



# Duty Disability Conversion Final Proposal

LEOFF Plan 2 Retirement Board

December 17, 2008

# Issue

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- Members who retired as a result of duty related disabilities prior to the creation of duty disability retirements are not receiving the favorable tax treatment on their benefits to which they are entitled.

# Proposal Summary

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- Covert eligible service and disability retirements to occupational disability
  - Most benefits not recalculated
  - Favorable tax treatment
- Costs are indeterminate

# Duty Disability Conversion

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Questions?

# LAW ENFORCEMENT OFFICERS' AND FIRE FIGHTERS' PLAN 2 RETIREMENT BOARD

## Duty Disability Retirement Conversion

### Final Proposal

December 17, 2008

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#### 1. Issue

Members who retired as a result of duty related disabilities prior to the creation of duty disability retirements are not receiving the favorable tax treatment on their benefits to which they are entitled.

#### 2. Proposal Summary

Convert eligible service and disability retirements to occupational disability retirements only for the purpose of allowing affected retirees to take advantage of favorable tax treatment on the first 10% of the member's salary. This option does not recalculate the base benefit of the retiree.<sup>1</sup>

#### 3. Staff

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#### 4. Members Impacted

As of June 30, 2007 there were 924 total retirees and beneficiaries. The number of retirees potentially impacted is unknown due to a lack of data regarding disabled members.

#### 5. Current Situation

All members of the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF) Plan 2 are eligible for normal retirement at age 53, and early retirement beginning at age 50. A member who is disabled from a duty related injury can retire earlier. There are three levels of duty-related disability benefits in LEOFF Plan 2 including a minimum disability benefit, an occupational disability benefit, and a catastrophic disability benefit. Some of the duty related disability benefits receive favorable tax treatment.

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<sup>1</sup> The Board passed a motion at the October 22, 2008 meeting to hear Option 1 as a Final Proposal.

The LEOFF Plan 2 duty related disability benefits that have been enacted since 2004 have mostly been prospective. Only the Survivor Health Care benefit and the favorable tax treatment for the Minimum Disability benefit were enacted retroactively.

## **5. Background Information and Policy Issues**

### **Duty Related Disability Benefits**

Prior to 2004, there were no specific duty related disability retirement benefits for a member who was injured in the course of employment. Members who were disabled in the course of employment received the same benefits as members whose disability was not duty related.

A disabled member with 10 or more years of service was eligible to receive an actuarially reduced<sup>2</sup> retirement benefit or could request a refund of 150 percent of their accumulated contributions. A member with less than 10 years of service could request 100 percent of their contributions and interest. These benefits did not receive favorable tax treatment.

Legislation enacted since 2004 created three levels of duty related disability benefits in LEOFF Plan 2. The disability program now includes a minimum disability benefit, an occupational disability benefit, and a catastrophic disability benefit. While some of the duty related disability benefits provide favorable tax treatment, only those members who retired due to duty disability under the new provisions receive the favorable tax treatment. Members who retired due to duty disability under the prior provisions do not receive favorable tax treatment.

### **Minimum Duty Disability Benefit**

Legislation enacted in 2004 created the minimum duty related disability benefit in 2004. This legislation created a minimum level of benefits provided to a member disabled in the course of employment and qualifies for favorable tax treatment.

A LEOFF Plan 2 member who leaves service as a result of a line of duty disability can receive a retirement allowance of at least 10 percent of final average salary. If the 2 percent per year of service disability benefit, actuarially reduced for the difference between age 53 and age at retirement, results in a greater benefit than the minimum 10 percent, the member receives the greater benefit. In either case, the first 10 percent of the line of duty disability benefit is not subject to federal income tax.

Alternatively, a member of LEOFF 2 who is disabled in the line of duty may request a refund of 150 percent of his or her accumulated contributions in lieu of the disability retirement allowance. This withdrawal benefit receives favorable tax treatment.

The line of duty disability minimum benefit was effective June 10, 2004 and applied to all LEOFF Plan 2 members disabled in the line of duty on or after January 1, 2001 so that

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<sup>2</sup> The actuarial reduction was based on the difference between the member's age and age 53

affected members could take advantage of the favorable tax treatment and file amended tax returns.

### **Occupational Duty Disability Benefit**

Legislation enacted in 2005 created the Occupational Duty Disability Benefit. This legislation removed the actuarial reduction from the monthly retirement benefit for members with 10 or more years of service whose duty-related disability prevents them from engaging in any future employment as a law enforcement officer or fire fighter.

The Occupational Duty Disability Benefit did not provided any additional favorable tax treatment beyond that provided by the Minimum Duty Disability Benefit where the first 10 percent of the benefit receives favorable tax treatment.

The Occupational Duty Disability was prospective from its effective date of May 13, 2005.

### **Catastrophic Duty Disability Benefit**

Legislation enacted in 2006 created the Catastrophic Duty Disability Benefit. This legislation created a disability allowance equal to 70 percent of final average salary, which receives favorable tax treatment and is not actuarially reduced for early retirement, for a LEOFF Plan 2 member who is catastrophically disabled in the course of employment.

