Overview and Analysis Supporting The Favorable Federal Tax Treatment of Public School Employee Retiree Healthcare Contributions

Department of Technology, Management & Budget

For MPSERS Reporting Units

In light of recent statutory changes that have been made to the Michigan Public School Employees Retirement System's (MPSERS) retiree healthcare plan ("MPSERS Plan"), several important questions have arisen as to the federal tax treatment of certain contributions being made to the MPSERS Healthcare Trust ("Healthcare Trust"). In view of the fact that these issues directly impact each of the 650+ Michigan public school districts, community colleges, and universities that participates in MPSERS (hereinafter, in the aggregate referred to as "Reporting Units"), along with more than 200,000 current and former employees of the Reporting Units who retire and become eligible for benefits under the MPSERS Plan ("Employees") (collectively the Reporting Units and Employees are referred to as "Taxpayers"), the following summary and analysis is provided to inform interested parties of the applicable federal regulations and rulings that govern the tax treatment of contributions to the Healthcare Trust at issue. This overview is not intended—nor should it be construed—as legal advice.[1] Taxpayers are encouraged to seek and obtain their own counsel as to any federal tax liability they might incur, the ultimate determination of which is made by the Internal Revenue Service (IRS).

Issues

Whether the 3% mandatory reduction from the compensation of Employees for which the Reporting Units remit as employer contributions to the Healthcare Trust pursuant to 2012 PA 300 (the "mandatory contributions") should be excluded from gross income and wages for purposes of federal taxation. (Note that this document does not review any tax aspects of 457 Plan contributions made by Employees of the Reporting Units.)

IRS Determination Regarding the Federal Tax Treatment of the Retiree Healthcare Contributions

Although the IRS has not issued a global determination as to the federal tax treatment of the retiree healthcare contributions provided under 2012 PA 300, the IRS has recently—in early 2016—formally considered and issued rulings against certain protective claims for refunds filed by individual Reporting Units related to contributions at issue. The IRS has indicated, in pertinent part, that the mandatory contributions provided under 2012 PA 300 are considered employee contributions (not employer contributions) to the Healthcare Trust and, thus, they are not excluded from

[1] The private letter rulings cited in this overview apply only to the taxpayer that received the ruling and cannot be used or cited as precedent, but are exemplary of prior analysis and conclusions of similar facts presented to the IRS.

taxable gross income under Code Section 106 and, as such, also are considered wages under Code Section 3121(a) with respect to FICA taxes.

In contrast, the IRS has indicated that the 3% mandatory contributions made pursuant to 2010 PA 75 are considered employer contributions excluded from taxable gross income under Code Section 106 and not considered wages under Code Section 3121.

BACKGROUND

Each Reporting Unit is responsible for reporting, deducting, and remitting applicable taxes on their employees' gross income in accordance with federal tax regulations. Since the enactment of the aforementioned statutory changes to the MPSERS Plan—which require Reporting Units to reduce the Employees' compensation by three percent and remit such amounts as an employer contribution to the Healthcare Trust—most Reporting Units have treated and reported these mandatory contributions as being excludable from employees' gross income and wages for purposes of federal taxation. On the other hand, a distinct minority of Reporting Units have reported these mandatory contributions as being taxable and assessed applicable taxes accordingly. Of this latter group, several Reporting Units have filed protective claims for refunds with the IRS relative to these amounts.

As of February 2016, the IRS has begun issuing determinations on the aforementioned protective claims—all of which have been adverse to the Taxpayers. While these administrative determinations are not final—as they are subject to appeal—they nevertheless indicate the IRS's view that the mandatory contributions to the Healthcare Trust at issue are taxable income and wages, which would potentially impact all Taxpayers. (Note that in its determinations the IRS has also commented on the taxability of 457 Plan contributions, which are not reviewed in this document.)

SUMMARY OF RETIREE HEALTHCARE PLAN STRUCTURE

The State of Michigan sponsors the MPSERS Plan and established the Healthcare Trust to fund the post-retirement medical benefits for retirees and their health insurance dependents who are eligible to participate under the MPSERS Plan. Eligible retirees are Employees of the Reporting Units who retire under MPSERS and become eligible for and enroll in the MPSERS Plan, and their spouses and eligible dependent-children.

