Memorandum

MIAMI-DADE COUNTY

Date: July 3, 2012

To: Honorable Chairman Joe A. Martinez
and Members, Board of County Commissioners

From: Carlos A. Gimenez
Mayor

Subject: Tax Advantaged Plan Alternatives for Terminal Leave Payout

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On March 6, 2012, the Board of County Commissioners (Board) adopted Resolution R-250-12 directing to evaluate alternative options that provide the opportunity for retiring employees receiving leave payouts to maximize the benefits in a tax advantaged manner and to report back to the Board. It was further directed that the report be submitted with a recommended plan and implementation schedule which would be at no cost to Miami-Dade County.

The analysis of the tax advantaged leave payout alternatives permissible under the Internal Revenue Code has been completed. All available options considered are of varying complexity to design and administer; each with its own advantages and disadvantages. Attached is a copy of the Gallagher Benefit Services, Inc. report along with the legal opinion, from its subcontractor law firm, Holland and Knight, pertaining to the alternatives available.

Offering any of these tax advantaged leave payout alternatives to union employees is subject to collective bargaining and would require negotiation and a contract amendment. Presently, there is no contract provision requiring this new benefit.

Out of the possible alternatives discussed in the report, if a plan needed to be implemented, the Administration would recommend a 401(a) plan to be funded with terminal sick leave payouts. The costs associated with developing such plan, if any, can be quantified once a Request for Proposals is crafted and vendor responses are evaluated.

As stated earlier, this type of employee benefit is subject to collective bargaining and as the report from Gallagher indicates, there are numerous options to consider. We are not making a recommendation to implement this plan at this time.

If you have any questions or concerns, please feel free to contact Deputy Mayor Edward Marquez at 305-375-1451, or me directly.

Attachment

c: Robert A. Cuevas, Jr., County Attorney
Office of the Mayor Senior Staff
Lester Sola, Director, Internal Services Department
Mary Lou Rizzo, Assistant Director, Internal Services Department
Charles Anderson, Commission Auditor

MEMO

To: Miami-Dade County
From: Gallagher Benefit Services, Inc.
Date: June 25, 2012
Subject: Alternative Options for the Payout of Accrued Leave

Pursuant to R-250-12 resolution dated March 6, 2012, Mayor Carlos Gimenez was "directed to evaluate alternative options for the payout of accrued leave for employees separating from County that provide the opportunity to the governmental entity and the retiring employee receiving the payout to maximize the benefits in a tax advantaged manner." Gallagher Benefit Services, Inc. obtained a legal opinion letter from Holland & Knight LLP (Exhibit 1) which describes the types of plans that would offer Tax-Advantaged Savings to both the County and the eligible employees under the Internal Revenue Code of 1986, as amended ("Code"). The legal opinion permits the County to rely on the opinion letter to the same extent as if it were addressed to the County.

For purposes of this memo, the reference to "Tax-Advantaged Savings" means the conversion of some portion of an employee's accrued leave (which is currently considered taxable wages) into a nonelective employer contribution to an employee benefit plan on behalf of such employee. The types of leave considered include Sick Leave, Annual Leave, Holiday Leave and Compensatory Time. By converting accrued leave (taxable wages) into a nonelective employer contribution to a benefit plan, both the County and the employee legally avoid/defer paying certain taxes on the amount of the nonelective employer contribution as follows:

- The County would not be required to pay:
  - Social Security taxes (6.2% capped at the Social Security Taxable Wage Base of $110,000 in 2012); and
  - Medicare taxes (1.45%).
- The employee, on whose behalf the nonelective employer contribution would be made, would not be required to pay:
  - Social Security taxes (historically 6.2% capped at the Social Security Taxable Wage Base of $110,000 in 2012; however, this was reduced to 4.2% for 2011 and 2012);
  - Medicare taxes (1.45%); and
  - Federal income tax on such contribution (until such time that monies are distributed from the plan).

RECOMMENDATION:

Holland and Knight identified three types of vehicles that would permit the County to achieve Tax-Advantaged Savings: (1) a retirement plan known as a "401(a) plan"; (2) a deferred compensation plan known as a "457(b) plan"; and (3) a health plan known as a "Health Reimbursement Account" or "HRA". In order to achieve the desired Tax-Advantaged Savings, individual employees must not have actual or constructive receipt of their accrued leave payments. Converting accrued leave payments into a mandatory County contribution to some vehicle for the benefit of the employee would accomplish this goal.

After reviewing the advantages and disadvantages of each alternative, and the cost to the County of administering each alternative (described more fully below), Gallagher would recommend the County consider implementing a 401(a) plan. The 401(a) plan has definite advantages when compared to a 457(b) plan, including higher maximum contributions; less coordination issues with other plans; and the ability to obtain an IRS opinion letter on its tax-qualified status. The 401(a) plan also has definite advantages when compared to an HRA, including the broad use of the dollars in the plan (once distributed), the ability to leave dollars to a beneficiary on death, no administrative cost to the County, and the lack of nondiscrimination rules (described more fully below).

Depending on the alternative chosen, the County will need to determine which groups of employees to include in the plan and what types of accrued leave will be eligible for conversion. In addition, the County will develop, within the parameters of the Code, the plan design it will incorporate in the chosen-alternative.

As more fully discussed below, Gallagher would recommend the County implement a 401(a) Plan to which the County would make a nonelective employer contribution of an employee's accrued Sick Leave up to the permitted statutory maximum contribution, currently $50,000 annually.

Why a 401(a) plan? We recommend the 401(a) Plan (rather than the other identified alternatives – a 457(b) deferred compensation plan or a Health Reimbursement Account ("HRA")) for the following reasons:

As compared to a 457(b) deferred compensation plan, a 401(a) plan offers the following benefits:

- Maximum annual contribution is higher
- Contribution to the 401(a) Plan would not limit the employee's ability to voluntarily defer compensation into the County's current 457(b) Plan
- Ability to rely on an IRS opinion letter without requesting a separate private letter ruling

As compared to an HRA, a 401(a) plan offers the following benefits:

- Monies can be rolled over to another eligible retirement plan
- Once distributed from the 401(a) plan, monies can be used for any purpose and are not limited to health expenses
- Monies remaining in the 401(a) on a participant's death can be given to the participant's chosen beneficiary (unlike in an HRA where the monies, if not used, would be forfeited)
- Ability to rely on an IRS opinion letter without requesting a separate private letter ruling
- No testing to ensure that eligibility and benefits are not discriminating in favor of the County's highly compensated employees
- There are providers who might offer 401(a) administration at no additional cost to the County

Why only Sick Leave? We recommend limiting the contribution to Sick Leave due to:

- The higher accrual limits on the County's Sick Leave than the other types of leave considered
- The fact that employees entering the FRS DROP can cash out accrued Annual and/or Holiday Leave. Employees cannot cash out any portion of their Sick Leave upon entering DROP, thereby remaining with a considerable leave balance.

DISCUSSION:

There are three types of plans (as well as the option to use multiple plans) that the County could implement that would meet its stated Tax-Advantaged Savings objectives. Each of those alternatives is briefly described below, including a summary of the advantages and disadvantages of each.

1. 401(a) Qualified Retirement Plan

Brief Description: This is a retirement plan under the rules of the Code. Further, it would be a "defined contribution" plan; meaning, the amount of contributions would be established under the terms of the plan. The Code sets an annual maximum amount of contributions that can be made by or on behalf of an employee to all 401(a) defined contribution plans sponsored by a single employer – the maximum for 2012 is $50,000. With regard to the County, the amount of contributions would be some established, objective formula established by the County in the 401(a) plan document (for example, 100% of a terminating employee's eligible accrued Sick Leave, up to the maximum permitted by the Code).

Advantages:

- Maximum Contribution: The maximum annual contribution that can be made to a 401(a) plan is more than the maximum contribution that can be made to a 457(b) plan. The Code sets annual limits on the amount that can be contributed to all of an employer's 401(a) plans for each employee who participates in such plans. The limit for 2012 is $50,000; and such amount is indexed annually (the maximum was $49,000 for 2011, 2010 and 2009). Therefore, the maximum amount of Terminal Accrued Leave Payments the County could make to a newly-created 401(a) plan would be $50,000 in 2012. The amount of Terminal Accrued Leave Payments beyond the permitted maximum would be paid to the employee as taxable wages (as is the County's current practice).
- Nondiscrimination Rules: The Code imposes requirements on certain plans to ensure that eligibility, contributions and/or benefits do not discriminate in favor of the employer's highly compensated employees. Governmental entities such as the County are not required to comply with nondiscrimination rules for a 401(a) Plan.
- Eligibility: The County has discretion in crafting different eligibility classifications (for example, some, but not all, bargaining units and/or some, but not all, non-bargaining unit employee classifications) because, as a governmental entity, is not subject to the Code's eligibility requirements. The plan and its features are a subject of mandatory collective bargaining with each bargaining unit.

