

Volunteer Firefighter Incentive Plan

Transition plan associated with IRS audit
and closing agreement

January 11, 2023

Today's Discussion

- Current VFIP & Trust
- IRS Compliance Concerns
 - Resolution with IRS
- Replacement Plan and Trust
 - Proposed Timeline

VFIP – Current Plan Overview

- 10 years of incentive service credit and age 55
- 25 years of incentive service credit and age 50
- 30 years of incentive service credit regardless of age
- Deferred: Eligible participants with 10 years of incentive service credit separating from volunteer firefighting service before attaining the age requirement enter pay status at age 60
- Current incentive benefit is \$857, multiplied by the eligible years of service
- Various straight life and survivor monthly benefit payment options available; lump sum payments only available under limited circumstances involving the participant's death

VFIP – Current Trust

- Irrevocable Trust established by City Council
 - Funded by General Fund transfers from the City and accrued investment earnings
 - Use is restricted to provide benefits under the current VFIP
 - All vested benefit obligations to current VFIP beneficiaries must be satisfied in conjunction with closure of VFIP
 - Current Trust assets are approximately \$13.9 million (12/31/2022)

VFIP – IRS Compliance Concerns

- The IRS declared that the current VFIP is not a volunteer firefighters' length of service award plan ("LOSAP") and therefore is not eligible for certain tax-deferrals
 - The annual dollar amount exceeds the IRS annual limit for LOSAP (currently \$7,000 annual maximum) - the IRS considers the cumulative amount, NOT the annual accrual amount of benefit
 - Since the VFIP is not a tax advantaged LOSAP, the IRS would require all participants to pay taxes on future payments beginning at the time of the first vested right to a plan benefit (i.e, taxes are generally due prior to payments being received)
 - The IRS initially opined on the City's ability to contribute and grow money tax free in the irrevocable trust; it didn't opine on the tax implications to the participants

VFIP – IRS Compliance Concerns – Cont'd

- Under the current VFIP, a participant's accrued benefits generally vest upon 10 years of incentive service credit and then each credited year thereafter.
- The IRS declared that taxes must be paid by participants as of each vesting date, even if the participants have not received any payments.
- This requires the City to issue a W-2 to each participant based on vested accrued benefits, which are actuarially determined.
- Participants would receive a W-2 annually and pay taxes annually on money that has vested, but generally not yet received.
- The City is also obligated to pay taxes based on the actuarially determined vested values.

VFIP – Resolution with IRS

- City Administration and experts initially challenged the IRS determinations, and subsequently explored multiple potential resolutions taking into account the interests of participants and the City
- Viable Resolution: Close out the current VFIP and associated Trust and create replacement versions
 - Closure of the current VFIP will be initiated by City Council action after 90 days
 - All Trust assets will be depleted to fund and payout vested VFIP benefits to participants and beneficiaries
 - Payments will be in a lump sum to all vested participants less applicable tax withholding. This includes vested active & deferred participants as well as retired participants currently in pay status
 - Once all Trust assets have been depleted for the lump sum payments, the City will fund the remaining lump sum payments from its General Fund (estimated to be approximately \$5M)
 - IRS appears to recognize the City's good faith efforts, as evident by its agreement to impose only the minimum penalty

Replacement – Firefighter Incentive Plan (FIP)

- City Council acknowledges & appreciates the dedication of our firefighters and wants to continue its financial commitment to them
- City Council supports a replacement plan and trust to continue to incentivize our firefighters for their valuable service
- City Administration recommends approval of a replacement trust and incentive plan which incorporates certain aspects of the current VFIP, and provides benefits to participants that aren't generally taxed until received

FIP – Moving Forward...

- Current VFIP *active* participants will transfer all months and years of service credit to the replacement FIP
- The years and months of service for active participants will transfer but participants will not get paid twice for that service
 - For example, if you received a lump sum payment for 18 years of service from the VFIP in conjunction with its closure, you will come into the FIP with 18 years of service and when 2 more years are completed for a total of 20 years of service, you will vest in and be paid for the 2 additional years of service

FIP – Earning Service Credit

- FIP is an incentive plan based on months of service, with no age requirement associated with payout
- Volunteers generally become participants on their start date; enrollment into the plan for eligible firefighter volunteers is automatic
- Credited service is provided on a monthly basis (attendance and leaves of absences may impact whether service is credited for a particular month)
- There are 4 tiers of service and pay out amounts
 - Tier 1 120 months (10 years) of credited service; vesting and payout upon completion of 120 months (benefits accruals are credited upon completion of years 3 through 10)
 - Tier 2 240 months (20 years) of credited service; vesting and payout upon completion of 240 months (benefits accruals are credited upon completion of years 11 through 20)
 - Tier 3 300 months (25 years) of credited service; vesting and payout upon completion of 300 months (benefits accruals are credited upon completion of years 21 through 25)
 - Tier 4 360 months (30 years) of credited service; vesting and payout upon completion of 360 months (benefits accruals are credited upon completion of years 26 through 30)
- The dollar value, per month, for participants who serve as a station officer will be at a 1.3 multiplier
- No service credit accrued after 360 months of credited service

FIP – Service Credit Cont'd...

- Participants will become vested in a Tier when they complete the required number of months of credited service.
- After completing a Tier, a payment will be distributed within 45 days of the vesting date to the participant. This payment will be subject to tax withholding. A participant will receive a W-2 at the end of the calendar year in which payment is made.
- If a participant leaves or is terminated from the department without reaching the applicable tier vesting date, no payment will be made or due.
 - If the former participant returns (i.e. is rehired) within 24 months of his/her termination date, then his/her prior unvested account and corresponding months of credited service shall be restored only when such participant completes an additional 24 months of credited service after his/her rehire date without another termination.

Proposed Timeline

- January 11, 2023: City Administration presentation to Department Chiefs and VFIP Committee (90-day notification of change)
- April 17, 2023: City Administration presents transition materials to City Council asking City Council to:
 - Close current VFIP and Trust and authorize payout of lump sum benefits
 - Adopt New FIP and Trust
- April 30, 2023: VFIP closure date on which actuarial valuations will be based
- May 2023: City distributes lump sum payments to VFIP participants already in pay status on the day prior to the closure date
- June 2023: City distributes lump sum payments to vested active and deferred VFIP participants
- January 2024: VFIP payees receive W-2s for 2023 lump sum payments