Under 2010 PA 75, the State of Michigan began requiring a 3% mandatory reduction to Employees' compensation to be remitted to the Healthcare Trust as an employer contribution. Under 2012 PA 300, the Reporting Units continued the 3% mandatory reduction in Employees' compensation and remittance of them as an employer contribution to the Healthcare Trust; provided, however, that Employees were given a one-time irrevocable election window to opt out of the future right to receive premium subsidies under the MPSERS Plan and, thereby would no longer be subject to a 3% mandatory reduction in their compensation. Employees who did not opt-out under this one-time irrevocable election window continue to experience a 3% mandatory reduction in their compensation, which is remitted as an employer contribution to the Healthcare Trust, and retain the future right to receive premium subsidies under the MPSERS Plan. Once the one-time irrevocable election period closed, Employees have no individual or discretionary rights to modify or revoke such election in the future and no individual elections within the Healthcare Trust. Further, there is no election as to the level of mandatory contributions (on the part of the Reporting Units or Employee). These amounts are calculated and determined by the state statute and are mandatory with respect to all Employees who retain the future right to receive premium subsidies under the MPSERS Plan.

Only employer contributions, which include the mandatory contributions, are made to the Healthcare Trust. Mandatory contributions to the Healthcare Trust are made during an employee's active employment. Upon retirement, if an Employee satisfies the eligibility conditions for premium subsidies under the MPSERS Plan, the Healthcare Trust is used to pay such Employee's premium subsidies and otherwise fund the health benefits payable under the MPSERS Plan. The assets of the Healthcare Trust can be used solely for the payment of medical care expenses (as defined under Code Section 213(d)) incurred after an eligible Employee's retirement and administrative expenses of the MPSERS Plan or Healthcare Trust; the assets cannot be used or diverted for any other purpose. If an Employee is not eligible for premium subsidies under the MPSERS Plan (e.g. he/she does not meet the eligibility conditions under the MPSERS Plan upon retirement or dies before becoming eligible), the Healthcare Trust will not pay cash or other non-medical benefits to such Employee (or his/her beneficiaries) in lieu of medical expenses.[2]

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[2] 2012 Act 300 provides that if an Employee is subject to the 3% mandatory contributions to the Healthcare Trust, but subsequently does not become eligible for the full value of premium subsidies in accordance with the terms of the MPSERS Plan, then such Employee (or the beneficiary of a deceased Employee) will receive a separate retirement allowance from the assets of the MPSERS Retirement System. There is **no** individual election on the part of an Employee or his/her beneficiary as to whether to receive the premium subsidy under the MPSERS Plan or the separate retirement allowance under the MPSERS Retirement System. If an Employee is eligible for the premium subsidy under the MPSERS Plan, then that is the sole benefit available to him/her with no right to elect the separate retirement allowance from the MPSERS Retirement System. In other words, the separate retirement allowance from the MPSERS Retirement System is available only when the Employee (or his/her health insurance dependent) is not eligible, as

Employer contributions, including the mandatory contributions, are deposited in the Healthcare Trust and invested among the investments selected, if any, by the Trustees of the Healthcare Trust (Employees do not direct the investment of Trust assets). The Healthcare Trust's assets are derived solely from these employer contributions, including the mandatory contributions, as well as investment earnings thereon. Healthcare Trust assets are held for the exclusive purposes of providing benefits to participants of the MPSERS Plan and their beneficiaries and defraying the reasonable expenses of administering the MPSERS Plan and the Healthcare Trust. The Healthcare Trust Agreement provides that no portion of the corpus or income of Trust will revert to the Taxpayer and that no private interests participate in or benefit from the operation of the Healthcare Trust other than as providers of goods or services.

In each case, the mandatory contributions are derived from a 3% reduction in the Employee's compensation, for which the Reporting Unit remits as an employer contribution to the Healthcare Trust. After the window period closed for the one-time irrevocable election, no Employee of the Reporting Unit has a choice as to whether or not to make the mandatory contributions nor any control over the nature of such contributions. These contributions within the Healthcare Trust are then subject to the protections and provisions as set forth in such Trust. More detail regarding the mandatory contributions required under Michigan law is attached. See Attachment 1.

TAX PRINCIPLES REGARDING RETIREE HEALTHCARE CONTRIBUTIONS

26 USC § 61. Gross Income Defined.

Section 61(a)(1) provides that, except as otherwise provided in Subtitle A, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items. Section 1.61-21(a)(3) and (4) of the Income Tax Regulations state that a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation to the person performing such services.

26 USC Part III. Items Specifically Excluded from Gross Income.

Section 105(a) provides that, except as otherwise provided in § 105, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to

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determined by the statutory law, to receive the premium subsidies under the MPSERS Plan. Only MPSERS has discretion to decide eligibility terms under the MPSERS Plan; the Employee has no discretion as to his or her eligibility for the premium subsidies under the MPSERS Plan (aside from his or her one-time irrevocable election under the MPSERS Plan).

contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer.

Section 105(e) states that amounts received under an accident or health plan for employees are treated as amounts received through accident or health insurance for purposes of § 105. Section 1.105-5(a) of the regulations states that an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness.

Section 106 provides that the gross income of an employee does not include employer-provided coverage under an accident or health plan. Section 1.106-1 of the regulations provides that the gross income of an employee does not include contributions which the employee's employer makes to an accident or health plan for compensation (through insurance or otherwise) for personal injuries or sickness to the employee or the employee's spouse or dependents.

Section 115 provides that gross income does not include income derived from any public utility or the exercise of any essential government function and accruing to a state or any political subdivision thereof.

26 U.S. Code § 451 – General Rule for Taxable Year of Inclusion; 26 CFR 1.451-2 – Constructive Receipt of Income.

Income, although not actually in the employee's possession, is constructively received by the employee in the taxable year during which it is credited to the employee's account, set apart for the employee, or otherwise made available so that the employee may draw upon it at any time. However, income is not constructively received if the employee's receipt of it is subject to substantial limitations or restrictions.

26 U.S. Code §§ 3101, 3111, 3121, 3401 – Rules for Exclusion of FICA and FUTA taxes.

Section 3101 imposes taxes under the Federal Insurance Contributions Act (FICA) "on the income of every individual" in an amount equal to a percentage "of the wages received by him with respect to employment." Section 3111 provides that the employer portion of FICA tax is imposed directly upon the employer as "an excise tax, with respect to having individuals in his employ." Similarly, section 3301 provides that FUTA tax is imposed on every employer as an excise tax with respect to individuals in his employ equal to a percentage of wages paid by the employer with respect to employment.

Section 3121(a) provides for FICA purposes and section 3306(b) provides for FUTA purposes, with certain exceptions, that the term "wages" means "all remuneration for employment." However, sections 3121(a)(2) and 3306(b)(2) provide that the term "wages" does not include any payment made to or on behalf of an employee, or any of his dependents, for medical or hospitalization expenses. Section 3401(a) provides that for purposes of federal income tax withholding, "wages" means all remuneration for services performed by an employee for his employer, including the cash value of any benefits. However, Rev. Rul. 56-632, 1956-2 C.B. 101, holds that when premiums paid by an employer under policies providing hospital and surgical services are excludable from employees' gross income under section 106, the amounts paid by the employer are not subject to federal income tax withholding.

PERTINENT IRS RULINGS AND GUIDANCE

Rev. Rul. 75-539, 1975-2 C.B. 45. This ruling examines two scenarios involving the federal tax treatment accorded to the provision of an employee's accumulated unused sick leave balances. In the first scenario, a labor contract (Contract A) provides that, upon retirement, an employee will receive a portion of accumulated unused sick leave credits as a lump sum cash payment or, at the election of the employee, the payment may be applied instead toward the employee's cost of participating in the employer's health plan. In the other scenario, the labor contract (Contract B) provides that the value of the employee's accumulated unused sick leave credits will be applied toward the employee's cost of participating in the retiree healthcare plan (until the funds are exhausted), with no cash option and any unused funds reverting to the employer.

This ruling holds that, under Contract A, the value of unused accumulated sick leave credits that is to be applied to the employee's cost of participating in the retiree healthcare plan is "constructively received" by the employee under 26 USC § 451, and therefore is includible in the retired employee's gross income. However, under Contract B, the value of the unused accumulated sick leave credits, which are not otherwise payable to the employee as cash, is not constructively received by the retired employee; rather, it is a contribution by the employer to the employer's health plan that is excludable from the retired employee's gross income under 26 USC § 106.

