



MONTANA TEACHERS' RETIREMENT SYSTEM
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SPECIAL FISCAL YEAR END INFORMATION

TO: School Business Officials
FROM: Janet Cooper, Benefits Officer
DATE: April 23, 2002
RE: Termination Pay

As the end of the fiscal year rapidly approaches, the Teachers' Retirement System (TRS) would like to take this opportunity to discuss the calculation of termination pay contributions to insure the proper handling of the contributions that will be remitted to this office. Termination pay includes, any form of bona fide vacation leave, sick leave, severance pay, amounts provided under a window or early termination incentive plan, or other payments that are contingent upon the employee terminating employment and retiring. Termination pay does not include amounts that are not wages and amounts that are earned prior to termination under a non-qualified deferred compensation plan. If the employer's termination pay package includes options, or benefits other than cash payments, please contact the TRS prior to withholding or remitting contributions to TRS.

If a TRS member elects termination pay Option 1 or 2, Section §19-20-716, MCA, requires that **both** the employee and employer pay the required contributions due. In other words the employer cannot require the employee to pay both the employee and employer contributions due the TRS.

A member may elect to have their employer deduct the employee contributions from termination pay and defer paying state and federal income taxes until benefits are actually received. The Internal Revenue Service calls this type of an election an "employer pick-up". Once elected, employees have no choice but to have their employer deduct the employee contributions due from the total amount of termination pay they are eligible to receive at the time of termination **and** retirement. The gross termination pay amount will continue to be subject to Social Security withholding.

In order to qualify for the tax deferral of contributions, the "Termination Pay – Irrevocable Election Form" must be executed by the employee and employer at least **90** days prior to the employee's termination date. Please visit the TRS web site at <http://www.trs.doa.state.mt.us> for the "Termination Pay – Irrevocable Election Form", and a complete copy of instructions. The "Termination Pay – Irrevocable Election Form" must be signed by **both** the retiring member and the employer at least 90 days prior to **termination**. It is generally assumed that the last day of teaching will be the date of termination. If this assumption is not correct, please notify TRS of the correct termination date to avoid any unnecessary delay in processing a member's benefits.

If the 90 day requirement is not satisfied, the employer is required to deduct **all** applicable withholdings such as Social Security deductions, Federal and State income taxes, and then must issue the employee a check for the net termination pay after all applicable taxes have been withheld. The employee termination pay contributions due the TRS must be remitted by personal check by the employee, and may not be deducted and reported by the employer.

If the employee has signed the "Termination Pay – Irrevocable Election Form", the employer must withhold employee termination pay contributions due the TRS, under Option 1 or 2, from the gross amount of the termination pay less Social Security deductions, regardless of whether the amount is greater than the member anticipated. The member cannot be given an option to report more or less than the total employee contributions due on the gross termination pay.

Termination Pay Contributions Cost Calculation

To be included in the calculation of benefits, termination pay **must** be paid at the time of **termination and retirement**. If termination pay is paid to the retiring TRS member within 60 days of termination, it will be considered paid at the time of termination. Employers are responsible for correctly reporting termination pay to the TRS, withholding employee contributions if the "Termination Pay – Irrevocable Election Form" is in place, and reporting the correct amount on the member's Form W-2. If the employer is withholding the employee's termination pay contributions as tax-deferred, **both** the employee and employer contributions due the TRS must be remitted with the employer's regular monthly billing report.

The following is an example of Part III of the Termination Pay Form properly completed, with the assumption that the member and the employer have signed the "Termination Pay – Irrevocable Election Form" 90 days prior to the member's date of termination, and the member elected Termination Pay Option 1.

III. CALCULATION OF CONTRIBUTIONS DUE ON TERMINATION PAY:				
OPTION 1	Member's Age at Retirement <u>49</u>			
(A) EMPLOYEE CONTRIBUTIONS	(NOTE: See "Special Instructions" on reverse side)			
\$ <u>5,000.00</u>	X	<u>3.74</u> %	X	<u>28.00</u>
Termination Pay		See Table		Creditable Service
				= \$ <u>5,236.00</u>
				Contribution Due
Amount of Employee Contributions Due To Be Remitted by Employer As Tax-Deferred				\$ <u>4,600.00</u>
Amount of Employee Contributions Due To Be Remitted by Employee As Taxed (Personal Payment)				\$ <u>636.00</u>
(B) EMPLOYER CONTRIBUTIONS				
\$ <u>5,000.00</u>	X	<u>3.96</u> %	X	<u>28.00</u>
Termination Pay		See Table		Creditable Service
				= \$ <u>5,544.00</u>
				Contribution Due
OPTION 2				
(A) EMPLOYEE CONTRIBUTION RATE	7.150%	X	\$ _____	= \$ _____
(B) EMPLOYER CONTRIBUTION RATE	7.470%	X	\$ _____	= \$ _____
The employee and employer contributions due on termination pay must be remitted by the 15th of the month following termination. The completed termination pay form must accompany the monthly report with which you submit the employee and employer contributions due. If the contributions due are not submitted in a timely manner, additional interest will be due.				

The following example provides a breakdown of the termination pay relative to an estimated Social Security deduction and the proper remittance of the contributions to the TRS. Please note: the employer is responsible for determining and withholding the proper Social Security deductions.

TERMINATION PAY DISTRIBUTION

Gross Amount of Termination Pay	\$5,000.00	
Estimated Social Security deductions	- <u>400.00</u>	
Net Amount of Termination Pay	\$4,600.00	(Maximum That Can Be Tax-Deferred)
Employee Contributions Due TRS	\$5,236.00	
Tax-Deferred Amount	- <u>\$4,600.00</u>	
Employer's Out of Pocket Expense	\$ 636.00	(Personal Check - Payable to TRS)

Remember, a member electing **not** to have employee contributions remitted on termination pay with tax-deferred dollars, or a member that does **not** execute the "Termination Pay – Irrevocable Election Form", may still select termination pay Option 1 or 2. However, Section 415(c) of the IRC limits the amount of contributions that a member may make to a defined benefits plan with

after tax dollars. Please contact the TRS for additional information regarding IRC 415(c) limits.