A catastrophic disability is defined as a member's inability to perform any substantial gainful activity due to a physical or mental condition that may be expected to result in death or last for at least 12 months. Substantial gainful activity is defined as average earnings of more than \$940 per month (2008), adjusted annually based on Federal Social Security standards.

The total disability benefit is reduced to the extent that in combination with certain workers' compensation payments and Social Security disability benefits, the disabled member would not receive more that 100 percent of final average salary.

The Catastrophic Duty Disability was prospective from its effective date of March 14, 2006.

### **Identifying Duty Disability Retirees**

Prior to 2004, actuarial reductions resulted in only a modest duty disability retirement. Due to the inadequacy of this benefit, it is believed that most duty disabled members opted for a refund of accumulated contributions in lieu of the actuarially reduced duty disability retirement benefit.

Data prior to the 2004 duty disability legislation regarding the number of duty related disability retirements is limited. According to the Department of Retirement Systems (DRS) there were 66 disability retirements prior to 2004 and 11 disability withdrawals. However, there were also 5,022 member withdrawals, any of which could have been related to a duty related disability. There were also 292 service retirements prior to 2004. Any member who was disabled on the job and was retirement eligible would have likely been processed as a service retirement rather than a disability retirement.

Given this information it is clear that it is difficult to specifically determine the number of members that suffered a duty-related disability. Thus, it would be a challenge to identify those that might be eligible to have their benefits converted to duty related. Additionally, it could be challenging to contact some of those identified as duty related disabilities.

Members that retired as service or disability retirees can be contacted as they must still have current contact information on file with DRS to receive pension payments. However, for members who withdrew their account it is highly unlikely that current address information or other contact information is available. If these members can be identified, it is possible that information such as their social security number could be utilized to locate the member.

## **6. Policy Options**

### **Option 1**

Convert eligible service and disability retirements to occupational disability retirements only for the purpose of allowing affected retirees to take advantage of favorable tax treatment on the first 10% of the member's salary. This option does not recalculate the base benefit of the retiree.

### **Option 2**

Convert eligible service and disability retirements to occupational disability retirements and recalculate benefits. This option would remove any early retirement reduction factors applied to the original benefit calculation and allows for favorable tax treatment on the first 10% of the member's salary.

### **Option 3**

Convert eligible withdrawn accounts to occupational duty disability retirement. Under this option an eligible member would restore their withdrawn account and then have a disability benefit calculated providing a monthly annuity.

### **Option 4**

Convert eligible service and disability retirements (and possibly eligible withdrawn accounts) to catastrophic disabilities. This option would assure that the member would receive at least 70% of their Final Average Salary and favorable tax treatment.

# DRAFT FISCAL NOTE SUMMARY

RESPONDING AGENCY:	CODE:	DATE:	PROPOSAL [NAME or Z-NUMBER]:
Office of the State Actuary	035	11/25/08	LEOFF 2 Duty Disability Reclassification

## WHAT THE READER SHOULD KNOW

This document represents the first page of a draft fiscal note. The Office of the State Actuary ("we") prepared this summary based on our understanding of the proposal as of the date shown above. We intend this summary to be used by the Law Enforcement Officers' and Fire Fighters' Retirement System Plan 2 Board (LEOFF 2) throughout the 2008 Interim only. We will prepare a complete draft fiscal note to replace this preliminary summary prior to the start of the 2009 Legislative Session. If a legislator introduces this proposal as a bill during the next legislative session, we will prepare a final fiscal note based on that bill language. The actuarial results shown in this summary may change when we prepare our final version for the Legislature.

## SUMMARY OF RESULTS

Due to the lack of data available about the members potentially impacted, the costs for this proposal are indeterminate.

This proposal grants Department of Retirement Systems (DRS) the authority to reclassify LEOFF 2 members with in the line of duty disabilities provided they:

- Left service prior to 2001.
- Currently receives a non-duty-disability or service retirement pension allowance.
- Can prove their disability occurred in the line of duty.

We have data for six members currently receiving a non-duty disability pension who left service prior to 2001 whose annual benefits are less than 10 percent of their FAS. This proposal would increase their annual pension amount to 10 percent provided they could prove their disabilities occurred in the line of duty. This increase in pension amount increases the cost of LEOFF 2.

We do not have any data for members currently receiving service retirement pension allowances that this proposal could impact. This proposal could increase pension benefit amounts if a member currently receives less than 10 percent of FAS, increasing the cost of LEOFF 2. On the other hand reclassifying these members as having duty-disabilities means we would apply the disability mortality table to them prospectively, decreasing the cost of LEOFF 2.

For all members impacted by this proposal, whether their annual benefit amounts would change or not, benefit payments up to 10 percent of their FAS would receive favorable tax treatment by the IRS. The favorable tax treatment will not impact the cost of LEOFF 2.

We will prepare a draft fiscal note for this proposal prior to the 2009 Legislative Session. We will include sensitivity analysis of the cost of this proposal in that draft fiscal note.