200241050

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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Uniform Issue List No.: 414.09-00

PERSON TO CONTACT

TELEPHONE NUMBER

OFFICE SYMBOLS
T:EP:RA:T1

DATE
JUL 19 2002

LEGEND:

Employer A =
City Charter D =

Plan X =

Ordinance P =
Employees C =

Ladies and Gentlemen:

Employer A requests a ruling concerning the pick-up of certain employee contributions under its qualified retirement plan pursuant to section 414(h) of the Internal Revenue Code ("Code").

Plan X is a defined benefit plan, the terms of which are set forth in the provisions of City Charter D, which provides retirement income to qualifying employees and former employees of Employer A, and survivor income to their qualifying beneficiaries. In the case of Employees C, Plan X requires annual employee contributions, the amount of which is determined as a percentage of compensation. City Charter D states that Plan X is intended to be a qualified pension plan under section 401 of the Internal Revenue Code.

Employer A adopted Ordinance P, which provides in part as follows:

Section 1.

[City Charter D] is hereby amended to read as follows:

Section 2.405 Member Contributions-Amounts

(a) Effective as of January 1, , member contributions to the retirement system shall be deducted from each member's paychecks at the following rates:

Benefit Group	*% of Annual Compensation*
General	
Public Safety non-command	
Public Safety command	

Continuation of employment by a member shall constitute consent and agreement to the deduction of applicable member contributions.

(b) The Employer shall pick-up the member contributions required by this Section for all compensation earned after the effective date of this subsection. The contributions so picked up shall be treated as employer contributions in determining tax treatment under the United States Internal Revenue Code. The Employer shall pick-up the member contributions from funds established and available in the salaries account, which funds would otherwise have been designated as member contributions and paid to

> the retirement system. Member contributions picked up by the Employer pursuant to this subsection shall be treated for all other purposes of this and other laws of the Employer in the same manner and to the same extent as member contributions made prior to the effective date of this subsection. The member does not have the option of receiving the picked-up member contributions in cash instead of having it paid into the Retirement Systems.

Employer A requests three rulings as follows:

1. That no part of the mandatory contribution picked up by Employer A be constituted as gross income to Employees C for federal income tax treatment for the taxable year in which the pick-up is made.

2. That the contribution, whether picked up by salary reduction, offset against future salary increases, or both, and, though designated as employee contributions, will be treated as employer contributions for federal income tax purposes.

3. That the contribution picked up by Employer A will not constitute wages from which federal income tax will be withheld.

Code section 414(h)(2) provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if such contributions are made to a plan described in Code section 401(a), established by a state government or a political subdivision thereof, or any agency or instrumentality of any one of the foregoing, 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 Code section 414(h)(2) 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. Rev. Rul. 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 Code section 3401(a)(12)(A), 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, 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 Code 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.

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.

Employer A's Ordinance P satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 by providing that Employer A will pick up and make contributions to Plan X in lieu of contributions by electing employees and that no such employee will have the option of receiving the contribution in cash instead of having such contribution paid to Plan X.

Accordingly, we conclude (1) that no part of the mandatory contribution picked up by Employer A will be constituted as gross income to Employees C for federal income tax treatment for the taxable year in which the pick-up is made, (2) that the contribution, whether picked up by salary reduction, offset against future salary increases, or both, and, though designated as employee contributions, will be treated as employer contributions for federal income tax purposes, and (3) that the contribution picked up by the employer will not constitute wages from which federal income tax will be withheld.

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 being 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.

These rulings express no opinion as to the impact of these proposed transactions upon the qualified, nor the continuing qualified status of the plan involved. These rulings are based on the assumption that Plan X will be qualified under section 401(a) of the Code at all relevant times.

In accordance with Revenue Ruling 87-10, this ruling does not apply to any contribution before January 1, , the effective date of the City Charter D authorization.

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,

Andrew E. Zuckerman, Manager
Employee Plans Technical Group 1
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of letter ruling
Form 437