

**BEFORE THE BOARD OF TRUSTEES  
TEACHERS' RETIREMENT SYSTEM OF THE STATE OF ILLINOIS**

**In the Matter of:** )  
 )  
 )  
 **Richard Olson** )  
 )  
 **Petitioner.** )

**PROPOSED DECISION RECOMMENDED BY THE CLAIMS HEARING  
COMMITTEE IN THE ADMINISTRATIVE REVIEW OF RICHARD OLSON**

**I. Introduction**

Pursuant to 80 Ill. Admin. Code 1650.640(e), Petitioner Richard Olson agreed with System staff that his request for administrative review would be presented to the TRS Board of Trustees' Claims Hearing Committee solely upon the record agreed to by the parties. The Claims Hearing Committee met by telephonic conference on February 21, 2002, to consider Dr. Olson's appeal. Present were Presiding Hearing Officer Ralph Loewenstein, Committee Chairman James Bruner and Committee members Sharon Leggett and John Glennon.

Petitioner Olson filed the instant administrative review to challenge the staff's disallowance of \$38,670.54 in the 1998-99 school year and \$64,505.32 in the 1999-00 school year as creditable earnings to be used in Dr. Olson's final average salary calculation. These amounts were disallowed as creditable earnings based upon the staff's determination that their source was the Trust Under the Richard Olson Nonqualified Deferred Compensation Plan; a rabbi trust established for Petitioner's benefit by his employer, Freeport School District No. 145 (Freeport), on October 25, 1993.

Petitioner concedes that monies contributed to and distributed from a rabbi trust are not creditable earnings under 80 Ill. Adm. Code 1650.450 (TRS Rule 1650.450). However, Dr. Olson takes the position that, by revoking his rabbi trust

agreement with Freeport, the source of the pay increases was no longer Olson's rabbi trust but the school educational fund. In other words, by revoking the irrevocable trust, Olson caused what were previously noncreditable funds to be transformed into creditable earnings.

It is the position of the System that the source of the funds was Dr. Olson's rabbi trust and that Freeport and Olson merely reprocessed the funds through the district payroll, which did not change their noncreditable nature. At issue in this case is also the question of whether Dr. Olson filed a timely appeal. The System takes the position that Dr. Olson's six month appeal period ran from December 18, 1997, the date former General Counsel Carl Mowery advised Dr. Olson that monies from the rabbi trust would never be creditable. Dr. Olson claims his appeal is timely because the revocation of his rabbi trust created a wholly new issue requiring a new denial and appeal period.

After considering the Position Statements of the parties, their stipulations of fact and the agreed upon exhibits contained in the Claims Hearing Packet, the Committee's recommendation is to uphold the staff's determination. As will be more fully explained, the Committee finds that Petitioner did not timely file his appeal and that, even had he done so, the earnings in question were noncreditable, nonqualified deferred compensation.

## **II. Findings of Fact**

Prior to hearing, the parties stipulated to the following facts which the Claims Hearing Committee adopts in their entirety. The stipulations are as follows:

- 1) Richard Olson (Olson) was employed by Freeport School District No. 145 (Freeport) beginning July 1, 1992.
- 2) On October 25, 1993, Olson and Freeport entered into a Nonqualified Deferred Compensation Incentive Plan Agreement.
- 3) To effectuate the Nonqualified Deferred Compensation Incentive Plan Agreement an irrevocable trust was established on October 25, 1993.

- 4) The law firm of Scariano, Kula, Elch & Himes, Freeport's legal counsel prepared the Nonqualified Deferred Compensation Incentive Plan Agreement.
- 5) From October 25, 1993 to August 14, 1995, the trustee of the irrevocable trust was Justino Petrarca. From August 14, 1995 to July 15, 1998, the trustee of the irrevocable trust was listed as Today's Trust.
- 6) Money contributed pursuant to the Nonqualified Deferred Compensation Incentive Plan Agreement through August 14, 1995 was invested with Merrill Lynch in the name of Justino Petrarca, Trustee, Board of Education Freeport School District No. 145.
- 7) Justino Petrarca was employed as an attorney with the law firm of Scariano, Kula, and Elch & Himes while serving as trustee of the funds invested with Merrill Lynch on behalf of Olson.
- 8) On April 18, 1996, Dan Boyle of the Scariano law firm directed Today's Trust to close out the Merrill Lynch account and deposit the nonqualified funds with Mercantile Bank, Freeport, Illinois (a.k.a. Today's Bank and Firststar Bank).
- 9) In the 1993-94 school year, pursuant to Olson's Nonqualified Deferred Compensation Incentive Plan Agreement, Freeport paid \$25,313.00 into Olson's trust.
- 10) In the 1994-95 school year, Freeport paid \$29,648.00 into Olson's trust.
- 11) In the 1995-96 school year, Freeport paid \$21,165.00 into the Olson trust.
- 12) In the 1996-97 school year, Freeport paid \$21,165.00 into Olson's trust.
- 13) In the 1997-98 school year, Freeport paid \$21,165.00 into Olson's trust.
- 14) On June 28, 1996, Today's Trust paid Olson \$5,423.00 directly.
- 15) This \$5,423.00 was reported as creditable earnings in the 1995-96 school year on behalf of Olson by Freeport, which the System disallowed.

