200240054

Uniform Issue List: 414.09-00

JUL 10 2002

T:EP:RA:T1

Attn:

Legend:

Employer A =

State B =

Plan X =

Ordinance C =

Dear :

This is in response to a ruling request dated December 21, 2001, concerning the pick up of certain employee contributions to Plan X under section 414(h)(2) of the Internal Revenue Code ("Code").

The following facts and representations have been submitted:

On June 18, the Council of Employer A passed Ordinance C adopting Plan X, effective July 1, Prior to July 1, Employer A's police officers participated in a retirement system sponsored by State B. Under the terms of the Plan, any full-time employee of Employer A is eligible to participate in the Plan provided that such individual is employed as a certified police officer. Plan X requires mandatory employee contributions equal to seven per cent of compensation and is intended to qualify under Code section 401(a).

According to Plan X's terms, every individual who was a covered employee as of June 30, could have elected to participate in Plan X effective July 1, continuing until his or her termination date. Such election was irrevocable, made on a written application supplied by Employer A, and contained an agreement to make, as a condition of his or her employment with Employer A, participant contributions. If an employee who was otherwise eligible to participate failed to return the completed application, he or she ceased to be a covered employee as of July 1 Every other employee who becomes a covered employee on or after July 1 becomes a participant on the date he or she first performs an hour of service as a covered employee.

Ordinance C provides that Employer A will pick up the mandatory employee contributions within the meaning of Code section 414(h)(2). It states that participant contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee. Section 26 of Plan X provides for participant contributions to be picked up by Employer M. The Section further provides that these contributions become a part of both the participant's "employee contribution benefit" and participant's "accrued benefit". Therefore, participants in Plan X do not have the option to receive the picked up contributions directly instead of having them paid by Employer A to Plan X.

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

1) That the mandatory contributions to Plan X made by participants and picked up by Employer A under section 26 of the Plan will be treated as employer contributions for federal income tax purposes.

2) That the mandatory contributions made by participants and picked up by Employer A will not be included in the current gross income of the employees for federal income tax purposes.

3) That the mandatory contributions of participants picked up by Employer A will not constitute wages subject to federal income tax withholding.

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 for federal income tax purposes 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.

In this case, the one-time irrevocable election by employees who wish to participate in the pick up of employee contributions under Plan X does not violate Revenue Rulings 81-35 and 81-36 because it does not result in such employees having sufficient control of the contributed amounts to preclude such amounts from being treated as employer contributions.

Employer A's Ordinance C and Plan X satisfy 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 participating employees. No 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 the mandatory contributions to Plan X made by participants and picked up by Employer A under section 26 of the Plan will be treated as employer contributions for federal income tax purposes.

2) That the mandatory contributions made by participants and picked up by Employer A will not be included in the current gross income of the employees for federal income tax purposes.

3) That the mandatory contributions of participants picked up by Employer A will not constitute wages subject to federal income tax withholding.

The effective date for the commencement of any proposed pick up as specified in the final resolution cannot be any earlier than the later of the date the final resolution is signed or put into effect.

This ruling is based on the assumption that Plan X is qualified under Code section 401(a) at all relevant times.

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 Code section 3121(v)(1)(B).

This ruling is directed only to the taxpayer who requested it. Code section 6110(k) provides that it may not be used or cited by others as precedent.

A copy of this ruling has been sent to your authorized representative pursuant to a power of attornev on file in this office. If you have any questions, please call T:EP:RA:T1 at (202) 283-9610.

Sincerely yours,

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

Enclosures:
Deleted Copy of the Ruling
Notice 437

cc: