocable payroll deduction authorization to the Plans, including to repay a refund, purchase service credit, and repay of benefits required upon return to work. Pursuant to State statutes and Plan rules, these payments are made on a pre-tax basis utilizing employer pick up under IRC §414(h)(2). However, such payment arrangements may constitute impermissible cash or deferred elections under IRC §401(k). If these payroll deductions constitute a cash or deferred arrangement (“CODA”), then the payments do not meet requirements for pre-tax employer pick up under IRC §414(h)(2).

The School Plan allows employer pick up under IRC §414(h)(2) for member repayment of refunds under NRS §79-921(5)(b), purchase of past service credit under NRS §§79-933.03, 79-933.0, 79-933.05 and 79-933.06 pursuant to an irrevocable payroll deduction authorization. NRS §79-958(4) states:

> The employer shall pick up the member contributions made through irrevocable payroll deduction authorizations pursuant to section 79-921 and 79-933.03 to 79-933.06, and the contributions so picked up shall be treated as employer contributions ….

In addition, the NPERS Board may set rules for repayment of benefits for the School Plan under NRS §79-904.01. It is our understanding that the Board allows irrevocable payroll deductions that are picked up by the employer under IRC §414(h)(2) for such repayment of benefits.

The Judges Plan statutes do not specify how members may repay refunds, and there is no purchase of service provisions in these statutes.

The Patrol Plan requires that retired members repay retirement benefits received if the termination of employment is not valid because the member returns to work within 120 days of ceasing employment under NRS §81-2014(20). However, there is no description of the methods that may be used to repay benefits. Likewise, NRS §§81-2031(1) and 81-2031.06 allow members who received a refund of contributions to repay the refunded amount in order to restore their benefits and service under the Patrol Plan. NRS §81-2021.07 indicates that the Plan will accept transfers from other retirement plans to repay a refund as purchase of permissive service credit under IRC §415, but no other methods of repayment are described in the statute.

Both the State Plan and County Plan have similar statutes regarding repayment of benefits, which is required if the retired member returns to work within 120 days of ceasing employment. The repayment of benefits may be made via a binding, irrevocable payroll deduction authorization. Both Plans also permit former members who return to work after withdrawing their benefits to repay the withdrawal amounts and restore benefits under the Plans, including via irrevocable payroll deduction authorization. *See* NRS §§84-1322 and 23-2320. It is our understanding that such payroll deduction payments are made on a pre-tax basis as an employer pick up under IRC §414(h)(2).

Finally, section 2.16 of the Deferred Compensation Plan document in requires members to repay benefits distributed to a member who returns to work within 120 days of ceasing employment.

Analysis

Governmental employers are not permitted to adopt a CODA after May 5, 1986. The establishment of a CODA jeopardizes the qualified status of a retirement plan under IRC §401(a). IRC §401(k)(4)(B)(ii) provides that:

> A cash or deferred arrangement shall not be treated as a <u>qualified</u> cash or deferred arrangement if it is part of plan maintained by a State or local government … .

A cash or deferred arrangement is defined in Treas. Reg. §1.401(k)-1(a)(3) as:

> … any direct or indirect election by an employee to have the employer either – (A) provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available; or (B) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation.

Essentially, a CODA provides an employee the ability to choose between cash compensation in the present or a benefit under a plan that defers the inclusion of such benefits in the income of an employee until a later date.

However, a cash or deferred election does not include a one-time, irrevocable election made no later than the employee's first becoming eligible under the plan or any other plan or arrangement of the employer that is described in IRC §219(g)(5)(A). *See* Treas. Reg. §1.401(k)-1(a)(3)(B)(v).

Based on this definition of a one-time, irrevocable election, it appears that the irrevocable payroll deduction authorizations for repayment of refunds, to purchase service credit, and for repayment of benefits required upon return to work permitted under State statutes and Plan rules do not meet the requirements for this exemption from being a cash or deferred arrangement. The opportunity to elect a payroll deduction can be made more than one time and for multiple purposes, and although the authorization is irrevocable once made, such election to defer compensation would normally be made later than the date the employee is first eligible under the applicable Plan. Therefore, these irrevocable payroll deduction authorizations generally do not meet the requirements for a one-time, irrevocable election under Treas. Reg. §1.401(k)-1(a)(3)(B)(v).

Furthermore, an irrevocable payroll deduction authorization to make such repayments permitted under State statutes and Plan rules are impermissible cash or deferred arrangements, only to the extent the payroll deductions are contributed on a pre-tax basis. When members agree to an irrevocable payroll deduction authorization in order to purchase service credit or repay a refund or repay benefits to the Plans on a pre-tax basis, they are choosing to receive a benefit under a plan that defers compensation, such as qualified plan under IRC §401(a) or a deferred compensation plan under IRC §457(b), in lieu of receiving cash compensation. This is because the payroll deduction amounts are being treated as picked up by the employer as pre-tax contributions to the Plans in accordance with IRC §414(h)(2) and State statutes and Plan rules.

In Rev. Rul. 2006-43, the IRS clarified what it believed the requirements to be for a valid "pick-up" of employee contributions to be treated as employer contributions (pre-tax):

> [C]ontributions to a qualified plan established by a State government will not be treated as picked up by the employing unit under §414(h)(2) unless the employing unit:
>
> (1) Specifies that the contributions, although designated as employee contributions, are being paid by the employer. For this purpose, the employing unit must take formal action to provide that the contributions on behalf of a specific class of employees of the employing unit, although designated as employee contributions, will be paid by the employing unit in lieu of employee contributions. A person duly authorized to take such action with respect to the employing unit must take such action. The action must apply only prospectively and be evidenced by a contemporaneous written document (e.g., minutes of a meeting, a resolution, or an ordinance).
>
> (2) Does not permit a participating employee from and after the date of the 'pick-up' to have a cash or deferred election right (within the meaning of § 1.401(k)-1(a)(3)) with respect to designated employee contributions. Thus, for example, participating employees must not be permitted to opt out of the "pick-up", or to receive the contributed amounts directly instead of having them paid by the employing unit to the plan.

Since the irrevocable payroll deduction authorizations do not meet requirements for a one-time, irrevocable election under Treas. Reg. §1.401(k)-1(a)(3)(B)(v) for the reasons described above, these authorizations are a CODA and do not satisfy the requirement in item (2) above.

It should be recognized that this issue has developed over time. In prior years, IRS rulings allowed more than one salary reduction election by an employee to purchase service credit on a pre-tax basis (for example, see Private Letter Ruling 9750053). However, beginning in 2005, the IRS generally would no longer provide an opinion on the validity of an employer pick up transaction in Private Letter Rulings. Moreover, recent rulings from the IRS clearly indicate that voluntary elections by employees to increase their contribution amounts to a retirement plan cannot be picked up and would be CODA if paid on pre-tax basis. *See* Private Letter Rulings 201532036 and 201601013.

With regard to the Deferred Compensation Plan, neither the CODA prohibition of IRC §401(k)(4)(B)(ii) nor the pick-up provision of IRC §414(h)(2) applies. But by the same token, there is no provision for the repayment by pre-tax salary reduction (other than as a new elective deferral) when the person has not had a distributable event such as a bona fide termination of employment. As with overpayments from qualified plans generally under IRS correction procedures in EPCRS, unless the repayment is made by a transfer from a qualified plan, IRA or another governmental 457(b) plan (for example, if the amount had been rolled over by the member), then the repayment is made on an after-tax basis. We would note that, however that there is special relief for operation violations of IRC section 457Ib) plan that essentially allows operational violations of 457(b) to be retroactively corrected.[1] Governmental 457(b) plan operational violations can also be corrected under EPCRS on a “provisional;” basis consistent with general correction principles.[2]

Conclusion

Therefore, it appears that the irrevocable payroll deduction authorizations allowed under State statutes and Plan rules to purchase service credit, repay refunds, or for repayment of benefits do not satisfy the definition of a pick-up in order to be treated as pre-tax employer contributions under IRC §414(h)(2) and are also (except in the case of the Deferred Compensation Plan) impermissible cash or deferred arrangements, and should no longer be utilized. However, these authorizations are only an impermissible CODA to the extent the payroll deductions are contributed on a pre-tax basis via employer pick up. This means that irrevocable payroll deduction authorizations could continue for the purposes of purchasing service credit, repaying refunds, or repaying benefit amounts received before a valid termination of service, so long as a member’s payroll deduction amounts were contributed to the Plan on an **after-tax basis**. Alternatively, the Plans could discontinue accepting payment from members through payroll deduction and accept only lump sum payments or rollovers for the purpose of purchasing service credit, repaying refunds, or repayment benefits. Please note, however, that it is not common for public retirement systems to accept only rollovers or lump sum payments for these purposes because many members do not have the ability to pay large lump sum amounts.

