State of New Jersey

PHILIP D. MURPHY
*Governor*

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*Lt. Governor*

DEPARTMENT OF THE TREASURY
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ELIZABETH MAHER MUOIO
*State Treasurer*

JOHN D. MEGARIOTIS
*Acting Director*

January 29, 2019

Dominick Yaniero
[redacted]

RE: [redacted]

**FINAL ADMINISTRATIVE DETERMINATION**

Dear Mr. Yaniero:

I am writing in reference to the Board of Trustees of the Police and Firemen's Retirement System's (PFRS) denial of your request to waive, reduce or adjust the accrued interest which is owed on the outstanding balance of your pension loan as determined by the Division of Pensions and Benefits (Division). The PFRS Board initially reviewed and denied your request to waive, reduce or adjust the accrued interest assessed on your outstanding loan obligation at its October 15, 2018 meeting.[1] On November 1, 2018, you appealed the Board's decision. You did not dispute that you took the loan or that you owed interest as originally calculated on the loan. However, you dispute the interest charged beyond the original term of the loan.[2] On December 10, 2018, the Board considered your appeal and determined that no material facts are in dispute and directed the Board Secretary in conjunction with the Attorney General's Office to prepare Findings of Fact and

[1] At that meeting, you were represented by Robert A. Silber, Esq.
[2] As discussed more fully below, the Board notes that the original term of the loan has not changed. The payment schedule was adjusted based on the fact that monthly payments were not made between July 1, 2014 and June 1, 2017. The loan was reamortized to keep the original end date of April 1, 2019. Your monthly payments increased and additional interest was calculated. The additional interest accrued because the loan balance did not decrease each month, as anticipated in the original calculation.

Conclusions of Law, which were presented and approved by the PFRS Board at its January 28, 2019 meeting.

The PFRS Board has reviewed your correspondence and the relevant documentation and finds that the laws governing the PFRS do not permit the Board to grant your request to recalculate or adjust the amount of accrued interest charged by the Division on the outstanding balance of your loan obligation.

## FINDINGS OF FACT

You were enrolled in the PFRS on October 19, 1991 as a result of your employment as a Correction Officer Recruit with the New Jersey Department of Corrections, East Jersey State Prison (biweekly payroll number 00661). On or about February 1995, you began taking pension loans and continued doing so during your active PFRS membership. You remained with East Jersey State Prison until the 2nd quarter of 2010, at which time you transferred positions, becoming employed by Corrections-Adult Diagnostic & Treatment (biweekly payroll number 00666). As of the 4th quarter of 2012, you did not have an outstanding loan balance.

On April 2, 2014, the Division received your retirement application requesting a Special retirement effective July 1, 2014. At approximately the same time, you took a pension loan in the amount of $49,992.00. Check number 893404 was issued to you for $49,992.00 on April 16, 2014. A *Certification of Payroll Deductions* (Certification) was issued to your employer implementing the loan repayment schedule for 117 biweekly payments of $448.95, for a total of $57,016.65. Interest was calculated at 5.25% per year,[3] based on a decreasing balance each month. Your employer should have provided you with a copy of the Certification. Repayment of the loan started May 17, 2014, through the scheduled deductions and 4 biweekly payments of $448.95 were deducted from your payroll check and remitted to your PFRS account for your loan obligation prior to your

[3] The interest rate of 5.25% was set by the State Treasurer pursuant to N.J.S.A. 43:16A-16.1.

retirement. The PFRS Board approved your Special retirement at its meeting on June 9, 2014 and your employment ended on June 30, 2014. At your retirement, in addition to the outstanding loan balance, you had an outstanding arrears balance as a result of purchasing additional membership service. Division records establish that you contacted the Division to pay off your remaining arrears balance.[4] However, there is no record that you inquired about your remaining loan obligation.

Once you retired and began receiving a pension, loan deductions were not taken from your pension check. There is no record you inquired about the status of your loan repayment obligation between 2014 and 2017.

