

INTERNAL REVENUE CODE SECTION 415(b) FACT SHEET

What is Internal Revenue Code Section 415(b)?

Internal Revenue Code Section 415(b) (IRC 415) is a federal provision that limits that amount of annual retirement benefit an individual can receive from tax-qualified defined benefit pension plans such as the Federated City Employees' Retirement System ("Federated") and the Police & Fire Department Retirement Plan ("PF"). The annual retirement benefits payable from the Federated and PF Plans are subject to the dollar limits imposed by IRC 415.

The Federated and Police & Fire retirement plans may lose their tax-exempt status if they fail to comply with IRC 415.

What is the IRC 415 Benefit Limit?

IRC 415 places a dollar limit on the annual retirement benefit ("allowance") that a retiree can receive from a tax-qualified pension plan. For example, in 2025, the maximum dollar limit was \$280,000. The IRC 415 benefit limit is indexed annually based on inflation.

Adjustments are made to a retiree's individual IRC 415 dollar limit based on the following factors, which are discussed further below:

- Age at retirement
- Less than 10 years of service
- Membership before January 1, 1990 ("Grandfather")
- Post tax contributions
- Unqualified joint & survivor benefit

Age at Retirement

If a member retires before age 62, their IRC 415 limit is adjusted to be the actuarial equivalent as if the member was aged 62. A retiree's age-adjusted limit is based on the retiree's age at retirement rounded down to the nearest month. The current year age-adjusted benefit limit table by month can be found on Retirement Services' website, www.sjretirement.com.

There are two exceptions to the age-adjusted limit:

1. Retirees who were employed in the Police or Fire Department for at least 15 years are exempted from the age adjustment. Their IRC 415 limit is the maximum limit without age reduction. The retiree must have been in a position budgeted in the Police or Fire Department for at least 15 years. Federated retirees who were assigned to work in the Police Department but were in a position budgeted in another department such as Information Technology or Human Resources are not exempted from age adjustment.
2. Retirees who are approved by the Board for a service-connected or non-service-connected disability retirement are exempted from the age adjustment. Their IRC 415 limit is the maximum limit without age reduction.

Less than Ten Years of Service

If a retiree has less than 10 years of service, their IRC 415 limit is subject to additional actuarial reduction. Because Federated & PF pension allowances are based on years of service, it's unlikely that a Federated or PF retiree with less than 10 years of service will earn enough in retirement to exceed their dollar limit.

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Membership Before January 1, 1990 (“Grandfather”)

If a retiree was a member of the Federated or PF plan before January 1, 1990, they may be eligible for a “grandfather” benefit based on the plan benefits at the time they joined the plan. This is also referred to as a “TAMRA” (Technical and Miscellaneous Revenue Act of 1988) adjustment.

For retirees hired before January 1, 1990, their potential allowance in any given year cannot be lower than the allowance they would have received under plan rules in effect on October 14, 1987. The following plan rules were in effect on October 14, 1987, which are different from Tier 1 plan rules currently in effect:

- Final average salary based on the retiree’s 3 highest years.
- Annual COLA adjustment tied to the Consumer Price Index with a maximum of 3%, banking, and a one-year waiting period.
- Maximum 75% benefit (Police & Fire).

A retiree will be disqualified from the grandfather/TAMRA calculation, regardless of date of membership, if they took advantage of plan benefits that were not available on their date of membership, including the following:

- Any service purchase if the service was needed to be eligible to retire.
- The selection of a survivorship option.
- Retirement with reciprocal benefits.
- The utilization of an “Early Retirement Incentive” offered to employees in 1992 and 1993.

If a retiree is eligible for a grandfather/TAMRA benefit, their annual benefit allowance will be calculated in two ways. First it will be calculated based on the plan rules at the time of their retirement (i.e. the current rules) and adjusted based on their IRC 415 dollar limit. Second, it will be calculated based on the plan rules at the time of the date they joined the plan (this calculation is not subject to IRC 415 limit). If a retiree is impacted by IRC 415 in a given year, the retiree is automatically given the higher benefit between the two calculations. In some years the higher benefit may be the grandfather benefit, in other years it may be the IRC 415 adjusted benefit. Regardless, it’s evaluated every year and the retiree is given the higher benefit every year in which they’re impacted.

Post Tax Contributions

Retirees who were members of the Federated or PF plan on or before April 18, 1987, made post tax retirement contributions. The value of their post-tax retirement contributions does not count toward their IRC 415 limit. For example, if you’re IRC 415 limit is \$175,000 in a given year and you made \$10,000 in post tax retirement contributions before April 18, 1987, your maximum earnings for that year would be \$175,000 plus \$10,000 or \$185,000.

Unqualified Joint & Survivor Benefit

If a retiree has an “unqualified joint and survivor benefit” under IRC 415, their IRC 415 limit is subject to additional actuarial reduction. Below are several ways your survivorship benefit would be considered an unqualified joint & survivor benefit under the IRC 415 rules:

1. A retiree designates a non-spouse beneficiary, such as a registered domestic partner.
2. A Police and Fire Plan retiree chooses a “pop-up” survivorship option at retirement.
3. A retiree chooses a survivorship benefit that is less than 50% of the retiree’s benefit. For Police and Fire, there have been periods of time when the maximum survivorship benefit is less than

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50%. For example, in 2025 for Police, the maximum survivorship benefit is 42.5%, however, 50% of the retiree's maximum benefit is 45% ($90\% \times 50\% = 45\%$). Since the maximum survivorship is less than 50%, it would be considered an unqualified joint and survivor benefit. In this example, any retiree benefit over 85% will have an unmodified survivorship less than 50%, which would be an unqualified joint and survivor annuity.

