Post-Tax vs. Pre-Tax Pension Contributions
Frequently Asked Questions (FAQ)
&
DROP --- Post-Tax Pension Contributions FAQs

Q1. What are "post-tax pension contributions"?

A1. Pension contributions that you made to the Tampa Fire & Police Pension Fund during your career *prior to 10/1/2001*.

Q2. When did "pre-tax pension contributions" begin?

A2. Pension contributions began being made on a pre-tax basis effective fiscal year 10/1/2001 forward.

Q3. What's the difference between a post-tax pension contribution and a pre-tax contribution? Isn't a pension contribution just a pension contribution?

A3. Post-tax pension contributions are just what they sound like…made on a *post*-tax basis—*after* income taxes have been withheld.

Pre-tax pension contributions are just what they sound like…made on a *pre*-tax basis—*before* income taxes have been withheld.

Q4. Why the change in October 2001?

A4. The unions, the city and the pension board worked together to add an "employer pick-up" provision to the pension plan so that pension contributions could start being made on a pre-tax basis. That means less dollars withheld in income taxes from your paycheck and more take home dollars in your pocket.

Q5. What was involved in changing the pension plan in 2001 to get the benefit of pre-tax pension contributions?

A5. After the pension contract language for pre-tax contributions was collectively bargained and agreed to between the unions and the city, including a ratification vote by the active membership, the plan change was submitted to the local delegation in the fall of 2000, enacted by the Florida legislature in Tallahassee in the spring of 2001, and took effect with the first pay cycle in fiscal year 2001, which began October 2001.

Q6. What is the benefit to me of pre-tax pension contributions?

A6. Your pension contributions are made before federal income taxes are withheld. You pay taxes only on the money you take home. Income taxes on the pension contributions are paid when you actually receive that benefit. As a simple example only, if your gross pay is $2,000 and F&P pension contributions are 10% of pay, or $200, then you are taxed only on $1,800, rather than all $2,000. The pension contributions are withheld before federal income tax, which means more take home dollars in your pocket.

Q7. So what?

A7. Had your pension contributions still been *post*-tax (after taxes), then you would have paid taxes on the entire $2,000 before the $200 in pension contributions were withheld.

Q8. How can I tell what is post-tax and what is pre-tax on my self-service paycheck stub in PeopleSoft?

A8. In PeopleSoft, post-tax (after tax) pension contributions are called "FP PostTax" and pre-tax (before tax) pension contributions are called "F&P Plan N."

Q9. I seem to remember when I started 25 years ago that the first few years of pension benefits were not taxed at all. What was that all about?

A9. Back before 1986, when the tax code changed dramatically under President Ronald Reagan, if you paid in $50,000 in post-tax pension contributions to the pension fund, then the first $50,000 that you drew out in monthly pension benefits were not taxed. The instant that you drew out the same amount that you had put in, then your remaining pension benefit became taxable for the rest of your life. Under this old way, you recovered your post-tax pension contributions as quickly as possible.

Q10. That sounds like a sweet deal. How can I get in on that?

A10. You can't. The Internal Revenue Code changed in 1986. The thinking at the time on a national level in the federal government and IRS seemed to be that everybody was getting their post-tax pension contributions back too quickly rather than being paid over the period of the actual benefit.

The Internal Revenue Code was changed so that you began to recover your post-tax pension contributions in tiny increments spread out over the rest of your expected life. It's called the "exclusion ratio".

Q11. What's an "exclusion ratio?"

A11. The exclusion ratio is different for every single person. It is based upon your attained age and your life expectancy according to IRS mortality tables, your marital status, your spouse's attained age and life expectancy, the post-tax pension contributions you made to the fund, your monthly pension benefit when you start drawing benefits and the total amount of pension benefits that you are expected to draw out over your lifetime. Complicated enough?

Q12. What??

A12. We don't make the IRS rules, we just abide by them.

A simplified exclusion ratio example is, say someone retires with a $1,000 per month benefit and a remaining life expectancy of 30 years (30 years x 12 months in a year = 360 monthly payments) and is not married. At the snapshot taken at retirement for the exclusion ratio calculation, they are expected to draw out $360,000 over 30 years. They paid in $20,000 in post-tax pension contributions during their career. Taking the $20,000 post-tax pension contributions and dividing by $360,000 of expected lifetime of payments gives an exclusion ratio of 5.55%. ($20,000 divided by $360,000 = 5.5%) In other words, every month for that $1,000 benefit paid, 5.55% of it is not taxed because it represents a partial recovery of the post-tax pension contributions that person made during their career, in this simple example.

Q13. I still don't get it.

A13. The exclusion ratio is so small that it is barely noticeable each pension check. The direct deposit advice notice of that pensioner would show $1,000 gross and $55.50 non-tax. Meaning, that pensioner is only paying income tax on $944.50 ($1,000 gross minus $55.50 non-tax = $944.50), instead of all $1,000.

Q14. Do I ever recover the tax benefit of my entire post-tax pension contributions from the federal government?

A14. Yes, if you live long enough. If you got $1,000 per month for 30 years (360 months life expectancy) and 5.55% of each $1,000 check was not taxed, at the end of that 30 year life expectancy, you would have had the benefit of having

$19,980 not taxed during that time. Compare that to the $20,000 of post-tax pension contributions that you put into the fund during your career, and you are even. If you live beyond the IRS's life expectancy for you, then you come out ahead.

Q15. How do I tell on my direct deposit advice notice how much of my monthly pension benefit is not taxed because it represents a partial recovery of my post-tax pension contributions?

A15. The dollar amount is called plain old "non-tax."

Q16. I'm leaving DROP this fall and I keep hearing people talking about a "free check" we get in December. What's that all about?

A16. If someone leaves DROP by September 30^{th} of one year and is eligible for a DROP rollover that December 31, they will get a DROP statement, a DROP retirement distribution calculation, and a cover letter from the pension office that describes what happens and when.

If the DROP participant is rolling over to an IRA or to Nationwide Deferred Comp (or any tax qualified vehicle), the rollover is made directly from the pension fund's custodian bank to the rollover recipient bank by December 31.

There is also a separate check that goes to the DROP participant directly from the pension fund's custodian bank, mailed to their home that represents a partial recovery of post-tax pension contributions made during their career that accumulated during the DROP participation period. In other words, it's post-tax money that generally can't be rolled over, so it goes directly to the DROP participant. The figure is calculated and listed on the DROP calculation, which is mailed to the DROP participant's home with a letter of explanation. That check is a recovery of their money, free and clear, with no tax implications because they already paid taxes on it during their career.

Finally, the pension fund's custodian bank issues two 1099s to the DROP participant in this example: one for the rollover--none of which is taxable--and a second one for the partial recovery of post-tax pension contributions--none of which is taxable.

Q17. So this "extra check" isn't a mistake or a refund or a gift?

A17. No.

Q18. How come DROP people get this "extra check" or "free check"?

A18. Because during the time the person was in DROP, up to 5 years or 60 months for example, they weren't getting a check mailed to their home or direct deposited in their checking or savings account every month where that "exclusion ratio" comes into play. So at the end of the DROP participation period, 5 years or 60 months in this example, the tax benefit of the "exclusion ratio" has built up. The whole time in DROP, the DROP benefit accrues to the tax deferred DROP account.

At the end of DROP, the fund's external CPA calculates the DROP balance and rollover amount, including the "exclusion ratio" that applies to the time while in DROP, and you end up with two amounts at the bottom of the DROP Retirement

Distribution calculation: the amount subject to rollover (usually a big number), and an amount not generally subject to rollover (usually a small number)—and that smaller number represents the partial recovery of post-tax pension contributions. For a DROP participant, this calculation is even a little more complicated than the example in Q&A12 because there's the DROP rollover balance to factor in as well.

Q19. You lost me.

A19. You don't have to memorize the Internal Revenue Code or the mechanics. The fund's external CPA is a professional tax expert well versed in the incredibly complex and ever-changing Internal Revenue Code. The fund also retains the services of a national special tax counsel firm, also well versed in the Internal Revenue Code.

Q20. So this "extra check" or "free money" gets mailed to my house by the pension fund's custodian bank by December 31, which arrives after my DROP statement and calculations and cover letter, is mine free and clear and I don't have to pay income taxes on it later?

A20. Correct. The partial recovery of post-tax pension contributions is yours free and clear to enjoy. It is not taxable since you already paid taxes on your post-tax pension contributions during your career.

Q21. Is there a way to ballpark my "extra check?"

A21. No. The "exclusion ratio" is different for every single person, every single time. It is based upon your attained age at retirement, your life expectancy, your marital status, your spouse's attained age at your retirement, your spouse's life expectancy, the dollar amount of post-tax pension contributions you made during your career, and the total expected pension payout over your lifetime, including final DROP figures. This calculation is done by the fund's external CPA once, and only once, in December after the DROP participant has separated from service by September 30.

Q22. Does any DROP participant get this "extra check" any time they want it?

A22. No. This "extra check", which represents a partial recovery of post-tax pension contributions made during your career, is paid only to a DROP participant who separates from service prior to September 30 who receives a rollover or lump sum distribution of their DROP account by December 31.

Q23. So this “extra check” is only paid once to DROP participants when they get their rollover or lump sum by December 31?

A23. Yes.