

Privileged and Confidential

MEMORANDUM

TO Douglas S. Cleland, Township Manager

FROM John P. McLaughlin, Esquire
Brian M. Pinheiro, Esquire
Jonathan M. Calpas, Esquire

DATE March 21, 2012

RE Employer Nonelective Contributions to a Section 457 Deferred Compensation Plan

.....

At a recent Lower Merion Township Board of Commissioners meeting, the legality of nonelective employer contributions made by Lower Merion Township (the “Township”) to its Section 457 deferred compensation plan was questioned. You asked us to determine whether such contributions are permissible under the Fiscal Code of the Commonwealth of Pennsylvania (the “Commonwealth”).

As provided in greater detail below, we believe that Section 8.2 of the Fiscal Code¹ provides a political subdivision of the Commonwealth that maintains a Section 457 deferred compensation plan, such as the Township, with the ability to make nonelective employer contributions to such plan. For the reasons set forth below, we believe that neither Section 8.1 of the Fiscal Code² nor the *Schuylkill Haven Borough v. Schuylkill Haven Police Officers Association*³ decision apply in the context of nonelective employer contributions to a Section 457 deferred compensation plan.

Section 8.2 of the Fiscal Code. Section 8.2(a) of the Fiscal Code provides that the Commonwealth and any political subdivision or municipal authority thereof may establish eligible deferred compensation plans pursuant to Section 457 of the Internal Revenue Code of 1986 (the “IRC”). Section 8.2(e)(5) of the Fiscal Code specifically provides that “[a]ll deferred compensation plans shall be administered in compliance with section 457 and any other provisions of the [IRC] and applicable to the plans.” The Treasury regulations issued under Section 457 authorize employers to

¹ Section 8.2 of the Fiscal Code is codified at 72 P.S. § 4521.2.

² Section 8.1 of the Fiscal Code is codified at 72 P.S. § 4521.1.

³ 914 A.2d 936 (Pa. Commw. Ct. 2006).

make nonelective employer contributions to a Section 457 deferred compensation plan.⁴ Section 8.2 of the Fiscal Code does not expressly restrict the ability of political subdivisions of the Commonwealth to make nonelective employer contributions to Section 457 deferred compensation plans.

Yet, Section 8.2(g) of the Fiscal Code specifically limits the ability of the *Commonwealth* to make employer contributions to *its* deferred compensation program. Despite the broad application of Section 8.2 of the Fiscal Code to the Commonwealth, the State Employees' Retirement Board, political subdivisions of the Commonwealth *and* municipal authorities of the Commonwealth,⁵ the prohibition against employer contributions seems only to apply to the *Commonwealth's* deferred compensation plan. Therefore, this Section 8.2(g) prohibition should not affect the Section 457 deferred compensation plans maintained by political subdivisions of the Commonwealth, including the Township. It is a widely accepted principle of statutory interpretation that where a legislative body includes particular language in one section of a statute but omits it in another, there is a general presumption that the legislative body has acted intentionally and purposely with respect to such inclusion or exclusion. Based on our reading of Section 8.2 of the Fiscal Code, the Pennsylvania General Assembly provides each political subdivision of the Commonwealth with the ability to structure its own affairs with respect to deferred compensation plans. Thus, for example, some political subdivisions may wish to provide a more generous deferred compensation plan (*e.g.*, which may include a nonelective employer contribution) in conjunction with a less generous defined benefit plan, while other political subdivisions may choose the converse.

Section 8.1 of the Fiscal Code. Section 8.1(a) of the Fiscal Code provides that the governing body of a political subdivision may, by contract, agree with any employee to defer a portion of such employee's compensation. Curiously, Section 8.1 and 8.2 of the Fiscal Code both address deferred compensation plans, yet they were added to the Fiscal Code some 13 years apart.⁶ However, unlike Section 8.2 of the Fiscal Code, Section 8.1 of the Fiscal Code only addresses employee contributions to a deferred compensation plan and makes no reference to employer contributions to a deferred compensation arrangement or to Section 457. We believe this divergence can be explained through the timing of regulatory and legislative activity in the Federal government with respect to deferred compensation plans. Prior to the late 1970s, political subdivisions had significant freedom in structuring deferred compensation plans. However, this freedom was significantly curtailed by the Revenue Act of 1978 which added Section 457 to the IRC. Section 457 was further modified in the Tax Equity and Fiscal Responsibility Act of 1982 and the Tax Reform Act of 1986, the latter of which disallowed 401(k) plans for local government entities unless such a plan was in place before May 6, 1986. Based on the specific application of Section 8.2 to Section 457 deferred compensation plans, we believe that Section 8.1 applies to other types of deferred compensation plans (*i.e.*, non-Section 457 deferred compensation plans, such as 401(k) plans).

⁴ Treas. Reg. § 1.457-2(b) (defining the term "annual deferral" as "the amount of compensation deferred under an eligible plan, whether by salary reduction or by nonelective employer contribution").

⁵ Permutations of language that collectively reference the (i) Commonwealth and/or State Employees' Retirement Board; (ii) political subdivisions of the Commonwealth; and (iii) municipal authorities of the Commonwealth are used approximately 17 times throughout Section 8.2 of the Fiscal Code.

⁶ Section 8.1 was added to the Fiscal Code in 1974 and amended in 1982. Section 8.2 was added to the Fiscal Code in 1987 and amended in 1998.

Schuylkill Haven Borough v. Schuylkill Haven Police Officers Association. At issue in *Schuylkill Haven* was the permissibility of employer matching contributions to a deferred compensation plan, which took the form of a 401(k) plan.⁷ Ultimately, the court held that employer matching contributions to this 401(k) plan were impermissible pursuant to Section 8.1(a) of the Fiscal Code and Sections 1006(6) and 1125 of the Borough Code⁸ because such contributions were not explicitly authorized.⁹ Nowhere in *Schuylkill Haven* does the Commonwealth Court make a single reference to Section 8.2 of the Fiscal Code. Therefore, because *Schuylkill Haven* did not implicate a Section 457 deferred compensation plan and never addressed the application of Section 8.2 of the Fiscal Code, we believe that the holding of *Schuylkill Haven* can be limited to plans governed under Section 8.1 of the Fiscal Code. Unlike the 401(k) plan that was subject to Section 8.1 of the Fiscal Code in *Schuylkill Haven*, the Township's Section 457 deferred compensation plan is maintained pursuant to Section 8.2 of the Fiscal Code.

Conclusion. Based on our interpretation of Sections 8.1 and 8.2 of the Fiscal Code and our reading of *Schuylkill Haven*, we believe that the nonelective employer contributions made by the Township to its Section 457 deferred compensation plan are permissible under Section 8.2 of the Fiscal Code.

JMC/jmc
Enclosures

⁷ *Schuylkill Haven*, 914 A.2d 936, 938 (Pa. Commw. Ct. 2006).

⁸ Sections 1006(6) and 1125 of the Borough Code are codified at 53 P.S. §§ 46006(6) and 46125, respectively.

⁹ *Schuylkill Haven*, 914 A.2d 936, 940 (Pa. Commw. Ct. 2006).