

# THE LEGAL REPORT

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## PUBLIC SERVICE - WHO GETS THE CREDIT?

While “Public Service” is often encouraged<sup>1</sup>and easily defined<sup>2</sup> (“public” - being in the service of a community)( “service” - occupation or function of contributing to the welfare of others), Credit for such public service (i.e., “credit” - time given for payment of services sold on trust) is not so easily achieved.

As the public workforce continues its trend towards mobility (voluntary or otherwise), the crediting of service for pension purposes has become an issue of primary importance. These workplace changes have resulted in retirement boards and plan administrators being increasingly called upon to administer early retirement windows, installment purchase plans, leaves of absences, re-employment of prior members and retirees, reciprocal service arrangements, and other issues requiring trustees/administrators to actively manage the crediting of service.

Generally, retirement plan (“Plan”) provisions require a Retirement Board to “determine, by appropriate rules and regulations, the amount of service to be credited any member;” however, “service” is defined in many Plan documents as simply “personal service rendered to the municipality by an employee of the municipality,” and “credited service” as “service credited to a member’s service account stated in years and fraction of a year.” In addition, Plan documents (e.g., Statute, Charter, Ordinance, Collective Bargaining Agreement) do not specifically address issues such as: (1) What service (full-time, part-time, temporary, seasonal, independent contractor, etc.) entitles an individual to membership?; (2) What are “services rendered”? (sick/vacation time, paid or unpaid leaves, worker’s compensation, etc.); (3) What is a “day”, “month”, or “year” of service for crediting purposes?; (4) What happens if there is a break in service?; (5) When, why and how is service credit earned, forfeited, or reinstated?; (6) Are there differences between service credit earned and service credit purchased?; (7) Is service recognized for vesting, eligibility for pension, disability, death and health care benefits, benefit enhancement, or seniority?; (8) Who tracks service and how?; (9) Can service credit be purchased?; and (10) Can service be transferred or recognized between Plans?

Similarly, pension laws and “reforms” have dramatically increased pension plan portability by permitting participants to purchase service credit; transfer assets between retirement plans, and/or recognize service among plans. For example, the Reciprocal Retirement Act, Michigan Public Act 88 of 1961, as amended (MCL §38.1101 et seq.), provides for the continuity of retirement system

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<sup>1</sup> *“My fellow Americans, ask not what your country can do for you - ask what you can do for your country.”*

President John F. Kennedy - Inaugural Address (January 20, 1961)  
(Inscribed on his grave at Arlington National Cemetery)

<sup>2</sup> *See Dictionary.*

service credit for public employees who transfer their employment between units of government such that an eligible person may combine service credit between Michigan governmental units for purposes of qualifying for an age and service retirement from either retirement system, or in some (limited) instances consolidating pension benefits. Further, the Internal Revenue Code (IRC) gives members the flexibility to purchase service credit or repay previously refunded contributions using transfers from other plans (Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”).

Finally, a Retirement Board must recognize that service credit may be limited by certain laws, rules or regulations (e.g., service credit purchase limitations established by IRC §415 or service credit restrictions created by a percentage limitations established in a Plan), but may be enhanced by others (e.g., Uniformed Services Employment and Re-employment Rights Act, 38 U.S.C. §§ 4301-33 (1994) (“USERRA”) guarantees rights for individuals on military leave to service credit they would have attained had they remained continuously employed. 38 U.S.C. § 4316(a)).

These developments have created both new retirement planning opportunities and challenges for governmental plans. Since a Board’s responsibility is to the Plan, trustees must ensure that service credit provisions are correctly adopted/established in the Plan and consistently administered. For example, Plans which simply provide for purchases of “service at no cost to the Employer”, create ambiguity, and overlook the increased administrative responsibilities and costs for the Plan. With no universal formula used to determine the purchase of service credit, plan provisions should clearly define the terms and conditions of the purchase, as well as the responsibilities for administration. Therefore, service credit purchase provisions should clearly address: (1) **eligibility** (who may purchase, credit limits); (2) **type** (what time is eligible: military, governmental, generic, etc.); (3) **cost** (e.g., actuarial vs. % of compensation, interest rate); (4) methods of **payment** (e.g., lump-sum vs. installment, payroll deduction, payment periods); (5) **tax** issues (e.g., after-tax vs. pre-tax payments, basis recovery, IRC limits, rollovers, employer pick-up); (6) **vesting** issues (e.g., retirement, health care); (7) **accountability** (e.g., verification of prior service, processing and accounting of payments and credits); and (8) **contingencies** (e.g., pre-retirement death, separation from service before vesting, stop payments, annuity withdrawal).

The management of service credit is not a new concept. Historically, defined benefit plans have allowed members to repay contributions previously withdrawn after breaks in service, or to purchase time for military and governmental service (prior or intervening). However, plans have experienced greater utilization of existing plan provisions and plan sponsors have established additional pension options (i.e., purchase of “air” time, acceptance of rollovers into plan, etc.) which have increased the issues regarding the crediting of service.

It is important to remember that a Retirement Board does not have the discretionary authority to change or modify Plan provisions. The ability to recognize or purchase credit for such service must be specifically authorized by the Plan documents. However, a Retirement Board is responsible for the proper administration of the Plan, and trustees must ensure that the benefits are administered consistently with the Plan and applicable law (i.e., properly enacted and financed).

Accordingly, Plan provisions and policies should clearly define the terms and conditions of crediting service, as well as the responsibilities for administration, and a Retirement Board and its administrator(s) should not hesitate to seek clarification from the employer and bargaining agents, as well as plan professionals (i.e., actuary, custodian, attorney), to establish guidelines and policies

necessary to accomplish the intended goals. As always, the retirement system's actuary should be advised of all service credited for valuation purposes, and should be consulted to ascertain costs and the financial impact of service credit, as required by Public Act 728 of 2002.

It is only through the existence of specific Plan provisions, with clear policies and procedures, that members will receive due Credit for their Public Service.

End Note:     *“Remember Credit Is Money.”* - Benjamin Franklin

Important Note: This information is limited to pension matters and does not address the various issues related to personnel or other employment/retiree benefits, such as retiree health care. This summary is intended to be informational only and this article is intended to provide a general overview of the subject matter covered. This information should not be considered the rendering of legal or other professional services and should not be used as a substitute for consultation with professional advisers.