B. Earnings on Repayment of Overpayments

As noted above, there are a number of provisions of the Plans which provide for the repayment by members of benefit amounts that were incorrectly paid by the Plans. For example,

[1] Under language between IRC §457(b) and (c) (so-called “flush language”), “A plan which is established and maintained by an employer which is described in subsection (e)(1)(A) and which is administered in a manner which is inconsistent with the requirements of any of the preceding paragraphs shall be treated as not meeting the requirements of such paragraph as of the 1st plan year beginning more than 180 days after the date of notification by the Secretary of the inconsistency unless the employer corrects the inconsistency before the 1st day of such plan year.”

[2] Rev. Proc. 2019-19, Section 4.09.

> If the board determines that termination of employment has not occurred and a retirement benefit has been paid to a member of the retirement system pursuant to section 84-1321, the board shall require the member who has received such benefit to repay the benefit to the retirement system….

NRS §84-1301(31) (State); *see also* NRS §§23-2301(36), 23-2320(5) (County); NRS §24-701(26) (Judges); NRS §81-2014(20) (Patrol).

Such incorrect payments are referred to by the IRS as "overpayments". *See* IRS Rev. Proc. 2019-19, Section 5.01(3)(c) ("The term 'Overpayment' means a Qualification Failure due to a payment being made to a participant or beneficiary that exceeds the amount payable to the participant or beneficiary under the terms of the plan".)[3]

In order to correct an overpayment, the plan sponsor is to take "reasonable steps to have the Overpayment *(with appropriate interest)* returned by the recipient to the plan and reduce … future benefit payments (if any) due to the employee…. To the extent the amount returned by the recipient is less than the Overpayment, *adjusted for Earnings at the plan's earnings rate*, then the Plan Sponsor or another person contributes the difference to the plan." Rev. Proc. 2019-19, Sections 6.06(3) [regarding correction for overpayments for defined benefit plans], 6.06(4) [for defined contribution plans], and Appendix B, Sections 2.04(1) and 3. Overpayments to a participant or beneficiary of $100 or less do not have to be recovered. Id., Section 6.02(5)(c).

This emphasis in the IRS correction procedures for overpayments being recovered with earnings is founded in the general principle of correction under Rev. Proc. 2019-19 that "The correction method should restore the plan to the position it would have been in had the failure not occurred, including restoration of current and former participants and beneficiaries to the benefits and rights they would have had if the failure had not occurred." Id., Section 6.02(1).

In the case of a defined benefit plan, therefore, including a cash balance plan, the earnings component for requesting return of an overpayment is the rate of earnings of the plan itself for the period involved, which is what would restore the plan to the position it would have been in had the overpayment not occurred. On the other hand, in the event of recoupment of an overpayment by reducing future annuity payments, the actuarial present value of the reduction should equal the amount of the overpayment plus interest at the interest rate used by the plan to determine actuarial equivalence. Id., Appendix B, Section 2.04(1).

In the case of a defined contribution plan, if a plan permits employees to direct the investment of account balances into more than one investment fund, the earnings rate is based on the rate applicable to the employee's investment choices for the period of the failure. For administrative convenience, if most of the employees for whom the corrective contribution or allocation is made are nonhighly compensated employees, the rate of return of the fund with the highest rate of return under the plan for the period of the failure may be used to determine the earnings rate for all corrective contributions or allocations. If the employee had not made any applicable investment choices, the Earnings rate may be based on the rate of return under the plan as a whole (that is, the average of the rates earned by all of the funds in the valuation periods during

[3] This assumes, consistent with our understanding, that the requirement to repay is imposed because the original requirement of a bona fide termination of employment allowing the payment in the first instance was not met, as opposed to the original distribution having been valid under the terms of the plan, but subject to a repayment if rehired with a set period.

the period of the failure weighted by the portion of the plan assets invested in the various funds during the period of the failure). For administrative convenience, the earnings rate applicable to the corrective contribution or allocation for a valuation period with respect to any investment fund may be assumed to be the actual earnings rate for the plan's investments in that fund during that valuation period. Further, the earnings rate applicable to the corrective contribution or allocation for a portion of a valuation period may be a pro rata portion of the earnings rate for the entire valuation period, unless the application of this rule would result in either a significant understatement or overstatement of the actual earnings during that portion of the valuation period. Id., Appendix B, Section 3.

The procedure also allows an option of using a Department of Labor (DOL) online calculator to determine the interest, found at https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/correction-programs/vfcp. However, this is generally to be used when "it is not feasible to make a reasonable estimate of what the actual investment results would have been." Rev. Proc. 2019-19, Section 6.02(5)(A). We also note that EPCRS does not address whether earnings can be negative – i.e., where the plan has had losses. The more conservative interpretation is that, by analogy to IRS Rev. Rul. 91-4 dealing with refunds of erroneous contributions, if earnings would be negative, then the overpayment sought to be recovered would not be adjusted for earnings.

As a result, we would recommend that when an overpayment is sought to be recovered from a member on the grounds that the individual was not entitled to the payment, that the amount be adjusted for lost earnings. NPERS may find it useful to adopt a policy for determining earnings in the event of correction of an overpayment, depending on the plan and the facts in question.

C. Return of Contributions Made by Mistake

We discussed with NPERS the appropriate correction when an employer makes a contribution by mistake – for example, due to failure to limit compensation to the IRC §401(a)(17) limit. (We note that mandatory pre-tax employee salary reduction contributions are treated as "employer" contributions for tax purposes because they are deducted from salary and paid to the trust by the employer, rather than directly by the employee. IRC §414(h)(2).) Qualified plans such as the Plans are required to hold all assets in trust for the exclusive benefit of the participants and beneficiaries. IRC §401(a)(2). This is known as the "exclusive benefit" rule. The IRS has long interpreted this rule to allow a return of contributions to an employer only if the contribution was due to a mistake of fact and if returned within one year of the contribution. Such reversions are not to be increased for earnings, but may be reduced for losses. *See* IRS Rev. Rul. 91-4.

There is a workaround, however, as the rule only prohibits payments out of the plan back to the employer. If an overpayment does not meet the Rev. Rul. 91-4 criteria for repayment, the plan could instead provide a credit to the employer in the amount of the overpayment that the employer could apply to future contributions. For example, if it is found that an employer contributed $1000 to the plan two years ago in error, the plan would not return $1000 to the employer, but by agreement with NPERS, the employer could reduce its next contribution to the plan by the $1000 amount. We note that, where part of that contribution included mandatory salary reduction contributions that were picked up under IRC §414(h)(2), the plan should not return those to the employee. Rather, whether the employer – the entity which sent the money to the plan – receives a refund within one year or a credit against future contributions, making up any such erroneously picked up contributions to the employee would be the responsibility of that employer, which would then report them as wages to the employee on a Form W-2.

We would recommend that NPERS consider adopting a rule to refund mistaken contributions only in accordance with Rev. Rul. 91-4, and to provide a credit to the employer who made them in other situations.

D. Reasonable Allocation of Expenses

As noted above, the IRC requires that the assets held in trust for a qualified plan must be used exclusively for the benefit of the participants and beneficiaries of that plan. *See* IRC §401(a)(2). This effectively also means that plans should only pay expenses allocable to that plan. Where expenses arise in connection with administering the plans as a whole, they should also be reasonably allocated among those plans, to avoid using the assets of one plan to subsidize the expenses of another plan. Proper allocation of expenses to qualified plans is an area that has been receiving more attention lately. There is little clear guidance on how to make such allocations, but it must be reasonable, and the process to determine it should be documented. We note that the contract with Ameritas for administration of the State (DC and cash balance) Plan, County (DC and cash balance) Plan, DCP and Patrol DROP Plan includes both per member annual charges (which vary by plan) and per event, per member charges (such as a charge for a distribution). It may be advisable for the Board to confirm with Ameritas that they believe that charging expenses to the plans in question in this manner is a reasonable allocation of expenses among each Plan for purposes of the exclusive benefit rule, and as expenses are incurred, to review and document whether they are being reasonably allocated among the various Plans consistent with the exclusive benefit rule.

E. Cybersecurity

Cybersecurity is an increasing concern with retirement plan accounts, not only for the systems of recordkeepers and service providers, and NPERS' own systems, but in the area of hacking of plan members' own information (e.g., account usernames and passwords) which can then lead to unauthorized plan distributions. In this case, we note that the State Treasurer, rather than NPERS, is responsible for cybersecurity over the funds held under NPERS. In the area of participant requests for distributions, currently, paper distribution forms that are notarized are required by NPERS, which likely assists in protection against unauthorized distribution requests. However, NPERS should continue to monitor developments in this evolving area to stay on top of potential cyber-threats to participant information and funds.

