BEFORE THE ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

In the Matter of	)	
	)	
T.L.	)	OAH No. 20-0680-PER
	)	Agency No. 2020-006

FINAL DECISION FOLLOWING PROPOSALS FOR ACTION[1]

I. Introduction

T.L. first began employment with the District A in March 2002. Because she was not then in a teaching position, she was not eligible for membership in the Teachers' Retirement System (TRS). Accordingly, she was enrolled in the Public Employees' Retirement System (PERS).

T.L. terminated her employment with the District in May 2012, at the age of 53. At that time, she had no agreement with the District regarding being rehired. However, in August 2012, she was rehired by the District as a teacher and became a member of TRS.

In July 2019, T.L. submitted a PERS retirement application to the Division of Retirement and Benefits. The Division denied her application, asserting she was still employed by the District and therefore, ineligible for retirement.

T.L. appealed the Division's denial, and it was referred to the Office of Administrative Hearings for determination. The parties have now submitted the matter for summary adjudication after filing a joint stipulation of facts.[2] In its briefing, the Division essentially argues that in seeking payment of pension benefits, a PERS eligible employee cannot retire from one job and then come back to work for the same employer in a different retirement system unless the plan has a provision for in-service retirement. To the Division, the Internal Revenue Service would treat that scenario as per se proof of a sham retirement.

However, on these facts, the Division's justifications for denial of payment of T.L.'s PERS retirement are misplaced. As explained below, the Division has adopted a bright-line regulation for construing what is and is not a sham retirement for purposes of compliance with

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[1] A separate order is being issued contemporaneous with this final decision addressing the proposals for action filed in this case. Specific substantive changes to the final decision are referenced and cited in that order. Further, other minor changes have been made to this final decision to address typographical and stylistic issues.

[2] Neither party specifically addressed in their briefing whether this case was being submitted on summary adjudication per 2 AAC 64.250 or as briefing on the written record per 2 AAC 64.260. However, due to the filing of the joint stipulation of facts (December 31, 2020), it is construed that the parties intend to submit it for summary adjudication per 2 AAC 64.250.

IRS rules and regulations. The Division cannot, however, apply the regulation to T.L. retrospectively. Here, PERS and TRS are separate trusts. Based on the rules that govern T.L.'s retirement benefits, and absent evidence of a sham, the tax status of PERS will not be affected by a retiree's subsequent reemployment in a TRS position, regardless of whether it is a new employer or the same employer. Further, even if a pre-arranged transfer from one system to the other maintaining the same employer is prohibited under IRS rules, that is not what occurred here. Accordingly, the Division's decision is reversed, and T.L. is entitled to receive payment of her accrued PERS retirement.

II. Facts and Proceedings

The material facts in this case are undisputed. The important events are T.L.'s employment history and application for PERS benefits. Before turning to these facts, this decision will provide a short introduction to PERS, TRS, and the passage and implementation of 2 AAC 35.227.

A. PERS, TRS, and 2 AAC 35.227

PERS was established and became effective in January 1961.[3] It is a retirement program for public employees, including public employees of the state, participating municipalities, and participating school districts.[4] Not all public employees, however, can participate in PERS. Employees who work in specific jobs that are covered by a different public retirement program, such as judges, certain marine highway employees, and, importantly for this case, teachers, are covered by retirement programs specific to their employment. They are excluded from membership in PERS.[5] PERS is administered by the Commissioner of Administration, through the Division of Retirement and Benefits.[6]

Like PERS, TRS is a public retirement plan administered by the Commissioner of Administration and the Division.[7] TRS was Alaska's first retirement system and came into existence when Alaska was still a Territory.[8] It is a retirement plan for Alaska teachers and school administrators. To be eligible for membership in TRS, an employee must be working in a

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3 Joint Stipulation of Facts at ¶ 1.

4 AS 39.35.120.

5 *See generally* AS 39.35.001 and AS 39.35.680(22). Its purpose was to "encourage qualified personnel to enter and remain in service with participating employers by establishing plans for payment of retirement, disability, and death benefits to or on behalf of the members." AS 39.35.001.

6 AS 39.35.003; *McMullen v. Bell,* 128 P.3d 186, 190-91 (Alaska 2006).

7 *Bartley v. State, Department of Admin., Teacher's Retirement Bd.,* 110 P.3d 1254, 1255 (Alaska 2005).

8 AS 14.25.012.

job that requires a teaching certificate.[9]

Also important for this case are the tax rules that apply to retirement trusts like PERS and TRS. Under federal statutes that establish rules for federal income tax, PERS is a "qualified pension plan."[10] As a result of this tax-qualified status, contributions made to PERS are protected from federal income taxes until the funds are distributed. This allows employers and employees to make contributions to PERS on a pre-tax basis.[11]

As will be seen, an important issue in this case is the Division's concern that the IRS might find that PERS is not a genuine retirement program that meets the requirements for a qualified pension plan. In 2002, AS 39.35.010 was amended to state that PERS is intended to qualify under the Internal Revenue Code as a "qualified retirement plan."[12] PERS was subsequently amended in 2004 to clarify that a member does not possess a vested right in any benefit if it would result in disqualification of PERS by the IRS.[13]

The issue at the forefront of the concern for maintaining the tax status of the retirement system is the issue of sham retirements. If the system allows an employee to retire under circumstances where the employee should not be allowed to retire—such as, for example, the would-be retiree has an agreement to keep working for the employer as a contractor—then the IRS might revoke the system's tax status. To address this concern, the Department of Administration adopted 2 AAC 35.227 defining when a bona fide separation of service occurs for purposes of PERS. The regulation became effective on December 22, 2017.[14]

The regulation addressed three factors that affect whether a retirement is genuine or a sham: prearrangement, break in service, and age. On the issue of prearrangement for a job with the same employer, the regulation was strict: "a member's termination from employment is considered valid only if there is no prearrangement between the member and the employer for continued employment in any capacity after the retirement effective date."[15] On the issue of a break in service and age, the regulation requires a six-month break for persons under age 62, but

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9 AS 14.25.220(44)(A).

