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Statement of Position The Process of Paying a Defined-Benefit Lump-Sum Service Pension: From Application to Disbursement

Paying service pensions to retiring firefighters is the primary purpose of a volunteer fire relief association. There are numerous steps that must be taken by a relief association's board of trustees between the time a member applies for a service pension distribution and when the pension is paid. This Statement of Position identifies steps that a board of trustees should take to properly determine eligibility, calculate, and approve for payment the service pension.¹

Member Provides Notice and Applies

Relief associations should require each member who intends to take distribution of a service pension to file a notice of their intent to take the distribution. Relief associations should require that the notice be provided to the association at least a certain number of days prior to the intended date of distribution. This notice provides the relief association board of trustees with time to determine eligibility, to collect the necessary information and paperwork from the member, and to transfer funds, if necessary, to pay for the pension distribution.

Upon receipt of the notice, the relief association should provide the member with an application for the distribution. The application should ask for all information that the relief association board of trustees needs to determine the member's eligibility for a service pension and to determine the pension amount. Information a relief association should consider collecting includes: contact information; beneficiary information; age of the member; beginning and ending dates of service; dates for any breaks in service or leaves of absence; how the member would like to receive the payment; and any other information the board of trustees may require.

The relief association should also provide the member with any forms or notices required by Federal or State law. For example, relief associations are required under Internal

¹ The steps provided here are examples. No example can address all situations encountered by an individual relief association. In addition, critical sections of this Statement of Position apply to only defined-benefit lump-sum plans.

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This Statement of Position is not legal advice and is subject to revision.

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Revenue Code to provide a safe harbor notice to recipients of eligible rollover distributions. A safe harbor notice is a written explanation that describes the direct rollover rules, the mandatory income tax withholding rules for distributions not directly rolled over, the tax treatment of distributions not rolled over, and the circumstances under which distributions may be subject to different restrictions and tax consequences after being rolled over.²

Board of Trustees Reviews the Application

The member should submit the distribution application to the relief association board of trustees. Dates of service, breaks in service, and leaves of absence provided on the application should be confirmed against the relief association's records.

The board of trustees then must determine whether the member is eligible for the service pension distribution. To be eligible, the member must have: 1) met the minimum retirement age specified in the relief association's bylaws; 2) completed at least the minimum number of active years of fire department service required in the bylaws; 3) completed at least the minimum number of active years of relief association membership required in the bylaws; and 4) complied with any additional service and membership requirements specified in the association's bylaws.³

When determining eligibility, the board of trustees should be sure to refer to the bylaws that were in effect on the member's date of separation. If the member separated from active fire department service several years ago and has been deferred, the member's eligibility for a service pension and the pension amount are determined based on the bylaws in effect when the member separated.

Treasurer Calculates the Pension Amount

After the relief association board of trustees determines that the member is eligible for a service pension, the association's treasurer should calculate the pension amount, making sure to reference the correct bylaws. The benefit level used in the calculation is the level that was in effect when the member separated. The benefit level is multiplied by the member's completed years (and months, if applicable) of active service. If the member has completed fewer than 20 years of active service, the benefit will be reduced by the forfeitable (vesting) percentages contained in the bylaws.

When reviewing the bylaws, the treasurer should determine if monthly proration of service credit is allowed or if credit is given only for 12 completed months of active service. The bylaws that were in effect when the member separated must specifically authorize the monthly proration of service credit for a member to receive credit for

² For additional information regarding safe harbor notice requirements and sample safe harbor explanations, see Internal Revenue Notices 2009-68 at: http://www.irs.gov/irb/2009-39_IRB/ar14.html and 2014-74 at: <http://www.irs.gov/pub/irs-drop/n-14-74.pdf>.

³ Minn. Stat. § 424A.02, subd. 1.

months of service. If the bylaws did not authorize the monthly proration of service credit, the member will receive credit only for each completed 12 months of active service.

For example, if a member completed 15 years and 7 months of active service, the member would receive credit for 15 years and 7 months if monthly proration is authorized, or credit for 15 years only if completed years of service are required.

