Internal Revenue Service

200024057

Department of the Treasury

Washington, DC 20224

U.I.L. 414.09-00

Contact Person:

Telephone Number:

In reference to:

TEP:RA:T2/5002313

MAR 22 2000

Attn:

Legend

Statute P =

Statute Q =

Bill S =
State A =
Plan X =
Plan Y =
Employer M =
Resolution N =
Form A =

Group N Employees =

Dear

This is in response to a ruling request dated November 3, 1999, as supplemented by correspondence dated March 2, 2000, submitted on your behalf by your authorized representative, concerning the federal income tax treatment, under section 414(h)(2) of the Internal Revenue Code ("Code"), of certain contributions to Plan X and Plan Y.

The following facts and representations have been submitted by your authorized representative:

You represent that State A has established various pension plans that are qualified under section 401(a) of the Code, including Plan X and Plan Y. Employer M is a component unit political subdivision in State A and currently participates in Plan X and Plan Y. In 1988, the State A General Assembly enacted legislation which permits employers to "pick-up"

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mandatory employee contributions paid to Plan X and Plan Y so that these contributions may be exempt from federal tax under section 414(h) of the Code.

Bill S, which was passed by the State A General Assembly and signed into law by the Governor of State A in 1999, opened participation in the contributory pension benefit feature of Plan X and Plan Y to all governmental units that offer Plan X and Plan Y benefits to their personnel, including Employer M.

Pursuant to Form A dated July 8, 1999, Employer M irrevocably elected, effective September 1, 1999, to begin participating in Plan X and Plan Y in accordance with Statute P and Statute Q for the benefit of the Group N Employees. To effectuate its participation in the contributory pension benefit feature of Plan X and Plan Y, Employer M adopted Resolution N on July 8, 1999. Resolution N provides that Employer M shall pick-up the mandatory retirement contribution required to be made by the Group N Employees and will consider this amount as an employer contribution for Federal tax purposes only and therefore no Group N Employee will have access to these funds. Furthermore, the Group N Employee contributions will be paid by Employer M in lieu of such contributions being paid by the Group N Employee. The Group N Employee will not have the option of receiving the pick-up contribution in cash instead of having the contributions paid to Plan X or Plan Y.

Based on the aforementioned facts, you request the following rulings:

1. The amounts picked up by Employer M on behalf of the Group N Employees shall not be considered gross income to the Group N Employees on whose behalf the pick up is made.

2. The employee contributions picked up by Employer M, although designated as employee contributions, are treated as employer contributions for federal income tax purposes, where Employer M picks up these contributions through a reduction in salary.

3. The amounts picked up by Employer M are treated as employer contributions and will not constitute wages under section 3401(a)(12)(A) of the Code for federal income tax withholding purposes.

4. The above rulings apply whether the pick up is made through a reduction in salary, through an offset against future salary increases, or a combination of both.

Section 414(h)(2) of the Code provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if such contributions are made to a plan determined to be qualified under section 401(a), established by a state government or a political subdivision thereof, and are picked up by the employing unit.

The federal income tax treatment to be accorded contributions which are picked up by the employer within the meaning of section 414(h)(2) of the Code is specified in Revenue Ruling 77-462, 1977-2 C.B. 358. In that revenue ruling, the employer school district agreed to assume and pay the amounts employees were required by state law to contribute to a state pension plan. Revenue Ruling 77-462 concluded that the school district's picked-up contributions to the plan are excluded from the employees' gross income until such time as they are distributed to the employees. The revenue ruling held further that under the provisions of section 3401(a)(12)(A) of the Code, the school district's contributions to the plan are excluded from wages for purposes of the Collection of Income Tax at Source on Wages; therefore, no withholding is required from the employees' salaries with respect to such picked-up contributions.

The issue of whether contributions have been picked up by an employer within the meaning of section 414(h)(2) of the Code is addressed in Revenue Ruling 81-35, 1981-1 C.B. 255, and Revenue Ruling 81-36, 1981-1 C.B. 255. These revenue rulings established that the following two criteria must be met: (1) the employer must specify that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee; and (2) the employee must not be given the option of choosing to receive the contributed amounts directly instead of having them paid by the employer to the pension plan.

In Revenue Ruling 87-10, 1987-1 C.B. 136, the Internal Revenue Service considered whether contributions designated as employee contributions to a governmental plan are excludable from the gross income of the employee. The Service concluded that to satisfy the criteria set forth in Revenue Rulings 81-35 and 81-36 with respect to particular contributions, the required specification of designated employee contributions must be completed before the period to which such contributions relate.

In this request, Resolution N satisfies the criteria set forth in Rev. Rul. 81-35 and Rev. Rul. 81-36, by providing, in effect that Employer M will pick up the mandatory retirement contributions required to be made by the Group N Employees to Plan X and Plan Y in lieu of such contributions being paid by the Group N Employees. Under Resolution N, the Group N Employees participating in Plan X and Plan Y will not have access to these contributions and will not have the option of receiving the contributions in cash in stead of having such contributions paid to Plan X and Plan Y.

Accordingly, we conclude with respect to ruling requests numbers 1, 2, 3 and 4 that the amounts picked up by Employer M on behalf of the Group N Employees who participate in Plan X and Plan Y shall be treated as employer contributions and will not be includible in the Group N Employees' gross income in the year in which such amounts are contributed for federal income tax treatment. These amounts will be includible in the gross income of the Group N Employees or their beneficiaries only in the taxable year in which they are distributed, to the extent that the amounts represent contributions made by Employer M. Because we have determined that the picked-up amounts are to be treated as employer contributions, they are

excepted from wages as defined in section 3401(a)(12)(A) of the Code for federal income tax withholding purposes. In addition, no part of the amounts picked up by Employer M will constitute wages for federal income tax withholding purposes in the taxable year in which they are contributed to Plan X and Plan Y. For purposes of the application of section 414(h)(2) of the Code, it is immaterial whether an employer picks up contributions through a reduction in salary, an offset against future salary increases, or a combination of both.

These rulings apply only if the effective date for the commencement of the pick-up is no earlier than the later of the date Resolution N was signed or the date the pick-up is put into effect.

These rulings are based on the assumption that Plan X and Plan Y will be qualified under section 401(a) of the Code at the time of the proposed contributions and distributions.

No opinion is expressed as to whether the amounts in question are subject to tax under the Federal Insurance Contributions Act. No opinion is expressed as to whether the amounts in question are paid pursuant to a "salary reduction agreement" within the meaning of section 3121(v)(1)(B).

These rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited by others as precedent.

A copy of this letter has been sent to your authorized representative in accordance with the power of attorney on file with this office.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd
Manager, EP Technical Group 2
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy of this letter & Notice 437

cc: