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Local Finance Notice

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IMPLEMENTING CHAPTER 92 OF 2007 – THE IMPACT ON LOCAL UNITS

INTRODUCTION

Earlier this year, the State through the enactment of P.L. 2007, c.92, created a new retirement program for certain public employees: the Defined Contribution Retirement Program (DCRP), and established its membership requirements. Chapter 92 also imposes limits on sick and vacation leave retirement benefits for certain individuals. The law additionally sets limits on pension system membership for employees that receive compensation from a professional services contract. Furthermore, the enactment of P.L. 2007, c. 103 amended the Public Employees Retirement System (PERS) program and amended various laws on other benefit programs¹.

This Notice has been prepared after consultation with the State Division of Pensions and Benefits (Pensions). Due to the significant impact the law has upon so many individuals, Pensions has sought legal advice from the Division of Law. Many of the legal issues have not yet been resolved; therefore, this guidance may not be fully applicable and final decisions as to membership in the two systems rests with Pensions and the individual oversight boards.

These laws generally affect “local units” – any political subdivision of the State, or an agency, board, commission, authority or instrumentality of a subdivision. This includes municipalities, boards of education, counties, fire districts, local authorities, and any boards or commissions established by any of those agencies (e.g., planning boards). Many provisions of the law also affect state government agencies.

These laws are in effect now and have immediate impact on all local units. **Section C of this Notice covers limitations on pension membership for employees performing professional services under a professional services contract. This section has great importance to local units that are conducting reorganization meetings in January.** This Notice should be carefully reviewed by appropriate personnel in each local unit to assess the impact. Legal advisors should also be consulted as to its application for the local unit.

¹ This Notice does not address the impact of Chapter 103 and issues relating to new employees hired after July 1, 2007. For additional information concerning retirement system enrollment eligibility for new employees, refer to the August 2007 Certifying Officers memorandum prepared by the Divisions of Pensions and Benefits, which may be found at: [August 2007 Certifying Officer Memorandum](#).

This Notice provides local unit officials with general and specific information about the laws. It covers the following subjects:

- A. Requirements for membership in the DCRP
- B. Limits on the value of accumulated leave time for certain individuals
- C. Limitations on pension membership for individuals that perform professional services

To explain these issues, this Notice is divided into two parts. The first part (below) is a summary of the impact of each of the three elements. These broad “bullet points” provide key implications and actions local units must consider in implementing the law. Part Two (page 5), the Detailed Program Assessment provides the specifics that supports the impact section and provides legal and implementation references.

Section A - Impact of the DCRP Program

- On and after July 1, 2007, newly *elected officials and appointed gubernatorial appointees* must enroll in DCRP, not PERS.
 - An elected official, who is already enrolled in the PERS *prior to* July 1, 2007 based on an elected office, will remain a PERS member while in that elected office. If, however, *on or after* July 1, 2007, there is a break of service in that elected office, or the official is elected to a *different* elected office, the official will be enrolled in the DCRP and cannot continue with PERS membership under the new elected office.
- *Local unit employees* appointed by elected officials in a manner that is “substantially similar” to gubernatorial “advice and consent” will also be DCRP members.
 - Formal guidance on the type of positions that are covered by DCRP is forthcoming from the Local Finance Board and Department of Education.
- Together there are three categories of DCRP positions: elected officials, gubernatorial appointees, and local unit employees that meet the descriptions in the two previous items.
- A person in PERS prior to July 1, 2007 that is appointed to a position that requires membership in DCRP can remain in PERS if continuously a member. A person is a “member” of PERS if they are paying into PERS for a current position or have not contributed for less than two years.
- A person not making contributions to PERS for more than two years and who is appointed to a DCRP position must join DCRP.
- A person cannot be receiving a retirement benefit from a State retirement system and join DCRP.
- A professional under a professional services contract cannot join either PERS or DCRP.
- Special circumstances will likely require analysis by Pensions’ staff²

Section B - Impact of Leave Restrictions

- The following restrictions cover local unit elected officials and employees appointed by elected officials in a manner that is “substantially similar” to gubernatorial “advice and consent” (see Section A above). They are covered regardless of when they were appointed. The law took effect on July 1, 2007, except for those employees with employment agreements in affect on that date. For those employees it takes effect upon the expiration of the agreement.

² “Special circumstances” relate to unusual employment conditions such as individuals on disability leave, being on Civil Service special reemployment lists, or some other out-of-the ordinary employment situation.

- Covered employees that have accumulated more than \$15,000 worth of sick leave as of July 1, 2007 or at the end of an existing contract cannot accumulate additional time and the dollar value (\$15,000) is frozen in place and cannot be increased. This does not affect the accrual of sick leave days that are earned; it only caps the amount of cash received at retirement.
- All vacation leave of covered employees must be used in the year it was earned, unless its use was prevented because of “business demands.” This leave can then be accrued to the subsequent year. When this form of carry-forward leave is available, for accounting purposes, the old leave is used first.
- Covered employees that have banked more than one year’s worth of vacation leave as of July 1, 2007, or at the end of existing contract, have a limitation on the additional banking. No more than one year’s worth of vacation leave can be added to the previous total.
- Vacation in a year that could not be taken because of a declared State emergency may accrue at the discretion of the employer until a plan is developed to decide if the leave is used or the employee compensated for it.

Section C - Impact of Professional Service Contracts

- A professional service is one that meets the definition in the Local Public Contracts Law at N.J.S.A. 40A:11-2(g).
- For contracts starting on and after January 1, 2008, a professional that performs services under a professional service agreement with that local unit **and** is an employee cannot be a member of either PERS or DCRP.
- By applying the IRS Employee Test, the Pension Certifying Officer must document that all professionals serving as employees are not contractors. If they fail the test (and are considered a contractor), appropriate actions should be taken. This may include a change in employment conditions, canceling pension system membership, or executing a professional services agreement
- The ethics laws that apply to a local unit should be reviewed for compliance when a professional serves as both a contractor and an employee.
- Serving full time or part time is irrelevant; it is how the services are provided that is relevant.
- Special circumstances may require careful legal analysis to ensure compliance.

Moving Forward

The provisions of Chapter 92 present significant and ongoing responsibilities for local officials. Careful attention must be paid to its provisions to ensure the local unit is in compliance with the law. Over the coming months additional guidance will be issued by the State administrative agencies to assist local units in meeting their compliance requirements.

Since the law was enacted it has become clear to Pensions and the Division that some employees or contractors may seek to find ways to continue to provide services as a contractor and remain as a member of a pension system. It should be clear that the legislative history and intent of Chapter 92 is to eliminate that possibility, especially when coupled with heightened attention to the effect of local ethics laws and potential IRS scrutiny. This should be considered when local units make decisions on hiring and contracting.

Pensions will continue to provide local unit pension Certifying Officers and the public information about the programs directly and through their website at www.nj.gov/treasury/pensions and a site where [questions can be submitted directly to them](#).

Pension Certifying Agents can also contact a Division of Pensions and Benefits representative for additional information by calling (609) 292-7524 and following the prompts to “Speak with a Counselor” and “You are a Business Administrator or Human Resource Representative.” Questions concerning the application of the meaning of “professional service” can be submitted to the [Division of Local Government Services](#).

Additional resources that may assist local units in compliance with the law include:

- [The full text of Chapter 92](#)
- [Excerpts of the sections of Chapter 92 specific to this Notice](#)
- Pensions’ guidance on the DCRP:
 - [For PERS and TPAF Employees](#)
 - [For elected and appointed officials](#)

Approved: Susan Jacobucci, Director

Page	Shortcut text	Internet Address
1	August 2007 Certifying Officer Memorandum	http://www.state.nj.us/treasury/pensions/coltr07.htm
4	questions can be submitted directly to them	http://www.nj.gov/treasury/pensions/contacts.htm
4	Division of Local Government Services	lpcl@dca.state.nj.us
4	The full text of Chapter 92	http://www.nj.gov/treasury/pensions/chapt92.pdf
4	Excerpts of the sections of Chapter 92 specific to this Notice	
4	For PERS and TPAF Employees	http://www.nj.gov/treasury/pensions/fact79.htm
4	For elected and appointed officials	http://www.nj.gov/treasury/pensions/fact80.htm

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PART 2 - DETAILED PROGRAM ASSESSMENT

Section A. DCRP Membership Requirements – N.J.S.A. 43:15C-2

Membership Required

The Defined Contribution Retirement Program is a new pension system, where the value of the pension is based on the amount of the contributions made by the employee and employer and through investment earnings. The employee, through options provided under the plan, directs investment of contributions. In this regard it is similar to a Deferred Compensation program, where the employee has a portion of tax-deferred salary put into an account that the employee manages through investment options provided by the employer.

