| Employment and Training Administration<br>Advisory System<br>U.S. Department of Labor<br>Washington, D.C. 20210 | **CLASSIFICATION**<br>Retirement Pay |
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**ADVISORY: UNEMPLOYMENT INSURANCE PROGRAM LETTER NO. 22-87 Change 2**

**TO:** ALL STATE WORKFORCE AGENCIES

**FROM:** CHERYL ATKINSON Cheryl Atkinson
Administrator
Office of Workforce Security

**SUBJECT:** Treatment of Retirement Pay – Employee Contributions

1. Purpose. To answer questions related to the treatment of retirement pay for unemployment compensation (UC) purposes, particularly regarding the effect of employee contributions to retirement plans.

2. References. The Internal Revenue Code of 1986 (IRC), including Section 3304(a)(15) of the Federal Unemployment Tax Act (FUTA); and Unemployment Insurance Program Letter (UIPL) No. 22-87 (52 Fed. Reg. 22,546 (1987)), and Change 1 (60 Fed. Reg. 55,604, 55,606 (1995)).

3. Background. Section 3304(a)(15), FUTA, requires, as a condition for employers in a state to receive credit against the federal unemployment tax, that the amount of UC payable to an individual be reduced for any week "which begins in a period with respect to which such individual is receiving a governmental or other pension, retirement or retired pay, annuity, or any other similar periodic payment which is based on the previous work of such individual . . . ." Two subparagraphs go on to provide the following qualifications to this requirement:

- Under subparagraph (A), states must reduce UC due to receipt of retirement payments only when (i) a base period or chargeable employer maintained or contributed to the plan and (ii) the services performed for that employer affected eligibility for, or increased the amount of, the retirement payment. Subparagraph (A)(ii) does not apply to payments "made under the Social Security Act or the Railroad Retirement Act . . . ."

| RESCISSIONS<br>None | EXPIRATION DATE<br>Continuing |
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- Under subparagraph (B), states may "take into account" contributions made "by the individual for the pension, retirement or retired pay, annuity, or other similar periodic payment" to provide limits on any such reduction. This exception applies to **all** retirement plans to which the employee has made contributions.

The entire text of Section 3304(a)(15), FUTA, is provided in the Attachment. UIPL 22-87 provides the Department's interpretation of this Section. This Change 2 is issued to respond to questions from states, particularly those related to Subparagraph B.

**4. Questions and Answers:**

**Question 1:** How much latitude does a state have in "taking into account" an employee's contributions to set limits on the amount of any reduction in UC?

**Answer:** Since subparagraph (B) does not specify the degree of offset, states have broad latitude in how an employee's contributions are "taken into account." As a result, a state may disregard part or all of a retirement payment in determining the amount of UC payable "regardless of the relative proportions of employee and employer contributions." Therefore, a state may disregard up to 100 percent of a retirement payment as long as the employee contributed some amount to the retirement plan, and any reduction in the amount of UC payable need not be proportionate to the amount of the employee contribution.

If an employee at one time paid contributions to a plan that was later converted to one in which the employer paid 100% of the contributions, then the employee has made contributions to the plan. Therefore, the state has the option of "taking into account" the employee's contributions before the conversion.

**Question 2:** Must Social Security retirement benefits be deducted from UC?

**Answer:** No. As explained in the preceding Question and Answer, states may "take into account" contributions made "by an individual for the pension, retirement or retired pay, annuity, or other similar periodic payment." Since employees make contributions to Social Security, the state may "take into account" the employee's contributions to Social Security.

Confusion apparently exists concerning the treatment of Social Security payments because, as noted in the Background section, the qualification found in subparagraph (A)(ii) does not apply to Social Security. However, there is no similar limitation in the "take into account" provision in subparagraph (B).

**Question 3:** UIPL 22-87 says that, if a state chooses to exercise the "take into account" option, the state's UC law must clearly indicate that the retirement payments are not deducted from UC because of the employee's contribution. (Page 6 of UIPL 22-87.) If a state chooses to exercise the "take into account" option **solely** for Social Security payments, must the state's law explicitly state that it is "taking into account" the employee's contributions?

