INTERNAL REVENUE SERVICE
Index Nos: 3121.15-00
3121.16-00

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CC:EBE0:Br6 - PLR-103647-99

Number: **199922031**
Release Date: 6/4/1999

Attn:

KEY:

State A =
Employer M =

Plan X =
Plan Y =

Dear:

This is in response to a ruling request dated July 22, 1998, as supplemented by correspondence dated November 4, 1998, December 28, 1998, January 12, 1999, and February 25, 1999, submitted on your behalf by your authorized representative, concerning the federal employment tax treatment, under section 3121(b)(7)(F) of the Internal Revenue Code (Code), of certain contributions to State A pension plans.

The following facts and representations have been submitted:

State A has established various pension plans which are qualified under section 401(a) of the Code, including Plan X and Plan Y. Employer M, an instrumentality of State A, is a participating employer in Plan X and Plan Y. Employer M contributes to Plan X for employees who qualify as teachers under the State A statute. Employer M also contributes to Plan Y for nonteaching employees. State law requires that employees must participate in the plan for which they are eligible to participate unless they opt out of participation under the state statute allowing such an election as in the case of student employees at universities.

Employer M's Board of Education proposes to pass a resolution offering to employees eligible to participate in either Plan X or Plan Y, the opportunity to purchase allowable retirement credits on a pre-tax basis under certain terms and conditions. In addition, Employer M will pickup the contributions to Plan X and Plan Y to purchase additional eligible retirement credits on a pre-tax basis. Employer M states that "... in order to

permit tax deferral for these additional amounts, any member ... who wishes to purchase or restore [Plan X] and [Plan Y] credit by payroll deduction on a pre-tax basis must enter into a binding irrevocable payroll deduction authorization and such ... [amounts] are designated as being picked up by [Employer M] in accordance with the Internal Revenue Code requirements." The resolution will specify that contributions picked up by Employer M, although designated as employee contributions, will be paid by Employer M in lieu of being paid by the employees and that the employees will not be given the option of choosing to receive such amounts directly instead of having them paid by Employer M to Plan X or Plan Y. The resolution further states that Employer M will pick up the contributions of its employees to Plan X or Plan Y by a reduction of salary of such employees.

By letter dated January 21, 1999, the Internal Revenue Service ruled, in part, that, "the amounts picked up by Employer M on behalf of employees who participate in Plan X and Plan Y for purposes of purchasing additional retirement credits will qualify as pick-up contributions under Code section 414(h)(2)." We have been asked to address the following ruling request: "No FICA tax is required to be withheld on pre-tax pick-up contributions."

There are employees of Employer M who were employed before April 1, 1986, and for whom Employer M does not withhold taxes from wages for purposes of Medicare taxes. There are also employees of Employer M who were employed after March 31, 1986, and for whom Employer M does withhold taxes from wages for purposes of Medicare taxes.

Taxes under the Federal Insurance Contributions Act (FICA) consist of the old-age, survivors, and disability insurance (OASDI) taxes imposed under sections 3101(a) and 3111(a) of the Code and the hospital insurance (Medicare) taxes imposed under sections 3101(b) and 3111(b).

FICA taxes are computed as a percentage of "wages" paid by the employer and received by the employee with respect to "employment." 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."

Section 3121(b)(7) of the Code excepts from "employment" services performed in the employ of a state or a political subdivision of a state, or any instrumentality that is wholly owned by a state or political subdivision. However, for services performed after July 1, 1991, section 3121(b)(7)(F) generally applies the FICA exemption only to individuals who are members of retirement systems of states, political subdivisions, or instrumentalities.

Section 31.3121(b)(7)-2(d) of the Employment Tax Regulations explains what constitutes membership in a retirement system for purposes of section 3121(b)(7)(F) of the Code. An employee participating in a retirement system of his or her employer must be a qualified participant in the system in order to be considered a member of the retirement system. Generally, an employee will be considered a qualified participant if the employee accrues a benefit or receives an allocation under the retirement system sufficient to satisfy the minimum retirement benefit requirement of section 31.3121(b)(7)-2(e) of the regulations. Rev. Proc. 91-40, 1991-2 C.B. 694 further explains what constitutes membership in a retirement system.

Under section 3121(b)(7)(E), the government employment exception of section 3121(b)(7) does not apply to service covered by an agreement under section 218 of the Social Security Act that permits a governmental entity to elect Social Security coverage for groups of its employees (section 218 agreement).

Section 3121(u)(2) of the Code also provides a limited exception to section 3121(b)(7), subjecting certain state and local government employees to Medicare taxes, but not OASDI taxes. Under section 3121(u)(2), except in limited circumstances, services performed by state and local government employees hired after March 31, 1986, and not subject to a section 218 agreement are "employment" for Medicare tax purposes.

Based on the information submitted and authorities cited above, we conclude that contributions to Plan X and Plan Y picked up by Employer M on or after the effective date are not wages for Social Security tax purposes other than for purposes of the Medicare tax, assuming that the employee is a member of a retirement system within the meaning of section 3121(b)(7)(F) of the Code (and is not covered by a section 218 agreement as defined under section 3121(b)(7)(E)).

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code.

Sincerely yours,

HARRY BEKER
Chief, Branch 6
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosures: