RE: FINAL ADMINISTRATIVE DETERMINATION

March 27, 2019

Dear Mr. Arthurs:

I am writing in reference to Board of Trustees of the State Police Retirement System’s (SPRS) denial of your request to waive the amount of accrued interest owed on the outstanding balance of your pension loan as determined by the Division of Pensions and Benefits (Division). The SPRS Board initially reviewed and denied your request to waive the accrued interest owed on your outstanding loan obligation at its November 27, 2018 meeting. At that time, you acknowledged receipt of the pension loan. Thereafter, you appealed the Board’s decision. You dispute the amount of interest that you are assessed and the SPRS Board’s determination that it has no authority to grant your request to reduce or waive the accrued interest. Specifically, you disagree with the SPRS Board’s interpretation of the statutes, reliance on case law and statement that it must comply with the Internal Revenue Code Section 72(p). On January 22, 2019, the SPRS 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 Conclusions of Law, which were presented and approved by the SPRS Board at its March 26, 2019 meeting.
The SPRS Board has reviewed your correspondence and the relevant documentation and finds that the laws governing the SPRS do not permit the Board to grant your request to waive the accrued interest charged by the Division on the outstanding balance of your loan obligation.

**FINDINGS OF FACT**

You were enrolled in the SPRS on December 7, 1973, as a result of your employment as a Trooper with the New Jersey State Police. In or about 1980, you began taking pension loans and continued doing so during your active SPRS membership. From about 1995 up until your retirement you took at least one loan each year. In the 2nd quarter of 2003, you did not have an existing loan balance. However, in the 3rd quarter of 2003, immediately preceding your retirement, you took your last loan. Check number 498030 was issued to you on September 10, 2003, for $14,000.00. On September 10, 2003, a Certification of Extra Payroll Deductions (certification) was issued to your employer which included the loan repayment schedule: 54 biweekly deductions of $270.82 for a total of $14,624.28 to begin on September 20, 2003. Interest was calculated at 4.00% per year\(^1\), based on a decreasing balance each month. Your employer should have provided you with a copy of the certification.

In September 2003, you filed an application for Special retirement requesting a January 1, 2004 retirement date. Your employer certified that your employment terminated on January 1, 2004. As noted above, repayment of the loan started September 20, 2003 and a total of 15 biweekly payments of $270.82 were deducted from your payroll check and remitted to your SPRS account for your loan obligation prior to your retirement. The SPRS Board approved your Special retirement at its meeting on September 25, 2003. Once you retired and began receiving a pension, loan deductions were not taken from your pension check.

\(^1\) The interest rate for your loan is set by N.J.S.A. 53:5A-29.
On September 5, 2017, the Division notified you that a review of your SPRS membership account revealed that you had an existing loan balance in the amount of $12,022.97 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 $1,753.73 beginning with your pension check dated October 1, 2017 to satisfy the outstanding obligation including accrued interest. On September 13, 2017, you wrote to the Division requesting further information regarding the loan balance and additional charges on the obligation.

On September 26, 2017, Michael Kusmierczyk, Supervising Accountant with the Division responded to your letter. He explained that there was an outstanding loan balance as of your retirement date for which you should have been billed but was not. You were informed that the principal balance as of your retirement date was $12,022.97 and that interest accumulates on this balance until the obligation is paid in full; however, he was unable to provide you with the amount of interest owed since it is calculated by the loan program when the principal balance is almost satisfied. Additionally, Mr. Kusmierczyk provided you with copies of screen prints and documents regarding your loan obligation. Lastly, you were provided with appeal rights to the SPRS Board.

On October, 6, 2017, you appealed to the SPRS Board noting that the Division has yet to provide you with the amount of accrued interest owed on your loan balance and that you should not be required to pay almost 14 years of interest. Additionally, you claim in that in April 2004, after you failed to receive any correspondence regarding your loan, you sent a letter to the Treasury Department to inquire why you were not billed for your loan. However, you did not receive a reply. There is no record that the Division ever received your inquiry or that you ever followed up on that letter sent to the Treasury Department.

In January 2018, the Division sent you information regarding the interest on your loan, specifically, informing you that interest is owed in the amount of $9,050.64. Interest is calculated at 4.00% per year on the declining balance, and you owe interest from your date of retirement, January
1, 2004 through September 30, 2018. Acting Director John D. Megariotis also sent you a letter on January 16, 2018, indicating that your appeal of your outstanding loan balance is being held in abeyance until finalization of discussions with the Internal Revenue Service (IRS). In February 2018, you communicated via email with the Board Office regarding this letter and expressed your intent to attend the SPRS meeting and address the Board regarding your reasons that you should not have to pay for the years of accrued interest. The record indicates that the last payment for your loan obligation was deducted from your check dated October 1, 2018 which satisfied the loan and the amount of accrued interest. By letter dated November 1, 2018, you were notified that the SPRS Board would consider your appeal at its meeting on November 27, 2018.

The SPRS Board notes that after the January 16, 2018 letter to you, 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 SPRS.

