



Suite 403  
City – County Building  
400 Main Street  
Knoxville, Tennessee 37902  
Office: (865) 215-2500  
Fax: (865) 215-2068

## MEMORANDUM

Agenda Item No. 51

To: MPC Executive Committee  
From: Mark Donaldson, Dee Anne Reynolds  
Date: September 3, 2009  
Re: FY08/09 Budget Transfer for IRS Audit Contingent Liability \$28,236

This is to request approval to do a FY08/09 line item budget transfer of \$28,236 from MPC Salaries expense # 9110 to Liability Charges expense # 9915. This transaction is needed to reflect a contingent liability on our financial statement ending June 30, 2009 for MPC's portion of an IRS disputed amount of FICA and Medicare tax not paid on the employer and employee retirement portion of the Knox County Asset Accumulation Plan 401(a) for calendar 2006 and January to June of 2007. Knox County has recommended this course of action to all its related entities and will pursue the IRS dispute for the group.

Knox County's payroll audit scope of 2006 and 2007 with IRS found that Knox County has not paid FICA and Medicare tax of 7.65 percent on the six percent mandatory payments to the Knox County Asset Accumulation Plan 401(a) by the employees and the six percent match by the employers. Knox County set up the retirement plan in 1991 with professional advisement about the Internal Revenue code section 401(a) and determined these payments were not taxable. However, there is disagreement on qualifying aspects of the plan and IRS takes the position that the retirement "pick up payments" are part of a "salary reduction agreement" and thus should be taxed. IRS has recently won some circuit court cases in this regard.

William E. Mason, Attorney at Law, Kennerly, Montgomery & Finley, P.C., 550 Main Street, Knoxville, TN 37901, represents the Knox County Retirement and Pension Board and Kim Bennett, Executive Director, Knox County Pension Board, is point of contact with the IRS for all Knox County related entities. Any proposed agreement on payment, settlement or other such matter will be referred back to MPC for concurrence.

Due to advice by Mr. Mason, Knox County voluntarily amended the retirement plan and began withholding FICA and Medicare tax on the retirement pick up payments starting July 1, 2007 after notifying the employees. The IRS is taking the position that Knox County and employees may be liable to pay for the other 18 months covered by the audit. There is no lawsuit at this time, only ongoing meetings. Mr. Mason's June 10, 2009 Response to the IRS audit explains the background and issues.

Staff Recommendation: Staff recommends approval to do the FY08/09 budget transfer.  
MPC Executive Committee Recommendation: The Executive Committee will meet September 8, 2009 and will forward its recommendation to the full commission for consideration at the September 10, 2009 meeting.