- 16) On June 24, 1997, Today's Trust paid Olson \$22,811.00 directly.
- 17) This \$22,811.00 was reported as creditable earnings in the 1996-97 school year on behalf of Olson by Freeport, which the System disallowed.
- 18) On June 26, 1998, Today's Trust paid Olson \$44,412.00 directly, which Olson returned to the District on June 30, 1998.
- 19) On July 15, 1998, Olson and Freeport revoked Olson's irrevocable trust.
- 20) On May 21, 1999, \$67,505.13 was returned to Freeport by the trust.
- 21) Olson's TRS retirement date and his date of retirement with Freeport was July 1, 2000.
- 22) If Dr. Olson prevails in this administrative proceeding his initial TRS annuity will be \$8,666.75 per month and \$103,997.40 per annum.
- 23) If the System prevails in this administrative proceeding Dr. Olson's initial TRS annuity will remain \$7,683.80 per month and \$92,205.60 per annum.

Based upon the documentary evidence contained in the Claims Hearing Packet which was stipulated to by the parties, the Committee makes the following additional finding of fact:

- 1) The source of the \$38,670.54 and \$64,505.32 in question in this administrative review was Olson's irrevocable trust which was revoked on July 15, 1998, and returned to the District to pay the above salary increases in the 1998-99 and 1999-00 school years on behalf of Olson.

### **III. Issues to be Decided**

The Claims Hearing Committee is faced with deciding the following issues in this case.

- 1) Did Richard Olson waive his right to appeal the disallowance of the sums in question as creditable earnings in this case when he failed to appeal

former General Counsel Carl Mowery's determination letter of December 18, 1997 within the six month period following that decision as required by 80 Ill. Adm. Code 1650.620?

- 2) Are the sums in question in this appeal creditable earnings under 80 Ill. Adm. Code 1650.450?

#### **IV. Discussion and Analysis**

- 1) Dr. Olson failed to timely file his appeal to challenge the staff determination in this case.**

Pursuant to 80 Ill. Adm. Code 1650.620:

Any member, beneficiary, annuitant or employer may appeal a staff disposition of a claim or interpretation of the Act to the Board of Trustees within six months after the staff disposition or interpretation, by filing a written request for an administrative review with the Executive Director.

On December 18, 1997, former TRS General Counsel Carl Mowery, advised Dr. Olson through his counsel Anthony Scarriano as follows (Exhibit VV, page 256 and 257):

**The basic retirement benefit payable under Article 16 of the Illinois Pension Code is based upon an annuity benefit rate times number of years of creditable service times final salary. 40 ILCS 5/16- 133(a)(B)(1). The term "salary" is defined, in pertinent part, as "the actual compensation received by a teacher during any school year and recognized by the System in accordance with rules of the board." 40 ILCS 5/16-121 (emphasis added). Pursuant to its authority to promulgate rules with respect to the benefit programs, which it administers, the System adopted an administrative rule further defining the term "salary." Section 1650.450 of the Illinois Administrative Code. The System further interprets the definition of salary in its annual Employer Guide, which provides**

**guidance as to what items of compensation, would be recognized or not by the System.**

**The Employer Guide indicates, in pertinent part, that employer-paid fringe benefits are not reportable as salary. Employer-paid fringe benefits include “contributions to or proceeds from nonqualified tax-deferred compensation plans and annuities with the exception of contributions to plans eligible for tax deferred under IRS Sections 401(a), 457(b), and 403(b),” 1997 Employer Guide, p. 3.11 (emphasis added), Although the quoted language has been in the Employer Guide since 1994, the System has consistently held that contributions to or proceeds from nonqualified tax deferred arrangements are not includible in the calculation of salary.**

**Accordingly, the distribution from Mr. Olson’s nonqualified tax-deferred compensation arrangement is not includible in the calculation of “salary” for the purposes of Article 16 of the Illinois Pension Code.**

This staff determination dealt with whether these particular funds could ever be creditable earnings.