10 Joint Stipulation of Facts at ¶ 3; *see* 26 U.S.C. § 401(a).

11 Joint Stipulation of Facts at ¶¶ 4, 5; AS 39.35.160(a); 26 U.S.C. § 401(a); 26 U.S.C. § 414(h)(2); Division's Opposition to Brief by T.L., Ex. 1, ¶ 7 (April 26, 2021) (Opposition Brief).

12 Joint Stipulation of Facts at ¶ 6.

13 *Id.* at ¶ 7.

14 *Id.* at ¶ 8.

15 2 AAC 35.227(a). The next sentence of the regulation emphasizes its strictness: "If any prearrangement to return to work with the same employer exists before retirement, the member will be deemed to not have a bona fide termination of employment and the member's retirement shall be void." *Id.*

not for those older.[16]

B. T.L.'s Relevant Employment History and Application for PERS Benefits

T.L. began working as a classified employee for the District and first enrolled in PERS in March, 2002.[17] While it is unclear from the record what position of employment she held, what is clear is that she was in a non-TRS covered position (meaning she was in a position that did not require a teaching certificate).[18]

T.L. terminated her PERS employment with the District on May 23, 2012.[19] At the time, she was 53 years-old and had accumulated more than 10-years of credited service. When T.L. terminated her PERS employment, she was given no promise of reemployment by the District.[20] In fact, as the Division admits in its brief, T.L. had no plans on returning to the District whatsoever.[21]

However, shortly after leaving employment with the District in May 2012, she did return. This occurred on August 16, 2012, when she accepted a job with the District as a teacher and enrolled in TRS.[22] She has been continuously employed by the District in that capacity and as a TRS member from then until now.[23]

When T.L. terminated her employment with the District in May 2012, she was ineligible for retirement or early retirement under PERS because she was younger than 55.[24] However, she became eligible for regular retirement when she turned 60 years-old in 2019.[25] In July 2019, she applied for PERS retirement requesting benefits beginning October 1, 2019.[26]

The Division denied her application for retirement. It explained that she was ineligible to retire because she had become reemployed with the District with less than the six-month break in

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16 2 AAC 35.227(b) ("a member under age 62 at the time of retirement cannot return to employment in any capacity with the same employer until six months have elapsed from the date of retirement").

17 Joint Stipulation of Facts at ¶ 9; Record (R.) at 3. The record in this matter was not Bates stamped. Accordingly, all citations to the record will be to the page number within the single pdf document comprising the record supplied by the Division.

18 Opposition Brief at 1 ("Prior to working as a teacher, T.L. worked in a Public Employees' Retirement System (PERS) eligible position for Mat-Su SD from March 14, 2002 to May 23, 2012."); PERS eligibility, found at AS 39.35.680(22)(C)(iv), specifically excludes persons covered by TRS.

19 Joint Stipulation of Facts at ¶ 10; Opposition Brief at 4.

20 Joint Stipulation of Facts at ¶ 14; Opposition Brief at 4.

21 Opposition Brief at 1.

22 Joint Stipulation of Facts at ¶ 13.

23 *Id.* at ¶ 15.

24 *Id.* at ¶ 11.

25 *Id.* at ¶ 12.

26 *Id.* at ¶ 16; R. at 21-26.

service that was required for a bona fide separation of service.[27] The Division cited the regulation changes in November 2017 addressing bona fide separation of employment and that a member under the age of 62 at the time of retirement cannot return to employment in any capacity with the same employer until six months have elapsed from the date of termination.[28] Because she had returned to employment with the same employer with a break in employment of less than six months, and because she was under age 62, she was ineligible to receive PERS benefits while continuing employment with the District.[29]

Following this determination, T.L. filed a notice of appeal in this case.[30] The matter was then referred to OAH.[31]

III. Discussion

As noted, the relevant facts in this case are undisputed. Consequently, the case is appropriate for summary adjudication. Summary adjudication in an administrative proceeding is the equivalent of summary judgment in court proceedings.[32] If the relevant and material facts are undisputed and establish that the moving party is entitled to prevail, an evidentiary hearing is unnecessary.[33]

Below, this decision will first lay out what is not at issue in this decision—as will be explained, there is no conflict between T.L.'s right to a pension and the tax-qualified status of the pension system. Next, the decision will discuss what is at issue—whether T.L.'s retirement was a sham. Finally, the decision will discuss whether the bright-line break-in-service rule applies to T.L..

A. T.L.'s Constitutional Right to a Benefit is Not at Issue in This Case

As explained above, much of the focus by the Division has been on ensuring that PERS maintains its tax-qualified status. The Division raises concerns that the present payment of T.L.'s PERS retirement benefits may run afoul of IRS requirements concerning the tax-qualified status of PERS.[34]

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27 R. at 17.
28 R. at 14.
29 R. at 15; Joint Stipulation of Facts at ¶¶ 17, 18.
30 R. at 5-6.
31 OAH 20-0680-PER T.L.; case referral notice (July 21, 2020).
32 *Alaska Public Offices Comm'n v. Gillam,* OAH No. 11-0328-APO at 1-2 (Oct. 19, 2011, Alaska Public Offices Commission) (citing *Samaniego v. City of Kodiak*, 2 P.3d 78, 82-83 (Alaska 2000)).
33 *Id.* (citing *Smith v. State of Alaska*, 790 P.2d 1352, 1353 (Alaska 1990) and 2 Davis & Pierce, *Administrative Law Treatise* §9.5 at 54 (3d ed. 1994)).
34 Opposition Brief at 6-9, 17-18.