PLR 200802003. This private letter ruling addresses a government-sponsored retiree healthcare plan providing for mandatory employee participation and contributions (in the form of mandatory salary reduction contributions and mandatory contributions of accumulated leave credits), which are designated as being "picked-up" by the employer and remitted to the healthcare trust for the provision of benefits.

The IRS determined that the income of the Trust is derived from the exercise of an essential government function and will accrue to a government entity and, thus, is excludable from gross income under 26 USC § 115. The IRS likewise determined that the mandatory contributions made to the Trust on behalf of employees for the purpose of providing post-employment health coverage to the employees, their spouses and dependents is excludable from gross income under 26 USC § 106.

ANALYSIS

Introduction

As noted above, in the initial determinations received by certain Reporting Units from the IRS with respect to their protective refund claims, the IRS has taken the position that the mandatory contributions provided under 2012 PA 300 are akin to "voluntary salary reduction contributions," and thus are considered taxable gross income and wages. The IRS heavily relies on Revenue Ruling 75-539 in reaching its conclusion. For the reasons set forth below, the mandatory contributions made to the Healthcare Trust are clearly distinguishable from that Revenue Ruling, and have been properly categorized by the Taxpayer as employer contributions to the Healthcare Trust that should be excluded from taxable income and wages under Code Sections 106 and 3121.

What follows is an overview of the arguments that will be asserted by MPSERS in a forthcoming Private Letter Ruling request in support of a favorable global ruling as to the federal tax treatment to be accorded to the retiree healthcare contributions at issue.

Summary of Arguments

With regard to Revenue Ruling 75-539, as cited by the IRS in the aforementioned protective claim determinations, unlike Contract A under that Ruling, there is no subsequent election by an employee with regard to any amount that will be taken in cash under the current MPSERS Plan. Contract A under the Ruling involved a plan that provided an employee with a choice **at retirement** between a cash payment of unused sick leave and application of that unused sick leave to the cost of the employee's post-employment health insurance until exhausted. With the MPSERS Plan, there is no subsequent election that can be made by an employee who continues to receive a 3% reduction in his or her compensation which is remitted as an employer contribution to the Healthcare Trust. That is, once an Employee made his or her one-time irrevocable election to receive premium subsidies under the MPSERS Plan (and, thus, a 3% reduction in his or her compensation that is remitted to the Healthcare Trust) during the window period, such Employee thereafter does not have any future right to elect to receive a cash payment from the Healthcare Trust in lieu of receiving the premium subsidies under the MPSERS Plan.

By contrast, Contract B (also from Revenue Ruling 75-539) involved all of an employee's accumulated unused sick leave being placed in an account to pay for post-employment health insurance until the funds were exhausted, with no cash option to the employee and any unused funds reverting to the employer. With the MPSERS Plan, all amounts that are mandated to be contributed to the Healthcare Trust will similarly be used to pay post-employment health benefits until exhausted, with neither the ability of the Employee (or his/her beneficiaries) to elect to receive cash from the Healthcare Trust in lieu of such premium subsidies under the MPSERS Plan nor a reversion to the Reporting Units of such assets. Under that similar scenario, Revenue Ruling 75-539 stated with respect to Contract B that this did not create a constructive receipt problem and the value of the retiree benefit is excludable from income under Section 106.

PLR 200802003 (and subsequent PLRs 201003007, 201245010 and 201345020), dealt with situations where there was generally only one benefit level and an Employee's participation and contribution was mandatory for those eligible for the retiree healthcare benefit. Likewise, for the MPSERS Plan, after the initial one-time irrevocable election, there is no individual employee election within the Healthcare Trust itself, including no right to subsequently discontinue mandatory contributions while employed with the Reporting Unit, no election at all as to the level of contributions, and no right to elect cash in lieu of the premium subsidies under the MPSERS Plan. The rulings approved employee pre-tax contributions under a retiree medical plan to a 115 trust as long as such contributions are mandatory under the plan, which they are under the MPSERS Plan.

Additionally, another set of PLRs provide some facts and analysis similar to the MPSERS Plan. PLR 200727002 involves employees required to contribute a portion of the insurance premiums paid by the employer on a percentage of the employees' salary. The employee contributions were mandatory for all employees who would derive a benefit from the plan. PLR 200938009 also involved a retiree health plan where employees were required to contribute 3% of their salary. Those amounts were mandatory for all participants in the plan. Lastly, PLR 201034012 also involved employee contributions from salary, without an option to contribute additional amounts. For all participants who are in the Plan, they cannot elect non-Plan benefits in lieu of Plan contributions. These features all resemble the mandatory employee contributions involved in the MPSERS Plan for all participants in the MPSERS Plan. In each of these PLRs, the IRS concluded that the amounts paid to the retiree healthcare plans were not includable in gross income under Section 106 and did not constitute "wages" for FICA or FUTA purposes under Sections 3121(a) and 3306(b).

In addition to these PLRs based on facts that are similar to the MPSERS Plan situation here, there are other, analogous IRS rulings and regulations involving choice and one-time irrevocable elections that independently support the position that the 3% mandatory contributions to the Healthcare Trust are employer contributions under Code Sections 106 and 3121(a) and, thus, not subject to federal taxation.

First, an important PLR that brings together both the one-time irrevocable election and the “significant restriction or limitation” concepts is PLR 200120024. This ruling involves the plans of a governmental entity and a one-time irrevocable employee choice between two comprehensive benefit packages. In that fact scenario, those employees selecting a new package with lower benefits would receive an additional eight percent (8%) in current compensation. The IRS ruled that this election was not a cash or deferred arrangement (“CODA”) under Code Section 401(k). The reason for this conclusion was that one who chose to make the switch “must surrender his right to participate in the more generous program.” According to the IRS, this constituted a “substantial limitation on the right to receive higher compensation.” As a result, the employees who chose to remain with the existing program did not have constructive receipt of the forgone 8% cash compensation under Code Section 451.

An additional fact pattern and ruling in PLR 200846011 supports this conclusion. In that PLR, the IRS considered the federal tax treatment of certain retiree healthcare contributions (remitted by Employees of a collective bargaining unit) that were precipitated by the unit’s election to participate in the plan. The IRS ruled that said contributions were excludable from contributing employees’ gross income. PLR 200837002 also supports an analogous set of facts regarding collectively bargained retiree healthcare plans. This constructive receipt conclusion also is supported by PLR 200914018, where a similar one-time irrevocable waiver was determined not to constitute constructive receipt. That PLR includes both a one-time waiver and the conclusion by the IRS that “an employee will not be in constructive receipt of income due solely to the availability of the one-time irrevocable election to waiver retiree health benefits in return for an increase in the rate of pay for future services provided to the Taxpayer.”

Consistent with these rulings, the one-time irrevocable elections by the employees under the MPSERS Plan should not be considered CODAs, and, should not result in constructive receipt of income by the employees, because any choice between or among benefit structures involves significant limitations or restrictions (i.e. the employee would be making the irrevocable election to surrender his or her future right to receive premium subsidies under the MPSERS Plan).

Second, the concept of “significant detriment” can be applied to the one-time irrevocable choice Employees made in 2012. This tax doctrine is applied in several employee benefits contexts, the essence of which is that an individual taxpayer does *not* have control, and thus does not have taxable income, when the options presented involve any significant detriment. For example, in Treas. Reg, Sec. 1.411(a)-11(c)(2)(i), the IRS cites this doctrine as a basis for concluding that consent cannot be given when a significant detriment is imposed on one who does not give consent; under those circumstances one's "consent" cannot be considered voluntary.

In this vein, it is important to examine the context of the one-time irrevocable election which Employees made in 2012. Those Employees had only one choice—to opt in or out of the premium subsidy benefits under the MPSERS Plan in its entirety. Any election made during this one-time irrevocable election window provided Option A to retain the right to receive premium subsidies under the MPSERS Plan, or Option B of no future premium subsidies under the MPSERS Plan. Any choice made at that time, therefore, involves a corresponding limitation, restriction, or detriment—a 3% reduction in compensation that is remitted as an employer contribution to the Healthcare Trust along with a premium subsidy benefit under the MPSERS Plan, versus no premium subsidy benefit at all. Moreover, this factor has further significance in view of the fact that the 2012 election was a one-time irrevocable choice as to whether to *continue* participating in the program— a "choice" that had very long-term and lasting consequences.

