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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:TEGE:EOEG:ET2
PLR-130726-02

Date:
March 31, 2005

Legend

State A =
Department J =
Employer M =
Plan X =

Statutory Plans =
Date 1 =
Date 2 =
Date 3 =

Dear :

This is in response to your request for a ruling letter on two issues involving Plan X. Your request posed the following two questions:

1. Whether Plan X is a retirement system within the meaning of Internal Revenue Code (Code) section 3121(b)(7)(F)?

2. Whether the services Plan X participants perform for Employer M will be considered employment for Federal Insurance Contributions Act (FICA) purposes?

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FACTS

Employer M is a governmental entity created pursuant to the State A Revised Code and is an instrumentality of State A providing public educational services within State A. Employer M maintains Plan X. Plan X was established on Date 3 and is designed to offer eligible employees an alternative to participating in State A's Statutory Plans. An eligible employee who does not elect to participate in Plan X participates in the applicable State A Statutory Plan. Employer M represents that the Statutory Plans are retirement systems within the meaning of Code section 3121(b)(7)(F).

Plan X is a defined contribution plan and a non trusteed fully insured plan within the meaning of Code section 401(f)(1). In this regard, plan benefits are provided through individual annuity contracts selected by Plan participants. Plan X received its most recent favorable determination letter on Date 1 stating that it satisfied the requirements of section 401(a).

Plan X provides that all eligible employees may elect to participate in the Plan effective as of the employee's employment commencement date. An eligible employee is either an academic or administrative employee of Employer M. Under the terms of Plan X a "Participant" is an eligible employee who elects to participate.

Plax X provides for employer and employee contributions and specifies that the employer and employee contributions combined will not be less than the contributions required to meet the requirements of Code section 3121(b)(7)(F) and the applicable regulations. On Date 2 Employer M submitted additional information indicating that allocations to Participants have always exceeded 7.5 percent of Participants' compensation.

A Participant is eligible for employer contributions beginning on the date the participant commences participation under the Plan and ending on the date the participant terminates employment with Employer M, or the date on which the participant ceases to be an eligible employee, whichever is earlier. The terms of the Plan provide that Employer M shall make contributions to the Plan on each Participant's behalf in an amount equal to a specified percentage of the Participant's compensation. However, the Board of Trustees of Employer M may set different contribution rates for different classes of employees and may change the rate from plan year to plan year. Employer contributions are credited to each Participant's employer account.

Plan X also requires each Participant to make mandatory contributions called "nonelective contributions" equal to at least three percent of the Participant's compensation. The terms of Plan X specify that the amount of each Participant's nonelective contributions will equal the percentage of the Participant's compensation that would have been contributed by the Participant to the State A Statutory Plan, had

the employee not elected to participate in Plan X. Nonelective contributions are credited to each Participant's participant account.

Plan X generally defines "compensation" as all "salary, wages, and other earnings paid to a Participant." The Plan's definition of compensation is virtually identical to the definition of compensation used by State A for its Statutory Plans.

Participants choose to invest the amounts allocated to their accounts in annuity contracts offered by various companies that have entered into a "provider agreement" with Department J. A provider agreement permits a company to provide annuity contracts for Plan X Participants to invest in. The provider is the company selected by a Participant to provide the Participant's annuity contract. Participants' investment selections are subject to the terms and conditions contained in the respective annuity contracts.

Samples of all the contracts used to provide benefits under Plan X were submitted with this request for a ruling.

APPLICABLE LAW

For purposes of the Federal Insurance Contribution Acts (FICA), sections 3101 and 3111 of the Code impose a tax on the wages paid by employers to employees with respect to "employment."

The FICA tax comprises two separate taxes. Sections 3101(a) and 3111(a) of the Code impose Old-Age, Survivor's, and Disability Insurance (OASDI) taxes, and sections 3101(b) and 3111(b) impose Hospital Insurance (HI) taxes on employees and employers, respectively.

Section 3121(b)(7)(F) of the Code provides that, for purposes of the FICA tax, "employment" does not include service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly-owned thereby. Section 3121(b)(7)(F) and section 31.3131(b)(7)-2(c)(1) of the Employment Tax Regulations (regulations) provide that this exception does not apply to services performed after July 1, 1991, if the employee is not a member of a retirement system of such State, political subdivision, or instrumentality.

Section 31.3121(b)(7)-2(e)(1) of the regulations provides that for purposes of Code section 3121(b)(7), a retirement system includes 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.

Whether a plan is maintained to provide retirement benefits with respect to an employee is determined under the facts and circumstances of each case. The legal form of the

system is generally not relevant. Thus, for example, a retirement system may include a plan described in section 401(a), an annuity plan or contract under section 403, or a plan described in section 457 (b) or (f) of the Code.