Much of the focus by T.L., on the other hand, is on her constitutional right to her vested pension benefits. Here, however, there is no controversy that T.L. has a constitutional right to retirement benefits promised to her when she was first enrolled in PERS. As the Alaska Constitution provides: "Membership in employee retirement systems of the State or its political subdivisions shall constitute a contractual relationship. Accrued benefits of these systems shall not be diminished or impaired."[35] Further, there is no controversy that T.L.'s constitutional rights in retirement benefits under PERS vested immediately upon her enrollment in the system.[36]

There is also no controversy that PERS compliance with IRS rules and regulations is essential[37] and that for PERS to maintain its tax-qualified status, the IRS requires terminations of employment within the retirement system to be genuine and legitimate.[38] As the IRS explained in a private letter ruling:

> because a qualified pension plan is generally not permitted to pay benefits before retirement, an employee who 'retires' with the explicit understanding between the employer and employee that upon retirement the employee will immediately return to service with the employer has not legitimately retired and may not qualify for an early retirement benefit under the Plan.[39]

T.L. does not dispute this point and does not argue that she has a constitutional right to a benefit that would cause PERS to lose its tax-qualified status.[40]

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[35] Article XII, section 7 of the Alaska Constitution. Retirement benefits are a form of deferred compensation. They are "an element of the bargained-for consideration given in exchange for an employee's assumption and performance of the duties of his employment." *Metcalfe v. State,* 484 P.3d 93, 97 (2021) (citing *Hammond v. Hoffbeck*, 627 P.2d 1052, 1056-57 (Alaska 1981)).

[36] *Alford v. State, Dept. of Admin., Division of Retirement and Benefits,* 195 P.3d 118, 120 (Alaska 2008). As recently articulated in *Metcalfe v. State*:

> It was 40 years ago that we rejected the notion that "members" rights in public employees' benefit systems ... vested only at the time at which an individual employee is eligible to receive payment of those benefits ... In short, the right to conditional reinstatement and the restoration of credited service did not vest only when the former employee sought to exercise it; it vested when the Sate made the promise as an inducement to employment and the employee accepted it by beginning work and enrolling in the system.

Metcalfe v. State, 484 P.3d at 101.

[37] Reply on Behalf of T.L. to Opposition to Initial Brief, 11 (May 11, 2021) ("The Division also asserts the non-controversial proposition that PERS compliance with IRC and IRS guidance is essential.") (Reply Brief).

[38] *See generally* Opposition Brief, Ex. 1; IRS Private Letter Ruling 201147038, 2011 WL 5893533; 26 C.F.R. § 1.409A-1(h)(1)(ii).

[39] PLR 201147038, 2011 WL 5893533.

[40] Reply Brief at 11.

In this case, however, there is no tension between the fact that T.L. has a constitutional right and entitlement to retirement benefits that vested when she was originally employed with the District and the fact that the IRS requires terminations of employment from within tax-qualified retirement systems to be genuine and legitimate**.** In this instance, T.L. has not made any claim that she has a constitutional right to retirement benefits that may have vested if doing so will cause PERS to lose its tax-qualified status. Also, by taking the position she has in this case, T.L. appears ready to assume any potential liability that may arise to her personally if the IRS deems her receipt of her PERS pension benefits inappropriate. Accordingly, this decision accepts the Division's position that T.L. does not have a constitutional right to a benefit that would cause PERS to lose its tax-qualified status.

The question, then, is not about her constitutional rights. The important question is whether her receipt of pension benefits here would cause the system to lose its tax status.

B. The Essential Elements for Determining Whether a Retirement is a Sham

In analyzing this case, it is important to understand what the IRS is seeking to prevent in scrutinizing termination of employment from within tax-qualified retirement systems. This is because, as 26 C.F.R. § 1.409A-1(h)(1)(ii) makes clear, whether the IRS will construe a termination of employment as proper is determined based on the facts and circumstances of the case. Below, this decision will analyze the IRS rules and the Division's concerns. From that analysis, it becomes clear that the evil that the IRS seeks to avoid regarding termination of employment from within tax-qualified retirement systems is pre-arranged, illegitimate, and sham retirements. This decision will then apply the factors that govern sham retirements to T.L..

1. Double Dipping

In addressing the issue of sham retirements, both parties have included discussions of "double dipping"--allowing an employee who has vested in a plan to retire, beginning to receive retirement benefits, and then starting to work again and receiving both retirement benefits and pay. This focus on double dipping makes sense because double dipping has the appearance of being illicit. However, when both the IRS rules and regulations are analyzed, as well as the Division's interpretation of those rules and regulations, it becomes clear that avoiding double dipping is not what the IRS seeks to achieve. This is because both the IRS and the Division routinely allow double dipping to occur. Instead, double dipping is only symptomatic of a sham retirement rather than a bright-line indicator of a sham retirement.

As pointed out by both T.L. and the Division, the IRS allows for distributions from retirement plans during working retirements, without causing the plans to fail to qualify for tax-qualified status.[41]

> **Distributions During Working Retirement.** A trust forming part of a pension plan shall not be treated as failing to constitute a qualified trust under this section solely because the plan provides that a distribution may be made from such trust to an employee who has attained age 59½ and who is not separated from employment at the time of such distribution.[42]

IRS regulations at 26 C.F.R. § 1.409A-1(h)(1)(ii) also address the termination of employment issue. There, the IRS provides that:

> [w]hether a termination of employment has occurred is determined based on whether the facts and circumstances indicate that the employer and employee reasonably anticipated that no further services would be performed after a certain date
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> . . . .
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> An employee is presumed to have separated from service where the level of bona fide services performed decreases to a level equal to 20 percent or less of the average level of services performed by the employee during the immediately preceding 36–month period.[43]

Given these provisions, a retiree can clearly retire and begin to be paid their pension in certain circumstances, without necessarily violating the IRS code and regulations.

The Division points out that the IRS has rules for when these "in-service distributions," are allowed and that PERS does not meet these standards. The point here, however, is not that 26 U.S.C. § 401(a)(36) permits T.L.'s receipt of retirement benefits. The point here is simply that the avoidance of double dipping is not what the IRS intends.

The conclusion that double dipping is not illicit is further supported by Alaska authority. On this point, the Division acknowledges in an informational brochure the lack of a restriction on reemployment:

> Can I return to work after retirement?
>
> Yes. After you retire, you may work for a private company, in state or out of state, without limitations.
>
> You may work for an out of state or federal government employer without limitations.

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41 Initial Brief on Behalf of T.L., 16, 37 (March 26, 2021) (Initial Brief).
42 26 U.S.C. § 401(a)(36).
43 26 C.F.R. § 1.409A-1(h)(1)(ii).

> If you retired under the standard provisions for the PERS (excluding Retirement Incentive Program (RIP) retirees), you may reemploy and become a member of the *Teachers' Retirement System (TRS)*, Judicial Retirement System (JRS) or National Guard and Naval Militia Retirement System (NGNMRS) *without limitations*.[44]

Thus, even as the Division has now construed and applied the bona fide separation of employment policy, some PERS members can receive PERS pension distributions while continuing to work, so long as they change employers. For example, if T.L. had subsequently become employed as a teacher with the Anchorage school district, she would have been eligible to receive her PERS benefits. Support for this is found in the Division's answers to its Frequently Asked Questions regarding its Retiree Return to Work Policy.[45] Specifically, the relevant question and answer are as follows:

> 14. Does the period of absence only apply to the employer from which the employee is retiring, or does it apply to all PERS, TRS or EPORS participating employers? For example, if a State PERS employee retires July 1, can the employee go to work for a city on August 1 without violating the requirements?
>
> Yes. In order for the IRS to consider an employee to be "retired," the IRS requires an employee to have a bona fide separation from service with the employee's employer. Therefore, based upon this example, a State PERS employee could retire on July 1 and immediately commence non-covered employment with a local government, even though the local government also is a PERS employer. The requirements refer to employment with the same employer only.[46]

Therefore, according to the Division, an employee would remain eligible for their PERS retirement benefits if they legitimately terminated employment from one employer and went to work for a different employer.[47]

Finally, the Division's tax consultants have commented on double dipping. Specifically, those consultants have:

> provided regular advice to the Division that the *reemployment of PERS retirees would not jeopardize the qualified status of PERS or cause imposition of a penalty tax on the individual, but only so long as there was a bona fide separation from service at the time of retirement*. This advice also concluded that if the

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[44] Alaska Division of Retirement and Benefits brochure: *Working After Retirement* (March 2015) (emphasis added), available at: https://doa.alaska.gov/drb/pdf/pers/pers031WorkingAfterRetirement.pdf. What is significant in the above statement is what the Division fails to express. It does not indicate that if you return to the same employer, your retirement will be considered a sham. That omission provides support for the conclusion reached later in this decision that T.L.'s retirement was not a sham.

[45] Initial Brief at 18; Alaska Division of Retirement and Benefits Return to Work Policy, available at: https://doa.alaska.gov/drb/employer/returntowork/faqs.html#.YL60UahKi70.

[46] Return to Work Policy (No. 14).

[47] *Id.*

employee did not experience a bona fide separation, then additional scrutiny is needed.[48]

Based on the above, the intent of the IRS is not to avoid double dipping by retirees from within qualified retirement systems. There is simply too much authority, both at the federal level and within Alaska, allowing just the opposite. As such, the mere fact that T.L. is presently employed by the same employer from which she terminated her PERS employment and accrued her PERS benefits does not compel a conclusion that T.L.'s retirement was a sham. What is significant is that the evil the IRS is seeking to avoid in scrutinizing termination of employment within qualified retirement systems is something other than double dipping.

2. Flouting of the Rules

When the analysis provided by the Division is analyzed, it becomes apparent that the concern is with retirees who are flouting the rules. Thus, a retirement would be a sham if a retiree seeks to receive pension benefits from a retirement system when the retiree should still be enrolled and paying contributions into that same system. The Division places significant emphasis on this point.

The Division cites to a host of reasons for why it should not allow distributions from retirement plans it administers "*without a bona fide separation from service by the employee*."[49] Included within this analysis are references to and strong reliance on both IRS Private Letter Ruling 201147038 and a May 4-6, 2006, question and answer session between the American Bar Association's Joint Committee on Employee Benefits and the IRS (ABA/IRS Q&A).[50] What is important about the focus placed on both PLR 201147038, the ABA/IRS Q&A, and the itemized conclusions reached based on those references, is the focus on employees who are flouting the rules concerning a bona fide retirement.[51]

PLR 201147038 dealt with a *prearranged agreement* to return to employment with the same employer.[52] This decision accepts the Division's assertion that a pre-arranged agreement to return to work would render a retirement a sham.

