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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

UIL: 9999.98-00

Person to Contact:

Telephone Number:

Refer Reply to: OP:E:EP:T:3

Date:

OCT 14 1999

Attention:

Legend:

County A =

State B =

Group C Employees =

Law D =

Plan X =

Plan Y =

Dear

This is in response to your request originally submitted on April 13, 1999, and supplemented by letters dated August 10, 1999, and September 8, 1999, in which your authorized representative requested a private letter ruling concerning the federal income tax treatment under section 414(h)(2) of the Internal Revenue Code of certain contributions to Plan X.

County A is a political subdivision of State B. Group C Employees are employed by County A. 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.

Prior to the transaction in question, Group C Employees were participants in Plan Y, a related, yet distinct, state retirement plan. Group C Employees expressed a desire to become participants in Plan X in 1998.

Pursuant to section 9-11-40(9) of Law D, a member of Plan X may voluntarily transfer credited service he received under Plan Y to Plan X on payment of accumulated employer and employee contributions and interest in Plan Y plus five percent of current compensation for each year of service prorated for periods of less than a year.

354

Section 9-11-210(11) of Law D contains the enabling legislation which allows each department and political subdivision to pick up the employee contributions required by this section for all compensation paid on or after July 1, 1982.

County A agreed to pay the portion of each Group C Employee's contribution attributable to the additional five percent of current compensation directly to Plan X, only on the condition that each Group C Employee execute an agreement specifically stating the County A contribution is not intended to qualify as a pick-up payment pursuant to section 414(h)(2) of the Code. Furthermore, the agreement stated that County A's portion of the transfer will be made as a payment directly to Plan X, and will be includable in Group C Employees' gross taxable wages. In making the contributions directly to Plan X, County A did not specify to the plan administrator that the contributions were being paid by County A in lieu of contributions by the Group C Employees.

The Group C Employees were not given the option of choosing to receive the contributions directly instead of having them paid by County A to Plan X.

County A reported all such contributions pursuant to said agreement as additional taxable compensation on each Group C Employee's 1998 Form W-2. The contributions were not treated as wages for FICA purposes, or for income tax withholding purposes.

Based on the foregoing, you request a ruling that County A's above described 1998 contributions do not qualify as pick-up contributions pursuant to section 414(h)(2) 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 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.

It is represented that section 9-11-210(11) of Law D contains sufficient enabling legislation which allows County A to pick up required contributions but that it is inapplicable to the voluntary payments required to convert the plan service credits under section 9-11-40(9) of Law D. It also has been represented that Group C Employees must execute an agreement stating that the contribution is not intended to qualify as a pick-up contribution. The County A portion of the transfer will be made as a payment directly to Plan X and will be includable in each Group C Employees' gross taxable wages. In making the contributions directly to Plan X, County A did not specify that the contributions were being paid in lieu of contributions by Group C Employees. Therefore, the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 are not satisfied.

Accordingly, with respect to your ruling request we conclude that County A's 1998 contributions do not qualify as pick-up contributions pursuant to section 414(h)(2) of the Code.

This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that this ruling 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 a power of attorney on file in this office.

Sincerely yours,

/s/ Frances V. Sloan

Frances V. Sloan
Chief, Employee Plans
Technical Branch 3

Enclosures:
Deleted copy of letter
Notice of Intention to Disclose

356