Objectives

- Calculation of benefits
- Taxation of and tax reporting of benefits
- Contribution deductions
- Transfers / combinations of creditable service
- QILDROS

Calculation of Pension Benefits

- Formula
  - Pension benefit is a % of pensionable salary
    - The "%" is driven by length of creditable service
- Information needed
  - Pensionable salary
    - "Annualized basic salary attached to rank, plus longevity and any other pensionable earnings"
    - Varies by pension fund
    - IDOI can verify
  - Length of creditable service
    - Exclude felony conviction, LOA over 30 days in one year
    - Include paid transfers of service, repurchased disability or military breaks
Calculation of Pension Benefits

• Other items to keep in mind
  – Effective date of pension (deferred?)
  – Police receives creditable service credit by number of full years completed, Fire by full years and months completed
  – Did the member remit contributions on an after-tax basis (effects 1099R reporting)

• Benefit calculator available on IDOI webpage:
  – http://insurance.illinois.gov/applications/pension/
  – Old version error-prone

• Monthly minimums
  – Fire $1,159.27 (as of 07/01/08)
  – Police $1,000.00 (as of 01/01/01)

• Retirement
  – Age 50, 20 years of service
  – Fire: age 60, 10 years of service
  – Police: age 60, 8 years of service

• Non-duty disability
  – 50% of pensionable salary
  – No age requirement
  – Fire – must have 7 years of service (no minimum for Police)

• Duty Disability / Occupational Disease Disability
  – Greater of 65% of salary or the eligible retirement benefit
  – No age requirement (unless eligible for over 65%)
  – Only service requirement is for Occupational Disease Disability (5 years)
  – Dependent benefit paid for Fire only
    – Under 18 or legally disabled
    – $200 monthly to begin
    – 3% increases every January regardless of member increases
## Retirement Pension Increases

- **When is initial increase?**
  - Latter of month after attain age 55 or month after anniversary date of retirement
  - Example: DOB 01/08/55 DOR 08/17/06
    - 55 on 01/08/10  Anniversary of retirement 08/17/07
    - First increase due 02/01/10

- **How much is initial increase?**
  - 1/12 of 3% of the original monthly pension for each full month that has elapsed since the pension began
  - Example (above)
    - \( \frac{1}{12} \times 0.03 \times \text{original monthly pension} \times 41 \text{ months} \)
    - 10.25% initial increase

## Disability Pension Increases

- **When is initial increase?**
  - January 1 after attain age 60
  - Example: DOB 01/08/55 Disability pension begins 08/17/90
    - 60 on 01/08/15
    - First increase due 01/01/16

- **How much is initial increase?**
  - 3% of the original monthly pension for each full year that has elapsed since the pension began
  - Example (above)
    - \( 0.03 \times \text{original monthly pension} \times 25 \text{ years} \)
    - 75% initial increase

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**Disability Pension Increases**

- When are subsequent increases?
  - Every January 1st

- How much are subsequent increases?
  - 3% of the original monthly pension

**Pension Benefit Increases**

- Spouses do not receive annual increases

- Confirmed by IL Supreme Court in January 2009

- Payment of benefits – should be paid at the end of the period in which they are earned

**Converting a Disability Pension**

- Eligibility
  - 50 years old
  - 20 years of service (combined)

- Salary to use
  - DOH
  - Length of active service

- Taxability

- Confirmation of calculation by IDOI
Disability Buy Backs

- Up to 3 years of time on disability pension
- Return for at least as long as time being purchased
- Cost to member
  - Contributions
  - Interest at 6% compounded from date of scheduled deduction to date of payment

Buy Backs - Military Service After

- Up to 5 years of time
- 40 ILCS 5/3-110(b) or 40 ILCS 5/4-108(c)
- Cost to member
- Contributions
- No interest

Buy Backs - Military Service Before

- Public Act 095-1056
- Fire only
- Up to 24 months of service
- Cost to member
  - Member contributions
    - % rate in effect at time of hire
    - Starting salary
  - Employer portion
    - IDOI tax levy information
  - Interest
  - Extremely cost prohibitive
**Taxation of Pension Benefits**

- **Taxable**
  - Retirement
  - Non-duty disability
  - Duty/Occupational Disease disability over 65%

- **Non-taxable**
  - 65% Duty/Occupational Disease disability
  - Survivor benefit resulting from line-of-duty death
  - Do NOT issue a 1099R form, per IRS

- **Survivor benefit**
  - Taxability of original pension transfers to survivor benefit

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**Taxation of Pension Benefits**

- Illinois Article 3 and Article 4 pensions are liable for Federal withholding tax.

- They are not liable to the State of Illinois, or for Medicare or Social Security taxes.

- Pension Funds should not withhold IL SIT, Medicare, or Social Security tax from the pension. You may withhold other state income taxes but you are not required to.