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48 Opposition Brief, Ex. 1 at ¶ 17 (emphasis added).
49 *Id.* at ¶ 25(k).
50 *See generally* Opposition Brief at Ex. 1.
51 *Id.*
52 PLR 201147038, 2011 WL 5893533 ("because a qualified pension plan is generally not permitted to pay benefits before retirement, an employee who 'retires' with the explicit understanding between the employer and employee that upon retirement the employee will immediately return to service with the employer has not legitimately retired and may not qualify for an early retirement benefit under the Plan.").

The Division's reliance on the example in ABA/IRS Q&A, however, does not support the conclusion reached by the Division.[53] That example and the IRS response are as follows:

> An individual, who is a participant in Corp A 401(k) plan and money purchase pension plan, terminates employment with Corporation A in early 2003 when the individual is 60. The individual is hired by Corporation B, an entity not related to Corporation A, and terminates employment with Corporation B in late 2004. Corporation A rehires the individual after he terminates employment with Corporation B. Until the individual terminates employment with Corporation B, the individual did not intend to return to Corporation A and Corporation A did not intend to rehire the individual. Did the individual have a separation from service after termination with Corporation A for purposes of § 72(t)(2)(A)(v) and § 402(e)(4)(D)? If the individual had a separation from service, after the individual is rehired, does the individual cease to have had a separation from service?
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> **Proposed Response**: Because the individual terminated employment with Corporation A, and neither the individual or Corporation A intended to restore the employment relationship, the individual had a separation from service for purposes of § 72(t)(2)(A)(v) and § 402(e)(4)(D). After Corporation A rehires the individual, the individual no longer has had a separation from service for the purposes of those sections.
>
> **IRS Response**: **If there was no distribution before rehire, then once the individual is rehired he is treated as though there was no separation from service or termination of employment**. If the individual received a distribution before rehire, then there is a separation from service if the termination from Corporation A was bona fide and the employment by Corporation B was bona fide. For purposes of § 72(t), there should be no "separation" issue if (as the facts state) the individual is over age 59 ½. However, if the individual were 55, there would be an issue because there is a special rule in § 72(t) for separation from service after age 55.[54]

From this discussion, the Division concludes that any reemployment with the same employer before a retirement distribution is made must mean that the employee cannot subsequently draw retirement benefits that are based on contributions to a retirement plan made during the first employment. That conclusion, however, sweeps too far.

At issue in the example is the employee's participation in a single form of retirement, a 401(k) plan. The individual left Corporation A with no intent to return and went to work for Corporation B. The individual was subsequently hired back at Corporation A. The employee was eligible to participate in Corporation A's 401(k) plan during both terms of employment.[55]

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53 *Id.*, Ex. 1 at ¶ 14.
54 *Id.* (emphasis in the original).
55 *Id.*

Given that double dipping itself is not inherently evil, this informal colloquy supports a conclusion that a retirement that occurs after reemployment with the same employer *may be* considered a sham even if there was no prearrangement. It provides support for a conclusion that eligibility for a plan upon reemployment, and the rules governing contributions and withdrawals to or from a plan, may be important factors in determining whether a retirement is a sham. It does not, however, tell us that all retirements after reemployment are shams. Given that the discussion seems to permit a "break-in-service," and, thus, distribution from a 401(k) after reemployment with the same employer (if the distribution began before reemployment), even if this discussion were binding, it would not mean that all reemployment with the same employer is forbidden. Whether T.L.'s retirement and reemployment with the same employer is affected by the concerns raised by the ABA/IRS Q&A will be discussed below.

Another significant problem with the heavy reliance by the Division on the example from the ABA/IRS Q&A session is that it is not even non-binding agency guidance, but instead, something less than that. The first page of the ABA/IRS Q&A indicates:

> The following questions and answers are based on an oral presentation made by IRS and Treasury officials at the Tax Section's Employee Benefits Committee meeting on May 5, 2006. *The statements contained herein cannot be relied on even though they are printed as statements of the IRS. The questions were submitted by ABA members, and the responses were given at such meeting after explicit statements that their responses reflect the unofficial, individual views of the government participants as of the time of the discussion, and do not necessarily represent agency policy.* This report on the responses was prepared by designated JCEB representatives, based on the notes and recollections of the JCEB representatives at the meeting and on a review of audio tapes of the meeting. *This report has not been reviewed by IRS or Treasury.* The questions were submitted in advance to the agency, and it was understood that this report would be made available to the public.[56]

Accordingly, the authority on which the Division has placed so much emphasis is not IRS code. It is not agency regulation. It is not even non-binding IRS guidance. Instead, it is simply a hypothetical fact scenario where the IRS has completely disclaimed any reliance on it whatsoever.

Further, as 26 C.F.R. § 1.409A-1(h)(1)(ii) confirms, in determining whether a termination of employment has occurred, the outcome will not simply depend on the arbitrary passage of time. Instead, it will be determined by the reasonable intent of the parties at the time the

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[56] Opposition Brief, Ex. 2, at 1 (emphasis added).

termination occurred and based on the facts and circumstances of the particular case.

In sum, the Division is properly concerned with retirees who seek payment of their pension benefits while flouting the rules. Employees who do not properly separate from service with the employer—for example, by retiring and returning to work with the same employer as a contract employee with no break in service, and drawing a pension while no contributions are made to the system by the employee or employer—would be a clear case of flouting the rules.[57] However, that is not what is occurring here and that is why payment of retirement benefits on these facts will not cause PERS to lose its tax-qualified status.