On May 10, 2017, the Division notified you that a review of your PFRS membership account revealed that you had an existing loan balance in the amount of $49,228.72 that was not carried into retirement. No loan payments were deducted from your pension checks. In that letter, you were informed that the Division would begin deducting monthly loan payments in the amount of $2,615.29 beginning with your pension check dated June 1, 2017 to satisfy the outstanding obligation. The Division informed you that per the federal Internal Revenue Code (IRC) requirements for pension loans, your loan needed to be repaid in full with interest, by April 1, 2019, which is within 5 years from the date you took the loan. The adjusted repayment schedule was calculated to meet these federal requirements. You requested that the Division provide you with the amount to pay off your loan obligation because you did not want payments to continue to be deducted from your pension checks.

In a letter dated August 24, 2017, the Division indicated that if you sent a check for $47,581.55 by September 8, 2017, it would satisfy your existing loan obligation. That pay-off amount included interest in the amount of $8,813.99. The interest was recalculated at the same rate of 5.25%,[5] taking into account interest accruing through August 31, 2017. The interest calculation

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[4] The arrears is not a contested issue.
[5] This was the rate of interest used in the calculation of your original loan.

increased from that originally calculated in 2014 because the original interest calculation planned for the loan balance to decline monthly. Because loan payments were not made between July 2014 and June 2017, the outstanding loan balance did not decrease. Therefore, the amount of interest owed on the loan increased.

In an email dated August 31, 2017 to Division staff, you stated: "I just want to pay the loan off. I am asking, at this time, that the $8,813.99 interest be waived, and a new pay off amount be submitted to me …" On September 27, 2017, the Division notified you that the accrued interest could not be waived. Interest accrues until the loan is fully paid in accordance with N.J.S.A. 43:16A-16.1, N.J.S.A. 43:16A-16.2, N.J.S.A. 43:16A-18, and in accordance with the IRC and applicable regulations, interest is owed on your loan. You were provided with appeal rights to the PFRS Board.

You filed an appeal to the PFRS Board on October 18, 2017. Along with your appeal, you submitted a timeline of events related to your loan. In your appeal letter you stated that you had written a letter asking for a waiver of the accrued interest and requested that you be permitted to pay the loan balance due as of July 1, 2014, minus the loan payments taken from your pension checks beginning with your check dated June 1, 2017. Thereafter, you requested a reduction in the amount that was being taken from your monthly pension checks because the $2,615.29 deduction was a hardship. By letter dated November 15, 2017, the Division informed you that it was unable to reduce the deduction of $2,615.29 as your loan balance had to be paid within 5 years of the date you took the loan, or by April 16, 2019. Pursuant to the IRC requirements for pension loans, if loans are not repaid with interest within 5 years, they are considered a deemed distribution subject to federal tax consequences.

On January 8, 2018, Robert A. Silber, Esq., filed a letter of representation, explaining that he was retained to represent you in your appeal. On January 19, 2018, Mr. Silber was notified that your appeal was being held in abeyance until finalization of discussions with the Internal Revenue Service (IRS).

The PFRS Board notes that after the January 19, 2018 letter to Mr. Silber, the State of New Jersey entered into a Closing Agreement with the IRS that identifies problems with pension loans and a method to correct the identified errors, while maintaining the tax-qualified status of the PFRS. Specifically, for loans like yours, which could still be repaid within 5 years of the date on which the loan was taken, the loans were reamortized to be paid off within those 5 years in accordance with the IRC. The Closing Agreement also reiterated that IRC Section 72(p) needed to be enforced by the PFRS.

On May 2, 2018, you emailed the Division and stated, “I want to pay it off in full at its correct interest rate from the ‘contract’ application of the loan no more no less than what is right…” On May 16, 2018, the Division indicated that if you send a check in the amount of $25,534.44 by June 6, 2018, it would satisfy your existing loan obligation. That pay-off amount included interest for $10,304.49. An interest rate of 5.25%[6] was used to determine the amount of accrued interest, taking into account interest accruing through June 1, 2018. The interest calculation increased from that originally calculated in 2014 because the original interest calculation planned for the loan balance to decline monthly. Because loan payments were not made between July 2014 and June 2017, the outstanding loan balance did not decrease. Therefore, the amount of interest owed on the loan increased. Further, the calculation increased from that provided in 2017, because it calculated a final loan payment on June 1, 2018.

