SIN 414.01-08

Internal Revenue Service

Department of the Treasury
200118056
Washington, DC 20224

xxxxx
xxxxx
xxxxx

Attn: xxxxx
xxxxx

Contact Person:
xxxxx
Telephone Number:
xxxxx
In Reference to:

Date: T:EP:RA:T2, Rm 4H

FEB 9 2001

Legend:

State A = xxxxx

Employer M = xxxxx

Board L = xxxxx

Plan X = xxxxx

Group B = xxxxx

Statute C = xxxxx

Proposed Resolution N
= xxxxx

Proposed Resolution O
= xxxxx

Proposed Payroll Authorization Form P
= xxxxx

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Dear xxxxx:

This letter is in response to a request for a ruling, dated xxxxx, 1999, as amended and supplemented by correspondence dated xxxxx, 2000, xxxxx, 2000, xxxxx, 2000, xxxxx, 2000, xxxxx, 2000, xxxxx, 2000, and xxxxx, 2001, submitted on Employer M's behalf by its authorized representative, with respect to the federal income tax treatment of certain contributions to Plan X pursuant to section 414(h)(2) of the Internal Revenue Code. In a letter dated xxxxx, 2001, you requested that the ruling pertaining to the pick-up of terminal leave payments be considered under separate cover. This ruling is limited to the proposed pick-up of mandatory employee contributions made pursuant to Proposed Amendment Number One.

Employer M is a political subdivsion of State A. Employer M adopted Plan X, a defined contribution plan, in order to provide a supplemental retirement benefit for Group B employees. It is represented that Plan X meets the requirements for a qualified retirement plan under section 401(a) of the Code and its trust is tax-exempt under section 501(a) of the Code. Plan X became effective January 1, 1995.

Employer M proposes to amend Plan X to provide for a pick-up of certain contributions.

Proposed Amendment Number One provides that each Group B employee, at the beginning of each plan year, may irrevocably elect to participate in the mandatory participant contribution portion of Plan X by electing to contribute 3 percent, 6 percent, or 20 percent of the Group B employee's compensation to Plan X for each plan year. Once made, the Group B employee's election is irrevocable and shall remain in force until the Group B employee ceases to be an employee eligible to participate in Group B or terminates employment.

Section 15.01 of Plan X provides that Employer M reserves the right to amend Plan X. Section 4.05 of Statute C provides that Board L shall establish and maintain personnel and civil service, retirement, and group insurance programs.

Board L, as authorized by Statute C, has proposed several resolutions to implement the proposed amendment. Proposed Resolution N recognizes Board L's power under Statute C to adopt Proposed Amendment Number One to Plan X. Proposed Resolution N, as drafted, also authorizes Board L to execute the proposed amendment and provides for an effective date. Proposed Resolution N recognizes Board L's approval of Proposed Amendment Number One to Plan X.

Proposed Resolution O, as it pertains to Proposed Amendment One to Plan X, establishes conditions of irrevocable contributions and provides for an effective date for such amendment. Proposed Resolution O recognizes Board L's 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 O further provides that the following criteria shall apply to Plan X, as amended by Proposed Amendment Number One to permit employer pick-up contributions: (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 Group B employee; (2) that if the Group B employee desiring to have contributions picked up executes an irrevocable, binding payroll deduction with respect to these contributions, the Group B 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 Group B 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 Amendment Number One becomes effective.

Proposed Payroll Authorization Form P authorizes Employer M to make a deduction from the Group B employee's salary per pay period in an amount equal to 3 percent, 6 percent, or 20 percent of the Group B employee's compensation for the purpose of providing retirement benefits. With respect to the payroll deduction, the Group B employee acknowledges that this is an irrevocable deduction authorization; that after execution of Proposed Payroll Authorization Form P, the Group B 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 directly to Plan X in lieu of contributions by the Group B employee; that while this agreement is in effect, Plan X will only accept contributions from Employer M and not directly from the Group B employee; that the payroll deduction authorization will not become effective until signed by the Group B employee and delivered to an authorized representative of Employer M; and that the pick-up is only applicable to contributions to the extent the contribution 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 rulings as follows:

(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 Group B 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 or made available 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 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' 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 Code section 414(h)(2) is addressed in Revenue Ruling 81-35 and Revenue Ruling 81-36. 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 service prior to the date of the last governmental action necessary to effect the employer pick up.

Proposed Resolution O as it pertains to Proposed Amendment Number One satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 by providing that contributions made pursuant to Proposed Amendment Number One, 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 P 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 O, the effective date of the pick up of contributions made pursuant to Proposed Amendment Number One to Plan X is the later of the date Proposed Resolution O is adopted by Employer M, the date of execution of Proposed Payroll Authorization Form P, or the date Proposed Amendment Number One becomes effective. The pick-up does not apply to any contribution before the effective date or to any contribution that relates to compensation earned for services before the effective date.

Accordingly, assuming Proposed Amendment Number One, Proposed Resolution O, and Proposed Payroll Authorization Form P 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 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 or made available 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 an employer picks up contributions through a reduction in salary, an offset against future salary increases, or a combination of both.

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).

These rulings apply only if the effective date for the commencement of the proposed pick-up, as described in Proposed Resolution O, cannot be earlier than the later of the date that Proposed Resolution O is signed and becomes effective, the date of execution of Proposed Payroll Authorization Form P, or the date Proposed Amendment Number One to Plan X becomes effective. These rulings are also contingent upon the adoption by Employer M of Proposed Resolution O, Proposed Payroll Authorization Form P, and Proposed Amendment Number One as submitted with your revised ruling dated xxxxx , 2000.

These rulings are based on the assumption that Plan X will be qualified under section 401(a) of the Code at the time of the proposed contributions and distributions.

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 has been sent to your authorized representative in accordance with a power of attorney on file in this office.

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 this letter
Notice 437

cc: Manager, EP xxxxx Area

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