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

APR 8 2003

U.I.L. No.: 0414.0-00

T:EP:RA:UK:T4

Legend:

County X =

State G =

Board D =

Plan Z =

Plan W =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Dear :

This letter is in response to your request for a private letter ruling dated , as supplemented by a letter dated , submitted on your behalf by your authorized representative, concerning the federal income tax treatment of mandatory employee contributions that will be picked up by County X under section 414(h)(2) of the Code.

Your representative has submitted the following facts and representations:

County X is a county in State G that is governed by local county government Board D. Plan Z was established by County X on Date 1 to provide pension benefits for the employees of that county. Employees of County X are given the choice to participate in Plan Z or Plan W. Plan Z is a defined contribution money purchase plan where participants are required to contribute 4.5% of their compensation to the plan as a condition of employment. Additionally, participants may make an optional irrevocable election to contribute an additional one percent of compensation to the Plan. Once made, the election to increase the contribution percentage cannot be changed. County X will contribute 10.5% of a participant's compensation if such participant contributes 4.5% of compensation. County X's contribution increases to 11.5% of compensation if a participant elects to contribute 5.5% of compensation. Since Date 1, Employee contributions to the plan are picked-up by County X pursuant to section 414(h)(2) of the Internal Revenue Code (the Code).

As of Date 1, participants in Plan W were given a one-time election to have the value of their benefit under Plan W transferred to Plan Z.

Section 4.2 of the Plan Z document provides that if the employer in the Adoption Agreement so elects, each eligible participant shall be required to make employee after-tax contributions. If these contributions are picked-up by the employer, they will be treated as employer contributions for federal income tax purposes. These contributions will not be included in the employee's compensation in the year made, and are not subject to income tax withholding. The employer may pick-up the required contributions by a reduction in cash compensation, by an offset against future salary increases, or by a combination of both.

In section 8 of Plan Z's Adoption Agreement, County X has indicated that employee contributions will be picked-up in accordance with section 414(h)(2) of the Code.

Plan Z has not received a determination from the Internal Revenue Service that it is a qualified retirement plan under section 401(a) of the Code. However, County X represents that Plan Z meets the requirements of section 401(a) of the Code.

Based on the above facts, you request:

1. A determination that Plan Z qualifies as a government plan within the meaning of section 414(d) of the Code.

2. That required contributions to Plan Z picked-up by County X on behalf of participating employees will be treated as valid pick-up contributions under section 414(h)(2) of the Code.

3. That no part of the pick-up contributions will constitute gross income to participating employees for federal income tax purposes until distributed or otherwise made available to those employees.

4. That the contributions picked-up by County X will be treated as employer contributions for federal income tax purposes.

5. That the contributions picked-up by County X will not constitute wages from which federal income tax must be withheld in the taxable year in which contributed.

With respect to your ruling requests, section 414(d) of the Code provides that a "governmental plan" means a plan established and maintained for its employees by the government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

County X is a local county established and empowered by State G. Plan Z is an instrumentality of County X . County X is funded primarily by the imposition of tax assessments on the citizens residing in such county, as empowered by the laws of State G. All eligible participants in Plan Z are employees of County X, and are considered government employees of that county. Thus, Plan Z is a governmental plan within the meaning of section 414(d) of the Code.

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 that 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 application of section 414(h)(2) of the Code, whether District Y picks-up contributions through a reduction in a 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.

Section 4.1 of the Plan document and section 8 of the Adoption Agreement of Plan Z as adopted by County X satisfy the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 because it provides that County X will "pick-up" employee contributions to Plan Z and specifies that such picked-up contributions, although designated as employee contributions are being paid by the employer in lieu of contributions by participating employees and that the participating employees may not elect to receive such contributions directly instead of having such contributions paid by County X to Plan Z.

Additionally, as required under Revenue Ruling 87-10, the last governmental action required to effect the pick-up of employee contributions was the approval of Plan Z to include the pick-up of contributions by Board D and the execution of the Plan document, both of which took place on Date 4. Date 4 was prior to the effective date of the pick-up of required contributions, which was Date 1. Therefore, the pick-up of employee contributions satisfied the requirements of Revenue Ruling 87-10.

Accordingly, we conclude that:

1. That Plan Z qualifies as a government plan under section 414(d) of the Code.

2. That required contributions to Plan Z picked-up by County X on behalf of participating employees will be treated as valid pick-up contributions under section 414(h)(2) of the Code.

3. That no part of the picked-up contributions will constitute gross income to participating employees for federal income tax purposes until distributed or otherwise made available to those employees.

4. That the contributions picked up by County X will be treated as employer contributions for federal income tax purposes.

5. That the contributions picked-up by County X will not constitute wages from which federal income tax must be withheld in the taxable year in which contributed.

The effective date for the commencement of the pick-up will not be any earlier than Date !.

These rulings are based on the assumption that Plan Z meets the requirements for qualification under section 401(a) of the Code at the time of the 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 ruling is being sent to your authorized representative in accordance with a power of attorney on file with this office.

Sincerely yours,

Alan Pipkin, Manager
Employee Plans Technical Group 4
Tax Exempt and Government Entities Division

Enclosures:
Deleted Copy of Letter
Notice 437

cc:

cc: EP Area Manager