By letter dated September 20, 2018, both you and Mr. Silber were notified that the PFRS Board would consider your appeal at its meeting on September 20, 2018.

The Board considered your statements and the statements of Mr. Silber, and all of the documentation; however, the Board denied your request to waive, reduce or adjust any of the

[6] This was the rate of interest used in the calculation of your original loan.

accrued interest owed on the outstanding balance of your loan obligation. The basis of the Board's decision was set forth in its letter dated October 19, 2018.

Thereafter, you appealed the Board's determination. You asserted that you are not asking for a waiver of interest, but rather to adjust the interest on your pension loan. Further, you asserted that because your loan is current and within the 5-year timeframe under the IRC, there is no issue with the IRS. Finally, you clarified that the added interest is not "unfair" but rather you claim the State violated the loan agreement. You also dispute the Board's statement that it has no authority to waive loan interest. At its meeting on December 10, 2018, the Board determined that there were no material facts in dispute and directed the Board Secretary in conjunction with the Attorney General's Office to prepare Findings of Fact and Conclusions of Law, which constitutes the Board's Final Administrative Determination.

## CONCLUSIONS OF LAW

N.J.S.A. 43:16A-16.1 permits a member to take a loan in

> an amount equal to not more than 50% of the amount of his aggregate contributions, but not less than $50.00; provided that the amount so borrowed, together with interest thereon, can be repaid by additional deductions from salary, not in excess of 25% of the member's salary, made at the time the salary is paid to the member.
>
> …
>
> Loans shall be made to a member from his aggregate contributions….
>
> [N.J.S.A. 43:16A-16.1.]

Further, "[t]he rate of interest for a loan requested by a member prior to the effective date of P.L.2007, c.92 (C.43:15C-1 et al.) shall be 4% per annum on any unpaid balance thereof. N.J.S.A. 43:16A-16.1. After the enactment of Chapter 92, the State Treasurer sets "a commercially reasonable rate" on January 1 of each calendar year. Ibid. Additionally, N.J.S.A. 43:16A-16.2 states:

> In the case of any member who retires without repaying the full amount so borrowed, the Division of Pensions and Benefits shall deduct from the retirement benefit payments the same monthly amount which was deducted from the compensation of the member immediately preceding retirement until the balance of the amount borrowed together with the interest is repaid. In the case of a pensioner who dies before the outstanding balance of the loan and interest thereon has been recovered, the remaining balance shall be repaid from the proceeds of any other benefits payable on the account of the pensioner either in the form of monthly payments due to his beneficiaries or in the form of lump sum payments payable for pension or group life insurance.

The PFRS is a "qualified governmental defined benefit plan[] pursuant to sections 401(a) and 414(d) of the federal Internal Revenue Code of 1986, as amended, or such other provision of the federal Internal Revenue Code, as applicable, regulations of the U.S. Treasury Department, and other guidance of the federal IRS." N.J.S.A. 43:3C-18(a). The Director of the Division is "authorized to modify the provisions of the [PFRS], when a modification is required to maintain the qualified status of the [PFRS] under the Internal Revenue Code of 1986, applicable regulations of the U.S. Treasury Department, and other guidance of the federal IRS." N.J.S.A. 43:3C-18(c).

IRC Section 401(a) and federal tax law require that pension loans comply with IRC Section 72(p). Specifically, IRC Section 72(p)(2)(B) requires pension loans to be repaid within 5 years of issuance and IRC Section 72(p)(2)(A) prohibits total outstanding loan amounts from exceeding $50,000. Ibid. If a member fails to repay the pension loan within the 5-year period or the amount exceeds the IRS limit, then the loan becomes a "deemed distribution" taxable as income to the member and subject to additional penalties. IRC Section 72(p)(1). The deemed distribution does not cancel the loan obligation, which still must be repaid to the Plan, with applicable interest. See Rev. Proc. 2016-51, Section 6.02(1).