**Answer:** No. The Social Security contribution scheme is governed entirely by federal law, which by its terms provides for employee contributions to the Social Security trust fund based on the employee's work. Because it is clear from a reading of the relevant provisions of the federal law, that a state may exclude these payments from pension offset, there is no need for the state law to explain how it is doing so.

There also is no need for the state law to explain that it is "taking into account" the employee's contribution with regard to other retirement plans with employee contributions that are governed entirely by federal law, such as Railroad Retirement or Civil Service retirement payments. For retirement plans that the state law singles out that are not governed entirely by federal law, the state's law must, to guarantee conformity with federal law, explicitly state that it is "taking into account" the employee's contribution.

**Question 4:** During a collective bargaining process, employees may give up pay raises or cost of living adjustments in return for an increased employer contribution to the pension plan. May states consider these employer payments to be "contributions made by the individual?"

**Answer:** No. The controlling factor is whether the individual actually made any direct contributions to the plan. A direct contribution is one made by payroll deduction or otherwise from an employee's personal funds. A wage agreement that results in increased employer contributions to a retirement plan in exchange for a surrender in wages does not constitute a direct contribution to the pension plan by the employees.

This is consistent with other provisions of federal law. The Department of Labor's Pension, Welfare and Benefits Administration (PWBA) considers contributions made by an employer to a pension fund in these cases to be employer contributions for purposes of laws administered by PWBA. (Indeed, the Form 5500, Annual Return/Report of Employment Benefit Plan, filed by the employer, should reflect this.) Also, payments made by an employer to a retirement plan are not considered part of an employee's wages for federal income tax purposes under Section 3401 et seq., of the Internal Revenue Code (IRC). It would be inconsistent to attribute these contributions to employees for purposes of Section 3304(a)(15), FUTA (which is itself part of the IRC), when other provisions of the IRC do not consider them employee contributions.

**Question 5:** The federal legislative language is very complex. Could you give a simple statement of what retirement payments must cause a reduction in UC?

**Answer:** UC must be reduced only due to receipt of retirement pay that is—

- For a week of unemployment beginning during a period for which the individual is receiving retirement pay;
- Reasonably attributable to such week;
- Based on the previous work of the individual;
- 100% financed by a base period or chargeable employer; AND
- Based on work affecting eligibility for, or increasing the amount of, the retirement payment.

See UIPL 22-87, page 4, for a discussion of the various types of payments that fall under the term "retirement pay" and a more detailed discussion of these criteria.

5. Action. State administrators should distribute this advisory to appropriate staff.

6. Inquiries. Questions should be addressed to your Regional Office.

7. Attachment.

**Attachment**

## SECTION 3304(a)(15), FUTA

[The state law must provide that--]

(15) the amount of compensation payable to an individual for any week which begins after March 31, 1980, and which begins in a period with respect to which such individual is receiving a governmental or other pension, retirement or retired pay, annuity, or any other similar periodic payment which is based on the previous work of such individual shall be reduced (but not below zero) by an amount equal to the amount of such pension, retirement or retired pay, annuity, or other payment, which is reasonably attributable to such week except that-

(A) the requirements of this paragraph shall apply to any pension, retirement or retired pay, annuity, or other similar periodic payment only if-

(i) such pension, retirement or retired pay, annuity, or similar payment is under a plan maintained (or contributed to) by a base period employer or chargeable employer (as determined under applicable law), and

(ii) in the case of such a payment not made under the Social Security Act or the Railroad Retirement Act of 1974 (or the corresponding provisions of prior law), services performed for such employer by the individual after the beginning of the base period (or remuneration for such services) affect eligibility for, or increase the amount of, such pension, retirement or retired pay, annuity, or similar payment, and

(B) the State law may provide for limitations on the amount of any such a reduction to take into account contributions made by the individual for the pension, retirement or retired pay, annuity, or other similar periodic payment;