- Rollovers: If permitted by the 401(a) plan, a participant's account can be rolled into another eligible retirement plan or individual retirement account ("IRA").
- Benefits on Death: Upon the death of a participant in a 401(a) plan, the monies left in the participant's 401(a) plan account would be available to the participant's named beneficiary.
- IRS Opinion Letter: The IRS has an established program through which sponsors of 401(a) plans can request a determination on the tax-qualified status of the plan. This will ensure that the 401(a) plan document, as written, complies with the Code's requirements. Assuming the 401(a) plan is administered in accordance with the terms of the document, the IRS opinion letter would give the County assurance by the IRS of the 401(a) plan's Tax-Advantaged Savings. Some 401(a) plan providers offer plans that have been pre-approved by the IRS. In such cases, the County would be able to rely on the opinion letter received by the plan provider.

Disadvantages:

- Coordination with Florida Retirement System Investment Plan or any other County-sponsored 401(a) plan: The Florida Retirement System ("FRS") makes available two types of retirement plan options: (1) a 401(a) "defined benefit plan", which is the traditional pension plan; and (2) the "Investment Plan", which is a "defined contribution" plan. Since the maximum annual contribution imposed by the Code requires that all defined contribution plans sponsored by the employer be taken into account, the County's maximum contribution to a 401(a) Plan would have to be reduced by any contributions made to the FRS Investment Plan (or any other County-sponsored 401(a) plan) on behalf an employee participating in the Investment Plan in the year of the Terminal Accrued Leave Payment.
    - Based on data provided by the County regarding Terminal Leave Payments for Fiscal Years 2009 - 2011, it appears that approximately 10% of the County's employees participate in the Investment Plan. If those employees who participate in the Investment Plan are eligible to participate in the 401(a) Plan, then coordination of the maximum annual contribution would be required. This would mean that an employee in the Investment Plan could receive less benefit from the implementation of a 401(a) plan than an employee in FRS' defined benefit plan. This coordination could also add additional administrative burden on the County.
- Early Withdrawal Tax: Participants must pay federal income tax on distributions from a 401(a) plan. When the distribution is taken "early," a participant must pay an additional 10% income tax. This additional tax would apply to distributions made before the participant reaches age 59 ½ or, in this case, age 55 since the participant would have experienced a separation from County service. Although "qualified public safety employees" who have separated from County service may take a distribution from a 401(a) plan once they reach age 50, they would be subject to the early withdrawal tax prior to age 55. A "qualified public safety employee" is any employee of a state (or political subdivision) who provides police protection, firefighting services, or emergency medical services for any area within the jurisdiction of the state (or political subdivision).

External Cost of Administration:

Ultimately the cost charged by a 401(a) plan provider to offer, administer, and maintain the tax-compliance of a 401(a) plan would be the result of the purchasing process utilized by the County (whether it be through competitive bid or interlocal agreement with another governmental entity). We do know that certain Florida governmental entities have similar 401(a) plans with $0 administration cost charged to the Florida governmental entity by the plan's administrator. In those cases, the plan's administrator is compensated from the plan's investments (in the form of revenue sharing expenses charged against participants' investments).

2. 457(b) Deferred-Compensation Plan

Brief Description: This is a retirement-type plan that can be sponsored only by certain types of entities, including local governments. Eligible employees can elect to defer a portion of their salary/wages into a 457(b) plan on a tax-deferred basis. The Code sets a maximum amount of contributions that can be made by or on behalf of an employee to all 457(b) plans sponsored by an employer.

Advantages:

- Rollovers: If permitted by the 457(b) plan, a participant's account can be rolled into another eligible retirement plan or an IRA.
- Benefits on Death: Upon the death of a participant in a 457(b) plan, the monies left in the participant's 457(b) plan account would be available to the participant's named beneficiary.
- IRS Private Letter Ruling: The IRS has an established program through which sponsors of 457(b) plans can request a determination on the tax-qualified status of the plan. This will ensure that the 457(b) plan document, as written, complies with the Code's requirements. Assuming the 457(b) plan is administered in accordance with its terms, the IRS private letter ruling would give the County assurance by the IRS of the 457(b) plan's Tax-Advantaged Savings.
- Coordination with FRS: The contributions made to a 457(b) plan would not be impacted by contributions made to FRS.
- Early withdrawal tax: 457(b) plans sponsored by governmental employers are not subject to an early withdrawal tax.

Disadvantages:

- Maximum Contribution: The maximum annual contribution that can be made to a 457(b) plan is less than a 401(a) plan. The Code sets annual limits on the amount that can be contributed to all of an employer's 457(b) plans for each employee who participates in such plans. The limit for 2012 is $17,000; and such amount is indexed annually. Therefore, the maximum amount of Terminal Accrued Leave Payments the County could make to a newly-created 457(b) plan would be $17,000 in 2012. (Note there are also "catch up" provisions which would allow participants of a certain age, or within 3 years of retirement, to make additional contributions. For example, a participant who is age 50 or older could make an additional contribution of up to $5,500 in 2012, and such maximum catch up amount is adjusted annually).

- Coordination with other 457(b) Plans: The County's contribution to a 457(b) Plan may limit an employee's ability to voluntarily contribute additional dollars to other 457(b) Plans. The County already makes available a 457(b) Plan (with products offered through ICMA and Nationwide) to which employees can voluntarily elect to contribute a portion of their compensation. Fifty two percent (52%) of the County's employees are currently actively participating in a County 457(b) Plan. If the County creates another 457(b) Plan to which it contributes Terminal Accrued Leave Payments, an eligible employee's ability to also make voluntary contributions would be reduced.

    Example: Assume Employee John Smith, has annual compensation of $50,000. Each year, John elects to contribute $5,000 to the County's 457(b) Plan with ICMA; therefore, has taxable compensation of $45,000. John separates from the County in 2012 at a time when John is entitled to a Terminal Accrued Leave Payment of $17,000. If the County establishes a new 457(b) Plan and contributes the maximum $17,000 to such Plan on John's behalf, John would not be able to make his $5,000 voluntary contribution to the Plan since the maximum contribution would already have been reached.

- IRS Private Letter Ruling: Unlike the 401(a) IRS Opinion Letter, the County would have to request its own Private Letter Ruling from the IRS if it wants assurance that the 457(b) plan complies, as written, with the Code. In fact, Florida Statute § 112.215 requires that a 457(b) plan sponsored by a governmental entity receives an opinion from a federal agency that the compensation deferred under the plan will not be included in the employee's taxable income until such time as it is actually received by the employee under the terms of the plan. (Note that some 457(b) providers may be able to offer such an IRS determination to the County).

<u>External Cost of Administration</u>:

Ultimately the cost charged by a 457(b) plan provider to offer, administer and maintain the tax-compliance of the 457(b) plan would be the result of the purchasing process utilized by the County (whether it be through competitive bid or interlocal agreement with another governmental entity). We do know that the County currently has no administration costs for its 457(b) plan and we also know that certain other Florida governmental entities have similar 457(b) plans with $0 administration cost charged to the Florida governmental entity by the plan's administrator. In those cases, the plan's administrator is compensated from the plan's investments (in the form of revenue sharing expenses charged against participants' investments).

3. Health Reimbursement Account

Brief Description: A Health Reimbursement Account ("HRA") is an employer-funded account that provides for the reimbursement of medical and dental expenses of the employee or former employee, and his or her spouse and tax dependents. Such expenses would have to qualify as tax deductible medical expenses under the Code, and are generally for diagnosis, treatment, or prevention of disease, and for treatments affecting any part or function of the body. The expenses must be to alleviate or prevent a physical defect or illness.

Advantages:

- Maximum Contributions: There is no Code-imposed annual contribution limit.
- IRS Private Letter Ruling: The IRS has issued Private Letter Rulings on HRAs. Such ruling would give the County assurance by the IRS of the HRA's Tax-Advantaged Savings.

Disadvantages:

- Use of Funds: Monies in an HRA are limited to the reimbursement of tax-deductible medical and dental expenses.
- Eligibility/Nondiscrimination: The County has discretion in crafting different eligibility classifications (for example, some, but not all, bargaining units and/or some, but not all, non-bargaining unit employee classifications); however, the County would have to satisfy the nondiscrimination rules of Code section 105(h) to ensure the HRA is not discriminating in favor of highly compensated individuals – there is no governmental employer exception.
- Rollovers: The monies in an HRA cannot be rolled over into another plan or vehicle.
- Benefits on Death: The IRS has taken the position that the payment of death benefits from an HRA is not allowed. However, monies in the HRA can be used after the employee's death to reimburse eligible expenses of the employee's surviving spouse and tax dependents.
- IRS Private Letter Ruling: Unlike the 401(a) IRS Opinion Letter, the County would have to request its own Private Letter Ruling from the IRS if it wants assurance that the HRA plan complies, as written, with the Code. HRA providers cannot offer an IRS determination on which the County could rely.

External Cost of Administration:

Ultimately the cost charged by an HRA provider to offer and administer an HRA would be the result of the purchasing process utilized by the County (whether it be through competitive bid or interlocal agreement with another governmental entity). We contacted several HRA administrators and the costs to administer an HRA through those administrators range from $3 to $6 per participant per month. In addition to the monthly administrative charge, administrators may also assess one-time start up fees and/or a fee per each claim processed.