The Committee notes that Olson did not file his appeal until August 18, 2000, well past the deadline established by TRS rule. In his letter of July 28, 2000, Thomas Gray, TRS General Counsel, advised Petitioner’s counsel, Daniel Boyle, as follows:

**It is our further position that Mr. Mowery’s letter of December 18, 1997 constituted the staff’s disposition of Mr. Olson’s claim. Under the provisions of TRS Rule 1650.620, Mr. Olson had six months from the date of Mr. Mowery’s letter to seek an administrative review of the staff’s decision. For the record, if Mr. Olson now seeks an administrative review, please be advised the System is not waiving this defense.**

**The System would not view Mr. Olson's cashing of his present annuity checks as a waiver of his claim against the System. The System's position is that his claim was waived when he failed to challenge Mr. Mowery's prior determination. However, that is an issue for the Claims Hearing Committee and Board to decide in the event of an appeal.**

Based on the foregoing, as well as the plethora of correspondence cited in point 3 of the System's Position Statement which are contained in the stipulated exhibits, the Committee finds that Olson was well aware of the System's position that the earnings in question were not creditable and that the System gave written notice of its determination on December 18, 1997. Accordingly, Olson had six months from that date to file his appeal under the provisions of 80 Ill. Adm. Code 1650.620. The revocation of the irrevocable trust and the reprocessing of the rabbi trust funds through Freeport's payroll did not start a new six-month appeal period because the funds and issue remained the same regardless of the attempted recharacterization of the funds by Freeport and Olson. However, even had Olson timely filed his appeal, he would not have prevailed in his claim, as will be further explained by the Committee.

**2) The sums in question do not constitute creditable earnings under 80 Ill. Adm. Code 1650.450.**

As previously noted, Dr. Olson does not challenge the System's determination that funds contributed to or distributed from a nonqualified deferred compensation arrangement are not creditable earnings under 80 Ill. Adm. Code 1650.450. Olson claims that by revoking his irrevocable trust and allowing the money in the trust to return to Freeport, the salary raises in question were no longer being paid by his rabbi trust because the funds were transformed into new district monies no longer subject to treatment as noncreditable earnings. The Committee disagrees with this argument. The funds in question did not lose their noncreditable nature by being returned to the district to be reprocessed through the district payroll. Noncreditable earnings cannot be made creditable by simply recharacterizing their nature to suit the convenience of the member. The Committee finds the revocation of the irrevocable trust to be nothing more than a last ditch effort to justify what the System's staff had advised Olson's counsel would not be possible under the TRS salary rule.

The reprocessing issue in Dr. Olson's administrative review is no different substantively than that which was the subject of the Community Unit 300 v. TRS administrative review. In the Community Unit 300 case, the district and the collective bargaining unit agreed to process Early Retirement Incentive employee contributions through the district payroll in an effort to make the employee contributions creditable despite TRS Rule 1650.450(c)(7). In upholding the Board's decision that payroll processing does not make noncreditable earnings creditable, the Fourth Appellate Court observed in Barton v. TRS, No. 4-96-0735 (dec. March 26, 1997):

**The fact that the District paid the ERI contributions to the retiring teachers, rather than directly to TRS, is insignificant. The plaintiffs' letter of agreement clearly contemplates that the District's payments will be used to pay the required ERI contributions. The District is still making the ERI contribution "on behalf of the employee," even though the payment is made indirectly. 80 Ill. Adm. Code §1650.450 (c) (6) (1994). It is true that the teachers need not use these exact same funds to pay TRS required ERI contribution, nor must the teachers transfer the funds to TRS immediately. See 40 ILCS 5/16-133.5 (c) (West Supp. 1993) (employees may elect to have their contribution deducted from their monthly retirement annuity in 24 monthly installments, rather than pay the whole contribution amount up front). Nevertheless, the basic nature and purpose of the contribution payments is not changed simply because the money passes through the employees' hand before reaching TRS. Likewise, it is not significant that the District deducts state and federal income taxes from the contribution payments. Salary, for purpose of the Code, is not necessarily synonymous with taxable income.**

As in Barton, the basic nature and purpose of the funds - noncreditable, nonqualified, deferred compensation - was not changed by the artifice of the trust revocation and the repayment of the funds to Olson through payroll to enhance his final average salary.



The Committee further finds that the sums put into Dr. Olson's trust constituted remuneration for services rendered in the school years the sums were put aside. While noncreditable, the sums placed in Olson's rabbi trust were part of Dr. Olson's salary in the 1994-95 through 1997-98 school years. Dr. Olson merely took salary he had already earned and reprocessed it through district payroll to pay himself again with previously earned money. Dr. Olson clearly paid his own raises with his rabbi trust monies.

Salary for public service is clearly determined by the time the public service is performed. As stated in Bd. of Trustees v. Dept. of Ins., 65 Ill. Dec. 315, 441 N.E.2d 107 (1982):

**Our courts define "salary" as "a fixed, annual, periodical amount payable for services and depending upon the time of employment and not the amount of services rendered." (Board of Education of the City of Chicago v. Chicago Teachers Union, Local 1, American Federation of Teachers (1980), 89 Ill. App. 3d 861, 866, 45 Ill. Dec. 236, 412 N.E.2d 587, reversed on other grounds (1981), 88 Ill. 2d 63, 58 Ill. Dec. 860, 430 N.E.2d 1111, quoting In re Sanitary District Attorneys (1932), 351 Ill. 206, 274, 184 N.E. 332.**

In the public pension arena, there is good reason for this rule of law. By linking salary to dates of service, public pension funds are able to actuarially plan for the future and assess contributions accordingly. An arrangement such as Dr. Olson's shields annual earnings from pension contributions and allows a member to inflate salary when most beneficial to the member. This harms the System because it is denied the ability to garner adequate contributions to fund the retirement benefit created by infusing previously earned monies into the average salary calculation at the end of a member's teaching career. The Committee finds this result was never intended under the Pension Code nor TRS' salary rule.

Lastly, Dr. Olson's argument that the money in his rabbi trust was always the property of his employer is without merit. Rabbi trusts are a creature of federal tax law designed to allow taxation deferral. The district had no power under the rabbi trust to unilaterally take the money in the trust to pay school district expenses. As stated in the trust:

**Except as provided in Section 3 hereof, after the trust has become irrevocable, the District shall have no right or power to direct Trustee to return to the District or to divert to others any of the trust assets before all payment of benefits have been made to the plan participants and their beneficiaries pursuant to the terms of the Plan(s).**

That the contributions to the rabbi trust were intended to be a part of Olson's compensation in the 1993-94 through 1997-98 school years and not the property of the district is demonstrated in Freeport Counsel Daniel Boyle's letter to Dr. Olson of July 12, 1995 (Exhibit HH, page 233) in which he states:

**I am in receipt of School District check number 70002, representing the contribution to be made to your non-qualified deferred compensation trust/plan (emphasis added).**

This conclusion is further supported by Freeport Counsel Justino Petrarca's letter of May 18, 1994, to Daniel Casing, Freeport's Assistant Superintendent for Business. As stated therein (Exhibit P, page 166):

**This sum will represent the District's contribution to the Trust for the 1994-95 fiscal year and, accordingly, should be treated as an expenditure for such year.**

The Committee further disagrees with Olson's position that the funds in Olson's rabbi trust were subject to the claims of the district creditors, a federal requirement for a valid rabbi trust. As the staff rightly points out, in Illinois, the property of public bodies is not subject to the claims of judgment creditors (see Estate of Walter DeBow v. City of East St. Louis, 92 N.E.2d 1137, 170 Ill. Dec. 457 (1992) and Carmel v. Orr, 220 B.R.619 (1998)). No creditor of the district could ever have claimed a right to Olson's rabbi trust funds.

This is not a case of Illinois trust law. Rabbi trusts are not governed by Illinois trust law. They are a creature of federal tax law. If Olson's rabbi trust truly was the property of the district, it was required by law to be held solely in the Freeport's name (see Bd. of Ed. v. Bd. of Ed., 276 N.E. 2d 732 (1971)). That it was not is dispositive on the issue of ownership.

It is clear to the Committee that the money in the rabbi trust was Olson's compensation in prior years and was being used to pay Dr. Olson's 20 % raises in his two final years of employment, in derogation of TRS' salary rule.

**V. Conclusion**

The Claims Hearing Committee finds in favor of the staff on both its "failure to timely appeal" and "noncreditable earnings" determinations. The Committee recommends the Board adopt this proposed decision.

**VI. Notice of Right to File Exceptions**

Exceptions to the Claims Hearing Committee's Proposed Decision must be filed within fifteen (15) days of receipt by the Petitioner. A Final Decision will be issued by the Board of Trustees after it has considered the Claims Hearing Committee's Proposed Decision and any exceptions filed by the Petitioner.