DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200307092

SIN 414.09-00

NOV 19 2002

T:EP:RA:T:2

ATTN:

LEGEND:

Employer M =

County D =

Plan X =

Group B Employees =

Proposed Resolution O =

Proposed Resolution P =

Proposed Payroll
Authorization Form Q =

Dear

200307092

This letter is in response to a request for a private letter ruling dated 1 and supplemented by additional correspondence dated nd submitted on your behalf by your authorized representative, regarding the federal income tax treatment of certain contributions to Plan X under section 414(h) of the Internal Revenue Code (the "Code").

The following facts and representations have been submitted:

Employer M is an instrumentality and agency of County D. The Board of County Commissioners of County D has empowered the Personnel and Labor Relations Committee of the Board of Directors of Employer M to establish and maintain personnel, retirement and group insurance programs. Proposed Resolution O recognizes the Board of Directors power to adopt Plan X. The Board of Directors of Employer M, in accordance with Proposed Resolution O, plans to adopt Plan X, a defined contribution plan. Employer M represents that Plan X will meet the requirements for a qualified plan under section 401(a) of the Code and that its trust will be tax-exempt under section 501(a) of the Code. Plan X will become effective upon receipt of this letter ruling.

Plan X will initially cover Group B Employees. Plan X will provide that each employee who is eligible at the time the plan is established may irrevocably elect to participate in the plan only during the 24-month period following the establishment of the plan. Thereafter, newly hired employees who are eligible may irrevocably elect to participate in the plan only during the 24-month period following their date of hire. No elections to participate may be made at any other time. Eligible employees may elect to participate by electing to contribute three (3) percent, six (6) percent or twenty (20) percent of the employee's compensation to Plan X for each plan year. Once made, the employee's election will be irrevocable and shall remain in force until the employee terminates employment.

Proposed Resolution P, as it pertains to Plan X, establishes conditions of irrevocable contributions and provides for an effective date for the resolution. Proposed Resolution P recognizes the Board of Directors desire to amend Plan X to provide for the pick-up of employee contributions to Plan X in accordance with Revenue Rulings

81-35, 1981-1 C.B. 255 and 81-36, 1981-1 C.B. 255 and section 414(h)(2) of the Code.

Proposed Resolution P further provides that the following criteria shall apply to Plan X: (1) that employee contributions made pursuant to a binding irrevocable payroll deduction authorization to have such contributions picked up for purposes of providing supplemental retirement benefits, even though designated as employee contributions, are being paid by Employer M in lieu of the contributions of the employees; (2) that, if the employee desiring to have contributions picked-up executes an irrevocable, binding payroll deduction form, such as Proposed Authorization Form Q, with respect to these contributions, the employee shall not be entitled to any option of choosing to receive the contributed amounts directly instead of having them paid by Employer M to Plan X; and (3) that, with respect to any employee's contributions, the effective date of the pick-up by Employer M is the later of the date of the execution of the irrevocable payroll deduction authorization form, or the date proposed Plan X becomes effective.

Proposed Payroll Authorization Form Q authorizes Employer M to make a deduction from the employee's salary each pay period in an amount equal to three (3) percent, six (six) percent, or twenty (20) percent of the employee's compensation for the purposes of providing retirement benefits. With respect to the payroll deduction, the employee acknowledges that this is an irrevocable deduction authorization; that after execution of the proposed payroll authorization form, the employee does not have the option of receiving the deduction amounts directly instead of having them paid by Employer M to Plan X; that these contributions are being picked up by Employer M, and, although designated as employee contributions, such contributions are being paid in lieu of contributions by the employee; that while the agreement is in effect, the plan will only accept contributions from Employer M and not directly from the employee; that the payroll deduction authorization will not become effective until signed by the employee and delivered to an authorized representative of Employer M; and that the pick-up is only applicable to contributions to the extent the contributions is deducted from compensation earned for services rendered subsequent to the effective date of the payroll authorization form.

Based on the foregoing facts and representations you have requested the following rulings:

(1) The picked up contributions will be treated as employer contributions for federal income tax purposes in accordance with the requirements of section 414(h)(2) of the Code and Revenue Rulings 81-35 and 81-36.

(2) Contributions to be made under Plan X by Employer M will be excludable from the employees' wages for purposes of federal income tax withholding under section 3401 of the Code.

(3) Contributions to be made under Plan X by Employer M will not constitute gross income for federal income tax purposes until such time as they are distributed to the employees or their beneficiaries.

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 that 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. Furthermore, it is immaterial, for purposes of the applicability of section 414(h)(2), whether an employer picks up contributions through a reduction in salary, an offset against future salary increases or a combination of both.

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.

Proposed Resolution P as it pertains to Plan X satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 by providing that contributions made pursuant to Plan X, although designated as employee contributions, are being made by Employer M in lieu of contributions by the Group B Employees and that the Group B Employees shall not be entitled to any option of choosing to receive the contributed amounts directly instead of having them paid by Employer M to Plan X. Further, Proposed Payroll Authorization Form Q is irrevocable and also provides that the contributions are being picked up by Employer M and are paid directly to Plan X and that the Group B Employee does not have the option of receiving the contributed amounts directly. Pursuant to Proposed Resolution P, the effective date of the pick up of contributions made to Plan X is the later of the date of the execution of Proposed Payroll Authorization Form Q, or the date Plan X becomes effective.

Accordingly, assuming Plan X, Proposed Resolution O, Proposed Resolution P and Proposed Payroll Authorization Form Q are adopted and implemented as proposed, we conclude, with respect to rulings number one, two, and three, that the picked up contributions will be treated as employer contributions for federal income tax purposes in accordance with the requirements of section 414(h)(2) of the Code and Revenue Rulings 81-35 and 81-36; that, because we have determined that the picked-up amounts are to be treated as employer contributions, such contributions to be made to Plan X by Employer M will be excludable from the Group B

Employees' wages for purposes of federal income tax withholding under section 3401(a)(12)(A) of the Code in the taxable year in which they are contributed to Plan X; and that the picked-up contributions to be made under Plan X by Employer M will not constitute gross income for federal income tax purposes until such time as they are distributed to the Group B Employees or their beneficiaries to the extent the picked-up amounts represent contributions made by Employer M.

For purposes of the application of section 414(h)(2) of the Code, it is immaterial whether Employer M picks up contributions through a reduction in salary, an offset against future salary increase, 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 the Proposed Resolution P is signed and becomes effective, the date of the execution of Proposed Payroll Authorization Form Q, or the date Plan X becomes effective.

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 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) of the Code.

This ruling is based on Proposed Resolution O, Proposed Resolution P and Proposed Payroll Authorization Form Q submitted with your letter dated December 4, 2001. This ruling is further conditioned on the amended description of when eligible employees may irrevocably elect to participate as contained in your letter dated October 15, 2002.

This ruling only addresses the proposed amendment to Plan X that relates to the pick up of contributions pursuant to section 414(h) of the Code. This ruling does not express an opinion as to the status of Plan X under section 401(a) of the Code. The determination as to whether Plan X is qualified under section 401(a) is within the jurisdiction of the Employee Plans Determinations Office of the Internal Revenue Service.

This letter 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.

If you have any questions, please contact , T:EP:RA:T2, by telephone at or by fax at (

Sincerely yours,

(signed) JOYCE E. FLOYD

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

Enclosures:
Deleted copy of letter ruling
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