



# State of New Jersey

DEPARTMENT OF THE TREASURY  
DIVISION OF PENSIONS AND BENEFITS  
P. O. Box 295

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*Acting Director*

PHILIP D. MURPHY  
*Governor*

SHEILA Y. OLIVER  
*Lt. Governor*

April 5, 2019

Grace McMahan

[REDACTED]  
[REDACTED]

RE: [REDACTED]

Dear Ms. McMahan:

## **FINAL ADMINISTRATIVE DETERMINATION**

I am writing in reference to the Board of Trustees of the Teachers' Pension and Annuity Fund's (TPAF) denial of your request for the TPAF Board to refund any payments made for the outstanding balance of your pension loan obligation owed as determined by the Division of Pensions and Benefits, (Division) in 2017. At the TPAF Board meeting of December 6, 2018, the Board denied your request to refund \$1,220.47 paid to satisfy your loan obligation with interest to your TPAF account and to agree to your compensation demands. On January 14, 2019, you appealed the Board's decision. You did not dispute that you took the loan or that you owed interest as originally calculated on the loan. However, you dispute that you owe loan payments for April and May of 1992 and the accrued interest charged by the Division on the outstanding balance of your loan obligation. On March 7, 2019, the Board considered your appeal and determined that no material facts are in dispute and directed the Board Secretary in conjunction with the Attorney General's Office to prepare Findings of Fact and Conclusions of Law, which were presented and approved by the TPAF Board at its March 7, 2019 meeting.

The TPAF Board has reviewed your correspondence and the relevant documentation and finds that the laws governing the TPAF do not permit the Board to grant your request to refund the accrued interest charged by the Division on the outstanding balance of your loan obligation.

### **FINDINGS OF FACT**

You were enrolled in the Teachers' Pension and Annuity Fund on September 1, 1973 as a result of your employment as a Teacher with Elizabeth Board of Education. The record indicates you purchased 1 year and 4 months of former membership service with the Jersey City Board of Education from September 1, 1968 to October 31, 1969. On October 30, 1991, you applied for a loan in the maximum amount permitted. The loan application states: "I understand that I must repay this loan, together with any balance I may have outstanding on a present loan, with interest at four per centum per annum, through payroll deductions or in the case of retirement as indicated in the "LOAN PROVISIONS" section of this application." Check number 921665 was issued to you for \$6,260.00 on November 13, 1991. A *Certification of Payroll Deductions* (Certification) was issued to your employer implementing the loan repayment schedule for 30 payments of \$222.99, for a total of \$6,689.70 to begin on December 1, 1991. Interest was calculated at 4.00% per year, based on a decreasing balance each month. Your employer should have provided you with a copy of the Certification. Thereafter, you requested a loan pay-off amount from the Division. By correspondence dated March 30, 1992, the Division informed you that "if you wish to eliminate your remaining loan balance, we must receive a check for \$5,093.11 by May 14, 1992. This is based on the assumption that all of your payments during the last few months have been made as scheduled. The effective date of this lump sum payment will be June 1, 1992." You provided a check for \$5,093.11 dated May 14, 1992 to pay off your loan balance. On that same date, the Division sent a new Certification to your employer, stating that the member has satisfied their total loan obligation in full and to discontinue loan deductions on the effective date of June 1, 1992.

On July 2, 1992, the TPAF Board approved your April 20, 1992 application for deferred retirement, with an effective date of October 1, 2003.

On August 16, 2017, the Division notified you that a review of your TPAF membership account revealed that you had an existing loan balance in the amount of \$698.69 as of your

retirement date. Loan payments were anticipated for April through May 1992, when you were quoted with the loan payoff figure; however, these payments were not received. This remaining loan balance was never paid and interest on this balance has accrued through your retirement date. In that letter, you were informed that the Division would begin deducting monthly loan payments in the amount of \$279.04, beginning with your pension check dated September 1, 2017, to satisfy the outstanding obligation including accrued interest. On August 18, 2017 you faxed a letter to the Division disputing the obligation. You indicate that the loan was paid off in full before you separated from employment in March of 1992.

On September 1, 2017, Michael Kusmierczyk, Supervising Accountant with the Division responded to your letter and provided you with documentation regarding your loan obligation. Mr. Kusmierczyk explained that according to the records posted to your pension account, the last loan payment remitted to the Division was March 31, 1992. At the time you paid your lump-sum balance, it was anticipated that you would make regular payments through May 31, 1992 and your loan payments would cease on June 1, 1992. However no loan payments for the second quarter 1992 (April and May) were remitted. At the time you left employment, the balance of your loan was not paid nor was it carried into retirement on October 1, 2003. You were informed that the unpaid principal balance of \$698.69 continued to accrue interest for the period of time you did not participate in the pension plan. Your active loan was not carried into retirement; therefore, the loan balance would not appear on your retired statement of account. Additionally, Mr. Kusmierczyk provided you with copies of screen prints and documents regarding your loan obligation. According to federal guidelines, pension loans must be paid within a limited period of time; and therefore, the Division was not able to reduce your monthly payments. Lastly, you were provided with appeal rights to the TPAF Board.