F. Due Diligence in Searching for Lost Participants

Qualified plans under IRC §401(a), as well as eligible deferred compensation plans under IRC §457(b), have a duty to make reasonable efforts to locate missing participants when a minimum distribution is required to be paid in accordance with IRC §401(a)(9). Failure to exercise due diligence in administration of the plans with respect to locating missing participants or beneficiaries may lead to a variety of problems, including an excise tax (up to 50%) on late payments of required minimum distribution amounts, improper tax reporting, payment of benefits to the wrong person and noncompliance with required minimum distribution rules, which is an operational violation potentially leading to disqualification of the plan.

All of the System's statutes and Plan documents contain sufficient language for complying with required minimum distribution rules in form. The operational function of making required minimum distributions from the Plans is performed by NPERS staff. In our interview with NPERS, staff described a formal process for making required minimum distribution payments to participants on a timely basis, including the process for locating lost participants, and for participants who cannot be located, processing uncashed checks, and eventually sending benefits that cannot be distributed to the State's unclaimed property fund. The System's process for dealing with uncashed checks also includes treating such checks as a distribution and reporting the distribution on Form 1099-R, which is consistent with recent IRS guidance on uncashed checks. In Rev. Rul. 2019-19, the IRS confirmed that the employee's failure to cash a distribution check the plan issued does not alter the plan administrator's obligation to withhold income tax or to report the distribution on Form 1099-R.

Recently, the DOL and IRS have focused enforcement efforts on the issue of timely payment of required minimum distributions, and in particular the issue of locating lost participants in order to make required payments. In October 2017, the IRS published a memorandum that directed auditors of employee plans not to challenge a qualified plan as failing to satisfy required minimum distribution standards under IRC §401(a)(9) if the plan has taken the following steps:

1. Searched plan and related plan, sponsor, and publicly-available records or directories for alternative contact information;
2. Used any of the following search methods: a commercial locator service, a credit reporting agency, or a proprietary internet search tool for locating individuals; and
3. Attempted contact via United States Postal Service certified mail to the last known mailing address and through appropriate means for any address or contact information (including email addresses and telephone numbers).

If a plan has not completed the steps above (and show documentation that it has been done), the IRS auditor may challenge a qualified plan for violation of required minimum distribution standards or for the failure to commence or make a distribution to a participant or beneficiary to whom a payment is due. From our interviews with NPERS staff on the System's procedures for locating lost participants, we note that these procedures follow the steps set forth in the IRS guidance, other than it appears that the System attempts to contact lost participants via first-class mail, rather than *certified* mail.[4] Considering the focus on enforcement of required minimum distributions by the IRS, we recommend that the System modify their procedures for locating lost participants to include attempting at least one contact with lost participants via certified mail. Based on the IRS memorandum, it appears that a single attempt to contact a participant or beneficiary via certified mail is sufficient to satisfy the IRS guidance relating due diligence in making a required minimum distribution.

[4] Prior guidance had indicated that first class mail could be adequate. See, e.g., **DOL Field Assistance Bulletin 2014-01.**

G. Alternatives to State Unclaimed Property Fund

Related to the issue of missing participants, we discussed with NPERS staff an alternative method for dealing with benefits from the Plans for which the member cannot be located or will not cash a check other than transferring assets to the State's unclaimed property fund pursuant to the Uniform Disposition of Unclaimed Property Act in NRS §§69-1301 to 69-1329. A method commonly used by statewide retirement systems for dealing with such benefits is that such benefit are forfeited and the related assets then remain in the trust fund of the Plan, subject to restoration and distribution of a benefit to a lost participant or beneficiary who contacts the System.

Regulations under the vesting provisions of the IRC provide that "a right is not treated as forfeitable … merely because the benefit is forfeitable on account of the inability to find the participant or beneficiary to whom payment is due, provided that the plan provides for reinstatement of the benefit if a claim is made by the participant or beneficiary for the forfeited benefit." Treas. Reg. section 1.411(a)-4(b)(6). If that exception applies to private sector plans subject to the strict vesting rules of ERISA, it should apply to governmental plans subject to the less strict pre-ERISA vesting rules.

Currently, all qualified Plans of the System (State, County, School, Judges, and Patrol) are required by statute to transfer any benefits that the Plan is unable to distribute to a member by their required beginning date, in accordance with IRC §401(a)(9), to the State Treasurer to be held in the State's unclaimed property fund. For example, the School Plan statutes, at NRS §79-932(2), state:

> The board shall make reasonable efforts to locate the member or the member's beneficiary and distribute benefits by the required beginning date as specified by section 401(a)(9) of the Internal Revenue Code and the regulations issued thereunder. If the board is unable to make such a distribution, the benefit shall be distributed pursuant to the Uniform Disposition of Unclaimed Property Act and no amounts may be applied to increase the benefits of any member would otherwise receive under the School Employees Retirement Act.

Similar language is set forth in statutes governing the other Plans of the System. The provisions of the Nebraska Uniform Disposition of Unclaimed Property Act ("the Act") describe when benefits must be delivered to the State Treasurer, what penalties apply if such delivery is not made, and when benefits are presumed to be abandoned.

As discussed, following is a brief description of some of the relevant issues for the System to consider with respect to maintaining forfeited assets in the System rather than transferring such assets to the State's unclaimed property fund.

1. Currently, benefits forfeited after a member's required beginning date are required by law to be transferred to the State's unclaimed property fund. No further action is necessary. However, in order for the System to be permitted to maintain assets related to forfeited benefits in the Plans' trust funds, a statutory change would be required. The System would need to develop and communicate to stakeholders persuasive arguments that this change would be beneficial to members, including preparing a response to any counterarguments.

2. Pursuant to the provisions of the Act, the unclaimed property fund absolves the System of all liabilities and responsibilities with respect to any forfeited benefits under the Plans once assets are delivered to the State Treasurer. This reduces the administrative burden of the System to continue to search for lost participants who have attained their required beginning date. However, the Plans are required to make reasonable efforts to locate missing participants or uncashed checks before either turning assets over as unclaimed property or forfeiting them. And if that has been done, there is also no further obligation to locate the missing participants after forfeiture – as there is no benefit to be paid. Thus, the practical difference between the two methods of dealing with the assets of lost participants is which entity gets to keep the unclaimed assets.
3. Generally, keeping forfeited assets (and the investment income thereon) in the System to offset plan liabilities likely would be beneficial to the funding status of the Plans. However, it may not be beneficial to the System overall to be responsible for keeping participant records for some time with any attendant monetary costs and administrative burden of such maintenance. Members who do not make an effort to receive a distribution of their accrued benefits prior to becoming forfeitures often have small account balances.
4. We do not have sufficient information to determine whether members are more likely to eventually recover their accrued benefits from the unclaimed property fund or the System. However, if forfeited benefits remain in the System, NPERS could retain the records and assets of forfeited benefits for as long as desired. Thus, forfeited assets maintained by the System would not be considered abandoned property after a specified period, as they are under the Act. Maintaining forfeited assets with the System may be especially beneficial for members who have recently reached their required beginning date under a Plan, as such members are more likely to contact the System which just corresponded with them on this matter, rather than a different State agency. Typically, state retirement systems using the forfeiture approach will adopt a procedure for locating missing participants before forfeiture, expressly limit the period during which a participant can reappear and claim a benefit, and provide that there is no interest paid on reclaimed benefits.

Section 2. Issues Affecting the Defined Benefit Plans (Judges, Patrol and School)

A. Bona Fide Termination of Employment

Overview

As detailed below, all of the Plans require a retirement and termination of employment to receive a benefit. No Plans allow a distribution while a member is still in service. Though it would be permissible in some cases for plans to be amended to provide for certain in-service distributions, the Plans do not currently permit it.

In discussions with NPERS staff, the issue was raised that, while the plan documents may comply with the IRC, in operation, some members being paid on the basis of having retired and terminated employment might not have terminated employment in fact. This is a tax qualification issue because, as noted above, the IRS takes the position that a failure to follow the plan document is an operational failure resulting in disqualification of the plan unless and until corrected. Paying an amount to which a member is not entitled under the plan terms is such a violation, referred to in the IRS guidance as an "overpayment", which generally must be corrected by making efforts to recover the overpayment.

As with many other public plans, the Plans have adopted various "return–to-work" provisions in order to make it less likely that a non-bona fide termination of employment can occur resulting in an overpayment and a potential disqualification of the plan if not corrected.