This fact is bolstered in two further respects. One is that under the one-time irrevocable election window, an Employee who failed to make any election at all automatically continued to be subject to the 3% reduction in compensation that is remitted as an employer contribution to the to the Healthcare Trust (and thus potential future right to the premium subsidy benefit under the MPSERS Plan). The second fact that demonstrates the significant detriment attached to an Employee's healthcare "choice," is the fact that approximately 90% of all Employees continued receiving a 3% reduction in compensation (and thus remained potentially eligible for the premium subsidy benefit under the MPSERS Plan), by either affirmatively electing to do so or by making no election at all. Opting out under this one-time election was effectively a decision to end any retiree premium subsidy benefits provided by the MPSERS Plan for that Employee. Under these facts, the significant detriment doctrine can be applied in support of a conclusion that an Employee making his or her irrevocable election with respect to the MPSERS Plan should not be deemed to have made a cash or deferred election.

Third, the constructive receipt doctrine as applied to the one-time irrevocable election at issue should be similar to that which is applied in the context of the cafeteria plan and 401(k) plan rules. Prop. Treas. Reg. Sec. 1.125-2(a)(3) and Treas. Reg. Sec. 1.401(k)-1(a)(3)(iv) both provide that an employee does not have any constructive receipt of income under Code Section 451 where funds are not treated as currently available. Under these regulations, funds are not currently available if there are significant limitations or restrictions that accompany any election.

In view of the fact that the Employee's one-time election is irrevocable, and each of the corresponding benefits has its own limitations and restrictions, an Employee's election in this regard should not cause the attendant 3% mandatory contributions to be includable in the employee's current gross income. In addition, similar to Treas. Regs. Sec. 1.401(k)-1(a)(3)(v) providing that a one-time irrevocable election, made no later than the time an employee first becomes eligible under a plan to have a portion of his or her compensation contributed to the plan (including plans or arrangements not yet established), is not a cash of deferred election, we think this logic is analogous to the one-time, irrevocable election made with respect to the MPSERS Plan. Each of these concepts is consistent with, and supportive of, the one-time irrevocable election made under the MPSERS Plan and Healthcare Trust not being treated as a CODA.

Finally, in the pick-up context, Revenue Ruling 2006-43 is instructive solely with respect to the exclusion of the 3% mandatory contributions from taxable income under Code 106.[3] This ruling applies to governmental employers, and involves qualified pension plan contributions and the Internal Revenue Code Section 414(h)(2) "pick up" rules. Under these rules, employee contributions are considered to be "picked up" by their employer— and thus treated as employer contributions not subject to immediate income taxation—if the employer (1) specifies that employee contributions are to be paid by the employer, and (2) does not permit the employee to make a cash or deferred election. The ruling specifies that the employer must take formal action to provide that contributions on behalf of a specific class of employees, although nominally designated as employee contributions, will be paid by the employer in lieu of employee contributions. The IRS makes it clear that the "pick up" rules apply even if the employer picks up the contributions through either a reduction in salary or an offset against future salary increases. Employees may not be allowed to opt out of the pick up or to receive the amounts directly instead of having them contributed by the employer. By analogy, the 3% mandatory contributions under the MPSERS Plan and Healthcare

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[3] Obviously, the pick-up concept under a qualified retirement plan is unique as it deals with the deferral (not exclusion) of taxable income on contributions to and payable under a qualified retirement plan described in 401(a), which, admittedly and expressly, continue to be considered wages for purposes of immediate FICA taxation pursuant to Section 3121(v)(1)(B) at the time such pick up contributions are made to the qualified retirement plan. However, IRS guidance on pick up contributions are instructive and analogous to the 3% mandatory contributions to the Healthcare Trust as those contributions are similarly not being made pursuant to a cash or deferred election but rather as an employer contribution to the Healthcare Trust. Code Section 3121(a)(4) specifically excludes from the definition of wages for FICA tax purposes such employer contributions to the Healthcare Trust, without any add back under Section 3121(v).

Trust are statutory in nature (thus representing formal action by the employer) and are irrevocable and, therefore, should be similarly treated as employer contribution by the Reporting Units and not subject to federal taxation.

Other “pick up” rulings demonstrate the IRS view of employee contributions and elections. These rulings are discussed at PLRs 9402028 and 9536033, along with GCMs 38820 and 38194. The facts are similar in these cases, involving one-time irrevocable elections, mandatory contributions, employees with no options to receive cash in lieu of the contributions, and contributions "picked up" by their governmental employers.

Conclusion

Based on the foregoing, MPSERS intends to submit a PLR request to the IRS asking that its initial rulings provided to date—as to the aforementioned protective claims—be set aside and for the following rulings to be made:

> (1) The 3% mandatory contributions that are made under the MPSERS Plan and deposited into the Healthcare Trust pursuant to Michigan state law are treated as employer contributions and are excludable from employees’ gross income under section 106 of the Code; and
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> (2) The 3% mandatory contributions that are made under the MPSERS Plan and deposited in the Healthcare Trust pursuant to Michigan state law are not “wages” and are not subject to FICA taxes under section 3121(a), FUTA taxes under section 3306(b) or income tax withholding under section 3401(a) of the Code.

Although the forthcoming PLR request may ultimately affect the status of protective claims involving the same issues, Taxpayers and interested parties are reminded that the responsibility for preserving and pursuing individual claims remains their own. This may include the timely appeal of any denial of a protective claim issued to a Taxpayer, utilizing any number of appeal methods as outlined by the IRS in the denial letters.

ATTACHMENT 1: MEMBER EMPLOYEE CONTRIBUTIONS MANDATED UNDER MICHIGAN LAW

These mandatory contributions are set forth in Michigan law, as follows:

Section 43e of the MPSERS Act provides for a mandatory contribution for each employee that participates in the retiree healthcare plan. There was provided a one-time, limited window for an employee to make an irrevocable election to discontinue participation in the retiree health plan in its entirety. Every employee who participates in the retiree healthcare plan, however, is subject to the mandatory contribution. There is no annual option or election (or an option or election at any other time) as to whether to continue participation in the plan. And as a participant in the plan, there is no option or election with regard to whether the employee will pay the employee contribution, nor any option or election to pay an amount that is greater or smaller than the mandatory contribution that is mandated by state law. The portion of the MPSERS Act that requires the employee contribution and treats it as an employer contribution, is as follows:

> Except as otherwise provided in this section or section 91a, each Employee who first became an Employee before September 4, 2012 shall contribute 3% of the Employee's compensation to the appropriate funding account established under the public employee retirement health care funding act, 2010 PA 77, MCL 38.2731 to 38.2747. The Employee contributions under this section shall be deducted by the employer and remitted as employer contributions in a manner that the retirement system shall determine. As used in this section, "funding account" means the appropriate irrevocable trust created in the public employee retirement health care funding act, 2010 PA 77, MCL 38.2731 to 38.2747, for the deposit of funds and the payment of retirement health care benefits. [MCL 38.1343e (emphasis added)].

Section 91a of the MPSERS Act provided a one-time election for employees to opt out of participation in the retiree healthcare plan provided by MPSERS. That portion of the Act provides as follows:

> (5) Except as otherwise provided in this section, beginning September 4, 2012 and ending at 5 p.m. eastern standard time on January 9, 2013, the retirement system shall permit each qualified Employee to make an election to opt out of health insurance coverage premiums that would have been paid by the retirement system under section 91 and opt into the Tier 2 account provisions of this section effective on the transition date. A qualified Employee who makes the election

> under this subsection shall cease accruing years of service credit for purposes of calculating a portion of the health insurance coverage premiums that would have been paid by the retirement system under section 91 as if that section continued to apply. [MCL 38.1391a(5)]

Section 91 of the MPSERS Act provides for retiree healthcare, but provides that this plan is not available to certain employees. For example, it is not available to any newly hired employee after September 4, 2012 or any employee who opts out of the healthcare plan during the one-time election window. That portion of the Act provides as follows:

> (15) This section does not apply to a retirant or a health insurance dependent of that retirant under either of the following circumstances:
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> > (a) The individual first became an Employee or qualified participant on or after September 4, 2012.
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> > (b) The Employee made the election to opt out of health insurance coverage or receives a separate retirement allowance under section 91a. [MCL 38.1391(15)].