



City Policies

**SUBJECT: DEFERRED COMPENSATION – DRAG-UP PAY
UPON TERMINATION OR RETIREMENT**

NO. HR 17.0

REVISED: 11/24/98

REVISED: 09/15/03

REVISED: 06/15/04

REVISED: 03/16/09

APPROVED: *Angel R. Escobar*
Angel R. Escobar, City Manager

DATE: *3/17/09*

I. PURPOSE

The purpose of this policy is to provide eligible employees with options to receive or defer compensation in connection with accrued but unused vacation and sick leave pay upon retirement or termination. Payment of such accrued leave is referred to in this policy as "Drag-up" pay.

II. SCOPE

This policy applies to all City employees eligible to participate in deferred compensation plans offered by the City.

This policy is governed by, and subject to, Section 457 of the IRC and the Treasury regulations thereunder, as amended from time to time, and to the extent that there is a conflict between this policy and the IRC and applicable regulations, the provisions of the IRC and the regulations, as amended, shall control.

III. AUTHORIZATION FOR PAYMENT OF ACCRUED LEAVE

Under this policy, eligible employees may elect to defer the receipt and income taxation of a portion of their drag-up pay through participation in one or more deferred compensation plans offered to employees by the City of Corpus Christi. These plans are established under Section 457 of the Internal Revenue Code of 1986, as amended (referred to in this policy as the "IRC") and the Treasury regulations thereunder.

Authorization for payment of drag-up pay upon an employee's retirement or termination is provided in the City's Compensation and Classification Plan, or in collective bargaining agreements for Police Officers and Firefighters.

IV. DEFERRED COMPENSATION PROVISIONS – GENERAL RULES

Under IRC Section 457, each calendar year an employee may generally defer receipt and taxation of compensation up to a maximum of (a) 100% of his/her includible compensation or (b) a fixed dollar amount that is set each year, whichever is less, through a payroll deduction election made before the compensation is earned.

A deferral of a payment, including a payment of drag-up pay, must be elected before this amount is paid or made available to the employee. Drag-up pay cannot be deferred after the employee terminates his or her employment.

V. DEFERRED COMPENSATION CATCH-UP PROVISION UNDER IRC SECTION 457 IN THREE YEARS BEFORE NORMAL RETIREMENT DATE

- a. IRC Section 457 and the Treasury regulations thereunder provide for a limited catch-up period to enable employees to make up for years in which they did not defer the maximum compensation allowed by law. The catch-up period is defined by federal law as one or more of the employee's last three taxable years (generally calendar years) ending before the year the employee reaches normal retirement age. No catch-up contributions can be made under this make-up provision in the calendar year that includes the employee's normal retirement age.
- b. For purposes of the limited catch-up period, "normal retirement age" is the age and date designated in writing by the employee to the City in accord with applicable Treasury regulations for purposes of this catch-up provision.
 1. The normal retirement age designated by the employee must be not later than age 70 $\frac{1}{2}$ and not earlier than the age at which the employee may retire without the consent of the City and receive immediate retirement benefits under his/her applicable retirement plan or system without any reduction in retirement benefits.
 2. The age and date specified by the employee cannot be later than any applicable mandatory retirement age, or later than the age and date at which the employee retires or terminates employment with the City.
 3. To the extent permitted by applicable Treasury regulations, qualified police or firefighters may designate a normal retirement age for such purpose that is earlier than the age permitted under this general rule, but in no event earlier than age 40.
- c. An employee may use this catch-up provision only once during one or more of the three calendar years in the catch-up period. If this option is not used, the opportunity to use it ends.
- d. If an employee has not deferred the maximum amount of compensation allowable during years before the catch-up period when he/she was eligible to participate in the deferred compensation plan, the employee can catch-up by electing to defer the receipt of current compensation based on the difference between (1) the compensation that was eligible to be deferred in prior years, and (2) the compensation that was actually deferred in prior years.

- e. An employee's catch-up contribution based on his/her underutilized limit in prior years cannot exceed the amount permitted by Section 457 and the Treasury regulations thereunder (two times the normal fixed dollar amount in effect for that calendar year.
- f. Subject to approval of the City Manager, an eligible employee who is about to retire or terminate can elect in advance (1) to receive or defer a portion of his/her drag-up pay in the calendar month preceding the calendar month in which the retirement or termination will occur, and (2) to receive or defer the remainder of his/her drag-up pay in the calendar month of retirement or termination, provided that the drag-up pay must actually be paid before the employee has a severance from employment, and provided further that in order for the employee to use the catch-up provision, the drag-up pay must be paid in the calendar year that does not include the employee's normal retirement age. The amount so elected in any calendar year must be limited to the annual deferral amount permitted by IRC Section 457.
- g. Retiring or terminating employees who are not eligible for the catch-up can elect in advance to defer compensation (including drag-up pay) in the calendar month in which they retire or termination, subject to the annual deferral amount permitted by IRC Section 457. The amount of any deferral must also take into account any other deferrals of compensation elected by the employee in that calendar year.

VI. DEFERRAL OF ADDITIONAL COMPENSATION UNDER IRC SECTION 457 AFTER ATTAINING AGE 50

- a. An employee who is at least age 50 by the end of the year may elect to contribute an additional amount that is established for each year in excess of the normal annual dollar limit.
- b. The age 50 additional contribution does not apply for any year for which a higher catch-up contribution limit applies. An employee who is eligible for the age 50 additional contribution in a year that is one of the employee's last three calendar years before he/she reaches normal retirement age is entitled to the either (1) the normal annual limit plus the age 50 additional contribution, or (2) the catch-up contribution limit, whichever is greater.