In November 27, 2018, the SPRS Board considered your submissions and statements, including your contention that it was the Division, not you, that had control over deducting the loan from your retirement check, but you are being held responsible for the interest that has accrued. However, you admitted you were aware that your outstanding loan was not being repaid, you sent a letter to the Treasury Department, not the Division, and that you thought that at some future point, the Division would eventually begin the loan repayment, but did not expect it to be years later. After careful consideration, the SPRS Board denied your request to waive the accrued interest owed on the outstanding balance of your loan obligation. The basis of the SPRS Board’s decision was set forth in its letter dated November 29, 2018.

Thereafter, you appealed the SPRS Board’s determination. You assert that an inordinate amount of interest is tacked onto your loan because of an error by the State. You argue that the Board’s reliance on Sellers v. Bd. of Trs., Police & Firemen’s Ret. Sys., 399 N.J. Super. 51, 62 (App.
Div. 2008) is misplaced because Sellers permitted the Board to exercise inherent equitable powers, and that reducing interest on your loan does not harm the overall pension scheme. Further, you disagree with the SPRS Board’s interpretation of the statutes governing the SPRS and the SPRS Board’s reliance on the Internal Revenue Code Section 72(p). At its meeting on January 22, 2019, the SPRS Board considered your arguments, 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**

The SPRS loan program is governed by N.J.S.A. 53:5A-29 which states in pertinent part:

Loans shall be made to a member from the member’s aggregate contributions. The interest earned on such loans shall be treated in the same manner as interest earned from investments of the retirement system.

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 allowance payments the same monthly amount which was deducted from the salary of the member immediately preceding retirement until the balance of the amount borrowed together with the interest is repaid. In the case of a retirant 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 retirant either in the form of monthly payments due to the retirant’s beneficiaries or in the form of lump sum payments payable for pension or group life insurance.

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. 53:5A-29. After the enactment of Chapter 92, the State Treasurer sets “a commercially reasonable rate” on January 1 of each calendar year. Ibid. Finally, the member must repay “the amount so borrowed, together with interest on any unpaid balance thereof…” Ibid.
The SPRS 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 Internal Revenue Service.” N.J.S.A. 43:3C-18(a). The Director of the Division is “authorized to modify the provisions of the [SPRS], when a modification is required to maintain the qualified status of the [SPRS] under the Internal Revenue Code of 1986, applicable regulations of the U.S. Treasury Department, and other guidance of the federal Internal Revenue Service (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 several loans from your SPRS account, and that you took the last loan on September 10, 2003. There is also no dispute that you began repaying your loan through payroll deductions and that prior to your retirement a total of 15 biweekly deductions were taken, in accordance with the Certification of Payroll deductions. There is also no dispute that the repayment ceased when you retired and deductions were not taken from your pension check. You admitted knowledge that deductions were not being taken from your loan check to repay your pension loan. While you did send a letter to the Treasury Department, you did not directly contact the Division. The Division did not receive your letter and you admit that you never received a response to your letter and you never followed up. The SPRS 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 to repay your
loan.

The SPRS Board is also aware that the issue of the repayment of loans in retirement
implicates more than just your loan. Because the SPRS is a federally tax-qualified plan, as
required by N.J.S.A. 43:3C-18(a), the SPRS’s failure to comply with all the requirements of the
IRC could result in the IRS determining that the SPRS 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 SPRS tax-qualified, signed a Closing Agreement with the IRS. In addition
to setting forth methods to repay certain loans, the Closing Agreement reiterates that the plan is
subject to IRC Section 72(p). Even when a loan is not properly repaid under the provisions of IRC
Section 72(p), and there is a reported deemed distribution, the deemed distribution would not
relieve a member of the obligation to repay the loan, with interest.

You assert that the interest that accrued is not a result of your error. While the SPRS
Board acknowledges that the Division did not withhold loan repayments from your pension check,
you admit that you were aware that your loan was not carried into retirement and even after you
received no response from the letter you assert you wrote to the Treasury Department you never
contacted the Division to start the repayment of the loan. Per N.J.S.A. 53:5A-29, 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, and your loan was not fully repaid as
contemplated by the loan repayment schedule. Therefore, per the statutory requirements that
govern the loan, N.J.S.A. 53:5A-29, there is additional interest that accrued on your loan that must
be repaid.
The SPRS Board also relies on its ability to correct errors pursuant to N.J.S.A. 53:5A-42 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, as far as practicable, correct such error and 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 reduce or refund 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). While you assert that applying equity and reducing the interest on your outstanding loan balance will not harm the overall pension scheme, reducing interest on the outstanding loan balance would violate N.J.S.A. 53:5A-29, IRC Section 72(p), and the State’s Closing Agreement with the IRS, which could result in the SPRS no longer being considered a tax-qualified plan, which would affect the entire State, the SPRS, and every member and retiree.

As noted above, the SPRS Board has considered your personal statements and your written submissions and because this matter does not entail any disputed questions of fact, the SPRS Board was able to reach its findings of fact and conclusions of law in this matter on the basis of the retirement system'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 State Police Retirement System.
You have the right, if you wish to appeal this final administrative action 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
State Police Retirement System

G-1/MER

C: DAG Christopher Meyer (ET); DAG Amy Chung (ET);