4. *Use of Multiple Plan Types:*

It is possible for the County to offer multiple plans in order to achieve Tax-Advantaged Savings. For example, the Holland and Knight opinion letter described an IRS ruling (PLR 200301032) that allowed for a "waterfall" type approach, where accrued leave was contributed to a health-type plan to a certain maximum. Any remaining accrued leave in excess of the health plan maximum was then contributed to a Code section 403(b) plan to the permitted maximum. Any remaining accrued leave in excess of the 403(b) plan maximum was then contributed to a 457(b) plan to the permitted maximum. (This information is provided only as an illustration; only educational entities can offer 403(b) plans).

The use of multiple plans could increase the tax savings to both the County and the employees. For example, the County could establish a 401(a) plan to receive Terminal Accrued Leave Payments to the maximum permitted. Any remaining Terminal Accrued Leave Payments after the 401(a) plan maximum is reached would be contributed to a 457(b) to the maximum permitted. Any remaining Terminal Accrued Leave Payments beyond the 457(b) maximum would be contributed to an HRA. However, implementing multiple plans for this purpose would create additional internal administrative complexity for the County and, depending on the types of plans established, could result in external costs of administration.

Comparison of Plan Types

	401(a) Plan	**457(b) Plan**	**HRA**
Maximum Contribution?	$50,000 (for 2012)	$17,000 (for 2012)	Unlimited
Coordination with other plans?	Yes, FRS Investment Plan or other 401(a) plan	Yes, other 457(b) Plans	No
Eligibility/Nondiscrimination Rules Apply?	No	No	Yes
Beneficiary Death Benefits Available?	Yes	Yes	No
Rollovers permitted?	Yes	Yes	No
Early withdrawal tax penalty?	Yes*	No**	No
Limitations on use of monies in plan?	No	No	Yes
IRS Opinion Letter Available	Yes	Private letter ruling only	Private letter ruling only

*10% penalty if employee separates from employment prior to the year in which the employee attains age 55 and receives a plan distribution prior to age 59 1/2.
**Any 401(a) plan dollars rolled into a 457(b) plan would be subject to early withdrawal tax penalties on distribution.

SIMILAR PROGRAMS OF OTHER FLORIDA GOVERNMENTAL ENTITIES

The County's Benefits Administration Unit, Internal Services Department surveyed various local entities and following is a brief summary of whether or not they offer a tax-advantaged plan for Terminal Accrued Leave Payments and, if yes, what type:

ENTITY	TAX-ADVANTAGED PLAN OFFERED	TYPE
Broward County Government	Yes	HRA: Retiree Healthcare Savings Plan for defined group of senior management
Broward County Public Schools	Yes	401(a) Plan
Coral Gables, City of	Yes	HRA: Post-employment health plan (for non-bargaining unit employees and Fire Union); Retiree Healthcare Savings Plan (Police Union)
Fort Lauderdale, City of	No	N/A
Miami, City of	Yes	HRA: Post-employment health plan for unions, Police and Fire
Miami-Dade County Public Schools	Yes	401(a) Plan
North Miami, City of	No	N/A
Palm Beach County Public Schools	Yes	401(a) Plan for Teachers
Pinellas County Government	Yes (Discontinued March 2008)	401(a) Plan

In addition to the above, the following entities in the state of Florida maintain a 401(a) Tax-Advantaged Plan (based on the Florida client list of one 401(a) administrator with whom we are familiar):

- 59 Florida school districts (other than the 3 identified above), including Monroe, Collier, Hendry and Lee County Schools
- 3 other governmental entities, including the City of Ocala, Pinellas County Sheriff's Office, and Sumter County
- 16 Colleges, including Miami-Dade College, Broward College, and Palm Beach State College
- 3 Universities, including Florida State and University of Florida
- 8 Community Colleges, including South Florida Community College, Florida Keys Community College and Hillsborough Community College

CONSIDERATIONS AND RECOMMENDATIONS

When designing its Tax-Advantaged Savings Plan, the County will have various considerations, including:

- What Type of Plan to establish?
- What Type(s) of Leave to include?
- Which group(s) of employees will be eligible?
- How to Define Normal Retirement Age?
- Whether to Permit Loans?

Type of Plan

Holland & Knight's opinion letter presented three alternatives. A 401(a) plan offers the following advantages when compared to the other alternatives:

As compared to a 457(b) plan, a 401(a) plan offers the following benefits:

- Maximum annual contribution is higher ($50,000 in 2012 versus $17,000)
- Contribution of Terminal Accrued Leave would not limit the employee's ability to defer compensation into the County's current 457(b) Plan
- Ability to rely on an IRS opinion letter without the expense of requesting a private letter ruling

As compared to an HRA, a 401(a) plan offers the following benefits:

- Monies can be rolled over to another eligible retirement plan
- Once distributed from the 401(a) plan, monies can be used for any purpose and are not limited to health expenses
- Monies remaining in the 401(a) on a participant's death can be given to the participant's chosen beneficiary
- Ability to rely on an IRS opinion letter without the expense of requesting a private letter ruling
- No nondiscrimination requirements
- There are providers who might offer 401(a) administration at no direct cost to the County

Recommendation on Type of Plan:

We recommend the 401(a) Plan versus the other available options based on the advantages described above.

Types of Leave

The County offers, and we received data on, various types of accrued leave subject to collective bargaining, that could be eligible for contribution to a Tax-Advantaged Savings Plan, including

Annual Leave, Sick Leave, Holiday Leave, and Compensatory Time. A brief summary of each type of leave, with its maximum accrual limitations and other relevant information, follows:

Annual Leave:

- Maximum payout is 500 hours. Any accumulated annual leave in excess of the maximum is forfeited.
- Employees in the Florida Retirement System who are eligible to enroll and elect to participate in DROP have the option of requesting payment for the balance of their accrued annual leave up to the maximum number of hours.

Sick Leave:

- Maximum payout of 1,000 hours, with the following exceptions:
    - Unless otherwise provided in a collective bargaining agreement.
    - Employees with 30 or more years of County service have no maximum.
    - Special risk employees with 25 or more years of County service have no maximum.

Holiday Leave:

- Non-Job Basis Employees can accrue a maximum of 80 hours of Holiday Leave (unless otherwise provided in a collective bargaining agreement).
- Job-Basis Employees can accrue Holiday Leave without limit.
- Employees in the Florida Retirement System who are eligible to enroll and elect to participate in DROP have the option of requesting payment for the Holiday Leave earned in the 11 months immediately preceding the month in which the payout is made.

Compensatory Time:

- PBA and IAFF bargaining unit employees are paid for all outstanding compensatory time at the time of separation. Budget permitting, a department director may pay a job-basis employee for Compensatory Time earned prior to becoming job-basis.
- PBA and IAFF bargaining unit employees enrolled in FRS who are eligible to enroll and elect to participate in DROP have the option of requesting payment for Compensatory Time that was earned in the 11 months directly preceding the month in which the payout is made.

Recommendation on Type of Leave:

We would recommend the 401(a) plan be structured to receive, at a minimum, the payment of Sick Leave for the following reasons:

- Based on Terminal Leave Payment data from the County for fiscal years 2009 through 2011, Sick Leave accounted for more than half of the Terminal Leave payments paid, as follows: 56.3% for fiscal year 2011 and 2010; and 53.5% for 2009.
- Sick Leave has a higher maximum accrual (1,000 hours) compared to Annual Leave (500 hours).

- Sick Leave is not capped for employees with long tenure with the County (30 years, or 25 years for special risk).

Eligible Employees

As a governmental employer, the County is not subject to the nondiscrimination requirements of the Code. This means the County has latitude in crafting eligibility classifications for a 401(a) plan without ensuring whether or not the eligibility classifications favor or disfavor one group of employees over another. As a result, the County has the ability to make the 401(a) plan eligible to any combination of the following: any or all collective bargaining units; non-bargaining unit employees; Mayoral purview employees; non-Mayoral purview employees; different departments; etc.

<u>Recommendation on Employees to be Eligible</u>:

For bargaining unit employees, the County will negotiate with each specific union to determine employee participation. For non-bargaining unit employees, the County will have to decide which types of employees to include based on factors including demographics, projected tax savings, and ease of internal administration.

Distributions

In a 401(a) plan, an employee generally cannot withdraw any funds prior to separation, retirement, death, or disability. The County has the ability to draft the 401(a) plan's provisions regarding the timing of distributions, which includes defining "retirement age" for purposes of such distributions, as long as such provisions satisfy the Code's minimum requirements.