On October 2, 2017, you appealed to the TPAF Board noting that the Division has no grounds for deducting any amount for the alleged outstanding loan balance as the Division has violated multiple state statutes and surpassed the statute of limitation.

On January 12, 2018, you were notified that your appeal was being held in abeyance until finalization of discussions with the Internal Revenue Service (IRS).

The TPAF Board notes that after the January 18, 2018 letter to you, the State of New Jersey entered into a Closing Agreement with the IRS that identifies problems with pension loans and a method to correct the identified errors, while maintaining the tax-qualified status of the TPAF.

On October 22, 2018, you were notified that the TPAF Board would consider your appeal at its meeting on December 6, 2018.

On December 6, 2018, the Board considered your personal statements and the statements of your husband, Dennis McMahon, your submissions and all of the documentation; however, the Board denied your request to refund the pension funds deducted from your pension checks with interest and the additional expenses. The basis of the Board's decision was set forth in its letter dated December 21, 2018.

Thereafter, you appealed the Board's determination. In your appeal, you reiterated your argument that you fully paid off your loan prior to your last day of employment of March 19, 1992 based on your payment of \$5,093.11, and request a refund of \$1,220.47 deducted from your 2017 pension checks and other assorted fees. In addition, you state that the Division is in violation of the statute of limitations contained in N.J.S.A. 2A:14-1, breached the loan contract, and violated many equitable doctrines. You disagree with the TPAF Board's interpretation of the statutes governing the TPAF and the TPAF Board's reliance on the Internal Revenue Code Section 72(p). You argue that the Board's reliance on Sellers v. Bd. Of Trs., Police & Firemen's Ret. Sys., 399

N.J. Super. 51,62 (App. Div. 2008) is misplaced because the issues have no bearing on your pension loan case.

At its meeting on March 7, 2019, the Board determined that there were no material facts in dispute and directed the Board Secretary in conjunction with the Attorney General's Office to prepare Findings of Fact and Conclusions of Law, which constitutes the Board's Final Administrative Determination.

### **CONCLUSIONS OF LAW**

The Board denied your request to refund \$1,220.47 paid to satisfy your loan obligation with interest to your TPAF account and to agree to your compensation demands. The Board relied upon N.J.S.A. 18A:66-35 and N.J.S.A. 18A:66-35.1.

N.J.S.A. 18A:66-35 states in pertinent part:

an amount equal to not more than 50% of the amount of his accumulated deductions, but not less than \$50.00; provided, that the amount so borrowed, together with interest thereon, can be repaid by additional deductions from compensation, not in excess of 25% of the member's compensation, made at the same time compensation is paid to the member. The amount so borrowed, together with interest on any unpaid balance thereof, shall be repaid to the retirement system in equal installments by deduction from the compensation of the member at the time the compensation is paid or in such lump sum amount to repay the balance of the loan but such installment shall be at least equal to the member's rate of contribution to the retirement system and at least sufficient to repay the amount borrowed with interest thereon.

...

Loans shall be made to a member from his accumulated deductions. The interest earned on such loans shall be treated in the same manner as interest earned from investments of the retirement system.

Further, "[t]he rate of interest for a loan requested by a member prior to the effective date of P.L.2007, c.92 (C.43:15C-1 et al.) shall be 4% per annum on any unpaid balance thereof. N.J.S.A. 18A:66-35.

After the enactment of Chapter 92, the State Treasurer sets "a commercially reasonable rate" on January 1 of each calendar year. Ibid. Additionally, N.J.S.A. 18A:66-35.1 states:

In the case of any member who retires without paying the full amount so borrowed, the Division of Pensions and Benefits shall deduct from the retirement benefit payments the same monthly amount which was deducted from the compensation of the member immediately preceding retirement until

the balance of the amount borrowed together with the interest is repaid. In the case of a pensioner who dies before the outstanding balance of the loan and interest thereon has been recovered, the remaining balance shall be repaid from the proceeds of any other benefit payable on the account of the pensioner either in the form of monthly payments due to his beneficiaries or in the form of lump sum payments payable for pension or group life insurance.

The TPAF is a “qualified governmental defined benefit plan[] pursuant to sections 401(a) and 414(d) of the federal Internal Revenue Code of 1986, as amended, or such other provision of the federal Internal Revenue Code, as applicable, regulations of the U.S. Treasury Department, and other guidance of the federal Internal Revenue Service.” N.J.S.A. 43:3C-18(a). The Director of the Division is “authorized to modify the provisions of the [TPAF], when a modification is required to maintain the qualified status of the [TPAF] under the Internal Revenue Code of 1986, applicable regulations of the U.S. Treasury Department, and other guidance of the federal Internal Revenue Service (IRS).” N.J.S.A. 43:3C-18(c).

