DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

April 5, 2002

Number: **INFO 2002-0068**
Release Date: 6/28/2002

CC:TEGE:EOEG:ET2:
PLR-154452-01
UIL: 3121.02-05

[redacted]

Dear [redacted]

Reference: Private Letter Ruling Request

Legend

City =
Year 1 =
Year 2 =
Occupation 1 =
Occupation 2 =

[redacted]

This relates to your letter dated August 16, 2001, requesting a ruling that, pursuant to sections 3121(b)(7)(E) or 3121(b)(7)(F) of the Internal Revenue Code, your wages are not subject to taxes under the Federal Insurance Contributions Act (FICA). For the reasons set forth below and discussed in previous phone conversations, we are unable to issue the requested ruling.

The Internal Revenue Service may decline to issue letter rulings when appropriate in the interest of sound tax administration or on other grounds whenever warranted by the facts and circumstances of a particular case. See Rev. Proc. 2002-1, 2002-1 I.R.B. 1, section 7.01. After carefully reviewing the statement of facts and statement of law set forth in your ruling request, the Service has concluded that it is inappropriate to rule in this case. Accordingly, we decline to rule on your request and will refund the user fee submitted with your request. Your user fee will be returned under separate cover.

As we discussed, the issue is better suited for a determination by the Social Security Administration (SSA) as to whether you are covered by a section 218 agreement. A section 218 agreement is an agreement between the State and the SSA to provide social security coverage for state and local government employees. The issue of whether the services you perform are covered by a section 218 agreement is a question of fact. The Service ordinarily will not rule on issues of a factual nature. Rev. Proc. 2002-1, 2002-1 I.R.B. 1, section 7.01. However, we have reviewed the facts furnished in your request, and we are happy to provide the following general information, which we hope will be helpful to you.

Facts

As we understand the facts of this matter, you performed services in Occupation 1 for the City from Year 1 until your retirement in Year 2. During this time, you were a participant in the pension plan maintained by City for Occupation 1. Subsequent to your retirement in Year 2, you began receiving benefits under this plan. Prior to the time you began performing services in Occupation 1, the City entered into a section 218 agreement with SSA. Both portions of FICA were withheld and paid on the wages you earned in Occupation 1. [1]

After your retirement from Occupation 1, you began performing services in Occupation 2 within the City. You were told that you would not be allowed to participate in the defined benefit plan available to employees of Occupation 2, because you were already receiving benefits under the pension plan maintained by the City employees for Occupation 1. Accordingly, you enrolled in the City Deferred Compensation Plan, a Section 457 Plan, and agreed to deposit 7.5% of your compensation into the plan.

Several months after you began performing services in Occupation 2, you were advised that the remuneration you received was subject to FICA taxes. Thereafter, FICA tax was withheld and paid on such remuneration. Based on the facts you provided, it is not clear whether the services you currently perform are covered under a section 218 agreement. It is also not clear whether City Deferred Compensation Plan you are currently participating in is considered the same retirement system as the pension plan maintained by the City for Occupation 1.

Law and Analysis

In general, all payments of remuneration by an employer for services performed by an employee are subject to FICA taxes, unless the payments are specifically excepted from the term “wages” or the services are specifically excepted from the term “employment.”

For FICA purposes, section 3121(b)(7) of the Code generally excludes from “employment” services performed in the employ of any state, or any political subdivision thereof, or any wholly-owned instrumentality of any one or more of the foregoing. However, under Code section 3121(b)(7)(E), the exception from employment does not apply to services included under a section 218 agreement. In the event that the services performed by the employees are not included under a section 218 agreement, Code section 3121(b)(7)(F) provides that the exception from employment shall not apply to services performed by an employee of a state, political subdivision or wholly

[1]FICA taxes are composed of the old-age, survivors, and disability insurance (OASDI) taxes imposed under the Internal Revenue Code (“Code”) sections 3101(a) and 3111(a), also known as social security taxes, and the hospital insurance tax imposed by sections 3101(b) and 3111(b), also known as medicare taxes.

owned instrumentality thereof by an individual who is not a member of the retirement system of such state, political subdivision or wholly owned instrumentality. See section 31.3121(b)(7)-2 of the Employment Tax Regulations.

If the employees are qualified participants in a retirement system of the employer within the meaning of the regulations and, therefore, exempt under Code section 3121(b)(7)(F) from the taxes imposed under the FICA, they may nevertheless be subject to the medicare portion of the FICA taxes. Under Code section 3121(u)(2)(C) of the Code, all State or local government employees hired after March 31, 1986 are subject to the Medicare portion of the FICA taxes regardless of membership in a retirement system provided by the employer.

Retirement System

Section 3121(b)(7)(F), effective for services performed after July 1, 1991, excludes from "employment" only the services of an employee of a state, political subdivision, or wholly-owned instrumentality thereof who is a member of a retirement system. The term "retirement system" is defined as any pension, annuity, retirement or similar fund or system within the meaning of section 218 of the Social Security Act that is maintained by a state, political subdivision or instrumentality thereof to provide retirement benefits to its employees who are participants. Section 31.3121(b)(7)-2(e)(1), Employment Tax Regulations. The social security system is not a retirement system for purposes of section 3121(b)(7)(F).