For purposes of distributions, a 401(a) plan's "retirement age" must be an age that is not earlier than the earliest age that is reasonably representative of the typical retirement age for the industry in which the covered workforce is employed. The IRS has created some safe harbors for setting "normal retirement age" as follows:

- Age 62 or later is automatically considered to satisfy the 401(a) normal retirement age distribution rules
- Not earlier than age 55 but less than age 62 satisfies the 401(a) normal retirement age distribution rules if, based on all the facts and circumstances, the County makes a reasonable good faith determination of the County's typical retirement age
- For "qualified public safety officers" (including police, fire and emergency medical services), age 50 or later would satisfy the 401(a) normal retirement age distribution rules. However, although qualified public safety officers can be eligible for a distribution at age 50, they would be subject to a 10% early withdrawal tax prior to age 55.

Note: The plan could be drafted to provide a "normal retirement age" as any time during the year in which someone attains the above ages. As discussed earlier, some vendors offer plan documents that have been pre-approved by the IRS. Those documents are generally fill-in-the-blank documents that contain parameters that an adopting employer (such as the County) would have to fit within. If the County utilizes a vendor's pre-approved document, the County may have some limitations on its ability to fully customize the plan's definition of "normal retirement age."

Regardless of the plan's definition of "normal retirement age," the Code requires that a participant in a 401(a) plan begin receiving distributions from the 401(a) plan as of the later of retirement or the April 1st following the calendar year in which the participant attains 70 ½ years of age.

In addition, the County's 401(a) plan could include a loan provision which would allow participants to access monies in their 401(a) plan account up to Code-prescribed limits (currently, the lesser of $50,000 or 50% of the participant's nonforfeitable account balance). This would benefit participants who retired or separated but have not yet attained the plan's "normal retirement age."

Recommendation on Distribution Provisions:

We would recommend the County consider utilizing the safe harbors created by the IRS when defining the 401(a) plan's "normal retirement age," which is an event that would entitle a participant to take a distribution.

For regular employees, the County should define "normal retirement age" as 62 or later, unless the County determines, based on its demographics, that its typical retirement age is earlier than age 62, in which case that age could be lowered, but not below age 55. For employees who qualify as "qualified public safety officers", the 401(a) plan could define "normal retirement age" as age 50 or later; however, we would recommend utilizing the same retirement age as regular employees in order to avoid the 10% early withdrawal tax.

This recommendation is subject to the limitations contained in a provider's pre-approved plan document and the County's preferred definition of "normal retirement age" should be included in a County-issued RFP when soliciting 401(a) vendors.

Finally, we would recommend the 401(a) plan include a loan provision, up to the permissible Code maximum (again, the lesser of $50,000 or 50% of the participant's nonforfeitable account balance), so that participants have the ability to keep their monies in a tax-advantaged vehicle (and thus defer federal income taxation) but still have access to some portion of their plan account.

SAVINGS EXAMPLES

The County provided us with data regarding Terminal Accrued Leave Payouts by the County in 2009, 2010 and 2011.

For illustrative purposes, we calculated the Social Security tax savings and the Medicare tax savings the County would have received over a three-year period (FY 2009 through 2011) if they implemented a 401(a) plan prior to FY 2009 based on the following assumptions:

- All employees who retired at or after age 55
- Only Sick Leave was considered
- The contribution for each employee was capped at the current 2012 maximum permissible 401(a) plan contribution of $50,000 (not reduced for contributions made to the FRS Investment Plan or other defined contribution plan)
- Terminal Accrued Leave Payouts under $5,000 were disregarded
- Leave eligible for contribution was rounded down to the nearest $100,000.

	Retiree Sick Leave Contribution Analysis			
Fiscal Year	Sick Leave (capped at $50,000 per year)	Social Security tax savings (at 6.2% up to Social Security Taxable Wage Base)	Medicare tax savings (at 1.45%)	Total Tax Savings
2009	$6,800,000	$421,600	$98,600	$520,200
2010	$8,600,000	$533,200	$124,700	$657,900
2011	$10,400,000	$644,800	$150,800	$795,600
Total (2009 – 2011)	**$25,800,000**	**$1,599,600**	**$374,100**	**$1,973,700**

If the County establishes a 401(a) Plan (or other Tax-Advantaged Plan), results in future years will vary based on the amount of Terminal Accrued Leave Payouts, which will be affected by:

- The age of employees eligible to participate
- Number of employees separating from service
- Amount of accrued leave owing to such separating employees
- Classes of employees eligible to participate in the plan (for example, the plan may only be available to some combination of collective bargaining units and non bargaining unit employees, based on union negotiations for the union employees and the County's discretion for nonbargaining unit employees)
- Types of Leave Payouts eligible to be contributed to the plan (for example, if the County decides to include Sick Leave only)

The following is a summary of the tax savings (based on the same assumptions above) if the County had contributed Sick Leave only to individuals separating at or after age 55 for any reason, not just retirement.

	Separation For Any Reason Sick Leave Contribution Analysis			
Fiscal Year	Sick Leave (capped at $50,000 per year)	Social Security tax savings (at 6.2% up to Social Security Taxable Wage Base)	Medicare tax savings (at 1.45%)	Total Tax Savings
2009	$7,000,000	$434,000	$101,500	$527,850
2010	$8,600,000	$533,200	$124,700	$657,900
2011	$10,500,000	$651,000	$152,250	$795,600
Total (2009 – 2011)	**$26,100,000**	**$1,618,200**	**$378,450**	**$1,996,650**

The following is a summary of the tax savings (based on the same assumptions as above) if the County had contributed all types of leave payments (including Annual, Sick and Holiday/Compensatory Leave) to a 401(a) Plan regardless of age:

	Separation For Any Reason All Leave Contribution Analysis			
Fiscal Year	Eligible Expense (i.e., All Leave Payout capped at $50,000 per year)	Social Security tax savings (at 6.2% up to Social Security Taxable Wage Base)	Medicare tax savings (at 1.45%)	Total Tax Savings
2009	$16,700,000	$1,035,400	$242,150	$1,277,550
2010	$18,600,000	$1,153,200	$269,700	$1,422,900
2011	$23,500,000	$1,457,000	$340,750	$1,797,750
Total (2009 – 2011)	**$58,800,000**	**$3,645,600**	**$852,600**	**$4,498,200**

Attached as Exhibit 2 are spreadsheets showing the tax savings for the County for 2009, 2010 and 2011 as summarized above.

EXHIBIT 1

OPINION LETTER

Holland & Knight

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April 6, 2012

Paul Hebert, JD
Area Vice President, Compliance
Gallagher Benefit Services, Inc.
2255 Glades Road
Boca Raton, FL 33431

Re: Miami-Dade County Proposed Accrued Leave Conversion Program

Dear Paul:

As you requested, this letter provides our advice concerning the options available to Miami-Dade County (the "County") with respect to an accrued leave conversion program and the federal tax consequences arising from such a program.

The analysis and discussion contained in this letter is based upon the accuracy and validity of the information contained in documentation you have provided to us, and the following statement of Facts.

FACTS

Pursuant to the County's Leave Manual (the "Manual"), the County maintains a comprehensive policy with respect to the accrual of various types of leave, including annual leave, sick leave, holiday leave and compensatory time. Under the Manual, in the case of certain types of leave, an employee is permitted to carry over unused leave from year to year, up to a maximum number of hours. The Manual further provides that in the case of certain types of leave, the County will make a payment of the value of the employee's accumulated accrued leave amounts to the employee upon the employee's separation from employment, including retirement (collectively, the "Terminal Accrued Leave Payments"). We understand that the County made Terminal Accrued Leave Payments of approximately $32 million in Fiscal Year 2011. The County does not maintain a plan or program under which any accumulated accrued leave is converted by the County to contributions to employee benefit or retirement programs. The County is paying the employer's share of Social Security, Medicare or federal unemployment taxes with respect to the Terminal Accrued Leave Payments.[1]

The County has proposed to establish a plan or program (the "Leave Conversion Plan") under which all or a portion of the employee's accumulated accrued leave is converted by the County to contributions to one or more employee benefit or retirement programs in a manner such that the employee does not include the amounts converted in his or her taxable income and

[1] The employer portion of the Social Security tax is equal to 6.2% of the employee's earnings up to the Social Security Wage Base which is $110,100 in 2012. The employer portion of the Medicare tax is equal to 1.45% of the employee's earnings. The federal unemployment tax paid by an employer currently is equal to 6.0% of the employee's first $7,000 in earnings, subject to a credit for state unemployment taxes.

the County is not required to pay Social Security, Medicare or federal unemployment taxes with respect to such amounts. We understand that the Leave Conversion Plan would apply only to leave that is accrued after the Plan is established in order to ensure that the affected employees do not have constructive receipt of the already accrued leave for federal tax purposes, unless the County is permitted to unilaterally impose the leave conversion on such affected employees.

DISCUSSION

1. If the County establishes a Leave Conversion Plan, what type of employee benefit or retirement plans ("Employee Plans") have been approved by the Internal Revenue Service ("IRS") for the purpose of providing a tax-advantaged benefit to the County's employees?

Short Answer: In revenue rulings and private letter rulings ("PLR's"), the IRS has approved the conversion of accrued leave to contributions to health plans, health reimbursement accounts, Section 457(b) deferred compensation plans and Section 401(a) qualified retirement plans. The key factor is that the accrued leave is converted in a manner in which the employee does not have actual or constructive receipt of a cash payment and the contributions by the employer are treated as nonelective contributions to the respective Employee Plan or Plans. As a result, the employer does not pay Social Security, Medicare or federal unemployment taxes with respect to the converted leave.