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**Taxation of Pension Benefits**

- IRS Notice 98-2 “Simplified Method”
- Effective January 1, 1998
- Pension Fund MUST report taxability of pension benefit on 1099R form

- After-tax contributions
  - “Credit” against gross pension
  - Spread out over expected life of pensioner/spouse
**TAX REPORTING**

- **SS-4**
  - Application for Employer Identification Number
  - Why do you need your own EIN?
  - Complete and submit on-line (http://www.ssa.gov)

- **W-4P form**
  - Completed by pensioners to indicate marital status and number of exemptions claimed
  - Used by pension fund to determine amount of federal tax to withhold (using IRS tax tables found in IRS Publication 15 / "Circular E")

**TAX REPORTING**

- **Form 945**
  - Filed annually with the IRS by Pension Fund by mid-February
  - Reconciles your monthly 945 tax payments
  - Amounts received and dates received
  - Must balance to your 1099R's

- **Form 1099R (the "W-2" for pension benefits)**
  - Send to all pensioners (with a taxable pension) and to all recipients of contribution refunds
  - Send Payee copies by January 31 and IRS copies by February 28
  - Remember to report the taxability of the pension benefit if it began after January 1, 1998!

**TAX REPORTING**

- **Form 1099MISC**
  - Most overlooked form
  - Send to vendors:
    - All legal services
    - All medical services
    - All other vendors
      - Who are not incorporated AND
      - To whom you remitted $600 or more during the year

- **Form 1096**
  - Cover form for 1099R and 1099MISC
  - Send to IRS in February with IRS copies of 1099R and 1099MISC forms
Contributions

- Withhold only from pensionable earnings
- Rates
  - Fire
    - January 1976: 7.75%
    - January 1987: 8.25%
    - August 6, 1999: 8.455%
    - July 1, 2004: 9.455%
  - Police
    - July 1, 1969: 1.00%
    - July 23, 1943: 3.00%
    - July 20, 1949: 5.00%
    - July 17, 1959: 7.00%
    - July 1, 1971: 7.50%
    - July 1, 1975: 8.50%
    - July 1, 1987: 9.00%
    - January 1, 2001: 9.91%

Employer Pick-Up Plan

- a.k.a. "pre-tax" contributions
- Municipal ordinance passed
- No members are excluded
- Irrevocable
- Record keeping (keep track of after-tax balance for tax reporting on 1099R or for contribution refund)

Contribution Refunds

- After-tax contributions
  - Not subject to roll-over
  - Not subject to federal tax withholding
- Pre-tax contributions
  - Roll-over
    - To another "Qualified Plan"
    - Must be "Trustee to Trustee" to avoid tax penalty
  - Cash payout to member
    - Mandatory 20% federal tax withholding from payment
    - Additional tax penalty on member’s 1040 form
  - IRS Special Tax Notice is required to be sent to member
- 1099R issued for all contribution refunds
Transfer of Creditable Service

• Portability (Police only) – "moves" service time
  - Requirements
    - Must have at least 2 years of service with Prior Fund if worked for Prior Fund after 06/17/97
    - Must transfer 100% of service time
  - Calculation
    - Member reinstates service with Prior Fund (6% interest)
    - Prior Fund sends to New Fund
    - Member contributions
    - Interest on contributions (6% from date of each payroll deduction to date of transfer)
    - Match of member contributions and interest
    - Current Fund required to do True Cost calculation
    - Certified Actuary (or IDOI)
    - If True Cost amount is greater than amount coming from Prior Fund, Member must pay the difference (5 year window)
    - If True Cost amount is less than amount coming from Prior Fund, Current Fund keeps the excess money
    - Extremely cost prohibitive
    - Member only receives credit for transferred time when all payments are made

Transfer of Creditable Service

• Reciprocity (Fire only) – "combines" service time
  - Requirements
    - Must have at least 1 year of service with Prior Fund
    - Must have at least 3 years of service with Final Fund
    - Combined total service of 20 years, age 50
    - If hired after 07/01/04, you have 21 months to notify all funds in writing
  - Cost to Member
    - Member reinstates service with Prior Fund (6% interest)
    - Additional 1% due to all funds
    - Use salary as of first day of fiscal year
    - Interest due on service time prior to "Declaration Date"
    - If after "Declaration Date", fund can just withhold an additional 1% from payroll (10.455%)

Transfer of Creditable Service

• Reciprocity continued
• Pension Benefit
  - Retirement
    - Prior Funds = 1/12 of 2.5% of final monthly salary for each month of service in that fund
    - Final Fund = calculate pension as if ALL service was spent with Final Fund and subtract amounts paid by Prior Funds
    - Retirement benefit cannot be remitted from ANY fund until ALL funds are paid in full
    - Multiple 1099R forms received
  - Duty disability or Non-duty Disability – paid 100% by Current Fund
  - Occupational Disease Disability – each fund pays a prorated share based upon length of service
• Can be cost prohibitive
QUILDRO

- Qualified Illinois Domestic Relations Order
- Effective July 1, 2006
- Only applicable against contribution refund or a retirement pension
- 3 pieces, all of which must be filed in court (available on IDOI webpage)
  - Order
  - Consent
  - Calculation
    - Responsibility of attorneys to compare
    - Pension Fund may receive subpoena for information
- Should be approved by Board attorney before processing
- Taxes
  - Pensioner and Alternate Payee (ex-spouse) pay tax only on their portion
  - Each receives a 1099R
- Ceases when pensioner dies (not applicable to survivor pension)
- Alternate payee must keep Board advised of location

Conclusion

- Calculation of Benefits
- Taxation of and tax reporting of benefits
- Contribution deductions
- Transfers / combinations of creditable service
- QILDROS