



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

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR DISTRICT COUNSEL

Attn: Senior Attorney

FROM: Senior Technician Reviewer
Employee Benefits & Exempt Organizations, Branch 2

SUBJECT: Plan

LEGEND:

State =

Plan =

Retirement System =

Pursuant to your request, we have post-reviewed your _____ memorandum to the Chief, Examination Division, concerning whether wages earned by participants in the State's Plan are subject to Federal Insurance Contributions Act (FICA) tax. We agree with your analysis and conclusion that such compensation is not subject to FICA tax.

As background, any member of the State's Retirement System who is eligible for regular retirement may elect to participate in the Plan. This election may be made only once, for a specified period not to exceed _____ years, beginning within _____ days after the member first becomes eligible for regular retirement, and ending no later than _____ years and _____ days from the date the member first becomes eligible for regular retirement. In no case may the actual participation in the Plan exceed _____ years, and once specified, the period of participation may not be extended. A member participating in the Plan may not terminate participation prior to the end of the selected duration without terminating employment. Once participation in the Plan commences, the election to participate is irrevocable.

During the period of participation in the Plan, membership in the Retirement System ceases, the participant is considered by the Retirement System to be in a retired status. Retirement benefits which would otherwise have been due the participant

shall, during the period of participation in the Plan, be credited to the individual's subaccount in the Plan. Thus, it is our understanding that during the period of participation in the Plan, the participants receive current compensation from the State and their Retirement System benefits are credited to their Plan subaccounts. Upon termination of both their participation in the Plan and employment, a participant may receive, at his or her option, either a lump sum payment of their individual Plan subaccount, or systematic disbursements.

With respect to FICA tax, Code sections 3101 and 3111 impose FICA tax on wages received by employees and paid by employers with respect to employment. Under Code section 3121(b)(7)(F) the term "employment" does not include service performed in the employ of a State by any individual who is a member of a retirement system of such State. Under Treas. Reg. § 31.3121(b)(7)-2(d)(4), participants in the Plan will be deemed to be participants in the State Retirement System without regard to whether they continue to accrue a benefit or whether the distribution of benefits under the Retirement System has been suspended pending cessation of services. Thus, the compensation paid to the Plan participants and paid by the State will not be considered wages paid with respect to employment and, thus, will not be subject to FICA tax.

If you have any questions regarding this matter, feel free to contact attorney Michael Swim of my staff who may be reached on (202) 622-6040.

PATRICIA McDERMOTT
Senior Technician Reviewer, Branch 2
Employee Benefits & Exempt Organizations