Discussion:

In Revenue Ruling 75-539, the IRS addressed two fact patterns under which accumulated sick leave could be applied to the cost of accident and health insurance. In the first fact pattern, a retiring employee has the option to receive a cash payment for accumulated sick leave or have the payment applied to the cost of the health insurance. The ruling concludes that the employee's ability to relinquish the right to the cash payment and have such amount applied to the payment of the health insurance premiums results in constructive receipt of such amount. In the second fact pattern, the employer contributes the accumulated sick leave to an escrow account to pay the health insurance premiums until those amounts are exhausted. The employee cannot elect to receive accumulated sick leave in cash. The ruling concludes that, since the value of the accumulated sick leave is placed in escrow by the employer solely for the payment of the insurance premiums and may not in any event be received in cash by the employee or the employee's dependents, those amounts are not constructively received. In addition, the converted amounts are treated as employer contributions to the employer's health plan and are excludable from the employee's income under Section 106 of the Internal Revenue Code of 1986, as amended (the "Code").

Revenue Ruling 75-539 illustrates the IRS's position with respect to an employer's leave conversion plans that as long as the employee cannot elect to receive any amount in cash and the converted leave is automatically contributed by the employer to an Employee Plan, the employee will not have constructive receipt of the converted leave and the employer's contributions of the converted leave to an Employee Plan sponsored by the employer will be excluded from the employee's taxable income in the same manner and to the same extent as regular employer contributions to such plans.

The IRS has approved the conversion of accrued leave to contributions to health plans, health reimbursement accounts, Section 457(b) deferred compensation plans and Section 401(a) qualified retirement plans. The IRS ruled favorably with respect to leave conversion plan contributions to an employer health insurance plan in Revenue Ruling 75-539, discussed above, and PLR's 200222019 and 200301032. The IRS also ruled favorably with respect to leave conversion plan contributions to health reimbursement accounts in Revenue Ruling 2005-24. In addition, the IRS ruled favorably with respect to leave conversion contributions to Section 457(b) deferred compensation plans and qualified retirement plans in Revenue Ruling 2009-31 and PLR's 200311043, 200301032, 200252095, 200247050, 200222019, 199940043, and 2000027044. It should be noted that under the facts of PLR 200301032 the leave conversion contributions were made to a health plan, a retirement plan and a Section 457(b) plan. Under the facts of PLR 200222019, the leave conversion contributions were made to a health plan or a retirement plan, depending upon several factors concerning the particular retiring employee.

It also should be noted that the tax consequences to the employee of the employer contributions and the benefits subsequently provided to the employee through the employer's contributions will depend on the type of Employee Plan to which the contributions are made.

2. What are the tax consequences if the converted leave is contributed to a health reimbursement account under the Leave Conversion Plan?

Short Answer: Employer contributions to a health or accident plan, including a health reimbursement account, are excluded from the employees' income. The employees do not realize taxable income from the reimbursements paid to them from a health reimbursement account plan ("HRA"). The employer is not obligated to pay Social Security, Medicare or federal unemployment taxes on the contributions to an HRA, or on the reimbursements of medical expenses made to the employees under the HRA. The amount in an HRA can be used to reimburse the former employee and the former employee's spouse and dependents for medical and dental expenses that qualify as tax deductions under Section 213(d) of the Code, which generally include amounts paid for the diagnosis, treatment, or prevention of disease, and for treatments affecting any part or function of the body.

Discussion:

Section 106 of the Code provides that the gross income of an employee does not include employer-provided coverage under an accident or health plan, including an HRA. Section 1.106-1 of the Income Tax Regulations states that the gross income of an employee does not include contributions which the employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by the employee, the employee's spouse or the employee's dependents. The employer may contribute to an accident or health plan either by paying the premium on a policy of accident or health insurance or by contributions to an HRA which provides accident or health benefits directly to one or more employees. The rules under Section 106 apply to former employees as well as active employees.

Benefits provided to an employee from an accident or health plan, including reimbursement from an HRA of medical expenses incurred by the employee, are excluded from the income of the employee under Section 105(b) of the Code.

In general, Social Security, Medicare and federal unemployment taxes are imposed on the wages received by an individual with respect to employment. Under Section 3121(a) of the Code for Social Security and Medicare tax purposes and Section 3306(b) of the Code for federal employment tax purposes, subject to certain exceptions, the term "wages" means "all remuneration for employment."

However, employer contributions to an accident or health plan, including an HRA, are excluded from the definition of wages for purposes of Social Security and Medicare tax under Section 3121(a)(2) of the Code and for purposes of federal unemployment tax under Section 3306(b)(2) of the Code. Therefore, the County would not pay such taxes on the converted leave that is contributed to a County-sponsored HRA.

An HRA can be used to reimburse the former employee and the former employee's spouse and dependents for medical and dental expenses that qualify as tax deductions under Section 213(d) of the Code for medical care, including amounts paid for the diagnosis, treatment, or prevention of disease, and for treatments affecting any part or function of the body. The expenses must be to alleviate or prevent a physical defect or illness. Expenses for solely cosmetic reasons generally are not expenses for medical care. Examples include face lifts, hair transplants, and hair removal (electrolysis). Additionally, expenses that are merely beneficial to one's general health (for example, gym memberships and vacations) are not expenses for medical care. Medicines and drugs obtained with a doctor's prescription are reimbursable, but most medicines and drugs purchased over the counter are not reimbursable.

3. What are the tax consequences if the converted leave is contributed to an employer sponsored Section 401(a) qualified retirement plan or Section 457(b) deferred compensation plan under the Leave Conversion Plan?

Short Answer: Employer contributions to an employer sponsored Section 401(a) plan or Section 457(b) plan are excluded from the employees' income, subject to meeting the limits on contributions that apply to such plans and other applicable tax law requirements. Distributions from such plans to employees generally are treated as taxable income, but do not constitute "wages" for purposes of employment taxes. In general, distributions from such plans prior to age 59 1/2 are subject to a 10% early distribution tax. The employer is not obligated to pay Social Security, Medicare or federal unemployment taxes on the contributions to such plans or on the distributions paid to the employees from such plans.

Discussion:

Under Section 402 of the Code, contributions to an employer sponsored Section 401(a) qualified retirement plan are excluded from the income of the employee. Section 1.402(a)-1 of the Income Tax Regulations provides "If an employer makes a contribution for the benefit of an employee to a trust described in Section 401(a) for the taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under Section 501(a), the employee is not required to include such contribution in his income except for the year or years in which such contribution is distributed or made available to him."

With respect to a Section 457(b) deferred compensation plan, Section 457(g)(1) of the Code requires that all assets and income of the plan must be held in trust for the exclusive benefit of the participants and their beneficiaries. Section 457(g)(2) provides that amounts in such trust are includible in the gross income of participants and beneficiaries only to the extent and at the time provided in Section 457 of the Code. Section 457(a)(1) provides that compensation deferred under an eligible deferred compensation plan (i.e., one that meets the requirements of Section 457(b)) sponsored by a governmental employer is includible in gross income only for the taxable year in which such compensation is paid to the participant or beneficiary. Accordingly, employer contributions to a governmental Section 457(b) plan are excluded from the income of the participants.

With respect to a Section 401(a) plan, in general, distributions from such plans prior to age 59 1/2 are subject to a 10% early distribution tax. In addition, the amount distributed from a Section 457(b) plan is subject to the 10% early distribution tax to the extent that the distribution is attributable to a rollover from a Section 401(a) plan. There are exceptions to such tax for certain payments, including payments made after a separation from service after attaining age 55.

Section 3121(a)(5) of the Code for Social Security and Medicare tax purposes and Section 3306(b)(5) of the Code for federal unemployment tax purposes excludes from the definition of wages contributions to Section 401(a) qualified retirement plans and governmental Section 457(b) plans. Therefore, the County would not pay such taxes on the converted leave that is contributed to a County-sponsored Section 401(a) plan or Section 457(b) plan.

Section 415(c) of the Code imposes a limit on the annual contributions that may be made to a participant's account in a Section 401(a) defined contribution plan. The limit for 2012 is \$50,000. The limit is subject to cost-of-living adjustment each year. Under Section 415(f), if an employer maintains more than one defined contribution plan, the plans are treated as one plan for purposes of applying these contribution limits. This means that if the County established a Section 401(a) defined contribution plan in order to accept contributions of converted leave, the contributions for a participant could not exceed the annual limit. Furthermore, if the participant also has contributions made to the Florida Retirement System's investment plan (which is a defined contribution plan), the amount of the converted leave contributed for such participant to the County's plan combined with the contributions to the FRS plan in the same year could not exceed the limit. Accordingly, the County would be required to coordinate such contributions to its Section 401(a) plan with the contributions to the FRS plan to ensure that the annual limit on contributions is met.

