



PHILIP D. MURPHY  
*Governor*

SHEILA Y. OLIVER  
*Lt. Governor*

State of New Jersey  
DEPARTMENT OF THE TREASURY  
DIVISION OF PENSIONS AND BENEFITS  
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ELIZABETH MAHER MUOIO  
*State Treasurer*

JOHN D. MEGARIOTIS  
*Acting Director*

June 20, 2019

USCHER, QUIAT, USCHER & RUSSO, P. C.  
Joseph A. Russo, Esq.

[REDACTED]  
[REDACTED]

RE: Robert Baker

[REDACTED]

**FINAL ADMINISTRATIVE DETERMINATION**

Dear Mr. Russo:

I am writing in reference to the decision of the Board of Trustees (Board) of the Public Employees' Retirement System (PERS) in which it denied your request, on behalf of your client, Robert Baker, to waive the accrued interest owed on his outstanding pension loan balance as determined by the Division of Pensions and Benefits (Division). The Board initially reviewed and denied his request at its meeting of January 16, 2019. You appealed the Board's decision via letter dated February 23, 2019. In your letter of appeal, you asserted that the Board's reliance on the correction of errors statute, N.J.S.A. 43:15A-54, is misplaced. You further assert that the Board's reliance on Sellers v. Board of Trustees of the Police & Firemen's Retirement System, 399 N.J. Super. 51, 62 (App. Div. 2008), is misplaced, because waiving the accrued interest on Mr. Baker's outstanding pension loan would not result in harm to the overall pension scheme.

At its meeting of April 17, 2019, the Board considered your appeal of that decision and determined that there are 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 were presented and approved by the PERS Board at its June 19, 2019 meeting.

The Board has reviewed your written submissions and the relevant documentation, and finds that the statutes, regulations and relevant case law governing the PERS do not permit the Board to waive the accrued interest on the outstanding loan balance.

### **FINDINGS OF FACT**

The record establishes that Mr. Baker was enrolled in the PERS on or about April 1, 1972, as a result of his employment with William Paterson College. Immediately preceding his retirement, Mr. Baker took a pension loan from his PERS account and was issued a check dated February 25, 2004, in the amount of \$760.00. This new loan amount was added to his previous loan balance, and the Division issued a new payment schedule, reflecting the updated loan totals and new loan deductions. A Certification of Payroll Deductions was issued to Mr. Baker's employer noting that his loan deductions would begin on March 20, 2004, with 128 payments of \$104.85 deducted from his paychecks until the loan was satisfied in full. At that time, his employer should have provided him with a copy of the Certification of Payroll Deductions. Mr. Baker began paying back his loan through payroll deductions on March 20, 2004 and continued to make payments on his outstanding loan balance through June 30, 2004. Upon Mr. Baker's July 1, 2004, retirement, his outstanding loan balance was \$11,486.27. Loan payment deductions should have continued with Mr. Baker's first monthly retirement payment; however, this did not occur.

On October 13, 2017, the Division notified Mr. Baker via letter that a review of his PERS account revealed that his pension loan balance was never satisfied as required by N.J.S.A. 43:15A-34.<sup>1</sup> Therefore, the Division established a repayment schedule with payments being deducted from his monthly retirement allowance to satisfy the outstanding obligation with applicable interest. Starting with his check dated November 1, 2017, a payment of \$514.87 was deducted from his retirement allowance.

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<sup>1</sup> Additionally, all pension loans are subject to the Internal Revenue Code (IRS) I.R.C. § 72(p).

On or about December 12, 2017, you replied on Mr. Baker's behalf via letter and advised that he did not have an outstanding loan balance at retirement. You asserted that Mr. Baker was advised that he could not retire with an existing loan balance, and that he remained employed until his pension loan was paid off in full. You also requested that the Division provide evidence of the outstanding loan balance, and to reduce his monthly loan payment to the amount he had been paying on the loan prior to his retirement. Finally, you requested postponing the collection of the outstanding loan balance and any accrued interest until Mr. Baker had the opportunity to appeal the Division's decision.

On January 19, 2018, the Division replied to your letter and advised that a loan check was issued to Mr. Baker on February 25, 2004, in the amount of \$760.00. Because Mr. Baker had already had an outstanding loan balance in his PERS account, this amount was added to his outstanding loan balance. Although you asserted that Mr. Baker continued working for the sole purpose of paying off his pension loan, he applied for his retirement March 1, 2004, with an effective date of July 1, 2004. Thus, he took the final pension loan one week prior to filing for his retirement. The Division further advised that it was unable to waive the accrued interest on the outstanding pension loan obligation, however, due to Mr. Baker's hardship claim, the Division reduced the monthly loan deduction to \$351.00, which would commence with the February 1, 2018 retirement check. An interest rate of 4.00 percent was used to determine the amount of interest and the interest period is from July 1, 2004 through September 30, 2022. The total accrued interest is equal to \$10,004.06. The interest rate for loans requested prior to June 8, 2007, is set at 4.00%. N.J.S.A. 43:15A-34. Loans requested after June 8, 2007, have an interest rate set annually by the State Treasurer. Ibid. The interest rate remains constant through the life of the loan.

