



February 11, 2016

Dear Senator Stabenow and Congressman Levin:

We are writing on behalf of the school districts in the State of Michigan, who are all facing a potentially devastating ruling from the Internal Revenue Service (IRS) regarding the tax treatment of certain mandatory employee contributions to the Michigan Public School Employees' Retirement Systems' (MPERS) retiree health care program. The potential IRS ruling would have a direct, adverse impact on several local school districts whose claims for tax refunds would be denied—and the consequences of such a ruling will be felt by every local school district in the State of Michigan and more than 200,000 of their current and former employees. We are asking for your assistance in helping to resolve the issue so as to avoid an IRS ruling that would impose not only a prospective tax liability on these public school employers and their employees, but also a retroactive tax liability. As explained ahead, we believe that there is ample precedent to support our position that the retiree healthcare contributions at issue are exempt from both federal income and FICA taxes.

The controversy at issue stems from state statutory retirement reforms that were enacted relative to MPERS in 2010 and 2012. In 2010, to secure the financial viability of the MPERS retiree healthcare program, the State crafted and passed reform legislation that required every public school employee to share in the funding of the retiree healthcare program. Specifically, the legislation required each public school employee to contribute 3% of their compensation (roughly \$325 million annually) to a newly created Section 115 health care trust that would provide retiree health care benefits to those retirees who qualified for such benefits. While this cost-sharing measure, coupled with other benefit reduction provisions, represented a significant change—and sizeable sacrifice on the part of public school employees—it nevertheless permitted the State to continue the retiree healthcare program that covers nearly 500,000 current and future public school retirees in Michigan.

In 2012, further reform legislation was passed that provided a one-time irrevocable option for certain eligible employees in MPERS to opt out of retiree health care entirely. Any employee opting out of the health care plan became eligible for an increased employer match to his or her deferred compensation plan account, but in no circumstances could continue in the current health care plan. Employees who did not opt out of the health care plan continued to be required to meet all aspects of the retiree health care plan, one component of which is the requirement that they continue to make the 3% mandatory employee contribution.

Beginning in 2008, the IRS began to issue Private Letter Rulings (PLRs) to governmental entities and employees related to mandatory employee contributions to health care plans (including Section 115 health care trusts, similar to that which the State and MPERS established). One such ruling was PLR 200802003, a copy of which is attached. It sets forth the rationale that mandatory employee contributions to a health care trust are not subject to income or FICA taxes. We also believe that there is precedent in PLR 200938009 that even the one-time election by an employee to opt out of the health care plan supports the tax treatment that the school districts are seeking. That ruling is also attached.

We believe that those rulings (along with long-standing IRS law and interpretations) clearly provide that mandatory employee contributions in these cases are not subject to income tax or FICA tax. The State, public school districts and public school employees believe that the 2010 and 2012 reforms that result in mandatory employee contributions meet the IRS requirements for exemption from these taxes.

The State of Michigan (State), as plan sponsor on behalf of MPSERS, has intended since the beginning of the reform legislation to file for its own PLR, but both the 2010 and 2012 reform laws, however, have been challenged on state constitutional and other grounds (none of which relate to federal tax matters). The State is currently drafting a PLR request on the 2012 reform law.

In view of this background, we are aware that the vast majority of local school districts have treated the retiree health care contributions at issue as being exempt from both federal income and FICA taxes. Of the minority of local school districts who have reported these contributions as taxable (and remitted employer and employee taxes for the same) several have filed protective claims with the IRS (essentially, refund requests) for refunds of the FICA tax amounts that they paid for certain fiscal years since 2010. The IRS has indicated that it will rule against these claims related only to the 2012 law, but as discussed already, we believe that there is guidance and precedent from the IRS that would lead to the conclusion that these claims should be determined favorably by the IRS.

In the meantime, we are highly concerned that an adverse ruling from the IRS on the aforementioned refund claims filed by only a handful of public school employers would affect--at least indirectly--all local school districts. Specifically, we recognize that an adverse ruling on the individual claims would precipitate a broader determination, impacting all local school districts in the State of Michigan, not to mention more than 200,000 current and former employees who have been subject to the retiree health care contributions at issue.

Accordingly, we are respectfully asking you to assist us in getting these claims resolved favorably for the Michigan school districts that have filed the claims and thereby assist in the favorable resolution of this matter for hundreds of Michigan school districts and tens of thousands of Michigan public school employees.

We understand that some of these decisions may be issued soon, so we appreciate your prompt attention to this matter. We would be happy to provide any additional information or answer any questions you may have. Please contact Brad Biladeau at 517-327-5910 or [bbiladeau@gomasa.org](mailto:bbiladeau@gomasa.org) or Robert Dwan at 517-327-2581 or [rdwan@msbo.org](mailto:rdwan@msbo.org).

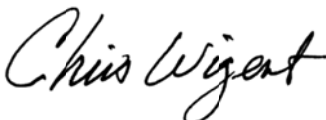
Sincerely,



Don Wotruba, Executive Director, MASB



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Chris Wigent, Executive Director, MASA