If the member is deferred, the treasurer must determine if the bylaws that were in effect when the member separated allowed for the payment of interest during the member's period of deferral. If the payment of interest is authorized, the bylaws should specify how the interest is calculated. Interest may be paid at a flat five percent during the period of deferral, for example, or may be paid at a variable rate.⁴ The interest payment method must also be determined. Interest may be paid for the entire period that the member is deferred, or may be paid for only the completed months or calendar years that the member was deferred. The relief association treasurer should review the bylaws and the association's past practice when determining deferred interest calculations.

The relief association should be sure to retain copies of its calculations and all other documentation regarding the payments.

A flow chart is attached that illustrates steps for calculating a defined-benefit lump-sum service pension.

Treasurer Calculates the Supplemental Benefit

Relief associations are required to pay a supplemental benefit to each member who receives a lump-sum distribution. The amount of the supplemental benefit is equal to 10 percent of the pre-tax lump-sum distribution, up to a maximum of \$1,000. The supplemental benefit is paid to the retiring member at the same time as the pension distribution. The 10 percent should be calculated based on the pension amount *before* any deferred interest is added. In addition, deferred interest should not be accrued on the supplemental benefit. Supplemental benefits are payable to members who are fully vested as well as to those who are partially vested. Relief associations are eligible for reimbursement from the State of Minnesota for qualified supplemental benefit payments.⁵

Board of Trustees Reviews the Calculations

The service pension and supplemental benefit amounts calculated by the treasurer should next be reviewed by the relief association's board of trustees. At least two trustees

⁴ For more information regarding interest earnings for deferred members, see the Office of the State Auditor's Statement of Position on this topic, at:

<http://www.auditor.state.mn.us/default.aspx?page=20110527.005>.

⁵ The supplemental benefit reimbursement form, instructions, and a sample form can be found on the Minnesota Department of Revenue's website at:

http://www.revenue.state.mn.us/local_gov/prop_tax_admin/Pages/sbr.aspx.

should independently verify the amounts calculated and the bylaws applied by the treasurer. The board of trustees may also decide to ask its auditor, attorney, or broker to review the calculations. It is important that several individuals verify the calculated amounts to ensure that the member is paid correctly.

The relief association board of trustees should also discuss implementation of tax withholding requirements and reporting with its broker, auditor, or attorney.

Board of Trustees Approves the Distribution

After the service pension and supplemental benefit amounts have been reviewed and verified, the board of trustees must vote to approve the distribution. The relief association should be sure to retain copies of the meeting minutes reflecting approval of the payment. Board meetings are open to members of the relief association and to the public.

An appeal process should be in place so that a member can appeal a decision should the board of trustees vote against approval of the distribution.

Members have several options on how to receive their distribution. The member should indicate on the application for the distribution which payment option he or she has chosen. Payment options include: (1) a single lump-sum payment payable to the retiring member (subject to current income tax withholding requirements); (2) an annuity contract;⁶ (3) a rollover to the member's individual retirement account (IRA);⁷ (4) a rollover to the member's individual Minnesota deferred compensation plan;⁸ or (5), if allowed by the relief association's bylaws, payment in a series of installment payments.⁹

⁶ The annuity must be purchased from an insurance carrier licensed to do business in the State of Minnesota. Minn. Stat. § 424A.015, subd. 3.