Section 31.3121(b)(7)-2(e)(2)(i) of the regulations provides that generally, a pension, annuity, retirement or similar fund or system is not a retirement system with respect to an employee unless it provides a retirement benefit to the employee that is comparable to the benefit provided under the Old-Age portion of the OASDI program of Social Security. Section 31.3121(b)(7)-2(e)(2)(iii)(A) of the regulations provides that, in the case of a defined contribution system, this requirement is met if, and only if, allocations to the employee's account (not including earnings) for a period are at least 7.5 percent of the employee's compensation for service for the State, political subdivision, or instrumentality during the period. Employer contributions may be taken into account for this purpose.

Section 31.3121(b)(7)-2(e)(2)(iii)(B) of the regulations provides that the definition of "compensation" used in determining whether a defined contribution retirement system meets the minimum retirement benefit requirement must generally be no less inclusive that the definition of the employee's base pay as designated by the employer or the retirement system, provided that such designation is reasonable under all the facts and circumstances.

Section 31.3121(b)(7)-2(e)(2)(iii)(C) of the regulations provides that a defined contribution retirement system does not satisfy the requirements of this paragraph (e)(2) with respect to an employee unless the employee's account is credited with earnings at a rate that is reasonable under all the facts and circumstances, or employees' accounts are held in a separate trust that is subject to general fiduciary standards and are credited with actual earnings on the trust fund. Whether an interest rate is reasonable is determined after reducing the rate to adjust for the payment of any administrative expenses.

Section 31.3121(b)(7)-2(c)(1) of the regulations provides that 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 regulations) in a retirement system that meets the requirements of paragraph (e) of the regulations with respect to that employee.

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.

DISCUSSION

Plan X satisfies the requirement that each participant in the Plan receive an annual allocation of at least 7.5% of compensation. The Plan provides that in each year an amount must be contributed that will satisfy the requirements of section 3121(b)(7)(F) of the Code. The taxpayer has represented that in each year amounts in excess of 7.5% of employees' compensation have been allocated to participants' accounts. Thus, Plan X satisfies the requirement of section 31.3121(b)(7)-2(e)(2)(iii)(A) of the regulations that each participant in a plan receive an annual allocation of at least 7.5% of compensation.

Plan X's definition of compensation is no less inclusive than the definition of base pay, and is in fact more inclusive as it includes amounts greater than base pay. Thus, Plan X satisfies the requirement of section 31.3121(b)(7)-2(e)(2)(iii)(B) of the regulations that the definition of compensation used in computing allocations as designated by the employer or the retirement system must be no less inclusive than the definition of the employee's base pay as designated by the employer or retirement system.

To determine whether the Plan met the reasonable interest rate requirement of section 31.3121(b)(7)-2(e)(2)(iii)(C) of the regulations this office reviewed every contract in which the Participants may choose to invest their allocations. This analysis considered in detail whether each contract credited the employee's accounts with earnings at a rate that is reasonable under all the facts and circumstances.

Our analysis of each contract resulted in the conclusion that Plan X satisfies the requirement that participant's accounts be credited annually with a reasonable rate of interest under the facts and circumstances. See regulation section 31.3121(b)(7)-2(e)(2)(iii)(C). In lieu of a trust, plan benefits are provided solely by annuities. An examination of the annuity contracts used to fund Participant benefits indicates that the reserve value of each contract is known at all times and any increase in such value is automatically allocated for the benefit of the Participant. All contracts used by the Plan provide for the annual allocation of interest to Participant accounts. Each of the contracts available to a Participant under the Plan credits employees' accounts with interest at a reasonable rate, net of expenses. In particular, it is noted that each of the contracts offers the Participant the opportunity to invest in a fixed account providing a guaranteed return of no less that 3 percent. Moreover, the interest crediting strategy of each of the insurance companies underwriting each of the annuity contacts takes into account, directly or indirectly, currently available interest rates. It is also noted that all of the contracts waive surrender charges upon annuitization and all offer reasonable purchase rates.

We conclude that Plan X satisfies the requirements of regulation section 31.3121(b)(7)-2(e)(2)(iii) for a defined contribution retirement system.

Plax X provides that eligible employees participate as of their employment commencement date which is the date an employee is first credited with an hour of service for the performance of duties. The Plan provides that such participation does not end until the earlier of the date an individual ceases to be an eligible employee or terminates employment.

We conclude that the services Participant's in Plan X perform for Employer M are not considered employment for FICA purposes. See regulation section 31.3121(b)(7)-2(c)

CONCLUSION

We conclude that Plan X is a retirement system within the meaning of Code section 3121(b)(7)(F) and the regulations thereunder.

We conclude that the services Plan X participants perform for Employer M will not be considered employment for FICA purposes.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

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

Sincerely,

Marie Cashman
Special Counsel to the Assistant Chief Counsel
Office of Division Counsel/Associate Chief Counsel
(Exempt Organizations/Employment Tax/Government Entities)
Tax Exempt & Government Entities