We have reviewed the matter with legal counsel to our plan administrators who confirmed that under existing IRS law and regulation such mandatory contributions are required and can not be waived, even for social security recipients.

We have also reviewed the matter with representatives from the Massachusetts Municipal Association who indicate that the likelihood of near term legislative or regulatory relief is unlikely, based upon the difficulty of mounting such a federal tax law change affecting a relatively small number of people and the other complicated issues intertwined with it.

The continued exemption of all city and state employees in Massachusetts (and a few other) states remains a controversial issue within the federal Congress, with considerable sentiment to end the exemption (at great cost to cities and towns and potential disadvantage to many employees). The federal legislation requiring participation of intermittent, seasonal and casual Massachusetts city and town employees in Social Security or a mandatory deferred compensation (OBRA) plan was a compromise achieved in 1989-90 that helped preserve the continuing exemption of regular employees in Massachusetts cities and towns from required participation in Social Security. Given the enormity of stakes involved, it is unlikely that this modest adjustment could be easily achieved.

Perhaps most important, from a legislative viewpoint, under existing federal law, persons receiving social security benefits, no matter what their age, are still required to pay both Social Security and Medicare taxes on all additional earnings (up to the $85,000 limit). Thus the legislation being sought would treat Social Security beneficiaries employed by the City even more favorably than those employed in private industry. This is not likely to be well received.

Currently Social Security beneficiaries employed by the City already receive a substantial benefit. Unlike individuals employed in private industry, any monies paid into the OBRA deferred compensation fund (plus interest) are available to the individual upon leaving city employment, rather than remaining in the Social Security or Medicare Trust Fund.

Very truly yours,

Robert W. Healy
City Manager

RWH/mec

CITY OF CAMBRIDGE • EXECUTIVE DEPARTMENT

Robert W. Healy, City Manager *Richard C. Rossi, Deputy City Manager*

4.

September 23, 2002

To The Honorable, The City Council:

In response to Awaiting Report Item No. 02-81, regarding a report on the feasibility of potential changes to the Deferred Compensation fund, Personnel Director Michael P. Gardner reports the following:

The federal Omnibus Budget Reconciliation Act of 1990 (OBRA) requires that all individuals employed by the City in positions that are not eligible for participation in the City-State Retirement System (e.g. seasonal, casual, intermittent employees) be enrolled in Social Security, with a provision that public employers are allowed to set up Section 457 deferred compensation accounts for those employees, in lieu of Social Security contributions. The City of Cambridge has opted to have those employees contribute to Section 457 deferred compensation accounts, allowing them to reduce their taxable income and preserve these funds for their own use upon leaving City employment. Unless an employee is receiving a pension from the City of Cambridge Retirement system or another Commonwealth of Massachusetts Public Employee Retirement System member, they must make the mandatory OBRA contributions of 7.5%.

These mandatory OBRA accounts are subject to the provisions of Social Security and the Internal Revenue Code Section 457. Under the provisions of Social Security, a person's age or Social Security benefits status does not affect the mandatory contribution regulation, thus age is not an allowed reason to cease the OBRA contribution. IRC Section 457 states that withdrawal of funds from accounts can only take place upon severance from employment, death, and unforeseeable emergency.

In general, participation in OBRA is thought of as more advantageous to the individual employee because of the flexibility allowed. The employee can leave contributions in the deferred compensation account to grow with other investments for use at retirement or, unlike Social Security, withdraw the funds from the deferred compensation account at the time employment with the City ends.

Recently a question has arisen as to whether an individual employed by the City under such circumstances who also draws Social Security benefits could be considered exempt from this mandatory deferred compensation requirement.

S-280

Consent Agenda #4

Awaiting Report Item Number 02-81, regarding a report on the feasibility of potential changes to the Deferred Compensation Fund.

In City Council September 23, 2002

PLACED ON FILE.