VII. ELECTION BY EMPLOYEE TO DEFER DRAG-UP PAY UNDER A DEFERRED COMPENSATION PLAN

- a. In order for an employee to be eligible to defer a portion of the drag-up pay he/she will be receiving under the Compensation & Classification Plan or Fire and/or Police Collective Bargaining Agreements, the employee must sign, date and deliver his/her election to receive or defer drag-up pay on or before the last day of the calendar month immediately preceding the calendar month in which the employee either (1) gives notice of his/her retirement or termination, or (2) retires or terminates, whichever is earlier. In addition, in order to use the catch-up contribution to defer drag-up pay, the deferral must occur before the calendar year that includes his/her normal retirement age.

Example:

1. An employee who has declared his/her normal retirement age as January 15, 2010 and who gives notice in November 2009 that his/her retirement will occur December 31, 2009 and whose drag-up pay will be paid December 30, 2009 must sign, date and deliver his/her drag-up pay election form on or before November 30, 2009.
 2. An employee who has declared his/her normal retirement age as January 15, 2010 and who gives notice in December 2009 that his/her retirement will occur January 15, 2010 and whose drag up pay will be paid January 14, 2010 must sign, date and deliver his/her drag-up pay election form on or before November 30, 2009.
 3. No drag-up pay can be deferred by the employee in either example as part of the catch-up contribution in the calendar year of his/her normal retirement age (2010), although it can be deferred as part of the normal annual deferred compensation limit as long as the deferral occurs before the termination of his/her employment.
- c. An employee who wishes (1) to receive or defer a portion of his/her drag-up pay in the calendar month preceding the calendar month in which the retirement or termination will occur, and (2) to receive or defer the remainder of his/her drag-up pay in the calendar month of retirement or termination (but before the actual date of retirement or termination) must also follow the procedures outlined in Section VIII below on a timely basis.
 - d. If an eligible employee makes a timely election to defer drag-up pay, the deferred drag-up pay is not paid to the employee at retirement or termination, but is invested and held in trust for the employee under the terms of the applicable deferred compensation plan until the determinable date in the future selected for receipt of the deferred amounts.
 - e. If an employee wishes to defer additional drag-up pay under the catch-up rules of IRC Section 457, he/she must provide the City with a written certification of eligibility for the catch-up provision from a representative of the applicable deferred compensation plan.
 1. The employee should contact a representative of the applicable deferred compensation plan for assistance in obtaining the certification and completing the forms required by the IRS and the applicable deferred compensation plan.
 2. The certification must state the calendar year(s) in which a catch-up deferral can be made.
 3. The Human Resources Department will verify the amount of drag-up pay which is due to the employee as of the date of the election.

VIII. REQUESTING CITY MANAGER TO APPROVE PARTIAL PAYMENT OF DRAG-UP PAY

An eligible employee who wishes to receive or defer a portion of his/her drag-up pay in the calendar month immediately preceding the calendar month of his/her retirement or termination and the balance in the calendar month of his/her retirement or termination should:

- a. The employee must sign, date and deliver his/her election to receive or defer drag-up pay on or before the last day of the calendar month preceding the calendar month in which the employee either (1) gives notice of his/her retirement or termination, or (2) retires or terminates, whichever is earlier.
- b. An employee's ability to receive or defer drag-up pay in the calendar month immediately preceding the calendar month of termination or retirement is not automatic.
 - 1. The employee must submit a written request to make a portion of his/her drag-up pay available before the month of termination or retirement.
 - 2. This request must be submitted by the employee to his/her department Director on or before the last day of the calendar month preceding the calendar month in which the employee either (1) gives notice of his/her retirement or termination, or (2) retires or terminates, whichever is earlier.
 - 3. The request must be approved by the applicable department Director, Director of Human Resources, or designee, Assistant City Manager, and City Manager.
 - 4. The City Manager will review and consider the employee's request for approval. The City Manager's decision is final.

X. EMPLOYEE RESPONSIBLE FOR OBTAINING OWN INCOME TAX ADVICE

The City provides the voluntary option for employees to participate in deferred compensation plans offered as a benefit to City employees. This in no way obligates the City for liability that may arise from any individual employee's income tax obligation under the Internal Revenue Code and/or IRS regulations.

Employees who use the deferred compensation plans made available by the City do so at their own risk. City employees are encouraged to obtain tax advice from a qualified tax attorney or other knowledgeable professional.

X. QUESTIONS REGARDING THIS POLICY

Questions regarding this policy shall be directed to the Director of Human Resources, or designee, who may be contacted at 361-826-3315.

**CITY OF CORPUS CHRISTI
ELECTION FORM FOR DEFERRED COMPENSATION OF DRAG-UP PAY**

Employee Name: _____ **ID#:** _____

Department: _____

I request to use the deferred compensation catch-up period provision provided for in Section 457 of the Internal Revenue Code based on the attached written certification of my eligibility from a representative of my applicable deferred compensation plan(s), which are:

_____ ; and

I elect, effective this date _____ (month & year), to defer a portion of my drag-up pay. This election is made on or before the last day of the calendar month immediately preceding the calendar month in which I either (1) give notice of my retirement or termination on _____ (month & year), or (2) retire or termination on _____ (month & year), whichever is earlier. I understand that this deferral must occur before the calendar year that includes my normal retirement age as defined in applicable Treasury regulations.

I request the City Manager to approve \$ _____ in vacation and/or sick leave accrual exchanged for cash. I understand that election to defer Accrued Leave Pay must be timely and that this pay will not be paid to me, but invested and held in trust for me under the terms of the applicable deferred compensation plan until the determinable date in the future selected for receipt of the deferred amounts.

Employee Signature Date

APPROVED BY:

Director of Human Resources: _____ Date: _____

Employee's Department Director: _____ Date: _____

Assistant City Manager: _____ Date: _____

City Manager: _____ Date: _____