3. The Length of Separation

As 26 C.F.R. § 1.409A-1(h)(1)(ii) confirms, in determining whether a termination of employment has occurred, the outcome will not simply depend on the arbitrary passage of time. In other words, the length of time of separation is not determinative of whether the separation was a sham. Instead, whether a retirement is a sham will be determined by the reasonable intent of the parties at the time the termination occurred and based on the facts and circumstances of the particular case. This supports a conclusion that the issue that the IRS is concerned about is whether a break in service was genuine. To that inquiry we turn next.

4. Applying the Rules to Determine Whether T.L.'s Retirement was a Sham

Above, this decision has reviewed 26 U.S.C. § 401(a)(36) (distributions during working retirement), 26 C.F.R. § 1.409A-1(h)(1)(ii) (addressing termination of employment), PLR 201147038 (dealing with a prearranged agreement to return to employment), the ABA/IRS Q&A (construing break-in-service rules for an employee who returns to service at a corporation with a 401K plan), and the conclusions by the Division's consultant.[58] As they all confirm, the evil the IRS seeks to avoid by applying its rules, regulations, and guidance concerning retirement from qualified retirements systems, is pre-arranged, illegitimate, and sham retirements—situations where a member has not properly separated from service with the member's employer. Below, this decision will apply this analysis to the facts of T.L.'s retirement from PERS.

Here, it is undisputed that at the time T.L. terminated her PERS employment with the District in May 2012, she was given no promise of reemployment.[59] She also had no plans on

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57 It would not, however, be a violation of the rules if the retiree was over 62. 2 AAC 64.250.

58 *Id.,* Ex. 1 at ¶ 17.

59 Joint Stipulation of Facts at ¶¶ 10, 14; Opposition Brief at 4.

returning to the District.[60] When she did become reemployed by the District in August 2012, it was as a teacher enrolled in TRS, not as an employee within PERS.[61] Nothing in this record suggests that T.L.'s employment was pre-arranged, illegitimate, a sham, or otherwise not a proper separation from service with the member's employer.

An important rule is that a prearranged promise of reemployment would indicate that the member had not properly separated from service with the member's employer.[62] Rather than having a prearranged agreement to return to employment, however, here T.L. was given no promise of reemployment by the District.[63] She had no plans on returning to the District whatsoever. She was required to compete for her position.[64] Accordingly, with respect to the issue of prearrangement, T.L.'s separation from the District was genuine.

Moreover, T.L.'s situation is different from a retiree who returns to work for the same employer in a position that otherwise would be required to make contributions to the retirement system from which the retiree is receiving benefits. It is also different from an employee who returns in a position that is not covered by any retirement plan.

Instead, here, at issue are separate and distinct retirement programs, PERS and TRS. Each is a separate trust, governed by a separate set of statutes. Although T.L. may have returned to work for the same employer, she returned to work within a different retirement system separate and distinct from the one in which she was originally employed. Unlike the employee at issue in the ABA/IRS Q&A example, T.L. is still making contributions to the retirement plan within which she is working, and the employer is making contributions as well. The rules are not being flouted. The facts of this case are therefore distinguishable from both the ABA/IRS Q&A example and PLR 201147038.

Nothing in the Division's argument explains why T.L.'s continuing to make contributions to a different retirement system is not a significant indication that her break in service from her PERS job was genuine. Although the Division relies heavily on the ABA/IRS Q&A example, there, a distribution of 401(K) benefits before reemployment with the same employer would have meant that the break in service was not a sham. Here, T.L.'s break in service is even more

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60 Opposition Brief at 1.
61 Joint Stipulation of Facts at ¶ 13.
62 *See* PLR 201147038, 2011 WL 5893533.
63 Joint Stipulation of Facts at ¶ 14; Opposition Brief at 4.
64 Opposition Brief at 1.

genuine than the break in service that example posits as acceptable.

It may be that the shorter the period between when an employee retires and subsequently becomes reemployed requires greater scrutiny to ensure that it is not a sham retirement. However, there is nothing in IRS rules or regulations that suggests any specific passage of time is conclusive as to the existence of a sham. A brief passage of time between retirement and reemployment may only be marginally more indicative of a sham than a slightly longer passage of time. Irrespective, any reliance on a specific number of days is arbitrary and inconclusive. That said, the Division is not constrained in seeking to impose a time limitation via regulation where any shorter timeframe between termination and reemployment will not be considered bona fide. However, as addressed in detail below, it cannot do so retrospectively, as it has sought to do here.

It is also clear that while double dipping may be symptomatic of a sham, it is also not determinative. As both the IRS and the Division make clear, plenty of double dipping has been deemed appropriate without concluding that retirees are engaging in pre-arranged, illegitimate, and sham retirements.

In sum, T.L.'s separation from her PERS employment was not a sham. Her application for retirement under PERS, while still employed in a TRS position for the same employer, was not a violation of the PERS, TRS, or IRS rules. Accordingly, applying the rule that T.L. does not have a vested right to a retirement benefit that would cause PERS to lose its status as a qualified pension plan does not affect her eligibility for benefits.

We next turn to the remaining arguments made by the Division for why T.L. is not eligible for a pension. These arguments are based on applications of statutes and regulations, rather than the effect on the plan's tax-qualified status.

C. The Division's Other Arguments

In asserting that T.L. is currently ineligible to receive her PERS retirement benefits, the Division makes several additional arguments. These include that she fails to satisfy the statutory requirements for eligibility contained in AS 39.35.370, and that its regulation, 2 AAC 35.227, justifies deeming her ineligible.[65] These arguments are addressed below.

1. T.L. Satisfies the Statutory Framework for Entitlement to PERS Retirement Benefits and the Word 'Terminate' in AS 39.35.370 Does Not Mean to Terminate From the Same Employer, but Instead, to

[65] *See generally* Opposition Brief.