In the case of the State's plan, the employee will contribute five and a half percent of base salary, and the public employer will contribute three percent. Various investment options will be available through the plan administrator, Prudential Financial.

The law at N.J.S.A. 43:15C-2 requires three classes of employees to enroll in the DCRP, subject to the exceptions that follow. The first two classes are:

1. All elected officials taking office on or after July 1, 2007, except that a person who is reelected to an elected office held prior to that date without a break in service may remain in PERS. Being elected to a different local office requires membership in DCRP for the new position.
2. Someone appointed by the Governor with advice and consent of the Legislature or who serves at the pleasure of the Governor only during that Governor's term of office.

The third class [N.J.S.A. 43:15C-2(a)(3)] has direct, but complicated impact on local government officials and is repeated verbatim (and formatted for readability) below:

“(3) A person who commences service on or after the effective date of this section (7/1/07):

- in an employment, office or position in a political subdivision of the State, or an agency, board, commission, authority or instrumentality of a subdivision,
- pursuant to an appointment by an elected public official or elected governing body,
- that requires the specific consent or approval of the elected governing body of the political subdivision that is substantially similar in nature to the advice and consent of the Senate for appointments by the Governor of the State
- as that similarity is determined by the elected governing body and set forth in an adopted ordinance or resolution,
- pursuant to guidelines or policy that shall be established by the Local Finance Board in the Department of Community Affairs or the Department of Education, as appropriate to the elected governing body.”

Thus, the Local Finance Board and the Department of Education have a significant role in guiding local units and the Division of Pensions and Benefits in determining what positions and individuals are required to be part of the new Defined Contribution Retirement Program. At this writing the Board and the Department are considering, but have not yet issued, guidance or policy. Both organizations are expected to act soon after the release of this Notice.

In the meantime, local officials are advised to consider the text of the law and the following exceptions, and recognize that final decisions on plan memberships will be delayed until the guidance is issued.

Exception to DCRP Membership

N.J.S.A. 43:15C-2(a) and (b) provides several types of exceptions to the requirement to join DCRP.

1. If an individual holds a professional license or certificate to perform **and** is serving in any of the following capacities, the person is qualified to join or remain in PERS and does not join DCRP:

• Certified Health Officer	• Tax Assessor
• Tax Collector	• Municipal Planner
• Chief Financial Officer	• Registered Municipal Clerk
• Construction Code Official	• Licensed Uniform Subcode Inspector
• Qualified Purchasing Agent	• Certified Public Works Manager

2. A person who is employed or appointed in the regular or normal course of employment or appointment procedures and consented to, or approved in a general or routine manner appropriate for and followed by the political subdivision, or the agency, board, commission, authority or instrumentality of a subdivision. The Local Finance Board will likely address and provide clarification of this provision.
3. Appointed individuals that are otherwise required to join DCRP are excused from membership if:
 - They are a PERS member prior to 7/1/07 and continuously thereafter
 - They are eligible for membership or enrolled in another pension program
 - They are retired and receiving a benefit from another state pension program
 - They are otherwise ineligible to join PERS
 - The salary of the position is less than \$1,500/year

The first item in number 3 (above) uses the term “continuously thereafter” for PERS membership as an exception from joining DCRP. Pensions has determined that the phrase generally means either the person is currently employed and contributing to PERS in an existing position, or was a member and left public employment, but the DCRP appointment takes place within two years of the person leaving public employment.

4. A person earning less than \$5,000 a year and is eligible for DCRP membership can decide to waive participation in DCRP. This decision is irrevocable for elected officials.

It is also important to note that membership in DCRP cannot be used to accumulate years of service for the purposes of qualifying for retirement health benefits credit.

In addition, because the law specifically refers to appointments made by elected officials, appointments made by local authority boards of commissioners are not subject to DCRP membership.

