



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

OFFICE OF  
CHIEF COUNSEL

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MEMORANDUM FOR  
FSLG SPECIALIST

FROM: Lynne A. Camillo, Branch Chief (CC:TEGE:EOEG:ET2)  
SUBJECT: FICA Tax on Remuneration Paid to Volunteer Firefighters

This Chief Counsel Advice responds to your memorandum dated September 26, 2002. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

LEGEND

State =

State Board =

Pension Plan =

ISSUE

Whether services performed by volunteer firefighters in State who are participants in Pension Plan are employment under section 3121(b)(7)(F) of the Code.

CONCLUSION

The Services performed by the volunteer firefighters are employment under section 3121(b)(7)(F) because the firefighters are not qualified participants in a state retirement system.

FACTS

State Board maintains Pension Plan for the benefit of volunteer firefighters in State. All volunteer firefighters in State are eligible to participate in Pension Plan. The only requirement is that .

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The retirement benefit under the Pension Plan is computed in three steps based upon the participant's (1) age, (2) years of service, and (3)

amount is computed. . First, the base pension

For example,

. Second, the base pension amount is adjusted downward if the participant has less than years of service. For example, the pension benefit of a participant with only years of service is reduced to percent of the base pension amount. A participant with less than years of service receives no benefit under Pension Plan. Third, the pension benefit amount computed in step two is adjusted downward if the participant retires before age . For example, a participant electing to receive benefits at age , the earliest permissible age under Pension Plan, receives percent of the benefits computed in step two. Benefits may also be reduced if a participant elects to receive their benefit in the form of

A participant may forfeit his or her benefit

The volunteer firefighters are compensated based upon an amount per hour or upon a system. Under the system,

. The volunteer firefighters normally work hours or less per week. The volunteer firefighters generally do not earn more than a dollars per year, and in most cases, much less than that.

#### LAW

Sections 3101(a) and 3111(a) of the Internal Revenue Code (the Code) impose the Old-Age Survivors and Disability Insurance (OASDI) portion of the taxes under the Federal Insurance Contributions Act (FICA) upon the wages of employees paid by employers with respect to employment. Sections 3101(b) and 3111(b) impose the Medicare portion of the FICA tax. In general, all payments of remuneration by an employer for services performed by an employee are subject to FICA taxes, unless the payments are specifically excepted from the term "wages" or the services are specifically excepted from the term "employment."

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Section 3121(b)(7) of the Code generally excludes from "employment" services performed in the employ of any state, or any political subdivision thereof, or any wholly-owned instrumentality of any one or more of the foregoing.

Section 3121(b)(7)(F), added to the Code by the Omnibus Budget Reconciliation Act of 1990 and effective for services performed after July 1, 1991, excludes from "employment" only the services of an employee of a state, political subdivision, or wholly-owned instrumentality who is a member of a retirement system. Section 31.3121(b)(7)-2(c)(1) of the Employment Tax Regulations provides that an employee is not a member of a retirement system at the time service is performed unless at that time he or she is a "qualified participant," as defined in paragraph 2(d) of the regulation, in a retirement system that meets the requirements of paragraph 2(e) of the regulation with respect to that employee.

A pension, annuity, retirement or similar fund or system is not a retirement system with respect to an employee on a given day unless it provides a retirement benefit under the system that is comparable to the benefit provided under the Old-Age portion of the OASDI program of social security. Section 31.3121(b)(7)-2(e)(2)(i). Section 31.3121(b)(7)-2(e)(2)(ii) provides that a defined benefit retirement system maintained by a state, political subdivision or instrumentality meets the requirements if and only if the employee has an accrued benefit under the system that entitles the employee to an annual benefit commencing on or before his or her social security retirement age that is at least equal to the annual Primary Insurance Amount (PIA) the employee would have under social security. For this purpose, the PIA is determined as if the employee had been covered under social security for all periods of service with the state, political subdivision or instrumentality, had never performed service for any other employer, and had been fully insured within the meaning of section 214(a) of the Social Security Act, except that all periods of service with the state, political subdivision or instrumentality must be taken into account, i.e., without reduction for low-earning years.

An employee is a qualified participant in a defined benefit retirement system with respect to services performed on a given day if the employee has a total accrued benefit that meets the minimum benefit requirement. Section 31.3121(b)(7)-2(d)(1)(i).

Additional requirements under the regulation apply to determine whether a part-time, seasonal or temporary employee is a "qualified participant" in the plan. A part-time employee is any employee who normally works 20 hours or less per week. A seasonal employee is any employee who normally works on a full-time basis less than five months in a year. A temporary employee is any employee performing services under a contractual arrangement with the employer of two years or less duration. Section 31.3121(b)(7)-2(d)(2)(iii).

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A part-time, seasonal, or temporary employee is not a qualified participant on a given day unless any benefit relied upon to meet the requirements of paragraph (d)(1) is 100-percent nonforfeitable on that day under rules similar to those under section 411(a)(11). Section 31.3121(b)(7)-2(d)(2)(i). A benefit does not fail to be nonforfeitable solely because it can be immediately distributed upon separation of service without the consent of the employee, provided that the present value of the benefit does not exceed \$3,500.

