Uniform Issue List No. 414.09-00

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TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

JUL -12 2002

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Attention: **********
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Legend:

Employer M = **********

Plan X = **********
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State P = **********

Ladies and Gentlemen:

This letter is in response to a request for a letter ruling dated January 5, 2001, 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').

Your authorized representative has submitted the following facts and representations:

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Employer M is a political subdivision of State P that is classified by the Legislature of State P as a first class township ("Employer M").

Pursuant to legislation of State P, police and firefighters employed by a political subdivision of State P have the right to collectively bargain with their municipal employers over the terms and conditions of employment, including pension arrangements. The legislation requires that all such agreements to be reduced to writing, which are commonly referred to as collective bargaining agreements.

In addition, the State P Legislature authorized the creation of pension plans whose membership is limited solely to police and firefighters employed by a political subdivision of State P. Pursuant to that legislation, Employer M enacted through ordinance, Plan X.

Plan X covers all "Members" defined as full-time police officers of Employer M. Plan X requires Members to pay into the fund at a rate of percent on compensation up to the social security maximum wage plus percent on compensation which is not subject to social security taxes. It was represented that Plan X meets the requirements of section 401(a) of the Code and the related trust is exempt from tax under section 501(a).

Prior to the expiration of the last collective bargaining agreement, Employer M and the bargaining representative representing Employer M reached an agreement for a new collective bargaining agreement which took effect on January 1, , and will expire on December 31, Pursuant to the current collective bargaining agreement, Employer M and the police officers agreed to have pension contributions picked up by Employer M. On October 18, , Employer M board of commissioners adopted an ordinance, which amended Plan X to provide for Employer M's "pick-up" of the contributions. Specifically, the ordinance provides that:

> "Effective January 1, , Employer M shall "pick-up" the contribution requirement by making the required contributions on behalf of each Member. No Member shall have the option to forego this contribution and receive the amount of the contribution as compensation. A corresponding reduction in the Member's salary shall be made in the amount of the pick-up contribution. For purposes of the Internal Revenue Code, such contributions shall be treated as employer contributions pursuant to Code section 414(h)(2), 26 U.S.C. 414(h)(2). In all other respects, the "pick-up" contributions made under this Section shall be treated the same as Member contributions made prior to January 1, ."

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Employer M requests the following rulings:

(1) The mandatory Member contributions to Plan X which are "picked-up" by Employer M, pursuant to the terms of the most recent collective bargaining agreement and ordinance which amended Plan X, are made pursuant to the terms of section 414(h)(2) of the Code, and therefore such amounts do not constitute gross income to the Members.

(2) The "picked-up" contributions to Plan X are not considered wages for Members for federal income tax withholding purposes, and that, as such, Federal income tax need not be deducted and withheld on the "picked-up" contributions.

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 determined to be qualified under section 401(a) of the Code, 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 establish 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 amounts directly instead of having them paid by the employer to the pension plan.

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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.

In the instant case, the ordinance was enacted on October 18, , effective January 1, , and Employer M could not pick up contributions until on or after January 1, . As such, the ordinance satisfies the criteria set forth in Revenue Ruling 87-10. Additionally the criteria in Revenue Rulings 81-35 and 81-36 are satisfied because the ordinance specifies that Employer M will assume and pay mandatory employee contributions to Plan X in lieu of contributions by the Members and that the Members may not elect to receive such contributions directly instead of having such contributions paid by Employer M to Plan X.

With respect to rulings (1) and (2), we conclude that the mandatory Member contributions to Plan X which are "picked-up" by Employer M, pursuant to the terms of the most recent collective agreement and ordinance which amended Plan X, are made pursuant to the terms of section 414(h)(2) of the Code, and therefore such amounts do not constitute gross income to the Members. Because we have determined that the picked-up amounts are to be treated as employer contributions, such amounts are excepted from wages as defined in section 3401(a)(12)(A) of the Code for federal withholding tax purposes.

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 the pick-up contributions commenced on or after January 1, , and at the time such amounts are distributed to the members.

No opinion is expressed as to whether the amounts in question are subject to tax under the Federal Insurance Contribution 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 that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

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The original of this letter has been sent to the first authorized representative in accordance with the current power of attorney (Form 2848) on file in this office.

If you have any questions please contact

Sincerely yours,

/s/ Alan Pipkin

Alan C. Pipkin, Manager
Employee Plans Technical Group 4
Tax Exempt & Government Entities Division

Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose, Notice 437