

## **TAX SHELTER PLAN FOR EMPLOYEE CONTRIBUTIONS**

**Employees' Retirement System of Alabama**  
P. O. Box 302150 ♦ Montgomery, Alabama 36130-2150  
(334) 517-7000 or 1-877-517-0020  
Web site: [www.rsa-al.gov](http://www.rsa-al.gov)

A retirement contribution tax shelter plan is available for employees of agencies that participate in the Employees' Retirement System (ERS), subject to approval of the employing agency. Attached is:

- Information that explains the tax shelter provision and the procedures by which a county, city, or other governmental employer may implement this plan.
- A model of a Resolution that must be adopted by the employer to implement this tax shelter plan.

This material is provided for your information. Implementation is solely at the discretion of each employer. The ERS staff will assist you in the evaluation and implementation of this tax shelter plan.

## TAX SHELTER PLAN PROVISION AND PROCEDURES

Upon initiation of unit participation, five percent (5%) [six percent (6%) for certified Firefighters/Law Enforcement Officers] of each employee's salary is deducted from his or her paycheck and paid to the ERS as an employee contribution. Since that contribution is included in the employee's salary, the employee must pay federal income tax on that money even though he or she does not in fact receive it.

On July 13, 1982, the Internal Revenue Service issued a ruling to the ERS, which stated that members would not have to pay federal income tax on the employee's retirement contribution, if the employing agency paid the contribution directly to the ERS rather than paying it to the employee and deducting it from his or her salary. This tax savings for the employee can be accomplished without cost to the employing agency if the agency simply agrees to pay the employee contribution for the employee and if the agency correspondingly reduces the employee's salary by the amount of the contribution. This is essentially a bookkeeping change. The contribution is paid for the employee by means of a reduction in salary rather than a deduction from salary.

This "tax-shelter" only defers payment of federal income tax on retirement contributions and does not preclude payment altogether. Federal income tax will have to be paid on these contributions by the employee when the ERS pays these contributions to the employee either through a return of contributions upon withdrawal from the ERS or upon payment of benefits upon retirement.

For all purposes other than federal income taxation, the employee's salary will be considered to be the same as before the salary reduction and retirement contribution "pick-up" by the employing board or agency. **State income tax will be required on the employee's full compensation including both the reduced salary and the retirement contribution.** Social Security taxes will be paid on the employee's full compensation including both the reduced salary and the retirement contribution. The employee's full compensation, reduced salary and retirement contribution, will be used in determining the employee's average salary for calculating his or her retirement benefit. Upon withdrawal from the ERS, the employee will receive these contributions just as he or she currently would.

For implementation of this tax-shelter plan, all the following criteria must be met:

1. The Board or employer must provide, by Resolution or otherwise, that it will "pick-up" or pay the employee contribution to the ERS.
2. The employer must provide that this "pick-up" will be in lieu of payment by the employee by deduction from his or her salary.
3. The employer must reduce or adjust the employee's salary downward by the amount of the contribution paid directly by the employer.
4. The employer must provide that this "pick-up" and reduction will apply to **all** of its employees who participate in the ERS.

5. The employer may only provide for prospective, not retroactive, application for this tax-shelter plan.

To implement this tax-shelter plan for its employees, the governing authority for each employer should:

1. Adopt a Resolution in substantially the same format as the attached Model Resolution.
2. Make the Resolution effective prospectively only.
3. Forward a copy of the Resolution to the Employees' Retirement System, P. O. Box 302150, Montgomery, Alabama 36130-2150.
4. Implement the necessary payroll procedure and reporting changes to cease withholding federal income tax from the 5 percent (5%) [6 percent (6%) for certified Firefighters/Law Enforcement Officers] contribution to the ERS, and to show the reduction in employee's gross income for federal income tax reporting purposes.

This tax-shelter plan will provide a significant tax savings for the overwhelming majority of public employees in the state of Alabama. There may be some employees because of their peculiar tax situations who would prefer not to have their retirement contributions tax-sheltered. **It cannot be emphasized strongly enough that the plan must be implemented for all the agency's employees or not implemented at all. Individual employees may not be given the option of participating in the tax-shelter plan or not participating.**

## TAX SHELTER PLAN RESOLUTION

WHEREAS, (Governing Board) wishes to provide maximum benefits to its employees within the limits of its budget; and

WHEREAS, employees of (Name of Agency) are members of the Employees' Retirement System of Alabama and under the current mandatory contribution procedure each member employee has 5 percent (5%) [6 percent (6%) for certified Firefighters/Law Enforcement Officers] of his compensation deducted and paid into the Employees' Retirement System of Alabama; and those contributions so deducted are currently fully taxable as income to the employee under federal tax laws; and

WHEREAS, §414(h)(2) of the Internal Revenue Code provides that such contributions may be excluded from the employee's gross income if these contributions are "picked-up" by the employer;

NOW, THEREFORE, BE IT RESOLVED by (Governing Board) that the salary of each employee who participates in the Employees' Retirement System shall be adjusted so that the (Name of Agency), as employer, shall pay on behalf of each and every one of such employees for each and every payroll period beginning on or after (Effective Date), that employee's contribution to the Employees' Retirement System of Alabama as required by §36-27-24 of the Code of Alabama 1975; that such payment on behalf of each employee of that employee's contribution to the Employees' Retirement System of Alabama shall be in lieu of any deduction from the employee's salary of said contribution; and

BE IT FURTHER RESOLVED that the employee contributions which are "picked-up" will continue to be designated employee contributions for purposes of the Employees' Retirement System of Alabama; that the employee contributions which are "picked-up" shall be a part of the employee's compensation for determining the amount of the contribution to be so "picked-up"; that the total amount of the contribution of each member employee to the Employees' Retirement System of Alabama shall not be reduced by this Resolution; that the amount of the retirement allowance of each member shall not be affected by this Resolution; that no other changes in the method of computation and transmittal of these "picked-up" employee contributions shall be affected hereby; and that the total amount paid to and on behalf of each member employee will not be increased hereby.

BE IT FURTHER RESOLVED that the system whereby the employee's contributions to the Employees' Retirement System of Alabama is "picked-up" shall apply equally to each and every such employee who participates in the Employees' Retirement System; that no such employee shall be given any option concerning this "pick-up"; that this system of "pick-up" shall be mandatory on all such employees.

### CERTIFICATION

I, (Name, Official Title, Name of Agency), hereby certify that the foregoing is a true and correct copy of the Resolution passed on (Date).

Signature of Official

Official Title