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CITY ATTORNEY

REPORT NO. R 21-0305
OCT 08 2021

REPORT RE:

**DRAFT ORDINANCE AMENDING CHAPTER 11.5 OF DIVISION 4 OF THE
LOS ANGELES ADMINISTRATIVE CODE TO ESTABLISH THE LOS ANGELES
FIRE AND POLICE PENSIONS RETIREE HEALTH CARE FUND AND TO
AUTHORIZE THE USE OF THE HEALTH CARE FUND TO PAY FOR RETIREE
HEALTH AND WELFARE PROGRAMS**

The Honorable City Council
of the City of Los Angeles
Room 395, City Hall
200 North Spring Street
Los Angeles, California 90012

Council File No. 21-0914

Honorable Members:

This Office has prepared and now transmits for your consideration the enclosed draft ordinance, approved as to form and legality. As recommended by the Board of Fire and Police Pension Commissioners (the Board), the draft ordinance would amend Chapter 11.5 of Division 4 of the Los Angeles Administrative Code (LAAC) to establish the Los Angeles Fire and Police Pensions Retiree Health Care Fund (LAFPP Health Care Fund). The LAFPP Health Care Fund is intended to qualify for exemption from federal income tax under Section 115 of the Internal Revenue Code, and thereby give Los Angeles Fire and Police Pensions (LAFPP or the Plan) increased flexibility in its health care funding mechanism. The draft ordinance would also specifically authorize the use of the LAFPP Health Care Fund to pay for LAFPP health and welfare benefits.

Background and Summary of Ordinance Provisions

The draft ordinance creates the LAFPP Health Care Fund as an alternative funding mechanism for LAFPP health and welfare benefits in place of the LAFPP Health Care Coverage Account established in Section 4.1150 of the LAAC (the Health Care Coverage Account). The draft ordinance authorizes the City and the Board to enter into a written trust agreement establishing their roles and responsibilities regarding the administration and investment of the LAFPP Health Care Fund. The trust agreement will name the Board as trustee of the LAFPP Health Care Fund.

The LAFPP Health Care Fund provides increased flexibility compared to the existing Health Care Coverage Account. Because the LAFPP Health Care Fund is not subject to the subordination requirement that governs the Health Care Coverage Account, it is not at risk of incurring tax liability when the cost of health and welfare benefits surpass the limits that the Health Care Coverage Account requires. The Health Care Coverage Account was established to comply with Section 401(h) of the Internal Revenue Code (Section 401(h)). Section 401(h) allows a pension plan such as LAFPP to provide health benefits for retirees and their dependents on a tax-free basis when certain requirements are satisfied. One of these requirements is that health benefits—combined with life insurance—provided by a pension plan must be subordinate to the retirement benefits the plan provides. In order to be subordinate, the aggregate amount of contributions for health benefits (along with life insurance contributions) must be less than 25% of all aggregate plan contributions. The subordination requirements of Section 401(h) governing the Health Care Coverage Account are similarly codified in LAAC Section 4.1150(b). While to date aggregate LAFPP health benefits contributions fall under the 25% threshold, they are on pace to exceed this limit in the future.

In contrast, the LAFPP Health Care Fund would not be subject to the Section 401(h) subordination requirement. Instead, the LAFPP Health Care Fund is intended to qualify for federal tax exemption under Section 115 of the Internal Revenue Code (Section 115). Section 115 has fewer requirements for tax exemption than Section 401(h). Section 115 dictates only that “income derived from any public utility or the exercise of any essential governmental function and accruing to a State or any political subdivision thereof” is not federally taxable. Because health benefits paid out of the LAFPP Health Care Fund are not required to be subordinate to the Plan retirement benefits, the LAFPP Health Care Fund would not become taxable if the Plan health benefits contributions surpass the 25% threshold.

Council Rule 38 Referral

A copy of the draft ordinance was sent, pursuant to Council Rule 38, to LAFPP and to the Office of the City Administrative Officer. Their respective comments have been incorporated into the draft ordinance.

If you have any questions regarding this matter, please contact Deputy City Attorney Miguel Bahamon at (213) 476-3774. He or another member of this Office will be available present when you consider this matter to answer questions you may have.

Sincerely,

MICHAEL N. FEUER, City Attorney

By 

DAVID MICHAELSON
Chief Assistant City Attorney

DM:MB:pj
Transmittal