Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

200051048

Contact Person:

Telephone Number: TED #
T:EP:RA:T4
In Reference to:

Date: SEP 25 2000

LEGEND:

County A =

State B =

Board C =

Plan X =

Law D =

Group S Employees =

Resolution R =

Dear

This letter is in response to a request for a private letter ruling dated submitted on your behalf by your authorized representative, regarding the federal income tax treatment of certain contributions to Plan X under section 414(h)(2) of the Internal Revenue Code (the "Code").

The following facts and representations have been submitted:

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County A is a political subdivision of State B. Group S Employees are employees under the authority of Board C. County A is a participating employer in Plan X. Plan X is a state retirement plan which is qualified under section 401(a) of the Code.

Plan X is a contributory plan. Benefits under Plan X are funded in part through mandatory contributions by participating employees. Required employee contributions to Plan X equal 2% of annual salary.

Section 21-313 of Law D contains enabling legislation that allows participating employers to pick up the employee contributions required by Law D.

Pursuant to Resolution R, which was adopted on , Board C elected to treat the mandatory employee contributions as picked up by the employer. Resolution R provides that Board C shall pick up the 2-percent defined contribution of all eligible employees' annual salary and will consider this amount as an employer contribution for federal income tax purposes only and therefore no employee will have access to these funds. Resolution R further provides that employee contributions will be paid by the employer in lieu of such contributions being paid by the employee. Finally, pursuant to Resolution R, the employee will not have the option of receiving the pick-up contribution in cash instead of having the contribution paid to the retirement plan.

Based on the aforementioned facts and representations, you have requested a ruling that no part of the contributions to Plan X picked up by Board C on behalf of eligible employees will constitute taxable income to such employees in the year of the pick up.

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 described in 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.

Revenue Ruling 87-10, 1987-1 C.B. 136, provides that in order to satisfy Revenue Rulings 81-35 and 81-36, the required specification of designated employee contributions must be completed before the period to which such contributions relate. Thus, employees may not exclude from current gross income designated employee contributions to a qualified plan that relate to compensation earned for services prior to the date of the last governmental action necessary to effect the pick up.

Plan X satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 because it specifies that Board C will assume and pay mandatory employee contributions to Plan X in lieu of contributions by Group S Employees and that Group S Employees may not elect to receive such contributions directly instead of having such contributions paid by Board C to Plan X.

Accordingly, we conclude that the amounts picked up by Board C on behalf of Group S Employees shall be treated as employer contributions and will not be includible in Group S Employees' gross income in the year in which such amounts are contributed. These amounts will be includible in the gross income of Group S Employees or their beneficiaries

only in the taxable year in which they are distributed, to the extent that the amounts represent contributions made by Board C.

Because we have determined that the picked-up amounts are to be treated as employer contributions, such amounts are excepted from wages as defined in section 3401(a)(12)(A) of the Code for federal income tax withholding purposes. Therefore, no withholding of federal income tax is required from Group S Employees' salaries with respect to such picked-up contributions. For purposes of the application of section 414(h)(2) of the Code, it is immaterial whether Board C 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 any proposed pick up is not any earlier than the later of the date Resolution R is signed or the date it is put in effect.

These rulings are based on the assumption that Plan X meets the requirements for qualification under section 401(a) of the Code at the time of the proposed contributions.

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) of the Code.

This letter ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

A copy of this letter is being sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

John G. Riddle, Jr.

John G. Riddle, Jr.
Manager, Employee Plans
Technical Group 4
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of letter ruling
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