

MSBO ISD Committee

FICA Withholding on 3% Employee Retiree Medical – Update

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- I. Legislation Background
 - a. Public Act (PA) 75
 - i. Effective July 1, 2010
 - ii. Mandatory participation
 - iii. Forfeiture of 3% contributions if not vested – generally 10 YOS
 - iv. Constitutional challenge – Michigan Supreme Ct hearing was November 8, 2017
 - b. PA 300
 - i. One-time election in or out – election window closed January 9, 2013
 - ii. Election generally available to employees with service credit as of September 3, 2012
 - iii. Elections effective first payroll in February 2013
 - iv. Forfeiture provision eliminated
 - v. Law validated by Michigan Supreme Ct.
- II. FICA Treatment of 3% Contributions
 - a. Initially most districts cautious and FICA withheld on PA 75 contributions
 - i. Protective claims filed beginning for 2010 (due 4/15/14)
 - ii. IRS will not rule on PA 75 FICA treatment because unsettled in MI courts

- b. Communications from ORS and law firms said “FICA should not apply”
- c. My observation of employee 3% retiree health FICA treatment across the State
 - i. All over the board
 - ii. Under PA 300 districts became more confident FICA did not apply
 - Beginning in 2013, gradually more districts did not withhold FICA
 - iii. Some districts continue FICA withholding
 - iv. MSBO survey October 2016:
 - a. 61% of 182 responses (112) did not withhold FICA on 3% contributions
 - b. 87% of 182 responses (159) did not withhold income tax on 3% contributions
- d. In December 2015 the IRS said **FICA and Income Tax** should apply to 3% contributions
 - i. February – May 2016
 - a. Districts received IRS requests for information
 - b. IRS provided “technical support” for its tax position
 - IRS had a poorly reasoned conclusion – did not understand facts
 - ii. Michigan filed a IRS Private Letter Ruling request for FICA and Income tax treatment of PA 75 and PA 300 contributions - March 30, 2016
 - IRS declined to rule – Michigan has no standing because not the employer
 - iii. Districts filed protests with IRS – May and June 2016
 - iv. IRS reversed its position in August 2016 - FICA and Income Tax **does not** apply to 3% employee contributions
 - a. 2013 to 2015
 - b. 2016? There is evidence IRS has refunded 2016 FICA on 3% contributions.
 - v. IRS to issue future guidance – possibility 3% contributions are subject to FICA?

vi. Private letter ruling request to be submitted “soon”.

III. What now?

a. If paying FICA on PA 300 contributions, consider to stop, but there are risks:

i. The IRS:

A. is saying the matter is settled for 2013 to 2015 (and 2016?) - 3% contributions are not subject to FICA

B. has rejected protective claim requests for 2013

- IRS says: “file your refund request now”

C. has been inconsistent in communications from district to district regarding status of protective claims

ii. If continue to apply FICA expect additional employee and union pressure to stop

iii. Any chance the IRS could reverse its position and say the 3% contributions are subject to FICA?

- Prospective application only?

b. If paid FICA and then stopped on PA 300 contributions

i. Risk IRS may change its position – see III, a. iii above.

ii. To request refunds need employee consents – 45 day wait period

- Must request employee consent for employer to request its portion of the FICA refund
- No consent – request refund of employer FICA only

iii. Form 941X – file by quarter

iv. Employee consent Tool Kit

v. Amended employee W2 (W2c) reporting required

- No impact on employee form 1040 reporting

c. The “election window” contributions – September 4, 2012 to first payroll ending in February 2013

i. At one time State said contributions between September 2012 and February 2013 are neither PA 75 nor PA 300 contributions!

- ii. We have learned election window contributions are under PA 300.
- iii. Apply for a refund of FICA paid on election window contributions?
 - A. Consider employee opting out of retiree health
 - PA 300 contributions moved to a 401(k) account
 - Are employee mandatory contributions to 401(k) subject to FICA?
 - B. IRS is learning about election window contributions
 - Districts have asked the IRS (Ogden, UT office) if election period PA 300 contributions transferred to a 401(k) account are subject to FICA.
 - C. Currently, IRS likely to approve January 2013 FICA refunds, but not 2012
- d. File a protective claim for January 2014 by April 15, 2018
- e. PA 75 Contributions
 - i. State attorney general did not support further appeals;
 - A. Lower court rulings held PA 75 unconstitutional
 - B. State of Michigan appealed to Michigan Supreme Ct
 - C. State of Michigan's Supreme Ct. argument – PA 300 was a retroactive fix of PA 75
 - ii. Favorable Court Ruling supporting PA 75 – probably FICA exempt
 - iii. Unfavorable Ruling – 3% refunds probably subject to FICA
 - Refunds to include interest – FICA taxable?

Absence of Federal Tax Penalty Protection

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