Connected with the possibility that a particular claimed termination of employment may not have been bona fide, is that some individuals may claim to return to work as independent contractors when they are in fact employees. Such misclassification can result in such person being paid while not having had an actual termination of employment or to have returned to work but not treated as having done so under that particular plan's return to work rules.

Summary of Recommendation

NPERS could identify those classes of employees where compliance in operation with the bona fide termination of employment and return to work rules has been questioned and put procedures in place to ensure better compliance by participating employers.

Analysis

1. <u>Summary of Current Termination of Employment and Return to Work Rules</u>

   a. <u>The State, County, Judges and Patrol Plans</u>

The State, County, Judges and Patrol Plans are substantially similar in this regard. Each pays benefits only upon a retirement following a "termination of employment." *See* NRS §§84-1301(31) and 84-1317 (State); NRS §§23-2315 and 23-2301(32) (County); NRS §§24-701(23) and 24-708 (Judges); NRS §§81-2014(16) and 81-2026 (Patrol).

Each of these Plans also provides a 120-day "hold-out" period during which a rehire of a terminated employee, also known as a return-to-work, is not to occur if the termination is to be considered valid. For example, the State Plan provides as follows:

> (36) Termination of employment occurs on the date on which the agency which employs the member determines that the member's employer-employee relationship with the State of Nebraska is dissolved. The agency which employs the member shall notify the board of the date on which such a termination has occurred. Termination of employment does not occur if an employee whose employer-employee relationship with the State of Nebraska is dissolved enters into an employer-employee relationship with the same or another agency of the State of Nebraska and there are less than one hundred twenty days between the date when the employee's employer-employee relationship ceased with the state and the date when the employer-employee relationship commenced with the same or another agency. It is the responsibility of the employer that is involved in the termination of employment to notify the board of such change in employment and provide the board with such information as the board deems necessary. If the board determines that termination of employment has not occurred and a retirement benefit has been paid to a member of the retirement system pursuant to section 84-1321, the board shall require the member who has received such benefit to repay the benefit to the retirement system….

NRS §84-1301(31).

The County, Judges and Patrol Plans have similar 120-day hold-out rules. *See* NRS §23-2301(36) (County); NRS §24-701(26) (Judges); NRS §81-2014(20) (Patrol).

   b. <u>The School Plan</u>

The School Plan similarly pays benefits only upon retirement following a "termination of employment". NRS §§79-902(31), 79-931. However, unlike the other plans, the return to work provisions of the School Plan are unique. The School Plan provides as follows:

> (44) Termination of employment occurs on the date on which the member experiences a bona fide separation from service of employment with the member's employer, the date of which separation is determined by the end of the member's contractual agreement or, if there is no contract or only partial fulfillment of a contract, by the employer.
>
> A member shall not be deemed to have terminated employment if the member subsequently provides service to any employer participating in the retirement system

provided for in the School Employees Retirement Act within one hundred eighty days after ceasing employment unless such service:

(a) Is bona fide unpaid voluntary service or substitute service, provided on an intermittent basis; or

(b) Is as provided in subsection (2) of section 79-920.

Nothing in this subdivision precludes an employer from adopting a policy which limits or denies employees who have terminated employment from providing voluntary or substitute service within one hundred eighty days after termination.

A member shall not be deemed to have terminated employment if the board determines that a claimed termination was not a bona fide separation from service with the employer or that a member was compensated for a full contractual period when the member terminated prior to the end date of the contract; and

(45) Voluntary service or volunteer means providing bona fide unpaid service to any employer.

NRS §79-902(44), (45).

Substitute Employee is defined as follows:

(41) Substitute employee means a person hired by a public school as a temporary employee to assume the duties of regular employees due to a temporary absence of any regular employees. Substitute employee does not mean a person hired as a regular employee on an ongoing basis to assume the duties of other regular employees who are temporarily absent;

NRS §79-902(41).

c. The Deferred Compensation Plan

Consistent with the IRC, the Deferred Compensation Plan (the "DCP") provides that "any amount shall not be available to the participant or beneficiary prior to (a) the calendar year in which the participant attains age seventy and one-half years, (b) when the participant is separated from service with the state, or (c) when the participant has an unforeseeable emergency as determined by the Public Employees Retirement Board." NRS §84-1506. *See also* DCP Article 7 (which also permits certain de minimis in-service distributions of small inactive accounts, consistent with IRC §457(e)(1)(A)).

The DCP at section 2.16 provides a definition of "Severance from Employment" or "Separation from Service" as:

The date on which a Participant experiences a bona fide dissolution of the employment relationship with the Participant's current Employer, the date of which dissolution is determined by the Employer. The Employer will notify NPERS within 15 calendar days after the date such separation has occurred. Separation from service does not include ceasing employment if the Participant enters another employment relationship with the

> State within one hundred twenty (120) calendar days after ceasing employment or if it is determined by the Board that a purported separation was not bona fide. If the Board determines that a separation from service has not occurred and a termination benefit has been paid, the Board will require the Participant who received a termination benefit to repay the benefit to the Plan with any interest that may be required by the Code.

2. The IRS Definition of Termination of Employment

The IRC requires that a §401(a) pension plan, such as the each of the Plans (other than the DCP, though it is subject to a similar rule), cannot make a distribution (other than a return of after-tax contributions) prior to the earlier of a termination of employment or the attainment of normal retirement age as defined under the plan, and assuming that such definition of normal retirement age satisfies applicable regulations. *See* IRC §401(a)(36); Treas. Reg. §1.401-1(b); and the IRS regulations on normal retirement age found at Prop. Treas. Reg. §1.401(a)-1(b)(2)(v) (which, though only proposed, can be relied upon).

However, a plan must also comply with its terms, even if those are stricter than the IRC would allow, e.g., if the plan requires a termination of employment to commence a benefit either before or after normal retirement age, then a termination of employment is always required to commence a benefit distribution. Violation of a plan term is an "operational failure" which would disqualify the plan for federal tax purposes unless corrected. *See* IRS Rev. Proc. 2019-19, section 5.01(2).

The IRS has defined "termination of employment" for purposes of §409A plans in Treasury Regulations, and in at least one private letter ruling, (PLR) has applied the definition in the regulation to §401(a) plans such as those of NPERS as well. *See* PLR 201147038 and Treas. Reg. §1.409A-1(h)(1).

That regulation provides that:

> Whether a termination of employment has occurred is determined based on whether the facts and circumstances indicate that the employer and employee reasonably anticipated that no further services would be performed after a certain date or that the level of bona fide services the employee would perform after such date (whether as an employee or as an independent contractor) would permanently decrease to no more than 20 percent of the average level of bona fide services performed (whether as an employee or an independent contractor) over the immediately preceding 36-month period (or the full period of services to the employer if the employee has been providing services to the employer less than 36 months). Facts and circumstances to be considered in making this determination include, but are not limited to, whether the employee continues to be treated as an employee for other purposes (such as continuation of salary and participation in employee benefit programs), whether similarly situated service providers have been treated consistently, and whether the employee is permitted, and realistically available, to perform services for other service recipients in the same line of business.

Note that this definition treats employment and services as an independent contractor the same. However, in the case of a §401(a) plan, service as a bona fide independent contractor likely does not count as continued service because, unlike a §409A plan, in which both employees and independent contractors are permitted to participate, independent contractors are not permitted to participate in a §401(a) plan. *See, e.g.,* Rev. Proc. 2002-21. However, note that purported independent contractor status can raise a number of issues, as described in further detail below.

3. Application of the Definition of Termination of Employment under the Plans

Each of the Plans other than the School Plan has a provision that termination of employment is required to commence a benefit. A benefit cannot commence while the member is still employed, and a termination occurs on the date on which the participating employer determines that the member's employer-employee relationship with the employer and any other agency of the State of Nebraska is dissolved.

Moreover, each Plan other than the School Plan provides that termination of employment does not include ceasing employment with the participating employer if the member returns to regular employment with the employer or another agency of the State of Nebraska and there are less than 120 days between the date when the employee's employer-employee relationship ceased and the date when the employer-employee relationship re-commenced with the employer or another Nebraska state agency.

In the case of the School Plan, the hold-out period is 180 days after ceasing employment, but there are certain exemptions:

- bona fide unpaid voluntary service or substitute service, provided on an intermittent basis; and
- as provided in subsection (2) of NRS §79-920 (certain employees who return to employment in a position covered by the State Plan).

For this purpose, voluntary service or volunteer means providing bona fide unpaid service to any employer. Substitute service is as defined above.

However, the statute also provides that in any event, a member shall not be deemed to have terminated employment if the board determines that a claimed termination was not a bona fide separation from service with the employer or that a member was compensated for a full contractual period when the member terminated prior to the end date of the contract.

4. Common Use of Hold-out Periods

Because in a state retirement system situation, unlike the private sector, a retirement board as plan administrator is more removed from the participating employer, it can be difficult for the board to have much knowledge of what the intention of the employer and the employee are at the time of a purported termination of employment. For that reason, it is common for public retirement systems to provide for the types of "hold-out" periods described above during which no return to employment is permitted. This is not to satisfy a bright line test for what constitutes a bona fide termination of employment, but rather to make it difficult to "game" the system" with phony terminations where there is an intent to return to employment. The use of such hold-out periods has been reported on and surveyed by the National Association of State Retirement System Administrators, or “NASRA.”[5]

5. Returning to Service after Termination of Employment as an Independent Contractor

Because of statutory prohibitions against in-service distributions, sometimes referred colloquially to as “double-dipping,” and hold-out periods, it is not uncommon in public retirement administration to see members terminating employment and the returning to work claiming to not be common law employees, but instead independent contractors.

Unfortunately, the test for independent contractor status is inherently factual and thus hard to administer. This can put much pressure on retirement boards to correctly assess whether a particular retired member has returned to work as a bona fide independent contractor. However, in theory, a retired member can return to work as a bona fide independent contractor and still be considered to have had a termination of employment originally.

a. IRS Tests for Independent Contractor versus Employee

Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992), is the seminal case holding that "employee," for purposes of the employee benefit plan rules, is determined under traditional agency law principles, and cites the 20 factor test for employee status under IRS Rev. Rul. 87-41.

As the IRS subsequently explained in Rev. Proc. 2002-21:

> The employment relationship between workers and the employer maintaining a plan is fundamental to whether a plan is qualified under § 401(a) of the Internal Revenue Code. The determination of whether an employment relationship exists depends on the facts and circumstances of each particular case.... The issue of whether a worker is an employee of a particular entity for employment tax purposes is determined by reference to § 3121(d), which incorporates the common law definition of employee. The Supreme Court has also applied this common law definition of employee for purposes of determining whether a worker is an employee entitled to receive benefits under a retirement plan. *See* Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992). Courts have also found that common law factors are applicable to determine which of two entities is the employer for purposes of retirement plans. The critical issue in determining who is the employer of an individual is which entity has the right to direct and control the individual performing the services.

Whether a purported independent contractor is doing the same work as the member did as an employee is also an important factor indicating that the person is performing services as an employee rather than an independent contractor. In our experience, the IRS often treats such a circumstance as dispositive.

This is based in part on section 530(a) of the Revenue Act of 1978, as amended by section 269(c) of the Tax Equity and Fiscal Responsibility Act of 1982, which provides, for purposes of

[5] *See, e.g.*, “Balancing Objectives in Public Employee Post-Retirement Employment Policies: Reassessing Barriers to Continued Work” NASRA, Nov. 2018 (using the Nebraska School Plan as a case study), https://www.slge.org/assets/uploads/2018/11/slge-nasra-post-retirement-employment.pdf , *see also* “Public Retirement System Postretirement Employment Policies”, https://docs.google.com/spreadsheets/d/1-YCKLc8a2Q3C5IJ7ZssN6N2KSW6jKbR6C69fGdebw_A/edit#gid=0

the employment taxes under the IRC, a safe harbor that if a taxpayer did not treat an individual as an employee for any period, then the individual shall be deemed not to be an employee, unless the taxpayer had no reasonable basis for not treating the individual as an employee. For any period after December 31, 1978, this relief applies only if both of the following consistency rules are satisfied: (1) all federal tax returns (including information returns) required to be filed by the taxpayer with respect to the individual for the period are filed on a basis consistent with the taxpayer's treatment of the individual as not being an employee (the "reporting consistency rule"), and (2) the taxpayer (and any predecessor) has not treated any individual holding a substantially similar position as an employee for purposes of the employment taxes for periods beginning after December 31, 1977 (the "substantive consistency rule").

b. IRS Guidance on Independent Contractor versus Employee Status in the Governmental Context

Further, the IRS has issued some guidance specific to whether certain governmental workers are employees or independent contractors under certain facts and circumstances. For example, IRS Publication 963, the Federal-State Reference Guide, provides as follows:

> In many worker classification cases, some facts will support independent contractor status and others will support employee status. Independent contractors are rarely totally unconstrained in the performance of their contracts, and employees almost always have some degree of autonomy. The determination of a worker's status, therefore rests on the weight given to the facts as a whole, keeping in mind that no one factor is determinative.
>
> Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding
>
> In difficult cases, the IRS can provide a determination as to whether a worker is an employee or an independent contractor. To obtain a determination from the IRS, file Form SS-8. Either a governmental entity or a worker may submit Form SS-8. The IRS will acknowledge receipt of the Form SS-8 and will also request information from the worker. If a contract has been executed between the worker and the entity, a copy of the contract should be submitted with Form SS-8. In some cases, the IRS will contact the State Social Security Administrator to determine whether the entity and position are covered by a Section 218 Agreement. The IRS will generally issue a formal determination to the entity and will send a copy to the worker.

In another illustration of the issues that can arise regarding proper classification of school employees, the IRS, in Chief Counsel Advice 200147006, the IRS analyzed the situation of a school superintendent claiming to be an independent contractor:

> In this case, there is a written contract stating that the parties envisioned an independent contractor relationship. A and B have also formed limited liability company and a regular corporation, for which no information reporting is required.
>
> The realities of the situation suggest otherwise, however. The School Districts have sufficient behavioral control over the two school superintendents under State statute to create an employer-employee relationship. This statutory right to control cannot be

waived by private contract. The contracts recognize this risk by incorporating a clause which shifts to the superintendents the anticipated risk of the contract's being set aside.

It is clear from the contract and the August 28, 2000, memorandum that School District A intended to retain the services of Mr. A. Failure of ALLC to employ Mr. A, except by reason of his death or disability, constitutes a breach of the contract. The choice of the Designee in School District B's contract also indicates the desire to retain the services of a specific individual, though suggesting a stratagem intended to avoid giving that impression. The contracts make it clear that both individuals will continue to work in their offices on school district property, with very little change in their working conditions.

It also appears likely that the circumstances of employment of A and B require them to hold themselves out to others as employees and agents of their school districts. They hire, evaluate, and fire teachers. They represent the school districts in negotiations with teachers' unions. Documents and letters prepared on school district stationery also give an administrator apparent authority as an agent of a school system.

Under these facts, we conclude that the attempt to create an independent contractor relationship by contract is unsuccessful and that the school superintendents are employees of the school districts.

Specific Issues Raised

While we have in the past noted that terminations of employment for purposes of plan distributions must be bona fide, in this review, we were apprised of several areas where questions have arisen as to whether bona fide terminations of employment have occurred or the return to work hold-out requirements being satisfied, particularly involving common law employee versus independent contractor questions. For example:

1. A full-time teacher participates in the School Plan. On the side, the teacher performs officiating duties for athletic events for compensation from the school district. Some school districts report the additional compensation paid to the teacher for officiating on a 1099-MISC, claiming that the teacher is an independent contractor. Other school districts report that compensation as employee compensation on the W-2. This raises an issue as to whether compensation is being correctly determined for purposes of plan contributions and benefits.
2. In similar cases, under another entity, such as a mentoring program, a teacher may be performing additional duties outside of traditional teaching. In some instances, compensation for these services is being paid to the teacher by the school district, in other cases, it may be paid by the other entity. Whether such compensation is treated as employee compensation for purposes of retirement benefits has apparently been inconsistent.
3. Apparently, some "community partners" and schools seek out teachers who recently terminated employment and have them perform similar duties to when they were employees, but treat the individuals as independent contractors. This raises issues as to whether the individuals had a bona fide termination of employment, or are in violation of the relevant holdout rule.

4. We understand that there may be other instances of plan members “retiring” and commencing benefits but returning to work as purported independent contractors within the relevant hold-out period, sometimes immediately.

Conclusion

To attempt to reduce noncompliance with the termination of employment and return to work rules, NPERS could identify those classes of employees where compliance in operation with the those rules has been questioned and put procedures in place to ensure better compliance by participating employers. For specific categories, such as officiating at athletic events and mentoring programs, the facts could be determined and appropriate uniform treatment adopted.

1. More Outreach to Employers

One step NPERS may want to consider is more outreach and education to employers and their human resources personnel and auditor on these issues to reduce misunderstandings and to enhance compliance.