Similarly, under Section 457(b) of the Code, there is a limit on the annual amount of compensation that can be deferred under a Section 457(b) plan. For 2012, the limit is \$17,000. In addition, a participant who is age 50 or older during the year is allowed to contribute a "catch-up" amount, which is \$5,500 for 2012. The annual deferral limit and the catch up limit are subject to a cost-of-living adjustment each year. There also is a special provision applicable to Section 457(b) plans under which a participant who is within three years of normal retirement age can make additional contributions during those three years of up to 2 times the annual limit in order to make up for underutilized deferrals in prior years. This special provision cannot be applied in the same year with the age 50 catch up amount. A participant has a single limit for each year, regardless of the number of Section 457(b) plans in which he or she participates. This means that if the County established a Section 457(b) plan in order to accept contributions of converted leave, such contributions for a participant would be combined with the deferrals made by such participant to other Section 457(b) plans for purposes of satisfying the annual limit. Thus, a participant's deferrals to an existing Section 457(b) plan of the County or another employer would reduce the amount of the converted leave that could be contributed to a Section 457(b) plan established for purposes of the Leave Conversion Plan.

4. Are there any advantages or disadvantages to the County or the employees with respect to the type of Employee Plan to which the employer contributes the converted leave under the Leave Conversion Plan?

Short Answer: The leave conversion plan does not provide for employee elections with respect to the payment or conversion of the accumulated leave in order to avoid constructive receipt. Moreover, the converted leave is contributed by the employer to an Employee Plan which results in the exclusion from income for the employees with respect to the employer contributions. This structure allows the employee to avoid having taxable income from the converted leave and eliminates the employer's liability for Social Security, Medicare and federal unemployment taxes. In our view, there would not be an advantage or disadvantage among the Employee Plans that would serve this purpose.

Discussion:

It appears that there are no advantages or disadvantages with respect to the types of Employee Plans to which the County can contribute the converted leave under the Leave Conversion Plan. Specifically with respect to federal tax law, the County should contribute the converted leave to an Employee Plan that allows the employee to avoid having taxable income from the converted leave. In the case of a contribution to a retirement plan, as discussed above, the contribution is not gross income to the employee and the income deferral continues until the employee receives a distribution from the retirement plan. In the case of a contribution to an HRA, as discussed above, the contribution is excluded from the employee's income and the reimbursements of medical expenses received are also excluded from the employee's income.

It should be noted that the Leave Conversion Plan can be structured to make contributions of converted leave up to a certain amount to one type of Employee Plan, and then make contributions of the remaining leave, if any, to one or more other plans. Under the facts of PLR 200301032, the employer's leave conversion plan first applied the converted leave to provide for the payment of anticipated premiums payable by the employee under the employer's post-employment health plan until the employee reached age 65. Any remaining converted leave was then contributed by the employer to its retirement plan on behalf of the employee up to the applicable contribution limit. If any converted leave remained after such contribution, the employer used such remaining amount to make a contribution to the employer's Section 457(b) plan up to the applicable contribution limit. The determination of the contribution amounts was made by the employer pursuant to the terms of the leave conversion plan and the employee had no election or option with respect to the application of the converted leave. The IRS ruled that the employer's contributions under the leave conversion plan were not included in the gross income of the employees.

The Leave Conversion Plan also can be structured to give the employer some discretion to choose between Employee Plans. In PLR 200222019, the employer had to determine whether to contribute the converted leave to a health plan or a qualified retirement plan after taking into consideration certain factors concerning the particular employee.

Therefore, a properly structured Leave Conversion Plan does not have to be tied to only one Employee Plan. Rather, it appears that the Leave Conversion Plan could be structured to have some flexibility with respect to the way that the employee will benefit.

5. Does the IRS require that the alternatives under the Leave Conversion Plan be structured in a certain manner? For example, does the Leave Conversion Plan have to require a fixed percentage of the converted leave to be contributed to a specific Employee Plan?

Short Answer: The IRS allows some flexibility in the structuring of the Leave Conversion Plan as long as certain principles are followed. In order to avoid constructive receipt: (i) the employee may not have the ability to elect between receiving a cash payment for the accrued leave and having the converted leave contributed to an Employee Plan; and (ii) the employee may not have the ability to elect among the types of benefits which will be provided with the contributions of the converted leave under the Leave Conversion Plan. . The Leave Conversion Plan can apply to all or any portion or percentage of the employee's accumulated leave. In addition, the employee's accrued leave can be converted at any time, i.e., the conversion can take place prior to the employee's termination from employment. The Leave Conversion Plan also can provide for the payment to the employee of the accrued leave in excess of the amount that can be converted under the terms of the Leave Conversion Plan.

Discussion:

The IRS has established certain principles that must be followed in order for the converted leave not to be constructively received by the employees. Those principles can be summarized as follows: (i) the employee may not have the ability to elect between receiving a cash payment for the accrued leave and having the converted leave contributed to an Employee Plan; and (ii) the employee may not have the ability to elect among the types of benefits which will be provided with the contributions of the converted leave under the Leave Conversion Plan.

With respect to whether the Leave Conversion Plan can apply to all or a portion or a percentage of the employee's accumulated leave, the IRS rulings appear to allow great flexibility in structuring the plan. In one of the fact patterns in Revenue Ruling 75-539, the leave conversion plan provided that the value of 75% of the retiring employee's accumulated sick leave credits would be placed in an escrow account to pay premiums for health insurance until such account is fully expended. In PLR 200027044, the leave conversion plan provided that 100% of the retiring employee's unused sick leave would be converted to a contribution to the employer's defined benefit plan. In PLR 200301032, the leave conversion plan provided for 100% of the employee's accumulated leave to be converted to contributions to the employer's post-retirement health plan, Section 403(b) plan and Section 457(b) plan. The portion of the leave contributed to the health plan was the lesser of the amount of the converted leave and the premiums anticipated to be paid by the employee for coverage until age 65. If after the contribution to the health plan any converted leave remained, the employer contributed to the Section 403(b) plan the lesser of the amount of remaining converted leave and the maximum amount that could be contributed to the Section 403(b) plan. If after the contribution to the Section 403(b) plan any converted leave remained, the employer contributed to the Section 457(b) plan the lesser of the amount of remaining converted leave and the maximum amount that could be contributed to the Section

457(b) plan. The IRS's position in these rulings appears to allow for substantial flexibility in structuring the Leave Conversion Plan.

Although most of the IRS rulings on leave conversion plans involve plans that convert accumulated leave upon the employee's retirement or other termination of employment, there are some IRS rulings in which the accumulated leave was converted on a date on which the employee was still actively employed. For example, in PLR 199940043, the leave conversion plan provided for the contribution of unused leave at the end of each year to the employer's Section 401(a) plan.

The IRS also has ruled that the part of the employee's accumulated leave that is not contributed under the leave conversion plan can be paid in cash to the employee without adversely affecting the tax consequences of the contribution of the converted leave. In Revenue Ruling 2009-31, the IRS clearly allowed the leave that was in excess of the amount converted under the leave conversion plan to be paid to the employee. Under the facts of Situation 1 in Revenue Ruling 2009-31, the employer's paid time off plan did not permit the carryover of unused time. The employer established an unused PTO conversion plan that provided for the unused time at the end of every year to be applied to a contribution to the employer's Section 401(a) plan. To the extent that the unused time exceeded the maximum amount that was permitted to be contributed to the Section 401(a) plan, the remaining unused time would be paid to the employee.

Leave accrued after the commencement date of the Leave Conversion Plan can be contributed to an Employee Plan as a nonelective employer contribution without tax consequences to the employee. However, with regard to leave that is accrued prior to the date of adoption of the Leave Conversion Plan by the County and is payable upon termination of employment in accordance with the Manual, such accrued leave can be converted under the Leave Conversion Plan into a contribution to an Employee Plan without tax consequences to the employee only if the County has the unilateral right to convert such leave into a nonelective contribution to an Employee Plan. If the conversion of such accrued leave requires the election or the consent of the employee, then the IRS's position is that the employee will have taxable income as a result of such conversion. We are not providing any advice hereunder whether or not the County has the unilateral right to apply the Leave Conversion Plan to leave accrued by any employee prior to the date of adoption of the Leave Conversion Plan.

6. Are there any mandatory eligibility requirements or other restrictions that would apply to the Leave Conversion Plan?

Answer: There are no mandatory eligibility requirements or other restrictions that would apply to the Leave Conversion Plan under federal tax law or applicable Florida law. Therefore, the County has discretion to establish the eligibility for the Leave Conversion Plan. This means, for example, that the County could allow a certain unit of collectively bargained employees to participate while excluding another unit. Similarly, the County could provide eligibility for the employees of certain departments while excluding the employees working in one or more other departments. It should be noted that we are not addressing whether any collective bargaining agreement would require the County to provide eligibility for a group of bargained employees.

