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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200245056

SIN 414.09-00

T:EP:RA:T2

AUG 12 2002

LEGEND:

State A =

Employer M =

Plan X =

Group C Employees =

Resolution Y =

Dear

This letter is in response to a request for a private letter ruling dated revised by letters dated and 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 (the "Code").

The following facts and representations have been submitted:

Employer M is a municipality of State A. Pursuant to the statutes of State A, Employer M established Plan X for the

benefit of Group C Employees. Plan X is qualified under section 401(a) of the Code.

State A's Pension Code, which provides for mandatory employee contributions, specifically allows municipalities in State A to "pick-up" such mandatory contributions. Employer M proposes to adopt Resolution Y, which provides that Employer M will "pick-up" the Group C Employees' mandatory contributions to Plan X. Resolution Y specifies that such picked up contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee. It also provides that no employee will be given the option to receive cash in lieu of contributions.

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

1. That no part of mandatory contributions picked up by Employer M on behalf of Group C Employees will be includible in the gross income of the employees for purposes of federal income tax treatment,

2. That contributions, 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.

3. That contributions picked up by Employer M will not constitute wages from which federal income tax must be withheld.

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 that 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 application of section 414(h)(2) of the Code, whether Employer M 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 services prior to the date of the last governmental action necessary to effect the pick up.

Resolution Y proposed for adoption by Employer M satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 because it provides that Employer M will "pick-up" mandatory employee contributions to Plan X and specifies that such picked up contributions, although designated as employee contributions are being paid by the employer in lieu of contributions by Group C Employees and that Group C 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:

1. That no part of mandatory contributions picked up by Employer M on behalf of Group C Employees will be includible in the gross income of the employees for purposes of federal income tax treatment.

2. That contributions, 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.

3. That contributions picked up by Employer M will not constitute wages from which federal income tax must be withheld.

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 income tax withholding purposes. Therefore, no withholding of federal income tax is required from Group C Employees' salaries with respect to such picked-up contributions.

The effective date for the commencement of the proposed pick up as specified in the aforesaid proposed resolution will not be any earlier than the later of the date the resolution is signed or the date it is put in 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.

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 letter 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.

A copy of this letter is being sent to your authorized representative in accordance with a power of attorney on file in this office.

If you have any questions concerning this ruling, please contact T:EP:RA:T2, at

Sincerely yours,

Joyce E. Floyd.
Manager, Employee Plans
Technical Group 2
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of letter ruling
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