Uniform Issue List No. 414.09-00

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

MAR 18 2003

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Attention: **********

Legend:

Authority A = **********

City B = **********

Plan X = **********
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State M = *********

Ladies and Gentlemen:

This letter is in response to a request for a letter ruling dated December 18, 2002, as supplemented on February 26, 2003, and March 10, 2003, which was submitted 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 ("Code').

Your authorized representative has submitted the following facts and representations:

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Authority A is a governmental subdivision of State M, which was created by statutes of State M and acknowledged as carrying out an essential government function when it exercises its power. Authority A was established through the appointment of commissioners by resolution of the City Counsel of City B on August 17, 1932, pursuant to the laws of State M. The mayor of City B has since appointed commissioners of Authority A, and the City B Council ratifies their appointments. State M statutes permit a port authority to adopt bylaws. Pursuant to that authority, Authority A adopted bylaws and rules of procedure, which govern the manner is which actions the Board of Commissioners of Authority A takes.

Authority A is the sponsor of Plan X, a money purchase pension plan that was effective August 1, 1992. Plan X was determined to be qualified under section 401(a) of the Code by an Internal Revenue Service determination letter dated January 10, 2002. It is further represented that Plan X is a governmental plan within the meaning of section 414(d) of the Code.

Under section 3.1 of Plan X, an employee shall become a participant as of the first day of August, November, February or May coinciding with or next following the date on which the employee completes a consecutive six month period of employment with the employer measured from the date of employment.

State M law provides that for purposes of any public pension plan, each employer shall pick up the employee contributions pursuant to the law or the pension plan. The state statute requires a governmental unit to obtain an IRS private letter ruling that the picked up contributions are not includable in an employee's adjusted gross income until distributed or made available in order for the employer to discontinue withholding federal income on the picked-up contributions pursuant to section 414(h) of the Code.

Authority A, by action of its Board of Commissioners on October 22, 2002, approved a Resolution to amend Plan X to provide for mandatory employee contributions at a rate of five percent to be picked up by Authority A for purposes of federal income tax effective November 2, 2002. Amendment No. 4 was executed by and adopted on October 22, 2002, by an officer of Authority A.

Amendment No 4, section 4.1(d) requires the employer to pick up the mandatory employee contributions pursuant to the provisions of Code section 414(h) effective for all payroll periods beginning after November 2, 2002. As amended, section 4.12 of Plan X provides that mandatory employee contributions shall be required as a

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condition of employment once an employee becomes a participant in Plan X. As a result, each participant is required to make a contribution each payroll period equal to five percent of such participant's compensation for each payroll period.

A copy of the salary reduction agreement requires an employee to make a five percent employee contribution, and also provides for an election for the employees to make an additional voluntary after-tax contribution under Plan X.

Based on these facts, the following rulings are requested.

Authority A, as a governmental unit may sponsor a governmental plan pursuant to the provisions of section 414(d) of the Code, and pick up mandatory employee contributions to Plan X under the provisions of section 414(h)(2), with the result that such contributions are excludable from the gross income of the employees participating in Plan X.

Contributions that Authority A picks up pursuant to section 414(h)(2) of the Code are not subject to federal withholding taxes under section 3401.

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) of the Code, 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,

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1981-1 C.B. 255, and Revenue Ruling 81-36, 1981-1 C.B. 255. These revenue rulings establish 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 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.

Authority A is a governmental subdivision created by statutes of State M, and as such Authority A is eligible to establish a governmental plan described in section 414(d) of the Code. The resolution of Authority A passed on October 22, 2002, is consistent with the requirements of State M law, which requires employers to pick up employee contributions to public pension plans. As such, the resolution satisfies the criteria set forth in Revenue Ruling 87-10. Additionally the criteria in Revenue Rulings 81-35 and 81-36 are satisfied because the amendment authorized by the resolution specifies that Authority A will assume and pay mandatory employee contributions to Plan X and that the participants do not have the option to receive such contributions directly instead of having such contributions paid by Authority A to Plan X. Thus, the pick up amounts are treated as employer contributions under section 414(h)(2) of the Code.

With respect to the first ruling request Authority A, as a governmental unit may sponsor a governmental plan pursuant to the provisions of section 414(d) of the Code, and pick up mandatory employee contributions to Plan X under the provisions of section 414(h)(2), with the result that such contributions are excludable from the gross income of the employees participating in Plan X, effective for pay periods beginning after November 2, 2002.

With respect to the second ruling request, because we have determined that the pick up contributions are to be treated as employer contributions under section 414(h)(2) of the Code, such contributions are excepted from wages as defined in section 3401(a)(12) for federal income tax withholding purposes. Therefore, no withholding of federal income tax is required from the affected employees' salaries with respect to such picked-up amounts.

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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 the pick up contributions commenced on and after November 2, 2002.

No opinion is expressed as to whether the amounts in question are subject to tax under the Federal Insurance Contribution 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.

These rulings are 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 has been sent to the first authorized representative in accordance with the current power of attorney (Form 2848) on file in this office.

If you have any questions please contact _ , at

Sincerely yours,

Alan C. Pipkin, Manager
Employee Plans Technical Group 4
Tax Exempt & Government Entities Division

Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose, Notice 437