We also note that the nondiscrimination rules of Section 105(h) of the Code would be applicable to an HRA established by the County. Under Section 105(h), the County is prohibited from discriminating in favor of highly compensated individuals as to eligibility to participate in an HRA. This means that if the County establishes an HRA to which the County would make contributions of converted leave, the County would need to satisfy the nondiscrimination rules applicable under Section 105(h). We also note that the County is **not** subject to the eligibility rules imposed under Section 401(a) with respect to a qualified retirement plan.

7. What is the effect for tax purposes if the Leave Conversion Plan allows the employee to elect to receive a cash payment for a part of the employee's accumulated leave or to otherwise affect how the accumulated leave is used?

Answer: Based on the IRS revenue rulings and private letter rulings referenced in this letter, the IRS has consistently expressed the position that an employee will have constructive receipt of his or her unused leave if the employee has an election or option to receive a cash payment of the unused leave.

Furthermore, it appears that in order to avoid constructive receipt, the employer, rather than the employee, should choose the Employee Plan to which the converted leave will be contributed. The facts in the rulings generally have stated that the employer, in accordance with the terms of the leave conversion plan, automatically contributes the converted leave to the Employee Plan and the employee has no ability to affect the choice of the Employee Plan. However, we found some exceptions to this rule. In PLR 200311043, the employee had a choice of having unused vacation time at the end of each year permanently forfeited or contributed to a qualified retirement plan. It is not clear from the facts why an employee would not elect to avoid the forfeiture of the vacation time by electing to have the contribution to the plan. The IRS ruled that the employee's election did not result in constructive receipt because the employee did not have the option to receive cash or another taxable benefit. Additionally, in a situation not involving a leave conversion plan, in PLR 200914018, employee's were permitted to make a one-time irrevocable election when he commenced employment to receive an increase in base salary or retiree health benefits. Based on these rulings, the IRS may accept a properly structured election by the employees with respect to the type of Employee Plan, provided that the Employee Plans provide a nontaxable benefit only.

8. If the County's Leave Conversion Plan provided for a contribution of the converted leave to a health reimbursement account for the employee, can the unused account balance be paid to a beneficiary upon the employee's death?

Answer: As discussed above in this letter, benefits provided to an employee from an accident or health plan, including reimbursement under an HRA of medical expenses incurred by the employee, are excluded from the income of the employee under Section 105(b) of the Code. **However, the IRS's position is that the payment of a death benefit from an HRA is inconsistent with the requirements of Section 105(b).**

IRS Notice 2002-45, which describes the tax treatment of health reimbursement accounts, specifically states that arrangements providing for the payment of a death benefit without regard to medical care expenses do not qualify for tax-favored treatment. In addition, IRS Revenue Ruling 2005-24 describes four situations involving a medical reimbursement plan to which the employer makes contributions of converted leave. In Situation 3, the plan provides for the payment of a death benefit equal to the unused reimbursement amount in the employee's account upon his death. The IRS stated that Section 105(b) does not apply to amounts that the employee would be entitled to receive irrespective of whether or not the employee incurs expenses for medical care and, as a result, **none of the payments** under such a plan are excludable from gross income under Section 105(b) regardless of whether the payments are made to reimburse medical expenses. Therefore, if the HRA established by the County under the Leave Conversion Plan provides for the payment of a death benefit of all or a portion of the unused reimbursement amount, all payments from the HRA to the employee, his spouse, the employee's dependents or any beneficiaries would be taxable. In order to avoid such tax consequences, the HRA would have to provide for the forfeiture of the employee's unused reimbursement amount at the time that the unused reimbursement amount can no longer be used to reimburse medical expenses for the employee, his spouse or his dependents. We note that a Section 401(a) defined contribution plan is permitted to pay a benefit upon the participant's death to the participant's designated beneficiary. The death benefit is equal to the balance in the participant's account in the plan.

9. What are the County's administrative, record keeping and reporting requirements with respect to the Leave Conversion Plan?

Answer: The Leave Conversion Plan would be an amendment of the County's current leave policy as provided in the County's Leave Manual. Under the Manual, under certain circumstances, an employee is entitled to a payment of accumulated leave upon separation from employment. After an amendment to the County's policy to incorporate the Leave Conversion Plan, in lieu of a cash payment to the employee upon termination of employment, the County would convert the applicable amount to a contribution to a plan, such as a health reimbursement arrangement. From an administrative standpoint, the County's responsibilities with respect to the leave conversion and contribution to the Employee Plan likely would be similar to the current policy of making a payment to the employee. The amount of the accumulated leave still would have to be calculated by the County and instead of processing a payment of the leave to the employee, the County then would process a payment to the Employee Plan.

The County may have new administrative responsibilities if a new Employee Plan is established in connection with the Leave Conversion Plan. For example, if the County establishes a medical reimbursement plan which uses individual health reimbursement account arrangements, there will be new record keeping, processing and reporting requirements with respect to such Employee Plan.

The County should be able to outsource the administrative responsibilities for a new Employee Plan to a third party administrator ("TPA"). While the County is not able to shift the federal tax liabilities to the TPA, the County can be protected from the TPA's errors and omissions through indemnification and other contractual provisions.

In the event that record keeping errors occur and employees receive payments of accumulated leave that should have been converted and contributed to an Employee Plan, it is not likely that the IRS would treat the leave as constructively received by all of the employees who are eligible under the Leave Conversion Plan. Unless the errors were part of a systematic intentional disregard for the terms of the Leave Conversion Plan, the IRS likely would allow the County to continue the favorable tax treatment of the Leave Conversion Plan. It should be noted that in a situation where the County fails to withhold income or employment taxes in accordance with federal tax law, the County is liable for such withholding, together with interest and applicable penalties.

The County is not required to report the amount of the converted leave on the employee's Form W-2. However, as a result of the Patient Protection and Affordable Care Act, the contribution of the converted leave made by the County to a health plan must be reported on Form W-2 even though it is not included in the employee's income. The cost of employer-sponsored health care must be reported using Code DD in Box 12 of Form W-2. This would include a contribution of converted leave to an HRA. Additionally, contributions to a Section 457(b) plan, including a contribution of converted leave, must be reported using Code G in Box 12 of Form W-2. Contributions to a Section 401(a) plan, including a contribution of converted leave, would not have to be reported on Form W-2.

This letter is based as to matters of law solely on (i) the Internal Revenue Code of 1986, as amended and (ii) the laws of the State of Florida.

Our advice on each legal issue addressed herein represents our view concerning how that issue would be resolved were it to be considered by the highest court of the jurisdiction upon whose law our opinion on that issue is based. The manner in which any particular issue would be treated in any actual court case would depend on the facts and circumstances particular to the case, and our opinions are not a guaranty of any particular outcome.

This letter speaks as of the date hereof. We disclaim any obligation to provide you with any subsequent opinion or advice by reason of any future changes or events which may affect or alter any opinion rendered herein.

This letter is being delivered to you for your exclusive benefit in connection with the matters addressed herein and may not be relied upon by you for any other purpose. The County may rely upon our opinion to the same extent as if it were originally addressed to the County. This letter may not be relied upon by, furnished to, referred to, quoted, in whole or part, by, or filed with, any other person without our prior written consent. Furthermore, this letter should not be considered to be advice to any employee of the County.

Very truly yours,

HOLLAND & KNIGHT LLP

Holland & Knight L.L.P.

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EXHIBIT 2

HISTORICAL ILLUSTRATION OF TAX SAVINGS

Miami-Dade County Tax-Advantaged Plan Analysis
Terminal Leave Payouts for Employees Retiring at age 55 or older
$50,000 Cap on Contributions

CURR STATUS	
AGE AT PAYOUT	

	2009			
BARG2	Sick Leave	Sick to Plan*	Social Security Tax Savings	Medicare Tax Savings
A	$107,648	$107,648	$6,674	$1,561
C	$904,932	$659,696	$40,901	$9,566
D	$138,903	$138,903	$8,612	$2,014
E	$1,482,052	$1,164,890	$72,223	$16,891
F	$205,297	$196,203	$12,165	$2,845
G	$100,333	$100,333	$6,221	$1,455
H	$854,934	$837,126	$51,902	$12,138
K	$1,586,363	$1,402,374	$86,947	$20,334
L - M	$1,940,244	$1,469,586	$91,114	$21,309
L - NM	$407,420	$282,421	$17,510	$4,095
M	$282,283	$282,283	$17,502	$4,093
P	$511,435	$250,000	$15,500	$3,625
Grand Total	$8,521,844	$6,891,463	$427,271	$99,926

CURR STATUS	
AGE AT PAYOUT	

	2010			
BARG2	Sick Leave	Sick to Plan*	Social Security Tax Savings	Medicare Tax Savings
A	$221,761	$221,761	$13,749	$3,216
C	$1,029,652	$815,855	$50,583	$11,830
D	$168,791	$168,639	$10,456	$2,445
E	$1,825,519	$1,597,383	$99,038	$23,162
F	$132,913	$132,913	$8,241	$1,927
G	$172,637	$172,637	$10,703	$2,503
H	$991,926	$965,560	$59,865	$14,001
K	$2,084,742	$1,743,080	$108,071	$25,275
L - M	$3,286,719	$2,133,607	$132,284	$30,937
L - NM	$733,643	$190,651	$11,820	$2,764
M	$311,167	$311,167	$19,292	$4,512
P	$228,439	$164,791	$10,217	$2,389
Grand Total	$11,187,909	$8,618,044	$534,319	$124,962

CURR STATUS	
AGE AT PAYOUT	

	2011			
BARG2	Sick Leave	Sick to Plan*	Social Security Tax Savings	Medicare Tax Savings
A	$176,149	$176,149	$10,921	$2,554
C	$1,830,532	$1,393,604	$86,403	$20,207
D	$226,199	$226,195	$14,024	$3,280
E	$3,519,412	$2,608,194	$161,708	$37,819
F	$143,715	$143,715	$8,910	$2,084
G	$148,273	$148,273	$9,193	$2,150
H	$1,188,949	$1,102,047	$68,327	$15,980
K	$1,842,295	$1,668,692	$103,459	$24,196
L - M	$3,682,909	$2,085,071	$129,274	$30,234
L - NM	$593,731	$243,305	$15,085	$3,528
M	$541,487	$495,648	$30,730	$7,187
P	$238,094	$172,887	$10,719	$2,507
Grand Total	$14,131,744	$10,463,780	$648,754	$151,725

*The contribution rate for each employee capped at $50,000 with no reductions.