Terminate from PERS Employment

Eligibility for PERS retirement benefits is addressed by AS 39.35.370(e). This statute provides that benefits are payable and accrue "from the first day of the month after which *all of the following requirements are met*: (1) the member meets the eligibility requirements of this section; (2) the member terminates employment; and (3) the member applies for retirement."[66] The term "terminates" or the phrase "terminated employee" are not defined.

The Division argues that T.L. is not eligible for retirement under AS 39.35.370(e).[67] It asserts that because she returned to work for the District, she is not a terminated employee, and therefore, not eligible for retirement. In its view, the plain meaning of the word "terminate" means that an employee who is still working for the same employer cannot be a terminated employee.

T.L. argues that the definition of "employee" in AS 39.35.680(22)(A) to mean *a person eligible or covered under the plan*, applies here. To her, that means that because she is not an employee (because a person in TRS is not eligible to be covered under PERS), she must have terminated her employment for purposes of PERS under AS 39.35.370(e).[68]

Construing AS 39.35.370(e) in light of AS 39.35.680(22)(A) makes sense because statutes dealing with the same subject matter should be interpreted in *pari materia*.[69] It also makes sense to interpret a PERS statute as applying to PERS-eligible employment, rather than all possible employment.[70]

The Division responds that the definition does not govern eligibility under AS 39.35.370(e).[71] It explains that a sham retiree (for example, one who has a prearrangement to contract with the employee following retirement) would not be a covered employee either. Therefore, the mere fact that T.L. is not a covered employee for PERS does not control her

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66 AS 39.35.370(e) (emphasis added). The eligibility portion of the statute, as applicable here, provides that: "[s]ubject to AS 39.35.450, a terminated employee is eligible for a normal retirement benefit [ ] at the age of 60 with at least five years of credited service." AS 39.35.370(a)(1).

67 Opposition Brief at 19.

68 Initial Brief at 12-13, 19, 26-27.

69 *Bullock v. State, Dept. of Community and Regional Affairs,* 19 P.3d 1209, 1215 (Alaska 2001)

70 *Mechanical Contractors of Alaska, Inc. v. State, Dept. of Public Safety,* 91 P.3d 240, 249 (Alaska 2004) (holding that rules of statutory construction do not require that "statute be given the narrowest meaning allowed by their language; rather, the language should be given a "'reasonable or common sense construction, consonant with the objectives of the legislature'." (quoting *Mack v. State,* 900 P.2d 1202, 1205 (Alaska App.1995) (quoting *Belarde v. Anchorage,* 634 P.2d 567, 568 (Alaska App.1981))).

71 Opposition Brief at 19.

eligibility for retirement.[72]

But all that that tells us is that the termination must be bona fide. It does not answer the question of whether "terminated" means "terminated from the employer" or "terminated from covered employment." Here, as discussed thoroughly above, T.L.'s termination from her PERS-covered position was bona fide. Her membership in TRS, and the obligation that she and her employer make contributions to her TRS retirement account, show that she is not flouting the rules. Therefore, she, as a member of TRS,[73] is not an employee of the District for purpose of PERS distributions.[74]

Moreover, although under current law a PERS member who becomes reemployed must re-enroll and cease receiving benefits, that was not always true. Under former law, a PERS member might seek reemployment within PERS after the member's prior PERS employment ended and while continuing to receive PERS benefits.[75] If "terminate" in AS 39.35.370(e) meant terminate from the employer, the distribution allowed under the former statute could never have occurred.

In sum, although it is legitimate to inquire into whether a termination is genuine, the word "terminates" in AS 39.35.370(e) means "terminates from a covered position." It does not require that a person no longer work for the same employer.

2. 2 AAC 35.227 Does not Warrant T.L. Ineligible for PERS Retirement Benefits

The Division also contends that the Department of Administration's 2017 promulgation of 2 AAC 35.227 is binding on T.L..[76] It argues that the regulation is a reasonable interpretation of IRS requirements, and that its application in this instance is neither retroactive nor diminishes T.L.'s retirement benefits.[77] While the Division may be correct that it is not applying the regulation retroactively, it is applying it retrospectively and therefore, improperly. Further, while the regulation may be a reasonable interpretation of IRS rules and regulations as applied prospectively, it is impermissible to do so retrospectively.

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72 *Id.*

73 Thereby she is not eligible for PERS coverage for her TRS employment.

74 To be clear, T.L.'s membership in TRS is an important element of this decision. The reasoning of this decision would not apply to a person who is eligible for PERS membership. It may not apply to a person whose current employment or contract with a participating employer does not require the person or the employer to make contributions to a different pension plan than the one under the person seeks to retire.

75 AS 39.35.150(b) (repealed 2009).

76 Opposition Brief at 9-18.

77 *Id.*

The Division argues that it is not applying 2 AAC 35.227 retroactively.[78] It contends that procedural changes to a law that do not affect substantive rights may be applied retroactively. It also asserts that because T.L. did not apply for her PERS retirement benefits until 2019, application of the 2017 regulation to deny her benefits is not retroactive.

