

FORMAL OPINION

November 29, 1965

HONORABLE JOHN A. KERVICK
State Treasurer
State House
Trenton, New Jersey

FORMAL OPINION NO. 5

Dear Mr. Kervick:

You have requested our advice as to the effect on the Teachers' Pension and Annuity Fund and the Public Employees' Retirement System of Chapter 90 of P.L. 1965. This law amends the Supplemental Annuity Collective Trust of New Jersey Act, N.J.S.A. 52:18A-107, *et seq.* As provided in the Statement attached to the Bill, these amendments "...enable an eligible employee to enter agreements whereby, on their behalf, the employer will purchase annuities from the trust which will qualify for the tax sheltered or tax deferred treatment permitted pursuant to section 403(b) of the Internal Revenue Code."

The specific question posed is whether the employee's contributions to the Teachers' Pension and Annuity Fund or the Public Employees' Retirement System should be based on the employee's salary before the reduction or on the employee's salary after the reduction attributable to the purchase of an annuity.

It is our opinion for the reasons expressed herein that the employee's contributions to the Teachers' Pension and Annuity Fund and the Public Employees' Retirement System should be based on the employee's salary before the reduction and the benefit formula should likewise be expressed as a percentage of the final salary or final average salary before reduction.

Section 403(b) of the Internal Revenue Code concerns the taxation of annuities purchased by certain tax exempt organizations for their employees. It provides generally that if such an employer purchases an annuity contract for an employee and certain conditions are satisfied, the amounts paid by the employer for such annuity contract, subject to specified limitations, are excludable from the gross income of the employee. The Code was amended to include public school systems among those employers who qualify as tax exempt organizations. P.L. 87-370 (1961). The implication of section 403(b) which occasions this opinion relates to the amount of contributions due to the retirement system. In determining the amount of contributions payable to the system, such amounts are expressed as a percentage of contractual salary or base salary. Under a salary reduction agreement entered into pursuant to the authority of P.L. 1965, c. 90, the board of education contractually agrees to reduce the compensation of certain members of the retirement system in order to purchase annuities for such members.

This determination is important to the computation of the contributions due from the member as well as the employer and in fixing the benefits that would be payable upon retirement since the benefit formula is expressed as a percentage of final salary or final average salary.

N.J.S.A. 18:13-112.4 defines the compensation subject to contributions to the Teachers' Pension and Annuity Fund as the "... contractual salary for services as a teacher . . ." The statute governing the Public Employees' Retirement System contains no definition of the term "compensation", but in administering the statute, the Board of Trustees and the Division of Pensions consider the annual "base salary" as the compensation subject to contributions to the retirement system. See, *Memo-*

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randum Opinion P-10, 1961 (1960-63 Opinions of the Attorney General 181-82).

The relationship between the boards of education of this State and their employees is contractual and the employee's initial place on the minimum salary schedule is determined by contract. N.J.S.A. 18:13-13.4. The purchase of a tax favored annuity would be made pursuant to an agreement between the employee and the board. P.L. 1965, c. 90. The teacher enters into a salary reduction agreement which provides that a portion of his salary will be diverted to the purchase of the annuity. By this voluntary election the employee waives the right to receive payment of his entire salary in cash and agrees that a portion of the salary may be paid in the form of rights of participation under the annuity contract. The take-home pay of the employee is thus reduced but his annual compensation, albeit in a different form, is the same. By this device he defers payment of federal income tax on the portion of his salary used to purchase the annuity. Since the annual compensation of the employee remains the same, his contributions to his retirement system should be based on this "actual" compensation and not the reduced "take-home pay" he voluntarily requested to gain a tax advantage.

The conclusion drawn here is supported by *Memorandum Opinion P-5, 1961 (1960-63 Opinions of the Attorney General 175)*. There, the question under review was whether an employee member of the Teachers' Pension and Annuity Fund, who had been disabled and was receiving workmen's compensation at a reduced rate, was required to make contributions to the retirement system at a percentage of his contractual salary rather than at a percentage of the workmen's compensation benefits which he was then actually receiving. The opinion held that contributions must be made in accordance with the "contractual salary" and not in accordance with the workmen's compensation award. A similar result should obtain here because the same rationale underlies both situations. Simply stated, it is that an employee is entitled to a retirement allowance based upon his annual compensation and makes contributions on that basis, regardless of the dollars and cents amount he actually receives in any given year.

We are therefore of the opinion that where amounts paid toward the purchase of an annuity are derived from an employee's salary, contributions to the respective retirement systems should be based on the compensation before reduction and the benefit formula should be expressed as a percentage of final salary or final average salary before reduction.

Very truly yours,
ARTHUR J. SILLS
Attorney General

BY: RICHARD NEWMAN
Deputy Attorney General