A retirement system which satisfies the definition in the regulation must provide a minimum level of benefits, as defined in section 31.3121(b)(7)-2(e)(2). For a defined benefit plan, the system meets the requirements with respect to an employee if and only if, on a specific testing day, the employee has an accrued benefit under the system that entitles the employee to an annual benefit commencing on or before his or her social security retirement age that is at least equal to the annual Primary Insurance Amount the employee would have under social security. Rev. Rul. 91-40, 1991-2 C.B. 694, sets forth safe harbor formulas applicable to defined benefit retirement systems.

For a defined contribution plan, allocations to the employee's account (not including earnings) must be at least 7.5 percent of the employee's compensation. Employees' accounts must be credited with earnings at a reasonable interest rate, or they must be held in a separate trust subject to general fiduciary standards and credited with actual earnings of the trust fund.

Qualified Participant

An employee is not a member of a retirement system at the time service is performed unless at that time he or she is a "qualified participant" (as defined in paragraph (d) of the regulation) in a "retirement system" that meets the requirements of paragraph (e) of the regulation (minimum benefits) with respect to that employee. Section 31.3121(b)(7)-2(c)(1), Employment Tax Regulations. The determination of

whether a worker is a “qualified participant” is made on an employee-by-employee basis.

Section 31.3121(b)(7)-2(d)(1)(i) of the regulations defines “qualified participant” for purposes of defined benefit retirement systems. The regulation provides that an employee is a qualified participant in a defined benefit system with respect to services performed on a given day if, on that day, he or she is or ever has been an actual participant in the retirement system and, on that day, he or she actually has a total accrued benefit under the retirement system that meets the minimum retirement benefit requirement of paragraph (e)(2) of this section. An employee may not be treated as an actual participant or as actually having an accrued benefit for this purpose to the extent that such participation or benefit is subject to any conditions (other than vesting), such as a requirement that the employee attain a minimum age, perform a minimum period of service, make an election in order to participate, or be present at the end of the plan year in order to be credited with an accrual, that have not been satisfied.

Section 31.3121(b)(7)-2(d)(1)(ii) of the regulations defines “qualified participant” for purposes of defined contribution retirement systems. The regulation provides that whether an employee is a qualified participant is determined as services are performed. An employee is a qualified participant with respect to services performed on a given day if, on that day, he or she has satisfied all conditions (other than vesting) for receiving an allocation to his or her account (exclusive of earnings) that meets the minimum retirement benefit requirement of paragraph (e)(2) of the regulation with respect to compensation during any period ending on that day and beginning on or after the beginning of the plan year of the retirement system.

Treatment of Former Participants

In general, the rules of paragraph 3121(b)(7)-2(d) apply equally to former participants who continue to perform services for the same state, political subdivision or instrumentality thereof or who return after a break in service. Thus, for example, a former employee of a political subdivision with a deferred benefit under a defined benefit retirement system maintained by the political subdivision who is reemployed by the political subdivision but does not resume participation in the retirement system may continue to be a qualified participant in the system after becoming reemployed if his or her total accrued benefit under the system meets the minimum retirement benefit requirement of paragraph (e)(2) of this section taking into account all periods of service (including current service) required to be taken into account under that paragraph. Section 31.3121(b)(7)-2(d)(4)(i).

In order for a reemployed employee to be a qualified participant, it is not necessary that the employee accrue additional benefits under the plan on the basis of the service in the new position. Rather, the test is whether the employee’s total accrued benefit under the retirement plan satisfies the minimum benefit requirement, taking into account all the employee’s service with and compensation from the employer, including service and compensation in the new position. In other words, the

total accrued benefit might exceed the minimum benefit requirement, providing a sort of cushion which would enable the employer to treat the reemployed individual as a qualified participant even though the individual is not accruing additional benefits under the plan.

Treatment of Rehired Annuitants

A previously retired participant who is either "in pay status," i.e., currently receiving retirement benefits under the retirement system, or who has reached normal retirement age is deemed to be a qualified participant in the retirement system without regard to whether he or she continues to accrue a benefit or whether the distribution of benefits under the retirement system has been suspended pending cessation of services. Section 31.3121(b)(7)-2(d)(4)(ii) Employment Tax Regulations.

This rule also applies in the case of an employee who has retired from service with another state, political subdivision or instrumentality that maintains the same retirement system as the current employer, provided the employee is a former participant in the system by reason of the employee's former employment. Thus, for example, if a teacher retires from service with a school district that participates in a state-wide teachers' retirement system, begins to receive benefits from the system, and later becomes a substitute teacher in another school district that participates in the same state-wide system, the employee is treated as a rehired annuitant. Section 31.3121(b)(7)-2(d)(4)(ii), Employment Tax Regulations.

We hope this information is helpful to you. If you have any questions, please contact , (Employee ID#) at (202) 622-6040.

Sincerely,
LYNNE CAMILLO
Chief, Employment Tax Branch 2
Office of the Assistant Chief Counsel
(Exempt Organizations/Employment Tax/
Government Entities)