IRC Section 401(a) and federal tax law require that pension loans comply with IRC Section 72(p). Specifically, IRC Section 72(p)(2)(B) requires pension loans to be repaid within 5 years of issuance and IRC Section 72(p)(2)(A) prohibits total outstanding loan amounts from exceeding \$50,000. Ibid. If a member fails to repay the pension loan within the 5-year period or the amount exceeds the IRS limit, then the loan becomes a “deemed distribution” taxable as income to the member and subject to additional penalties. IRC Section 72(p)(1). The deemed distribution does not cancel the loan obligation, which still must be repaid to the Plan, with applicable interest. See Rev. Proc. 2016-51, Section 6.02(1).

There is no dispute that you took a loan from your TPAF account, on November 13, 1991, that you started repaying the loan through payroll deductions, and repayment ceased when you requested a loan pay-off from the Division. There is further no dispute that when the Division provided you with a loan payoff, the notification stated that the payoff was based on your loan payments being current and “[t]he effective date of this lump sum payment will be June 1, 1992.” There is no dispute that you went off payroll at the end of March 1992 and therefore did not make

payments for April and May 1992. While the Division did not carry these loan payments in retirement, you also did not notify the Division that you went off payroll prior to the June 1, 1992 payoff date for your loan. The TPAF Board acknowledges that your remaining loan payments were not carried into retirement and automatically deducted from your pension checks by the Division. When the Division realized your loan was not being repaid, you were informed by the Division of the outstanding loan obligation, and thereafter the Division implemented a modified repayment schedule to repay your loan.

The TPAF Board is also aware that the issue of the repayment of loans in retirement implicates more than just your loan. Because the TPAF is a federally tax-qualified plan, as required by N.J.S.A. 43:3C-18(a), the TPAF's failure to comply with all the requirements of the IRC could result in the IRS determining that the TPAF would no longer be a tax-qualified plan under IRC Sections 401(a) and 414(d). To that end, the Board is aware that the State Treasurer and Director of the Division, in accordance with his authority and responsibility under N.J.S.A. 43:3C-18(c) to keep the TPAF tax-qualified, signed a Closing Agreement with the IRS. In addition to setting forth methods to repay certain loans, the Closing Agreement reiterates that the plan is subject to IRC Section 72(p). Even when a loan is not properly repaid under the provisions of IRC Section 72(p), and there is a reported deemed distribution, the deemed distribution would not relieve a member of the obligation to repay the loan, with interest.

You contend that the interest that accrued is not a result of your error. Per N.J.S.A. 18A:66-35 and -35.1, interest accrues on any unpaid loan balance. Because loan payments were not made or taken from April and May 1992 pay checks, the balance of your loan was not paid off, as contemplated by the loan payoff quote. These remaining loan payments were not carried into retirement and deducted from your pension checks. Therefore, per the statutory requirements that govern the loan, N.J.S.A. 18A:66-35 and -35.1, there is additional interest that accrued on your loan that must be repaid.

The TPAF Board also relies on its ability to correct errors pursuant to N.J.S.A. 18A:66-63, which states, in pertinent part:

If any change or error in records results in a member or beneficiary receiving from the retirement system more or less than he would have been entitled to receive had the records been correct, then on discovery of the error, the board of trustees shall correct it and, so far as practicable, adjust the payments in such a manner that the actuarial equivalent of the benefit to which he was correctly entitled shall be paid

While the Board noted your original arguments, and those in your appeal letter, the Board has no authority to grant your request to waive the amount of accrued interest charged on your loan because doing so could harm the overall pension scheme. See Sellers v. Bd. of Trs., Police & Firemen's Ret. Sys., 399 N.J. Super. 51, 62 (App. Div. 2008). Reducing interest on the outstanding loan balance would violate N.J.S.A. 18A:66-35, N.J.S.A. 18A:66-35.1, IRC Section 72(p), and the State's Closing Agreement with the IRS, which could result in the TPAF no longer being considered a tax-qualified plan, which would affect the entire State, all employers in the TPAF, and every member and retiree.

The Board notes that the statute of limitations you cited in your appeal letter, N.J.S.A. 2A:14-1, does not apply to this matter as it is not the filing of civil litigation, and, as noted above, the Board has the authority to correct errors pursuant to N.J.S.A. 18A:66-63.

The TPAF Board has considered your written submissions and because this matter does not entail any disputed questions of fact, the TPAF Board was able to reach its findings of fact and conclusions of law in this matter on the basis of the retirement system's enabling statutes and without the need for an administrative hearing. Accordingly, this correspondence shall constitute the Final Administrative Determination of the Board of Trustees of the Teachers' Pension and Annuity Fund.

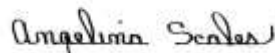
You have the right, if you wish to appeal this final administrative action to the Superior Court of New Jersey, Appellate Division, within 45 days of the date of this letter in accordance with the Rules Governing the Courts of the State of New Jersey. All appeals should be directed to:



Grace McMahon  
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Superior Court of New Jersey  
Appellate Division  
Attn: Court Clerk  
PO Box 006  
Trenton, NJ 08625  
Phone: (609) 292-4822

Sincerely,



Angelina Scales, Secretary  
Board of Trustees  
Teachers' Pension and Annuity Fund

G-7

c: DAG Amy Chung (ET)  
DAG Robert Garrison (ET)  
C. Chianese/M. Kusmierczyk/D. Dinkler (ET)