Miami-Dade County Tax Advantaged Plan Analysis
All Employees Age 55 and Older
$50,000 Cap on Contributions

CURR STATUS	
AGE AT PAYOUT	

	2009			
BARG2	Sick Leave	Sick to Plan*	Social Security Tax Savings	Medicare Tax Savings
A	$183,368	$167,958	$10,413	$2,435
C	$904,932	$659,696	$40,901	$9,566
D	$139,639	$138,903	$8,612	$2,014
E	$1,482,052	$1,164,890	$72,223	$16,891
F	$205,297	$196,203	$12,165	$2,845
G	$100,333	$100,333	$6,221	$1,455
H	$895,129	$859,637	$53,298	$12,465
K	$1,645,521	$1,429,191	$88,610	$20,723
L - M	$2,010,236	$1,496,239	$92,767	$21,695
L - NM	$407,420	$282,421	$17,510	$4,095
M	$282,963	$282,963	$17,544	$4,103
P	$511,435	$250,000	$15,500	$3,625
Grand Total	$8,768,323	$7,028,435	$435,763	$101,912

CURR STATUS	
AGE AT PAYOUT	

	2010			
BARG2	Sick Leave	Sick to Plan*	Social Security Tax Savings	Medicare Tax Savings
A	$232,259	$221,761	$13,749	$3,216
C	$1,029,652	$815,855	$50,583	$11,830
D	$173,128	$172,976	$10,725	$2,508
E	$1,877,031	$1,597,383	$99,038	$23,162
F	$132,913	$132,913	$8,241	$1,927
G	$173,240	$172,637	$10,703	$2,503
H	$1,005,595	$976,023	$60,513	$14,152
K	$2,102,971	$1,756,399	$108,897	$25,468
L - M	$3,338,719	$2,185,058	$135,474	$31,683
L - NM	$733,643	$190,651	$11,820	$2,764
M	$311,553	$311,553	$19,316	$4,518
P	$228,439	$164,791	$10,217	$2,389
Grand Total	$11,339,142	$8,698,000	$539,276	$126,121

CURR STATUS	
AGE AT PAYOUT	

	2011			
BARG2	Sick Leave	Sick to Plan*	Social Security Tax Savings	Medicare Tax Savings
A	$195,774	$195,691	$12,133	$2,838
C	$1,830,532	$1,393,604	$86,403	$20,207
D	$226,199	$226,195	$14,024	$3,280
E	$3,534,660	$2,608,194	$161,708	$37,819
F	$143,715	$143,715	$8,910	$2,084
G	$148,348	$148,273	$9,193	$2,150
H	$1,196,726	$1,109,637	$68,798	$16,090
K	$1,842,525	$1,668,852	$103,469	$24,198
L - M	$3,865,893	$2,135,071	$132,374	$30,959
L - NM	$615,507	$265,081	$16,435	$3,844
M	$544,575	$498,736	$30,922	$7,232
P	$238,094	$172,887	$10,719	$2,507
Grand Total	$14,382,547	$10,565,936	$655,088	$153,206

*The contribution rate for each employee capped at $50,000 with no reductions.

Miami-Dade Leave Management Tax Analysis
All Employees with Terminal Leave Payments
$50,000 Cap on Contributions

	2009						
BARG2	Total Expense	Annual Leave	Sick Leave	Holiday/Comp	Eligible Expense*	Soc Sec'y Tax Savings	Medicare Tax Savings
A	$354,025	$169,100	$183,368	$1,557	$342,653	$19,373	$4,968
C	$2,502,197	$672,649	$1,167,527	$662,020	$1,678,823	$102,125	$24,343
D	$345,604	$187,469	$139,639	$18,496	$345,604	$19,001	$5,011
E	$5,085,568	$1,620,727	$2,961,100	$503,741	$4,104,815	$252,082	$59,520
F	$336,558	$119,551	$205,297	$11,709	$327,464	$19,739	$4,748
G	$192,511	$81,323	$103,528	$7,659	$192,511	$11,649	$2,791
H	$1,766,150	$788,257	$928,338	$49,555	$1,748,342	$97,044	$25,351
K	$3,241,564	$1,279,869	$1,724,472	$237,223	$2,809,033	$171,335	$40,731
L - M	$4,782,292	$1,562,574	$2,686,374	$533,344	$3,138,887	$193,447	$45,514
L - NM	$1,054,650	$556,495	$486,973	$11,181	$812,861	$49,790	$11,786
M	$733,562	$411,286	$286,017	$36,259	$724,024	$43,657	$10,498
P	$975,153	$206,938	$580,200	$188,015	$533,068	$32,599	$7,729
Grand Total	$21,369,832	$7,656,239	$11,452,833	$2,260,760	$16,758,084	$1,011,841	$242,992

	2010						
BARG2	Total Expense	Annual Leave	Sick Leave	Holiday/Comp	Eligible Expense*	FICA Savings	MICA Savings
A	$505,211	$256,776	$232,423	$16,012	$505,211	$29,055	$7,326
C	$2,561,692	$427,221	$1,367,381	$767,089	$1,740,380	$105,277	$25,236
D	$404,068	$203,861	$179,258	$20,950	$403,534	$22,350	$5,851
E	$5,051,242	$1,504,772	$2,990,811	$555,658	$4,104,647	$246,226	$59,517
F	$201,026	$55,441	$138,607	$6,978	$201,026	$11,932	$2,915
G	$291,839	$87,898	$173,292	$30,648	$291,839	$16,951	$4,232
H	$2,150,786	$1,066,570	$1,029,204	$55,012	$2,085,040	$118,587	$30,233
K	$4,071,692	$1,507,730	$2,214,222	$349,740	$3,460,684	$210,788	$50,180
L - M	$6,377,389	$1,830,191	$3,701,724	$845,474	$4,069,985	$249,867	$59,016
L - NM	$1,221,214	$405,366	$801,721	$14,127	$553,971	$33,588	$8,033
M	$640,541	$283,469	$315,869	$41,203	$620,176	$36,018	$8,993
P	$881,992	$254,904	$590,482	$36,606	$654,454	$38,421	$9,490
Grand Total	$24,358,691	$7,884,201	$13,734,992	$2,739,498	$18,690,946	$1,119,059	$271,019

	2011						
BARG2	Total Expense	Annual Leave	Sick Leave	Holiday/Comp	Eligible Expense*	FICA Savings	MICA Savings
A	$650,412	$409,697	$220,695	$20,020	$650,412	$37,641	$9,431
C	$3,500,219	$403,128	$2,049,691	$1,047,401	$2,134,092	$129,468	$30,944
D	$600,387	$343,885	$226,199	$30,304	$600,387	$34,699	$8,706
E	$8,601,505	$1,852,221	$5,813,076	$936,209	$6,362,551	$381,328	$92,257
F	$424,756	$210,057	$192,790	$21,909	$408,562	$24,865	$5,924
G	$466,095	$249,449	$176,021	$40,625	$466,095	$28,131	$6,758
H	$2,716,848	$1,419,649	$1,217,122	$80,076	$2,577,944	$145,501	$37,380
K	$3,792,484	$1,646,951	$1,842,525	$303,008	$3,455,293	$206,880	$50,102
L - M	$7,984,250	$2,251,990	$4,549,433	$1,182,827	$4,175,335	$255,882	$60,542
L - NM	$1,125,627	$337,185	$783,101	$5,341	$650,673	$39,633	$9,435
M	$1,284,728	$675,002	$547,733	$61,993	$1,194,620	$71,136	$17,322
P	$1,093,285	$459,743	$533,342	$100,200	$884,128	$51,676	$12,820
Grand Total	$32,240,598	$10,258,956	$18,151,729	$3,829,912	$23,560,093	$1,406,840	$341,621

*The contribution rate for each employee capped at $50,000 with no reductions.