Uniform Issue List: 414.09-00
Internal Revenue Service

200021059

Department of the Treasury

Washington, DC 20224

OP:E:EP:T4

Person to Contact:

Telephone Number:

Refer Reply to:

Date:

Attn:

Legend:

State A =

Employer M =

Plan X =

Group B Employees =

Ladies and Gentlemen:

This letter is in response to your request for a private letter ruling dated August 24, 1999, and supplemented by a letter dated November 29, 1999, 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 ("Code").

The following facts and representations have been submitted:

Pursuant to the law of State A, Employer M, a municipality under the law of State A, has established Plan X for the benefit of Group B Employees. The law of State A requires Group B Employees to contribute 9 percent of their salary to Plan X. Further, it has been represented that Plan X satisfies the qualification requirements under section 401(a) of the Code.

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Employer M has adopted a resolution providing that Employer M shall pick up Group B Employees' contributions to Plan X in accordance with the law of State A and that Group B Employees' current cash salaries shall be reduced by the amount picked up. Group B Employees will not be given the option of receiving cash directly in lieu of contributions.

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

1. The mandatory employee contributions "picked up" by Employer M shall be excluded from the current gross income of Group B Employees until distributed.

2. The contributions "picked up" by Employer M will not constitute wages from which federal income taxes must be withheld.

Section 414(h) 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 employee's 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

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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. Furthermore, it is immaterial whether an employer picks up contributions through a reduction in salary, an offset against future salary increases, or a combination of both.

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 employee contributions must be completed before the period to which such contributions relate.

In this case, the resolution adopted by Employer M satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 because Employer M will assume and pay mandatory employee contributions to Plan X in lieu of contributions by Group B Employees, and Group B Employees may not elect to receive such contributions directly instead of having such contributions paid by Employer M to Plan X.

Accordingly, we conclude that the mandatory employee contributions "picked up" by Employer M shall be treated as employer contributions and will not be includible in Group B Employees' gross income in the year in which contributed. These amounts will be includible in the gross income of Group B Employees or their beneficiaries only in the taxable year in which they are distributed, to the extent that the amounts represent contributions by Employer M.

Because we have determined that the amounts picked up by Employer M on behalf of Group B Employees are to be treated as employer contributions, such amounts are excepted from wages as defined in section 3401(a)(12)(A). Therefore, no withholding of federal income tax is required from Group B 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 Employer M picks up contributions through a reduction in salary, an offset against future salary increases, or a combination of both.

The effective date for the commencement of the pick up of Group B Employees' contributions as specified in the aforesaid resolution cannot be earlier than the later of the

date the resolution is signed or the date it is put into 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 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 directed only to the taxpayer who 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 the power of attorney on file in this office.

Sincerely yours,

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

Enclosures:
Deleted Copy of Private Letter Ruling
Notice 437

cc: