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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index No.: 414.01-00

Contact Person:

Telephone Number:

In Reference to:
T:EP:RA:T1
Date:

MAY 30, 2000

EIN:

LEGEND:

State A =
Employer M =
Plan A =
Plan B =
Plan C =

Gentlemen:

This is in response to your ruling request dated May 12, 1999, concerning the federal income tax treatment, under section 414(h)(2) of the Internal Revenue Code (Code), of certain contributions to Plans A, B, and C.

The following facts and representations have been submitted:

Employer M is a political subdivision of State A. Plan A, which is a statewide defined benefit plan maintained by State A, was created under the law of State A for the purpose of providing retirement and certain other benefits to public employees.

During 1983, Employer M adopted an ordinance permitting Employer M to pick up the required contributions of its employees who are members of Plan A. Since February 1997 the law of State A has permitted participants of Plan A to purchase certain additional service credit and redeposit withdrawn contributions by payroll reduction and have the amounts designated by the employer as contributions paid by the employer pursuant to section 414(h) of the Code. The participants must complete a binding irrevocable payroll reduction authorization form.

204

In order that employees can purchase additional service credit or redeposit withdrawn contributions by payroll reduction contributions that are picked up by the employer, Employer M will adopt a proposed ordinance providing that:

1. employees may purchase additional service credit and redeposit withdrawn contributions by payroll reduction;

2. employees may not increase or decrease such payroll reduction;

3. employees may not terminate the payroll reduction unless they terminate employment or all such credit has been purchased;

4. employees may not make a partial payment; and

5. Employer M will not decrease, increase or terminate the payroll deduction unless the employee's employment has terminated or all such credit has been purchased.

Additionally, the proposed ordinance provides that (1) the contributions are being paid by the employer in lieu of contributions by the employee, (2) the employee does not have the option of choosing to receive the contributed amounts directly instead of having them paid by the employer to the pension plan, and (3) the election by an employee to have Employer M pick up such contributions will be binding and irrevocable.

Based on the facts and representations above, you request the following rulings:

1. The payroll reduction contributions used to purchase additional service credit and to redeposit withdrawn contributions will be treated as employer contributions picked up by the City within the meaning of section 414(h)(2) of the Code for federal income tax purposes and will not be taxable to the employee until

distribution, and

2. The payroll reduction contributions will not constitute wages under section 3401(a) of the Code.

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' 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 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 services prior to the date of the last governmental action necessary to effect the employer pick up.

Employer M proposes to adopt the ordinance described above to permit participants of Plan A to elect to have such payroll reduction contributions for the purchase of additional service credit or the redeposit of withdrawn contributions picked up by Employer M. The proposed ordinance provides that the participants will be required to complete a binding irrevocable payroll reduction authorization form if they so elect, and they will not have the option of choosing to receive the contributed amounts directly instead of having them paid to Plan A. The proposed ordinance further provides that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee.

Accordingly, with respect to ruling request one, the payroll reduction contributions used to purchase additional service credit and to redeposit withdrawn contributions will be treated as employer contributions picked up by Employer M within the meaning of section 414(h)(2) of the Code for federal income tax purposes.

Regarding ruling request two, since the picked-up contributions are to be treated as employer contributions, such contributions are excepted from wages as defined in section 3401(a)(12)(A) of the Code for federal income tax purposes.

In accordance with Revenue Ruling 87-10, this ruling applies no earlier than the later of the date the ordinance is adopted or put into effect.

This ruling is based on the assumption that Plan A will be qualified 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 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.

Sincerely yours,

(signed) John Swieca

John Swieca, Manager
Employee Plans Technical Group 1
Tax Exempt and Government Entities Division

Enclosures:
Deleted copy
Notice of Intention to Disclose