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On behalf of Mr. Baker you appealed the Division's determination on February 8, 2018 to the PERS Board, again requesting that the Board cancel the entirety of the outstanding loan balance and waive the accrued interest on the unpaid portion of Mr. Baker's loan, and reduce Mr. Baker's monthly loan deduction during the pendency of his appeal.

The Board considered Mr. Baker's appeal at its meeting of January 16, 2019. After careful consideration, the Board voted to deny Mr. Baker's request cancel the outstanding loan obligation and waive the accrued interest on the outstanding balance of his pension loan as determined by the Division.

Thereafter, on February 19, 2019, you appealed the Board's determination. You argued that the Board should exercise equitable principles to waive or decrease the amount of accrued interest on Mr. Baker's loan. You assert that, notwithstanding the potentially harmful impact to the PERS and its members if it were to ignore IRS directives as well as its rules and regulations, the overall pension scheme would not be harmed should the Board implement your request to waive the accrued interest on Mr. Baker's outstanding loan balance.

At its meeting on April 17, 2019, 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. 43:15A-34 governs the repayment of a PERS member's pension loan and states in part that "[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." After the enactment of Chapter 92, the State Treasurer sets "a commercially reasonable rate" on January 1 of each calendar year. Ibid. Further:

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.

[N.J.S.A. 43:15A-34.]

N.J.S.A. 43:15A-34.1 governs the payment of loans carried into the member's retirement:

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 PERS 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 [PERS], when a modification is required to maintain the qualified status of the [PERS] 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

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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 Mr. Baker took several loans throughout his career. There is further no dispute that, immediately prior to filing his retirement application, Mr. Baker took another pension loan from his PERS account, which was added to the previous loan balance and the Division created a new loan payment schedule. At that time, Mr. Baker's multiple loans were being repaid through payroll deductions and payroll deductions were taken (under the amended schedule) from March 20, 2004 through his retirement on July 1, 2004. Mr. Baker had to have known that he had 128 payments to make when he took out the final loan on his PERS account, but only made approximately 8 of the 128 payments need to satisfy his obligation. The Board acknowledges that his loan payments were not carried into retirement and automatically deducted from his pension checks by the Division. However, the Board could find no record of Mr. Baker contacting the Division in order to make the 120 payments he knew he needed to make to satisfy his loan obligation.

The PERS Board is also aware that the issue of the repayment of loans in retirement implicates more than just Mr. Baker's loan. Because the PERS is a federally tax-qualified plan, as required by N.J.S.A. 43:3C-18(a), the PERS's failure to comply with all the requirements of the IRC could result in the IRS determining that the PERS 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 PERS 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.

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In your appeal, you assert that the Division may waive interest on the loan because forgoing those monies would cause no harm to the fund. However, as stated above, the IRS rules and regulations require the Board to collect interest on outstanding loans. In fact, if the Board is not in compliance with IRS rules and regulations, the fund would be in jeopardy of losing its tax-exempt status. Clearly, if the Board were to grant your request, it has the potential to seriously harm the funds for all of its members. While the Board acknowledges that the Division did not withhold loan repayments from Mr. Baker's pension check, Mr. Baker was clearly aware that he had only paid back his loan for two months prior to his retirement, and that he had approximately 120 payments left before he satisfied his loan obligation. Notwithstanding this knowledge, Mr. Baker never contacted the Division regarding repayment after his retirement. Moreover, Mr. Baker had full use of the loan proceeds for a number of years.

Per N.J.S.A. 43:15A-34 and N.J.S.A. 43:15A-34.1, interest accrues on any unpaid loan balance. Because loan payments were not made or taken from his pension checks, the balance of his loan did not decrease, and his loan was not repaid as contemplated by the loan repayment schedule. Therefore, per the statutory requirements that govern the loan there is additional interest that accrued that must be repaid.

While the Board noted that Mr. Baker's loan was not carried into retirement and no deductions were made from his monthly retirement benefit, N.J.S.A. 43:15A-54, provides for the correction of errors, stating, in pertinent part:

If any change or error results in an employee or beneficiary receiving from the retirement system more or less than he would have been entitled to receive, then on discovery of the error, the retirement system shall correct it and, so far as practicable, adjust the payments in such a manner that the actuarial equivalent of the benefit to which he was correctly entitled shall be paid.

While the Board noted your arguments on Mr. Baker's behalf, it has no authority to grant your request to reduce or refund the amount of accrued interest charged on your loan because

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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. 43:15A-34 and N.J.S.A. 43:15A-34.1, IRC Section 72(p), and the State's Closing Agreement with the IRS, which could result in the PERS no longer being considered a tax-qualified plan, which would affect the entire State, all employers in the PERS, and every member and retiree.

As noted above, the PERS Board has considered your written submissions and because this matter does not entail any disputed questions of fact, the PERS 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 Public Employees' 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. All appeals should be directed to:

Superior Court of New Jersey  
Appellate Division  
Attn: Court Clerk  
PO Box 006  
Trenton, NJ 08625

Sincerely,



Jeff S. Ignatowicz, Secretary  
Board of Trustees  
Public Employees' Retirement System

G-12/JSI  
C: D. Dinkler (ET) Kusmierczyk (ET)