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 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. The participant must be entitled to a reasonable rate of interest on the distributable amount. Section 31.3121(b)(7)-2(d)(2)(ii) and (e)(2)(iii)(C).

Rev. Proc. 91-40, 1991-2 C.B. 694, section 3, provides safe-harbor formulas for defined benefit retirement systems. Benefits calculated under these formulas are deemed to meet the minimum retirement benefit requirement of section 31.3121(b)(7)-2(e) for defined benefit plans. Section 3.01(1) provides that a plan meets the minimum retirement benefit requirement with respect to an employee if it makes available to the employee a single life annuity payable no later than age 65 that is at least 1.5 percent of average compensation for each year or fraction of a year of credited service. For this purpose, average compensation may be defined as (1) the average of the employee's compensation over the 36 or fewer consecutive or non-consecutive months that provides the highest such average, (2) the average of the employee's compensation for his or her last 36 or fewer months of service, or (3) the average of the employee's compensation for his or her high consecutive or non-consecutive or final 3 or fewer calendar or plan years of service.

Under section 3.02 of the Rev. Proc., a defined benefit retirement system that calculates benefits based upon a pro rata accrual towards a projected normal retirement benefit may meet the minimum retirement benefit requirement in the same manner as provided in section 3.01(1) provided the projected normal retirement benefit under the plan formula is greater than or equal to the benefit described in such section.

Under section 4.01 of the Rev. Proc., a defined benefit retirement system that calculates benefits under a formula that does not meet one of the safe harbor formulas described in section 3 meets the minimum retirement benefit requirement with respect to an employee if the employee's accrued benefit as of the date of the determination is at least as great as the accrued benefit the employee would have if his or her accrued benefits had been calculated under the safe harbor formulas in section 3.01(1).

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Section 3.03(4) of the Rev. Proc. provides that in order to meet the requirements of any of the defined benefit safe harbor formulas with respect to a part-time, seasonal or temporary employee, a safe harbor formula may not permit double proration of the employee's benefits under the retirement system. Under this rule, the benefit under the retirement system may be prorated either on the basis of full-time service or on the basis of full-time compensation, but may not be prorated based upon both service and compensation. In addition, a safe harbor formula may not subject the crediting of service used in calculating the benefit of any part-time, seasonal or temporary employee to any conditions, such as a requirement that the employee attain a minimum age, perform a minimum period of service, be credited with a minimum number of hours of service, make an election in order to participate, or be present at the end of the plan year. The requirements of this section are deemed met with respect to an employee if the requirements of section 31.3121(b)(7)-2(d)(2)(ii) of the regulations are met.

### ANALYSIS

Whether an employee's services are excepted from employment under section 3121(b)(7) turns on whether the individual employee is a qualified participant in a retirement system at the time the services are performed. Although the concept of retirement system is generally broad, the system must provide a minimum benefit to an employee in order for the employee's services to be excepted from employment. Thus, the minimum benefit requirement must be met on an employee-by-employee basis. However, it is possible to conclude that the benefits provided under a particular system are so low that the minimum benefit requirement will never be met.

#### Qualified Participant

A part-time employee is not a qualified participant on a given day unless the participant's benefits are 100-percent nonforfeitable on that day. Section 31.3121(b)(7)-2(d)(2)(i). A volunteer firefighter is not entitled to any benefits under Pension Plan before completion of \_\_\_\_\_ years of service. Thus, the nonforfeitability requirement is not met for participants with less than \_\_\_\_\_ years of service.

Moreover,

, or

. Accordingly, the volunteer firefighters are not qualified participants in a retirement system within the meaning of section 3121(b)(7)(F), and therefore their services are not excepted from employment under section 3121(b)(7).

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## Retirement System

As discuss supra, the volunteer firefighters are not “qualified participants,” and thus is it unnecessary to consider whether Pension Plan is a retirement system with respect to the firefighters. However, because you specifically asked about the “retirement system” requirement as it relates to Pension Plan, we are providing the following discussion on that issue.

Pension Plan is a defined benefit pension plan. Thus, the standards provided in Rev. Proc. 91-40 determine whether Pension Plan is a retirement system with respect to each volunteer firefighter. Section 3 of the Rev. Proc. provides safe harbor formulas to determine the minimum retirement benefit that must be provided under Pension Plan, given the firefighter’s years of service and average compensation, in order for it to be considered a retirement system. Pension Plan’s formula is not a safe harbor formula because it does not consider compensation in determining the pension benefit under the plan. However, a retirement system that calculates benefits under a non-safe harbor formula meets the minimum benefit requirement if the employee’s accrued benefit is at least as great as the employee’s benefit would have been had the employee’s benefit been calculated under the safe harbor formula in section 3.01(1). Thus, it would be necessary with respect to each firefighter to compare the accrued benefit under Pension Plan with the minimum benefit required under the safe harbor formula.

## OTHER CONSIDERATIONS

[REDACTED]

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

Please call if you have any further questions.

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Lynne A. Camillo  
Branch Chief  
CC:TEGE:EOEG:ET2

cc: