

# CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 244

October 29, 1959

## TRANSFER FROM LOCAL TO STATE RETIREMENT SYSTEM

### Syllabus:

(1) Ordinary income is realized by a retired teacher upon distribution of funds transferred from a local retirement system to the State Teachers' Retirement System in the amount of the latest transferal over the teacher's contributions to the local system.

(2) The cost base for such members retirement allowance from the State Teachers' Retirement System is the unrecovered basis in the local retirement system.

(3) In the Instant case no taxable income is realized by a nonteaching employee from a transfer of funds from a local retirement system to the California State Employees Retirement System.

The X School Retirement System for the benefit of school teachers (hereinafter referred to as "certificated employees") and nonteaching employees (hereinafter referred to as "classified employees") of the X School District provides for the payment of benefits upon retirement. Each participating member is required to contribute a fixed percentage of his salary. These contributions are held until the member's retirement and then paid to him as the annuity portion of his retirement allowance. In addition all certificated members contribute a fixed yearly amount to the State Teachers' Retirement System. Upon retirement the member receives an additional allowance from the State Teachers' Retirement System.

Pursuant to the enactment of Section 14746.6 of the California State Teachers' Retirement System the classified employees (both active and retired) were transferred to the California State Employees Retirement System, effective July 1, 1957. The active certificated members did not elect to transfer to the State Teachers' Retirement System as a body. However, by reason of Section 14746.7 each retired certificated member now may elect, without right of revocation, to receive his entire retirement allowance from the State Teachers' Retirement System. In such case amount equal to the actuarial equivalent of the annuity portion of the retirement allowance to which the member was entitled under the City Retirement System is transferred directly to the retirement annuity fund of the State Teachers' Retirement System. Any excess over the amount due such fund is paid to the member. If the amount transferred is not sufficient to meet the member's obligation under the State retirement annuity

fund, the member is required to pay the difference directly to such fund. Where such transfers take place the State Teachers' Retirement Fund becomes liable for the payment of the members entire retirement allowance.

The problems herein are twofold; one concerns the taxable status of the distribution of the balance to the credit of a retired certificated member in the annuity reserve fund of the City School Retirement System, and the other concerns the taxing of retirement allowances to retired certificated members from the State Teachers' Retirement System. Distributions of the balance to the credit of a retired member in the annuity reserve fund of the X School Retirement System are, "amounts not received as annuities." Such distributions shall therefore be accorded tax treatment under Code Section 17108.

The retirement allowances received by retired certificated members from the State Teachers' Retirement System shall be taxed in accordance with the annuity rules of Article 1, Chapter 3, Revenue and Taxation Code.

Thus, with respect to certificated members who retire and transfer to the State Teachers' Retirement System before receiving any retirement payments from the X School Retirement System the amount of the balance to the credit of the member in the annuity reserve fund of the X School Retirement System, which is distributed to such member by reason of his transfer to the State Teachers' Retirement System, is includible in the members' gross income to the extent that it exceeds the total of his own contributions.

Where retired members have already recovered their cost at the time of transfer to the State Teachers' Retirement System the amount distributed to any such member from the annuity reserve fund of the X School Retirement System by reason of transfer to the State Teachers' Retirement System, is fully includible in the member's gross income. The cost base for such member's retirement allowance from the State Teachers' Retirement System would in such case be only that amount of his contributions to the State Teachers' Permanent Fund which had not been recovered.

In the case of members who, at the time of transfer to the State Teachers' Retirement System, had recovered a part of their cost, the amount distributed to any such member from the annuity reserve fund of the X School Retirement System shall be included in the member's gross income to the extent that it, when added to amounts the member had previously received, exceeds the consideration contributed by the member when added to amounts the member had previously received, exceeds the consideration contributed by the member.

The capital gain provisions of the Personal Income Tax Law will not apply to distributions made to retired members by the X School Retirement System on account of their transfer to the State Teachers' Retirement System in any of the above situations. This is so because the amounts so distributed are not total distributions payable with respect to such members within the meaning of the

statute. (See especially Section 17503(b) of the Personal Income Tax Law and Section 17503(a)(6)(ii) and (iii) of the Personal Income Tax Regulations.

The classified employees had membership only in the local system and were different than the teachers in that the teachers had dual membership. Since the level of benefits paid under the local system was less than the benefits paid under the teachers system to the retired teachers the Board of Education sponsored legislation in 1957 to permit discontinuance of the local system with respect to classified employees provided membership in the State Employees Retirement System was obtained. The retired classified employees received no refund of contributions made to the local system nor were they required to make any further contributions because of the change in retirement systems.