Finally, it is important to note there are other circumstances (e.g., individual on temporary disability or were laid off) that can affect how these decisions are made. Pensions and the related pension governing boards make the final determinations on membership, and will address unique circumstances as necessary. Pensions’ staff can be consulted for guidance in these circumstances.

Section B. Limits on Accumulated Leave Time

Sections 42 through 46 (individually cited below) of the law imposes limits on the value of sick and vacation leave that can be accumulated by all employees that meet the “substantially similar” determination discussed in Section A. These limits apply to all such covered employees, regardless of their pension system affiliation. The limitations also affect individuals that serve in both Civil Service (Title 11A) and non-Civil Service local units; both are treated the same. The provisions also affect individuals employed by public schools.

Nothing in any of the leave provisions can contradict a contract in effect on July 1, 2007, and no contract entered into subsequently can contradict the law.

Sick Leave

- 11A:6-19.1 Payment of accumulated sick leave by political subdivision under civil service
- 40A:9-10.2 Payment for accumulated sick leave by political subdivision, non-civil service
- 18A:30-3.5 Payment for accumulated sick leave by board of education

These laws prohibit the payment of supplemental compensation upon retirement in excess of \$15,000 for sick leave after July 1, 2007. The following provisions apply to these restrictions:

The value of accrued sick leave as of July 1, 2007 or upon expiration of an employment contract in effect on July 1, 2007 that has a value in excess of \$15,000 can be received upon retirement, but the amount cannot increase:

- If less than \$15,000 has accrued as of those dates, days can continue to accrue, but no more than \$15,000 will be paid upon retirement.
- The amount of the benefit is based on the number of days multiplied times the daily rate of pay in effect on July 1, 2007 or the last date of the contract.

In all cases, sick leave days can continue to accumulate – this section only limits the amount of payment upon retirement. Amendments to or extensions of any contract in effect on July 1, 2007 would likely be viewed as subverting the intention and letter of the law.

Vacation Leave

- 11A:6-3 Payment for accumulated vacation leave by political subdivision, civil service (not amended – it was existing law)
- 40A:9-10.3 Payment for accumulated vacation leave by political subdivision, non-civil service
- 18A:30-9 Payment for accumulated vacation leave by board of education

The new laws also direct that vacation leave not taken during the year because of locally determined “business demands” can only accrue for use in the following year. This is an extension of existing State and local Civil Service law to other public employers. The only exception to this is if an emergency declared by the Governor effectively prohibits the individual from taking vacation during the year. Then, pursuant to a plan established by the individual’s appointing authority, the leave is used or the individual is compensated for that leave. That decision cannot be made pursuant to collective negotiation or collective bargaining.

For individuals in a covered position on July 1, 2007, if more than one year’s vacation has accumulated prior to July 1, 2007, it can be retained and used at any time, but any new time is subject to this provision. In other words, after July 1, 2007 (or expiration of a contract) an employee’s vacation bank cannot accrue more than the previous leave plus no more than one year’s worth of current vacation time.

An individual taking a covered position after July 1, 2007 who brings accumulated time to the position is permitted to retain and use it as well.

Section C. Pension Membership and Professional Services

Section 20 (N.J.S.A. 43:15A-7.2) makes important changes concerning individuals that perform “professional” services in local units and PERS.

The law has two major provisions:

- Individuals that perform professional services under a professional service contract with that local unit cannot be members of PERS or DCRP²; and,

² N.J.S.A. 43:15C-2(b)(4) prohibits from DCRP membership a local unit employee who is ineligible for PERS

- A professional who is an employee must be a bona fide employee that meets the Internal Revenue Service “employee test” in order to be a member of PERS for those services.

The results of these provisions are that on and after January 1, 2008, new professional service contracts cannot have a person who is an employee of the local unit be a member of PERS or DCRP. If contractual services are provided, pension membership is not permitted.

These provisions have an impact on many local units, particularly where the professional is paid as an employee and receives compensation from a professional services contract. The following subsections elaborate on these two provisions in context of professional services, IRS considerations, and ethics laws.

For transition purposes, the law permits existing PERS members based on a professional services contract to continue to accrue PERS credit until the current contract expires. PERS credit cannot accrue after that contract expires. Alternatively, professionals who are in PERS and under contract cannot earn additional PERS credit after contracts in effect as of June 8, 2007 expire.

It is also important to consider that State contracting laws do not permit professional service contracts to be for more than one year and they cannot be “extended,” prior to or at their end date without entering into a new contract.

Meaning of Professional Service

In context of this section, the term “professional” or “professional service” refers to the definition of professional services in N.J.S.A. 40A:11-2(6):

"Professional services" means services rendered or performed by a person authorized by law to practice a recognized profession, whose practice is regulated by law, and the performance of which services requires knowledge of an advanced type in a field of learning acquired by a prolonged formal course of specialized instruction and study as distinguished from general academic instruction or apprenticeship and training.

Professional services may also mean services rendered in the provision or performance of goods or services that are original and creative in character in a recognized field of artistic endeavor.”

Typically, these positions include attorneys, engineers, architects, planners, and public health professionals, but exclude for example, construction and fire code officials.

An employee is someone who is paid a salary or hourly compensation that is subject to payroll deductions, particularly social security, and federal and state income withholding taxes. The law also requires (subject to certain exceptions discussed below) an employee that earns more than \$1,500 per year must enroll in one of the pension systems, as appropriate to the position (i.e., PERS or DCRP).

IRS Compliance

The law also brings into play IRS rules on determining if an individual is an employee or independent contractor.

These provisions mean that the Pensions Certifying Officer of each local unit must review their employees who are professionals and use the IRS criteria (see below) to determine if they meet the requirements for an employee, and thus membership in PERS or DCRP. If they fail the employee test, they are considered a contractor, which then requires removal from payroll and related benefits, and most likely, governing body passage of a resolution authorizing a professional services contract.

Conversely, if the position is determined to be that of an employee and there is a professional service contract under which the employee provides services, employment may continue, but the individual cannot be a member of a PERS or DCRP.

Because of the important nature of the employee test, for those professionals that are employees the Certifying Officer should analyze the facts, document the analysis, and keep it with the employee’s personnel file. This

may become important if the local unit is audited by Pensions, and is an important internal control that is subject to testing by the local unit auditor.

IRS Reference Sources

By the State using the established IRS Employee Test (commonly known as Revenue Ruling 87-41) as the basis for determining employee or contractor status local units, have a standard assessment tool and the opportunity for formal guidance. There are several IRS documents that discuss how to evaluate the individual circumstance:

- IRS Publication 1779 is a two-page brochure that summarizes the IRS Employee Test. It is available from the IRS at www.irs.gov/pub/irs-pdf/p1779.pdf
- IRS Publication 15a is about employees and the employer-employee relationship and includes examples of employees and contractors. It also discusses employee tax liability issues. It is available from the IRS at: www.irs.gov/pub/irs-pdf/p15a.pdf
- IRS Publication 963, the “Federal-State Reference Guide” is a comprehensive reference source for social security and Medicare coverage and Federal Insurance Contributions Act (FICA) tax withholding issues. Chapter 4 of this document provides details on determining worker status. It is available from the IRS at www.irs.gov/pub/irs-pdf/p963.pdf

As part of its services to employers, the IRS will also look at individual circumstances and will provide a determination for the purposes of federal employment taxes and income tax withholding. Because these two issues are at the heart of the IRS assessment, local units can contact the IRS to obtain a definitive answer if local analysis is inconclusive. IRS form SS-8 can be used to request a determination. It is online at www.irs.gov/pub/irs-pdf/fss8.pdf.

Implications of State Ethics Laws

It is well understood that there are a myriad of existing contractual and employee relationships between local units and their professionals that are affected by these provisions. The concerns of local officials and their professionals, however, should go beyond the contractual relationship and the IRS employee test.

There may be cases where the contractual and employment circumstances of these individuals or their associates may implicate provisions of the conflict of interest provisions of ethics laws governing the local unit.

Local officials should carefully consider situations involving a professional who passes the IRS employee test if there is a contract with an organization in which the professional has a business interest. In these cases, to ensure that the relationship does not create a conflict of interest under ethics law, it is strongly advised that an Advisory Opinion be solicited from the appropriate government ethics agencies: the Local Finance Board for local units under the Local Government Ethics Law, and the School Ethics Commission for public schools.

In cases where the local unit is governed by enabling legislation such as the Optional Municipal Charter Law, those laws should also be examined to ensure there is no breach of conflict of interest provisions.