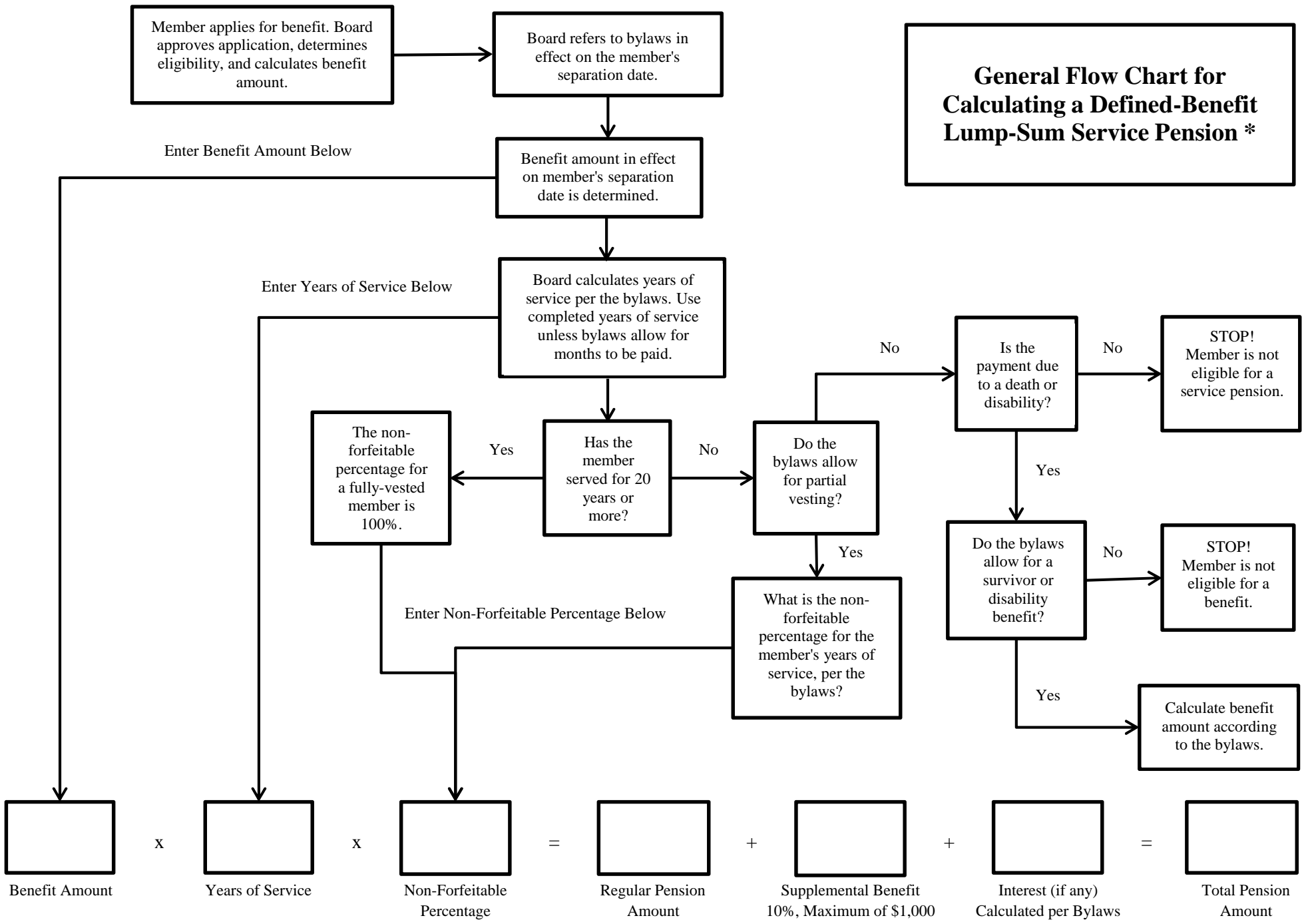
⁷ The rollover must be a direct transfer on an institution-by-institution basis. Minn. Stat. § 424A.015, subd. 4 (Your relief association must be "a qualified pension plan under Section 401(a) of the Internal Revenue Code, as amended..."); IRC § 408(a).

⁸ The rollover must be a direct transfer on an institution-by-institution basis. Minn. Stat. § 424A.015, subd. 5.

⁹ Minn. Stat. § 424A.02, subd. 8.

Attachment A

**General Flow Chart for
Calculating a Defined-Benefit
Lump-Sum Service Pension ***



* Assumes bylaws are written in accordance with Minnesota Statutes. This chart is meant for educational purposes only. It is not legal advice and is subject to revision. Those using this chart should read the attached Statement of Position, which contains additional important information. No sample or model can address all requirements for an individual relief association.