Does a Retiree's IRC 415 Limit Change Annually?

The IRC 415 benefit limit is indexed annually based on inflation. From year to year the maximum limit might increase, decrease, or stay the same.

If a retiree is exempted from the age-adjusted limit adjustment, the retiree's limit in the calendar year will be the maximum limit for that calendar year. For example, if the maximum limit is \$280,000 in 2025, the retiree's limit will be \$280,000 that year. If the maximum increases to \$285,000 in 2026, the retiree's limit will also increase to \$285,000 in 2026.

If a retiree's limit is age-adjusted, the retiree's limit will be adjusted as the maximum limit changes over time based on the ratio of their age-adjusted limit to the maximum limit at the time of retirement. For example, if, on the date of a member's retirement in 2023, the maximum dollar limit is \$250,000 and the retiree's age-adjusted limit is \$200,000, the retiree's limit will be designated as 80% of the maximum ($\$200,000$ divided by $\$250,000$). If, in following year (2024), the IRS increases the maximum limit to \$260,000, the retiree's new age-adjusted limit will be 80% of the new maximum, or \$208,000 ($\$260,000 \times 80\%$).

How do I know if I'm impacted by IRC 415 limits?

After a member retires, their retirement allowance is evaluated annually by the Plans' actuary to determine if it is limited by IRC 415.

If a retiree's allowance is limited by IRC 415, the Office of Retirement Services ("ORS") will notify impacted PF retirees no later than March 31st and Federated retirees no later than April 30th of each year. The retiree will see a "415 Reduction" line item on their monthly pension pay advice for the period in which their allowance must be reduced. For Police and Fire, the retiree's allowance will be reduced from March through January of the following year. Police & Fire retirees' February allowances are not adjusted for IRC 415. For Federated, the retiree's allowance will be reduced from April through March of the following year. If needed, the January and February IRC 415 reductions may be adjusted since they fall in a new calendar year in which the IRC 415 limit may be different.

If a retiree's allowance is not impacted by IRC 415 in a calendar year, they will not receive a notification from ORS. For example, if the retiree's allowance was reduced in 2023 due to the IRC 415 limit but the following year, 2024, the retiree's IRC dollar limit increases such that they are not impacted that year, ORS will not send the retiree a notification in 2024.

Do I receive an annual cost-of-living adjustment if I'm impacted by IRC 415?

Yes. Annual cost-of-living ("COLA") adjustments are added to retirees' pension allowances per the San José Municipal Code. The amount of your accumulated COLA is shown on your monthly pension pay advice.

If the combined total of your base pension plus your accumulated COLAs exceeds your IRC 415 dollar limit in a calendar year, your pension will be reduced so that the combined total does not exceed your dollar

limit. The IRC 415 reduction is shown on your monthly pension pay advice. It is a separate line item from your accumulated COLAs.

What is a Replacement Benefit Plan?

A Replacement Benefit Plan, pursuant to IRC section 415(m), provides for the replacement of the portion of the retirement allowance that exceeds IRC 415 dollar limit. The City of San José does not offer a Replacement Benefit Plan for retirees.

How does reciprocity impact my IRC 415 limit?

Generally, reciprocity will not impact the calculation of IRC 415 dollar limit unless you joined the Plan before January 1, 1990 (refer to the “Grandfather” section above for more information).

While reciprocity may not impact your limit, it’s important to be understand that your IRC 415 dollar limit applies separately to each individual retirement benefit you receive from a tax-qualified defined benefit plan. For example, if your IRC 415 dollar limit is \$150,000 and you receive one retirement benefit from Federated for \$200,000 in 2025, your annual benefit will be reduced by \$50,000 so that you do not exceed the \$150,000 dollar limit. However, if you receive two retirement benefits, one for \$100,000 from Federated and one for \$100,000 from CalPERS, neither of the benefits will be reduced, because both are under your \$150,000 limit. In this case, you will receive a combined total of \$200,000 without reductions.

Will IRC 415 apply to my survivor’s allowance after my death?

Yes. Per the San José Municipal Code, survivors are eligible to receive a portion of the amount of allowance to which the retiree was entitled to receive. A survivor’s benefit will be calculated based on the amount the retiree was entitled to receive in a calendar year including IRC 415 limits. In general, the IRC 415 limit for your survivor is based on the percentage of your benefit that your survivor would receive. For example, if your survivor is going to get 50% of your benefit upon your death, their 415 limit will be 50% of what your limit will be for that calendar year.

If a survivor’s benefit is impacted, ORS will notify them at the time of death or no later than March 31st (Police & Fire) or April 30th (Federated) of each year. The survivor will see a “415 Reduction” line item on their monthly pension pay advice for the period which their allowance must be reduced.

Will IRC 415 apply if I have a Domestic Relations Order (DRO)?

Yes. If the retiree has a DRO and an ex-spouse (“alternate payee”) is receiving a portion of the retirement allowance, IRC 415 limits are calculated based on the combined amount of the retiree’s allowance, the alternate payee’s allowance, and accumulated COLAs for both parties.

For a Separate Account DRO, if the alternate payee begins collecting benefits before the member retires, the alternate payee’s allowance will not be reduced until the month the member retires, if the member is impacted by IRC 415 dollar limits. At that time, the alternate payee’s 415 limit will be adjusted to the age of the member at the time the alternate payee began receiving benefits, not at the age at the time the member retires.

Who can I talk to about IRC 415?

Contact ORS and request to speak to a Benefits staff member about IRC 415. ORS’ phone is 800-732-6477 or 408-794-1000 and email is retirement.dept@sanjoseca.gov.