There is no dispute that you took a loan from your PFRS account on April 16, 2014, that you started repaying the loan through payroll deductions, and repayment ceased when you retired and deductions were not taken from your pension check. Further, there is no dispute that under the original loan repayment schedule, your loan was scheduled to be repaid by April 1, 2019. There is also no dispute that the interest rate on that loan is 5.25%. The Board acknowledges that your loan payments were not carried into retirement and automatically deducted from your pension checks by the Division. When the Division realized your loan was not being repaid, you received a letter, and the Division implemented a modified repayment schedule so that your loan, with interest, would be paid within 5 years, and not result in a deemed distribution under the IRC. A deemed distribution would result in federal tax consequences to you.

The PFRS Board is also aware that the issue of the repayment of loans in retirement implicates more than just your loan. Because the PFRS is a federally tax-qualified plan, as required by N.J.S.A. 43:3C-18(a), the PFRS's failure to comply with all the requirements of the IRC could result in the IRS determining that the PFRS would no longer be a tax-qualified plan under IRC Sections 401(a) and 414(d). To that end, the Board is aware that the State Treasurer and Director of the Division, in accordance with his authority and responsibility under N.J.S.A. 43:3C-18(c) to keep the PFRS tax-qualified, signed a Closing Agreement with the IRS. The Closing Agreement indicates that loans for which payments had not been made (or deducted by the Division), but which could still be repaid within 5 years from the date the loan was taken, would be reamortized to meet the IRC requirement that the loan be repaid within the 5 years. If the loan is not repaid, under the provisions of IRC Section 72(p), there will be a reported deemed distribution to you. The deemed distribution would not relieve you of the obligation to repay the loan, with interest.

You assert that you should only be required to repay the principal and interest as originally calculated when you took the loan in April 2014. However, per N.J.S.A. 43:16A-16.1, interest accrues on any unpaid loan balance. Because loan payments were not made or taken from your pension checks, the balance of your loan did not decrease as contemplated by the original loan term.

Therefore, per the statutory requirements that govern the loan, N.J.S.A. 43:16A-16.1 and -16.2, there is additional interest that accrued on your loan that must be repaid.

The PFRS Board also relies on its ability to correct errors pursuant to N.J.S.A. 43:16A-18, which states, in pertinent part:

> Should any change or error in the records result in any member or person receiving from the retirement system more or less than he would have been entitled to receive had the records been correct, the retirement system shall correct such error, and as far as practicable, shall adjust the payments in such manner that the actuarial equivalent of the benefit to which such member or beneficiary was correctly entitled shall be paid. The actuarial equivalent of any shortage in required contributions at the time of retirement on account of misstatement of age, leave of absence, or clerical error, shall be deducted from the retirement allowance otherwise payable.

While the Board noted your original arguments, and those in your appeal letter, the Board has no authority to grant your request to waive, reduce or adjust the amount of accrued interest charged on your loan because doing so could harm the overall pension scheme. See Sellers v. Bd. of Trs., Police & Firemen's Ret. Sys., 399 N.J. Super. 51, 62 (App. Div. 2008). Reducing interest on the outstanding loan balance would violate N.J.S.A. 43:16A-16.1, IRC Section 72(p), and the State's Closing Agreement with the IRS, which could result in the PFRS no longer being considered a tax-qualified plan, which would affect the entire State, all employers in the PFRS, and every member and retiree.

As noted above, the PFRS Board has reviewed your written submissions and because this matter does not entail any disputed questions of fact, the Board was able to reach its findings of fact and conclusions of law in this matter on the basis of the PFRS's enabling statutes and without the need for an administrative hearing.

Accordingly, this correspondence shall constitute the Final Administrative Determination of the Board of Trustees of the Police and Firemen's Retirement System. You have the right, if you wish, to appeal this final administrative determination to the Superior Court of New Jersey, Appellate

Division, within 45 days of the date of this letter in accordance with the Rules Governing the Courts of the State of New Jersey.

Sincerely,

Mary Ellen Rathbun

Mary Ellen Rathbun, Secretary
Board of Trustees
Police and Firemen's Retirement System

G-2/MER

C: DAG Schimmel (ET); DAG Amy Chung (ET);