Laws and rules can be construed as applied "prospectively," retroactively," or "retrospectively." They are applied prospectively when they operate on transactions that occur after the law or rule's effective date and retroactively when they operate on transactions that have already occurred or rights that existed before their effective date.[79] While retroactive and retrospective are often used by courts interchangeably,[80] they do not mean the same thing. "A law is retroactive in its operation when it looks or acts backward from its effective date and is retrospective if it has the same effect as to past transactions or considerations as to future ones."[81]

AS 01.10.090 provides that "[n]o statute is retrospective unless expressly declared therein." Further, neither a statute nor regulation will be allowed to apply retroactively or retrospectively unless there is a clear statement allowing that to occur. The "clear statement rule" has been summarized by the U.S. Supreme Court as follows: "a statutory grant of legislative rulemaking authority will not, as a general matter, be understood to encompass the power to promulgate retroactive rules unless that power is conveyed by [the legislative branch] in express terms."[82]

The authority for 2 AAC 35.227,[83] contains no authorization, express or otherwise, for either retroactive or retrospective application. Since the Administrator did not have authority to adopt the regulation and apply it retrospectively, it must be construed as prospective only. In this instance, 2 AAC 35.227 is arguably not being applied retroactively, because it is being applied now. However, it is being applied retrospectively, in that it is changing the rules that were applicable to T.L. at the time her retirement benefits vested. For this reason, the regulation's

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78 Opposition Brief at 11-14.

79 *Ficarra v. Department of Regulatory Agencies, Div. of Ins.,* 849 P.2d 6, 11 (Colo. 1993).

80 *Id.* at 12.

81 *Missouri Real Estate Com'n v. Rayford,* 307 S.W.2d 686, 690 (Mo. 2010) (internal quotations and citations omitted).

82 *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208 (1988); *see also, e.g., County of Clark v. LB Properties, Inc.*, 2013 WL 5230784, *2 (Nev. 2013) (discussing and applying same principle to state regulations).

83 2 AAC 35.227 (citing AS 39.35.003, AS 39.35.115, AS 39.35.150, AS 39.35.370, AS 39.35.678, AS 39.35.810).

application to T.L. is improper.

The Division argues that 2 AAC 35.227 is procedural as opposed to substantive. Procedural changes in the law that do not affect substantive rights may be applied retroactively.[84] "A corollary to this rule is that substantive statutes are given prospective effect because retroactive application is manifestly unjust by definition."[85]

In asserting that 2 AAC 35.227 is merely procedural rather than substantive, the Division cites *Rice v. Rice.*[86] *Rice* involved a divorce dispute concerning entitlement to a fireman's retirement benefits. The issue in *Rice* was whether a newly enacted statute, requiring retirement benefits to be divided between the fireman and his former wife, was simply a "procedural change" or a statute affecting the fireman's substantive rights, thereby preventing substantive application.[87] In holding that the retroactive application of the statute did not affect the fireman's substantive rights, the Court noted that even before the statute, it had long held the power to order an employee spouse to pay the non-employee spouse a percentage of his retirement benefits. Consequently, the statute at issue was simply a codification of existing rights and therefore, was procedural in nature.[88]

The Division argues that, like the statute at issue in *Rice,* the regulation here, 2 AAC 35.227, did not change or "alter the way the system was supposed to be managed prior to its promulgation."[89] The Division then focuses on PERS longstanding compliance with IRS rules and regulations.[90]

However, PERS compliance with IRS rules and regulations are not the changes at issue in analyzing the retrospective application of the regulation. As explained above, T.L.'s retirement does not offend IRS rules or cause the system to lose its tax status. Therefore, the Division cannot argue that 2 AAC 35.227 simply memorializes already existing constraints on T.L.'s eligibility for retirement.

The Division also argues that the regulation is not being applied retroactively because

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84 *Herning v. Eason*, 739 P.2d 167, 168 (Alaska 1987) (citing *Matanuska Maid, Inc. v. State*, 620 P.2d 182, 186-87 (Alaska 1980)).

85 *Yukon-Kuskokwim Health Corp., Inc. v. Trust Ins. Plan for Southwest Alaska*, 884 F.Supp. 1360 (D. Alaska 1994).

86 757 P.2d 60 (Alaska 1988); Opposition Brief at 12.

87 *See generally Rice* 757 P.2d. 60.

88 *Id.* at 61-62.

89 Opposition Brief at 13.

90 *Id.*

T.L. did not apply for retirement until 2019, after passage of the regulation. It asserts that "retirement" only occurs on the date that a member meets the eligibility requirements, terminates employment, and submits her application.[91]

As discussed above, however, applying the substantive requirements of 2 AAC 35.227 to T.L. would be a retrospective application of the regulation. T.L. had no notice in 2012 that her separation of service had to be at least six months long in order for her to qualify for retirement under PERS if still working. She had no opportunity to conform her conduct to the requirements of the regulation. Accordingly, the Division cannot deny T.L.'s benefit on the basis that she is out of compliance with 2 AAC 35.227.[92]

IV. Conclusion

T.L.'s termination from her PERS-covered position with the District in 2012 was bona fide. Her receipt of retirement benefits from PERS for retirement from that position will not cause PERS to lose its status as a tax-qualified pension plan. The statutes and regulations governing PERS do not prevent her from retiring and receiving benefits. For these reasons, T.L. is entitled to summary adjudication as a matter of law. The Division's decision is reversed, and T.L. is entitled to payment of her accrued PERS retirement.

DATED this __2nd__ day of August 2021.

By: _*Signed*_____
Z. Kent Sullivan
Administrative Law Judge

[91] Opposition Brief at 13-14.

[92] This decision does not hold or imply that the regulation is unreasonable or otherwise not enforceable prospectively.

ADOPTION

This Decision is issued under the authority of AS 39.35.006. The undersigned, in accordance with AS 44.64.060, adopts this Decision as the final administrative determination in this matter.

Judicial review of this decision may be obtained by filing an appeal in the Alaska Superior Court in accordance with Alaska Rule of Appellate Procedure 602(a)(2) within 30 days of the date of this decision.

DATED this __2nd__ day of _August___ 2021.

By: _*Signed*_____
Z. Kent Sullivan
Administrative Law Judge

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