



Agenda Item # _____

Staff Report

City of Manhattan Beach

TO: Honorable Mayor Aldinger and Members of the City Council

THROUGH: Geoff Dolan, City Manager

FROM: Bruce Moe, Director of Finance

DATE: April 15, 2008

SUBJECT: Consideration of a Resolution Setting a City Council Policy to Return Forfeited Employee Retirement Health Savings Account Contributions to an Employee's Beneficiaries

RECOMMENDATION:

The Finance Subcommittee and staff recommend that the City Council adopt Resolution no. 6131, adopting a policy which returns any forfeited retirement health savings account contributions made by or on behalf of City employees to an employee's beneficiaries.

FISCAL IMPLICATION:

There is no fiscal implication associated with this action.

BACKGROUND:

As one of the benefits available to our employees, the City offers the International City Management Association-Retirement Corporation (ICMA-RC) Retirement Health Savings program. This program is designed to permit employees to defer income for future qualified medical expenses, on a tax-free basis in and out. Similar to the City's 457 and 401 deferral programs, the employees have many options available for investing those funds at their discretion.

When the program was first introduced by ICMA-RC, many employees signed up with the understanding that contributions remaining after an employee's passing were considered transferable, not only to an employee's spouse and dependents, but also to other beneficiaries as designated by the employee. Further, the beneficiaries were able to use those funds on the same tax-free manner as the employee. However, in August 2006, the Internal Revenue Service issued ruling 2006-36, which concluded that reimbursement of medical expenses under the RHS plan for non-spouse and non-dependent beneficiaries does not meet the requirements of the Internal Revenue Code. The IRS further stipulated that RHS plans are to be treated in a manner consistent with Health Reimbursement Agreements, whereby any of the employee's plan assets will be forfeited to the plan sponsor (e.g. City) in the event there is no spouse or dependent eligible to receive those funds. As a result, beginning January 1, 2009, remaining funds can only be passed to an employee's spouse or dependents, and can no longer be passed to other beneficiaries. As a practical application, this means that any employees who have grown children and no spouse, who

participated in the RHS program, would not be able to pass along any remaining funds in the RHS account to their grown children. Similarly, domestic partners would not be capable of giving the funds to their partners. The funds would revert to the City as the plan sponsor.

DISCUSSION:

Because the funds deposited in the RHS account were derived either from employee contributions or from employer contributions made as part of overall compensation to the employee, the Finance Subcommittee and staff believe that it is only proper that any forfeited contributions received by the City flow back to the employees' designated beneficiaries. These recipients may include non-dependents or family members, or other parties designated by the employee through a will, trust or other means.

While legislation has been introduced allowing for distribution of funds to beneficiaries in the future, and may ultimately be passed by the Federal government, such action is not imminent. As a result, and with the January 1, 2009 effective date approaching in the coming months, staff recommends that this policy be adopted at this time.

The Finance Subcommittee approved this policy for consideration by the full City Council. Therefore, Resolution No. 6131 is presented for Council discussion and adoption.

Attachment A – Resolution No. 6131

RESOLUTION NO. 6131

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF
MANHATTAN BEACH, CALIFORNIA, ESTABLISHING A POLICY TO
DISBURSE FORFEITED EMPLOYEE RETIREMENT HEALTH
SAVINGS (RHS) FUNDS TO BENEFICIARIES

Whereas the City of Manhattan Beach contracts with the International City Management Association Retirement Corporation (ICMA-RC) to provide Retirement Health Savings (RHS) account services for certain City employees, and;

Whereas RHS accounts are structured to allow contributions and withdrawals on a tax-free basis when accumulated funds are used for qualified medical care expenditures, and;

Whereas, RHS accounts originally were considered transferable to an employee's spouse, dependents and beneficiaries upon his or her death, with continued tax-free use for qualified medical expenses, and;

Whereas the United States Department of Treasury, Internal Revenue Service issued ruling 2006-36 in August 2006, whereby reimbursement of medical expenses under a RHS plan for non-spouse and non-dependent beneficiaries does not meet the requirements of the Internal Revenue Code, and;

Whereas the IRS further stipulated that RHS plans are to be treated in a manner consistent with Health Reimbursement Agreements, whereby any of the employee's plan assets will be forfeited to the plan sponsor (e.g. City) in the event there is no spouse or dependent eligible to receive those funds, and;

Whereas this ruling takes effect January 1, 2009, and;

Whereas the City desires to continue providing this retirement medical savings instrument to its employees in order to assist them with medical expenses in retirement, and;

Whereas, the City and its employees desire assurances that non-spouse beneficiaries will receive any funds remaining in an employee's RHS account upon employee's death, and;

Whereas, the City recognizes that these contributions belong to current and former employees, and that it is appropriate to return any accrued and unspent funds that may be returned to the City as a result of the death of the current or former employee, to his or her beneficiaries.

Now, therefore, the City Council of the City of Manhattan Beach hereby resolves to:

- a. return any funds received from the RHS plan that are the result of the death of current or former employees, to his or her beneficiaries;
- b. authorize the City Manager to make such distributions on a dollar-for-dollar basis upon receipt of said funds from ICMA-RC, or its successors.
- c. Hold such member contributions in fiduciary accounts until distribution occurs.

SECTION 1. This resolution shall take effect immediately. The City Clerk shall make this resolution readily available for public inspection within thirty (30) days of the date this resolution is adopted.

SECTION 2. The City Clerk shall certify to the adoption of this resolution and thenceforth and thereafter the same shall be in full force and effect.

PASSED, APPROVED and ADOPTED this 15th day of April, 2008.

Ayes:
Noes:
Absent:
Abstain:

Mayor, City of Manhattan Beach, California

ATTEST:

City Clerk