



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

OFFICE OF
CHIEF COUNSEL

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The Honorable Charles T. Canady
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Canady,

This letter is in response to your inquiry dated July 3, 2000, on behalf of your constituent, [REDACTED]. [REDACTED] asks whether under a defined contribution retirement system provided to certain state or local government employees in lieu of social security coverage administrative costs charged against the account of a part-time, temporary or seasonal employee may reduce the principal amount of the employee's account. We provide the following general information in response to [REDACTED] question.

A defined contribution retirement system does not satisfy the minimum benefit requirement unless the employee's account is credited with earnings at a rate that is reasonable under all the facts and circumstances or the 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 the interest rate with which an employee's account is credited is reasonable is determined after reducing the rate to adjust for the payment of any administrative expenses.

The Employment Tax Regulations include a special rule for part-time, temporary, or seasonal employees that requires the employee's minimum benefit to be nonforfeitable. The minimum benefit is considered nonforfeitable if:

- The employee is unconditionally eligible to receive a single sum distribution on account of death or separation from service,
- The minimum distribution equals 7.5% of compensation for all periods of credited service, and
- The determination whether the employee's retirement benefit meets the minimum benefit requirement takes into account all periods of credited service.

Generally, wages of an employee of a state or local government are subject to Federal Insurance Contributions Act (FICA) taxes unless the employee is a member of a

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retirement system maintained by the state or local government entity. The services provided by employees who are members of a retirement system are excepted from the definition of the term "employment" for FICA tax purposes. For service in the employ of a state or local government entity to qualify for the exception from employment, the employee must be a member of a retirement system that provides at least a minimum level of retirement benefits to that employee. To meet this minimum benefit requirement a pension, annuity, retirement, or similar fund or system must provide a retirement benefit to the employee comparable to the benefit provided under the old-age portion of the Old-Age, Survivor, and Disability Insurance program of social security. Whether a retirement system meets this requirement is generally determined by the facts and circumstances of each case and on an individual basis.

A defined contribution retirement system maintained by a state or local government entity meets the minimum benefit requirement if allocations to an employee's account (not including earnings) for a period are at least 7.5 percent of the employee's compensation for service during that period. The period used to determine whether the defined contribution retirement system meets the minimum benefit requirement need not remain the same from day to day as long as the period begins on or after the beginning of the plan year and ends on the date the determination is made.

An employee is treated as a member of a retirement system only if he or she actually participates in the system and actually receives an allocation sufficient to satisfy the minimum benefit requirement (7.5 percent of the employee's compensation). An employee is a member of a defined contribution retirement system with respect to services performed on a given day if, on that day, he or she has satisfied all conditions for receiving an allocation to an account that meets the minimum benefit requirement during any period ending on that day and beginning on or after the beginning of the plan year.

A part-time, seasonal, or temporary employee is generally not a member of a defined contribution retirement system on a given day unless any benefit relied upon to meet the minimum benefit requirement is 100-percent nonforfeitable on that day. A part-time, seasonal, or temporary employee's benefit under a retirement system is considered nonforfeitable on a given day if on that day the employee is unconditionally entitled under the retirement system to a single-sum distribution on account of death or separation from service of an amount that is at least equal to 7.5 percent of the participant's compensation for all periods of credited service taken into account in determining whether the employee's benefit under the retirement system meets the minimum benefit requirement. Additionally, the participant must be entitled to interest on the distributable amount through the date of distribution at a rate satisfying the reasonable interest rate requirements.

I hope this information is helpful. If I can be of further assistance in this matter, please contact me or Dan Boeskin (ID # 50-16785) of this office at (202) 622-6040.

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Sincerely,

Jerry E. Holmes
Chief, Employment Tax Branch 2
Office of Assistant Chief Counsel
(Exempt Organizations/Employment
Tax/Governmental Entities)