

MEMORANDUM OF LAW

DATE: February 8, 1990

TO: D. Cruz Gonzalez, Risk Management Director,
via Jack McGrory, Assistant City Manager

FROM: City Attorney

SUBJECT: Proposed Treasury Regulation 1.125-2 and the
Supplemental Pension Savings Plan

In a memorandum dated January 31, 1990, you asked if proposed Treasury Regulation 1.125-2 found at 54 Fed. Reg. 9501 (1989) authorizes The City of San Diego to include an option in either the Flexible Benefits Plan (FBP) or the Management Benefits Plan (MBP) permitting an employee to make contributions to the Supplemental Pension Savings Plans (SPSP) directly from the employee's FBP or MBP account. You also asked if such contributions may be treated as employer contributions and whether or not such contributions to SPSP will affect the employee's Internal Revenue Code section 415 limits.

The proposed regulations state in part:

(c) Qualified cash or deferred arrangements. Elective contributions to a qualified cash or deferred arrangement (section 401(k)) are permitted under a cafeteria plan. In addition, after-tax employee contributions under a qualified plan subject to section 401(m) are permitted under a cafeteria plan. The right to make such contributions will not cause a plan to fail to be a cafeteria plan merely because, under the qualified plan, employer matching contributions are made with respect to elective or after-tax employee contributions.

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Similarly, a cafeteria plan does not include a benefit that defers the receipt of compensation merely because the cafeteria plan

provides the opportunity to make after-tax employee contributions subject to section 401(m) under a qualified plan. In addition, a cafeteria plan will not be treated as including a benefit that defers the receipt of compensation merely because, under the

qualified plan, employer matching contributions (as defined in section 401(m)(4)(A)) are made with respect to such elective contributions or after-tax employee contributions.

The City of San Diego's SPSP Plans are qualified deferred contribution plans subject to the nondiscrimination test found in Internal Revenue Code (IRC) section 401(m). The proposed regulations allow an employee to make after-tax (post-tax) contributions to a qualified defined contribution plan from a cafeteria plan such as FBP or MBP even if the defined contribution plan provides for employer matching contributions. These contributions are employee contributions. They cannot be tax deferred employer contributions. Under the Treasury Regulations, an employee's contributions to a defined contribution plan from a cafeteria plan are subject to the same federal and state income tax withholding requirements as the current cash option provision.

Although the proposed regulations do not offer any new tax advantages to the employee, the employee's take home pay will increase to the extent that the employee uses MBP or FBP allocations to offset the employee's payroll deductions to his or her SPSP account. The exercise of the option does not affect the individual employee's IRC section 415 limits, because the annual amount allocated to the defined contribution plan (SPSP) by the employee will not change.

If you have any further questions in this regard, please feel free to contact me.

JOHN W. WITT, City Attorney

By

John M. Kaheny

Chief Deputy City Attorney

JMK:skc:mrh:pev:357(x043.2)

cc Sam Gray

Doris Uzdavines

Valerie VanDeweghe

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