2. Use of IRS Form SS-8

As discussed in IRS Publication 963 quoted above, for difficult situations where the system and the participating employer and purported employee or independent contractor differ on whether the individual is in fact an employee or independent contractor, it may be possible to have a Form SS-8 filed to resolve the question based on the facts. We would note, however, that a Form SS-8 can only be filed by the employer or the individual. The system would not have standing to file. But the system could require that the employer and/or individual filing allow the system to review it first. In addition, an SS-8 can be filed for a class of employees. However, one of the questions in the SS-8 is “Did the worker perform services for the firm in any capacity before providing the services that are the subject of this determination request? ... If “Yes,” what were the dates of the prior service? If “Yes,” explain the differences, if any, between the current and prior service.” If there are not material differences, it can be expected that the IRS will rule that the person is an employee.

3. Possibility of a Private Letter Ruling on Return to Work

Another possible avenue for obtaining more clarity on whether particular facts for a return to work situation would be to seek a private letter ruling from the IRS, similar to PLR 201147038 discussed above. The IRS has the discretion to decide not to rule and return a ruling request, but we believe the IRS would likely entertain another ruling request in this area.

4. Plan Amendment

Finally, though it is a matter at the discretion of the legislature, if there is a desire by the legislature to allow in-service distributions without a termination of employment for certain categories of plan members, the statutes could be amended consistent with the IRC to permit that, but only after the individual has attained normal retirement age under the plan in question.

B. Cash or Deferred Arrangement Issues for School Plan

Overview

Currently, School Plan members contribute 9.78% of compensation to the Plan. Pursuant to NRS §79-958(3), these member contributions are picked up by the employer in accordance with the requirements set forth in IRC §414(h)(2). Contributions picked up by the employer in this manner are treated as employer contributions for purposes of federal income tax, and thus are not included in the gross income of the member until such amounts are distributed under the terms of the Plan.

In discussion with NPERS staff, the issue was raised whether an election made by employees in the School Plan relating to employer-provided health benefits may be an impermissible cash or deferred arrangement (“CODA”) under applicable federal law. According to NPERS, some participating school district employers offer what is called a “dual option negotiated agreement” to current employees who do not receive health insurance coverage from the employer. In such circumstances, the dual option offers current employees a choice between two options. Current employees are subject to Option 1, unless they make a one-time election to switch to Option 2 before a certain date. All future hires are only eligible for Option 2.

Under Option 1, the employee receives a base salary plus a specific amount of “flat” salary, which the employee may or may not use to purchase health and dental insurance through the school district’s IRC §125 cafeteria plan, at the employee’s election. Under Option 2, the employee receives a different base salary plus employer-provided health and dental insurance which we understand is not treated as taxable. There is no flat salary amount paid under Option 2. The benefit received under the School Plan will thus be different under the election because compensation for purposes of calculating the benefit will be more or less depending on the election made.

Analysis

It is important to determine whether a current employee’s ability to make an election to switch from Option 1 to Option 2, thereby reducing the total amount of compensation and contributions to the Plan in exchange for nontaxable health insurance, is a cash or deferred election because governmental employers are not permitted to adopt a CODA after May 5, 1986. Establishing a CODA jeopardizes the qualified status of a retirement plan under IRC §401(a). IRC §401(k)(4)(B)(ii) provides that:

> A cash or deferred arrangement shall not be treated as a qualified cash or deferred arrangement if it is part of plan maintained by a State or local government … .

A cash or deferred arrangement is defined in Treas. Reg. section 1.401(k)-1(a)(3) as:

> … any direct or indirect election by an employee to have the employer either – (A) provide an amount to the employee in the form of cash (or some other taxable benefit)

that is not currently available; or (2) contribute an amount to a trust, or provide an accrual or other benefit, under a plan deferring the receipt of compensation.

Essentially, a CODA provides an employee the ability to choose between cash compensation in the present or a benefit under a plan that defers the inclusion of income on compensation until a later date.

However, a cash or deferred election does not include a one-time, irrevocable election made no later than the employee's first becoming eligible under the plan or any other plan or arrangement of the employer that is described in IRC §219(g)(5)(A). Note that IRC §219(g)(5)(A) includes a qualified plan under IRC §401(a). *See* Treas. Reg. §1.401(k)-1(a)(3)(B)(v).

Based on the definition of a one-time, irrevocable election, it appears that the opportunity for current employees to elect to change from Option 1 to Option 2 does not meet the requirements for this exemption from being a cash or deferred arrangement. Although the opportunity to elect into Option 2 can only be made one time and is irrevocable once made, such election can be made later than the date the employee is first eligible under the School Plan. Therefore, the opportunity to elect into Option 2 is not a one-time, irrevocable election under Treas. Reg. §1.401(k)-1(a)(3)(B)(v).

Though there is little guidance on these facts to point to, we have seen this issue raised by the IRS in connection with elections that result in more or less salary being paid in exchange for other nontaxable benefits when it has an impact on the amount of pension benefits.

In addition, there is a separate constructive receipt issue as to whether a current employee's ability to continue to receive an additional flat salary amount or to elect to receive less salary in exchange for employer-provided health and dental insurance in a plan that does not meet the requirements of IRC §125 permits the difference in flat salary to be treated as a pre-tax employer contribution for health and dental insurance. However, this is a complex issue for the employer, not for the Plans, so we will not address it further here.[6]

Conclusion

Therefore, it appears that the "dual option negotiated agreements" between employers and employees that participate in the School Plan, which provides employees a choice between additional flat salary amounts under Option 1 and employer-provided health and dental insurance under Option 2, may present an impermissible cash or deferred arrangement as defined in Treas. Reg. §1.401(k)-1(a)(3).

[6] See, e.g., PLR 200704005: "Taxpayer's employees will have the option to have contributions made to the [medical] Plan in lieu of receiving a portion of regular compensation or accrued leave, or both. Contributions will be pursuant to an election. Once the election is made, the Plan provides that the election is irrevocable; it cannot be reversed or revoked by the employee, and the employee cannot receive cash refunds of the contributions. Employees will have 30 days from initial eligibility within which to make a one-time irrevocable election to participate in the Plan. Employees who have not previously elected to participate will have an annual period of 30-60 days in which to make a one-time irrevocable election…. Based on the representations made and authorities cited above, we conclude that, pursuant to employees' elections, contributions that are made to the Plan in lieu of employees receiving a portion of their regular compensation or accrued leave, or both, are not excludable from employees' gross income under section 106 of the Code. Contributions to the Plan are includable in employees' gross income under section 61 of the Code." See also Rev. Rul. 75-539. But see also Chief Counsel Advice (CCA) 201640015.

Section 3. Issues Affecting the Defined Contribution and Cash Balance Plans (State and County)

A. Eligible Employers – the County Plan

As noted in prior compliance reviews, the IRS has continued to have the definition of governmental plan under study and has been developing proposed regulations that would address when an entity is an agency or instrumentality of the state or a political subdivision of the state eligible to participate in a governmental plan (or whether a de minimis number of non-governmental employees might be permitted to participate under some circumstances).

The County Plan is the plan most likely to have entities that may be in the “grey area” of whether participation is permitted or not. We do understand that a subcommittee of the NPERS Board has been monitoring some such employers, including at least one county hospital, a healthcare entity, and certain athletic/fitness facilities. In a related area, some County Plan employers have terminated employees and leased them back from leasing companies or professional employer organizations (PEOs). We understand that, upon an employer ceasing to participate, these employees are vested automatically as in a partial termination.

Currently, in the absence of proposed or final regulations from the IRS (which when issued may well have transition relief for any grey area employers who fall on the non-governmental side of the line), we would not recommend changing these practices, but would recommend continuing to monitor grey area employers and action may need to be taken when the regulations are proposed, or if the agency or instrumentality relationship with a governmental entity clearly ceases to exist (for example, in a privatization). We note that there has begun to be some litigation in the area, including a suit by participants in a county hospital plan in North Carolina, and a suit involving the Brooklyn Public Library, as to whether their plans were governmental plans. Though not directly involving a state retirement system, the legal analysis is substantially the same, so this litigation trend is worth following.

B. Submission of the Cash Balance Plans for IRS Determination Letters before September 1

Under IRS Rev. Proc. 2019-20, the IRS will accept a determination letter application for an individually designed “statutory hybrid plan” as defined in Treas. Reg. §1.411(a)(13)-1(d)(5), during the 12-month period beginning September 1, 2019, and ending August 31, 2020. The State and County cash balance plans meet that definition, and we have informally confirmed with the IRS that, although governmental plans are not subject to the requirements of IRC §411 (so long as they meet the pre-ERISA vesting requirements), the IRS would accept determination letters from governmental statutory hybrid plans. An IRS determination letter can be relied upon by third parties that the plans in form meet the tax qualification requirements. In addition, the recipient of a determination letter can generally request relief under IRC §7805(b) from retroactive disqualification for a provision on which the IRS has issued a determination letter if it has relied on the letter in good faith. *See* Rev. Proc. 2020-1, Sections 11 and 13. Accordingly, since the filing of a determination letter application is available for these two plans prior to September 1, 2020, we would strongly advise that such a filing be made.

Section 4. Issues Affecting the §457(b) Deferred Compensation Plan

A. Contributions to the DCP

Section 6.2 of the Deferred Compensation Plan provides for investment changes elected by participants to be made only in percentages, but in practice, the DCP allows investment changes in specified dollar amounts. The Deferred Compensation Plan should be amended to allow both.

B. Suspension of Deferrals Due to Unforeseeable Emergency Distribution

Currently, section 7.6.7 of the Deferred Compensation Plan restricts participants who receive an unforeseeable emergency distribution from making elective deferrals to the Plan for a period of six months. This rule mirrors a rule formerly applicable with respect to hardship distributions from IRC §401(a) and §403(b) plans. However, pursuant to sections 41113 and 41114 of the Bipartisan Budget Act of 2018 and applicable final Treasury Regulations, such plans are now prohibited from suspending a participant's contributions as a condition of obtaining a hardship distribution. For this reason, we recommend that the Deferred Compensation Plan eliminate the rule suspending deferrals after an unforeseeable emergency distribution.

Appendix. Additional Issues

In addition to the above, NPERS had a number of specific questions. Although we have responded in email, our answers (in substantially the same form) are reproduced here.

A. DCP Online Enrollment

NPERS requested guidance in implementing an online enrollment option for the §457(b) Deferred Compensation Plan. Specifically, you asked for implementation guidance on how the timing of elections affects the timing of payroll deferrals and to which annual deferral limit payroll deferrals apply.

Timing of Election

A §457(b) deferred compensation plan must provide that compensation for a given month may be deferred only if the deferral is elected before the first day of that month. The regulation interpreting the first of the month rule provides as follows:

> To be an eligible plan, the plan must provide that compensation for any calendar month may be deferred by salary reduction only if an agreement providing for the deferral has been entered into before the first day of the month in which the compensation to be deferred under the agreement would otherwise be paid or made available, and any modification or revocation of such an agreement may not become effective before the first day of the month following the month in which the modification or revocation occurs. However, a new employee may defer compensation in the first calendar month of employment if an agreement providing for the deferral is entered into on or before the first day the participant performs services for the eligible employer. An eligible plan may provide that if a participant enters into an agreement providing for deferral by salary reduction under the plan, the agreement will remain in effect until the participant revokes or alters the terms of the agreement.

Prop. Treas. Reg. §1.457-4(b)(1).[7]

Thus, the rule is essentially that:

1. Existing employees can elect in month 1 to defer an amount provided that it is not payable before month 2, i.e., it is not payable in month 1. Thus, where a payroll period begins in month 1, but the pay cannot be paid until the end of the payroll period in month 2, an election in month 1 can be made for the month 2 payment, even though it covers some money earned in the month 1 period.
2. Under a clarification added by the proposed regulation, the existing employee rule applies to later changes in the election as well. For example, under the same facts as in 1., if that employee then elects at the beginning of month 3 to stop deferrals, that cannot be applied

[7] Although we quote the proposed regulation, this language is substantially similar to the current regulation and can be relied upon.

to any payroll period that ends in month 3; it has to wait to be applied in the first payroll period ending in month 4.

3. For new employees, an election that is made "on or before" the first day of employment ("performs services"), if it is made in month 1, can be applied to compensation paid in month 1.

But, note the practical issue that influences how this is satisfied and often delays salary reduction further. It is typically difficult to implement a new election or change an election once a payroll period has begun. Thus, as a practical matter, administrators will often not be able to implement a §457(b) election unless it is received a certain period before a payroll period begins in addition to the requirement that the payroll period not end before the following month. This means that, in practice, a §457(b) election will often not be implemented in the month following the election unless it is received well before the beginning of the month, or alternatively, will not be implemented until the payroll period that begins in the following month – even though under the IRS rule, it could technically be applied to compensation that is paid in month 2 but was earned earlier in the part of the payroll period at the end of month 1.

Of course, for new employees, it can also be hard to get an election on the first day of hire to use that rule.

In addition to technical compliance, it is important that when elections will be applied be communicated properly, so a participant know when their salary will start to be reduced.

What Year a Deferral Counts Toward the §457(b) Limit

Under Treas. Reg. §1.457-4(a), the applicable annual limit is that for "the year deferred or contributed." For a salary reduction deferral, that would be the time it would otherwise be paid as salary but is instead deferred. ("Contribution" refers to employer nonelective contributions, which are also subject to the same limit.)

B. Certain School Plan Athletic Officials

NPERS asked for guidance related to whether a full-time teacher, who is an employee of a school district, would also be considered an employee while officiating athletic events for the school district. As we understand it, there are various scenarios where this may arise, but NPERS has asked us to review the particular factual situation below. While there is some guidance on whether a teacher may be separately treated as an independent contractor while officiating school athletic events, this is ultimately a facts and circumstances-based question. However, given that NPERS indicated that most other school districts treat teachers who officiate athletic events as employees (and include the related wages on a Form W-2), and based on the authority discussed below, we believe the better view would be that the teacher is an employee in that activity because of the likelihood that work as a teacher can be said to be interrelated with work as a referee at school sporting events, and to apply that practice in all school districts and require the reporting of officiating-related wages to NPERS as compensation for retirement purposes.

As a preliminary matter we note that, based on the outlined fact pattern and the definitions under NRS §79-902, unless the alternative duties of a teacher as an athletic official would be reasonable to exclude from the definition of "Service" (because such duties do not constitute "employment") and/or the teacher's duties are not part of his or her work as a "Regular employee" (because the teacher is not acting as an "employee" during such time), such definitions of "Regular employee," "Service," and "Compensation," which are otherwise relatively broad, would likely require the inclusion of compensation tied to officiating duties for retirement purposes under NPERS. The issue therefore essentially boils down to one item: whether there is a credible argument that the teacher might be considered both an employee and an independent contractor, for different services at the same time.

As a general matter, to determine whether an individual is an employee, Nebraska courts have considered ten factors, with the "right of control" being recognized as the "chief factor distinguishing an employment relationship from that of an independent contractor." *See, e.g.,* Keller v. Tavarone, 628 N.W.2d 222 (Neb. 2001). This emphasis on the "control" exercised over the individual generally aligns with similar worker classification standards used by the IRS (*see generally,* Internal Revenue Manual section 4.23.5[8]; *see also* Rev. Rul. 87-21, and the IRS Federal-State Reference Guide, Publication 963), the Tax Court (*see, e.g.,* Schramm v. Commissioner, T.C. Memo. 2011-212), and the Supreme Court (*see* Nationwide Mut. Ins. Co. v. Darden, 503 U.S. 318 (1992)).

While the D.C. Circuit in *PIAA v. NLRB* did hold that athletic officials were independent contractors, this holding was largely based on "the few times on which PIAA actually pays the officials and the short duration of the officials' employment." And, as noted by NPERS, that case was concerned with the relationship between the officials and the athletic association, not with the school districts (and even noted the fact that the schools directly paid the officials for most of their games was a point against finding the officials to be employees of the athletic association). *See* Pennsylvania Interscholastic Athletic Association, Inc. v. National Labor Relations Board, 926 F.3d 837 (D.C. Cir. 2019). Though not entirely on point, this holding that a referee was not an employee of the athletic association is generally consistent with most other courts, and guidance from the IRS, that have examined similar issues with respect to athletic associations. *See, e.g.,* IRS FSA 1995 WL 1918516 (which details the distinction between Rev. Rul. 67-119 and 57-119, both of which dealt with athletic associations, but reached different conclusions based on the differences in control exercised over the officials), and Collegiate Basketball Officials Ass'n, Inc. v. N.L.R.B., 836 F.2d 143 (1987).

Additionally, mostly in the context of worker's compensation-related determinations of employee vs. independent contractor status, state courts have largely held that athletic officials be treated as independent contractors (for both the school district and the school itself) (*see, e.g.,* Farrar v. D.W. Daniel High School, 309 S.C. 523 (1992) and Brighton School Dist. v. Lyons, 873 P.2d 26 (1993); *see also* NASO Special Report: Officials & Independent Contractors, which is somewhat dated, but provides a good general overview and additional cases that are reasonably on point).

But please note that these cases do not appear to conduct the independent contractor analysis in the context of teacher who is also employed full-time by the same school district or school (and notably, there is dicta in *Brighton* indicating that the court's decision there was at least

[8] https://www.irs.gov/irm/part4/irm_04-023-005r

partially based on the fact that the official in question “was not hired by the School District on a regular or continuous basis” – which the NPERS teacher is).

In any event, the IRS has also indicated that an individual can work for the same entity in separate capacities (i.e., as both an employee and an independent contractor), provided that those are “separate and distinct,” not “interrelated” as to duties or remuneration, and that the applicable common-law facts and circumstances analysis is properly applied to each role. *See* IRS CCA 200206053 Q&A 34; *see also* IRS Rev. Rul. 58-505 (but note that this conflicts with some guidance from the states, such as an opinion from the West Virginia Attorney General’s office indicating that “whether such person is employed by the board of education in another capacity is irrelevant to the determination of whether, for purposes of officiating, they are an independent contractor” - 61 W. Va. Op. Atty. Gen. 92 (W.Va.A.G.), 1986 WL 288925).

As the guidance outlined above primarily trends in favor of treating athletic officials as independent contractors (as a general matter), without the additional fact that the athletic official is a full-time employee of the same school or school district, treating an official as an independent contractor would likely be a reasonable determination. However, there does not appear to be much in the way of direct guidance or case law on the specific issue of teachers who are full-time employees moonlighting as athletic officials (at the same school or for the same school district). Here, as the individual in question is such a full-time teacher, if his or her teaching duties and officiating duties are treated as “interrelated… which, as a whole, contain the elements establishing the existence of a common law relationship of employer and employee” then he or she would be considered an employee “with respect to *all* services performed…”. *See* IRS Rev. Rul. 58-505.

The IRS has noted in CCA 200206053 that a teacher who separately edits the school district’s newsletter conducts “two types of work [that] are sufficiently different that it is possible, though not certain, that the employee is working in two capacities.” And in Publication 963, that “a teacher may be retained to remove snow from school property. This individual may be an employee as a teacher but an independent contractor for the snow-removal activity.” Here, while the duties of teacher and athletic official do not appear very close in nature, it is also a closer call than a teacher who also runs a snow-removal business on the side.

We can also look to the remuneration agreement or contract between the teacher and the school, which the IRS notes as another factor in determining whether positions are “interrelated” – here, is the officiating done under a separate contract where the referee pay is identified as being for an independent contractor? This is one of the dividing lines used by the Wisconsin Worker’s Compensation Division in making similar determinations for statutory worker’s compensation coverage purposes (see Q&A 6: “What if a school hires a teacher or other school district employee to referee a sporting event. Is that referee an employee or an independent contractor? Answer: It depends upon the contractual agreement made between the two parties and the referee’s status under the nine-point independent contractor test. Under this scenario, a separate contract covering the refereeing duties is key… If a school district employee referees events **as part of his or her teaching contract or under no contract at all**, the referee is considered an employee of the school district and the referee is covered under the Act. If a school district employee referees events under a separate contract for each event he or she referees, and he or she meets the nine-point independent contractor test...” (emphasis added)). And note that there are other states with similar worker’s compensation statutes to Wisconsin, which generally exempt independent contractors (and in some cases specifically identify athletic officials as contractors) from coverage, unless they are officiating a game run by the entity that normally employs them (*see* NASO Special Report, page 10).

Given the above, this appears to be a close call, but on balance, as NPERS has indicated that most other school districts treat teachers who officiate athletic events as employees (and include the related wages on their Forms W-2), we believe the better view would be to continue this past practice in all school districts and require the reporting of officiating-related wages to NPERS as compensation for retirement purposes (particularly if similar facts in the past have specifically caused a particular school district to reach a different conclusion on employee versus independent contractor status, as a change in treatment could potentially invite IRS interest).

We also note that there are no explicit carve-outs for "independent contractors" in the applicable definitions under NRS §79-902, and so even given that some of the guidance discussed above would allow for separate treatment as an independent contractor when officiating games for Internal Revenue Code purposes, the argument outlined by NPERS as being made by a particular school district that the Pennsylvania Interscholastic Athletic Association case supports independent contractor status is arguably less persuasive when specifically applied to the provisions of NPERS.

And as a final matter, we note that while employee vs. independent contractor determinations are ultimately based on the relevant facts and circumstances, as the tax-related consequences of misclassification are ultimately more negative when an employee is improperly treated as an independent contractor, the general conservative position in these circumstances is erring on the side of classifying the individual as an employee. As also outlined above, the employer and the teacher in question, presumably with the involvement of NPERS, could also file a form SS-8 to obtain IRS review of the status as well.

C. De Facto Cash or Deferred Arrangement and DROP

The IRS tends to examine public plans very closely to determine whether a DROP election includes a potential cash or deferred arrangement (CODA) as described above. The following is an example from a public plan other than NPERS.

The DROP provision in question provided that DROP participants were eligible to receive lump sum annual leave payments and to have these payments included as compensation in their retirement calculations upon entry into DROP. As it happened, participants who did not elect to participate in DROP were entitled to receive leave payouts upon termination of employment and have those amounts included as compensation in their retirement benefit calculation at their later actual retirement. The IRS questioned whether this made the DROP election a CODA, since one choice or the other might lead to a larger annuity benefit.

The state plan argued that the same amount of leave is paid (or available to be taken as actual leave, which the plan argued is the same thing) regardless of the DROP election being made or not. Though one choice may result in a higher determination of compensation at a particular time and therefore a higher benefit than the other, the election did not result in a difference in leave available to be paid out in cash. Thus, the plan argued that the there was no direct or indirect election by an employee to have the employer either provide an amount to the employee in the form of cash or some other taxable benefit in exchange for an additional pension benefit within the meaning of Treas. Reg. §1.401(k)-1(a)(3). That is, participants received the same leave available to take as leave or as cash, whether or not their accrual is increased under the plan by the election, so it was not a CODA. After some back and forth, the IRS accepted that argument and issued a favorable determination letter; however, it is difficult to predict whether the outcome would be the same today or for other plans. This issue is important for NPERS to keep in mind, though, with respect to any employee elections.

D. Rollovers into DCP

NPERS also asked for guidance about permitting rollovers into the §457(b) deferred compensation plan by terminated participants.

Currently, the DCP document allows the Plan to accept rollover contributions that are an eligible rollover distribution from an eligible retirement plan. The Plan's definition of eligible retirement plan includes a "qualified trust described in Code section 401(a)". Thus, the DCP document already allows the Plan to accept rollover contributions from a §401(a) cash balance plan. (Of course, the distribution still has to be an eligible rollover distribution, which does not include amounts that are required minimum distributions (after 70 ½ or 72, as applicable) or being paid in annuity form. (The CARES Act has also made some changes to rollovers with respect to coronavirus-related distributions.)

With respect to the State and County Plans, the DCP may accept rollovers at any time after termination. The State and County Plans allows participants to defer distribution of their benefits (including cash balance amounts) until required beginning date. The DCP can take a rollover of any distribution that is an eligible rollover distribution, so unless a trust-to-trust transfer, that incorporates the indirect rollover time limit (generally, 60 days).

Different considerations apply for rollovers from the Patrol DROP Plan. IRS guidance indicates a lump sum distribution of a DROP account will be an eligible rollover distribution to the extent that it is not a required minimum distribution. Generally an extraordinary distribution from a DB plan is not considered a series of substantially equal periodic payments because the lump sum amount is substantially larger than a regular monthly pension payment, however, there are also rules under Treasury regulations for determining how much is eligible for rollover when a lump sum payment is made at the same time an annuity from the same plan commences. *See* Treas. Reg. §1.402(c)-2, A-6. (In addition, as noted above, the DCP document accepts rollover contributions from §401(a) qualified trusts, which would include a DROP account.)

Unlike the State and County Plans, the Patrol plan document requires that DROP accounts be distributed within 60 days of termination of employment (i.e., a bona fide retirement in fact). The DCP should not, therefore, accept rollovers from the DROP Plan after that window.

The DCP plan document should be amended to include the limitation that it will not accept rollover contributions of after-tax and Roth amounts. *See* IRC §402(c)(2).[9] The phrase "other amounts not eligible for rollover as directed by the Code" may suffice for this purpose.

[9] *See also* https://www.irs.gov/pub/irs-tege/rollover_chart.pdf for a chart illustrating rollovers from and to different types of plans.

Alternatively, you may want to consider adding language to the effect that the DCP will accept a rollover contribution of an eligible rollover distribution, except the portion of any distribution that is not includible in gross income or is a Roth rollover. NPERS may wish to be more detailed in any employee communications to avoid confusion.