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TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

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

U.I.L. 414.09-00

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FEB 26 2003

*T:EP:RA:UK*

Attn: xxxxx

xxxxx

LEGEND:

State A =

Fund F =

Employer M =

Plan X =

Group B Employees =

City A =

Ordinance O =

Dear

This is in response to a letter dated March 12, 2002, as supplemented by correspondence dated November 7, 2002, and January 24, 2003, in which your authorized representative requested a private letter ruling on your behalf concerning the federal income tax treatment of certain contributions made to Plan X under section 414(h)(2) of the Internal Revenue Code.

The following facts and representations have been submitted in support of the rulings being requested:

Fund F is a trust created in accordance with State A statutes to combine the pension and retirement funds of incorporated cities and towns of State A for purposes of management and investment, represented by and acting through its

Board of Trustees. Fund F established Plan X for the benefit of employees of municipalities which are chartered, incorporated or formed under the laws of State A. Section 14.8 of Plan X provides that the provisions of the Trust Indenture establishing Fund F is incorporated into and made a part of Plan X. Section 1.2 of Plan X provides that a municipality as described therein may adopt Plan X by executing a Joinder Agreement which incorporates Plan X by reference.

It is represented in your request that Employer M is a political subdivision of State A eligible to adopt Plan X, and meets the definition of Employer as defined in section 2.1(t) of Plan X.

Originally effective July 1, 1989, Plan X, a defined benefit plan, was restated effective July 1, 2001. The Joinder Agreement evidencing Employer M's adoption of Plan X, as restated, was executed and signed by the mayor of City A on May 17, 2001. Further, to implement the terms of Plan X, as restated, the Council of City A passed and approved Ordinance O on May 17, 2001. Ordinance O, which was signed by the mayor of City A, acknowledges Employer M's adoption of amendments to Plan X as reflected in Employer M's Joinder Agreement. Ordinance O also confirms the ratification and confirmation of Employer M's Joinder Agreement. Employer M's executed Joinder Agreement was approved by Fund F on June 29, 2001. It is represented that Plan X meets the qualification requirements of section 401(a) of the Code.

Section 3.3 of Plan X provides, in part, that if the Employer elects in the Joinder Agreement, all Participants shall be required as a condition of employment to make contributions as specified in the Joinder Agreement. These contributions shall be picked up and assumed by the Employer and paid to the fund in lieu of contributions by the Participants. Such contributions shall be designated as Employer contributions. Each Participant's compensation will be reduced by the amount paid to the fund by the Employer in lieu of the required contributions by the Participant. These contributions shall be excluded from the Participant's gross income for federal income tax purposes and from wages for purposes of withholding, in the taxable year in which contributed. No Participant shall have the option of receiving the contributed amounts directly as Compensation. Section 2.1(v) of Plan X defines fund as the fund established to provide benefits under Plan X.

When Employer M executed its Joinder Agreement on May 17, 2001, amending and restating Plan X, it elected the pick-up option as its plan design. Plan X, as amended and restated, reflecting the pick-up option is effective July 1, 2001. Section 4 of the Joinder Agreement, as executed by Employer M, provides that each Group B Employee shall be required to contribute to Plan X the percentage of his or her compensation required to be contributed as of July 1, 1989, the original effective date of Plan X. You represent that Plan X requires mandatory employee contributions equal to 3.75 percent of the Group B Employee's compensation. Section 4 further provides that these contributions shall be picked up and assumed by Employer M and paid to the fund which holds

the Plan X assets in lieu of contributions by the Group B Employees. Section 4 also provides that no Group B Employee shall have the option of receiving the contributed amounts directly as compensation.

Based upon the aforementioned facts, you request the following rulings:

1. Plan X constitutes a pick-up program by Employer M which satisfies the requirements of section 414(h)(2) of the Code.

2. No part of any mandatory contribution to Plan X picked up by Employer M on behalf of the Group B Employees in Plan X will be considered gross income to the Group B Employees until distributed or otherwise made available to such employees within the meaning of section 402(a) of the Code.

3. The mandatory contributions will be treated as employer contributions for federal income tax purposes.

4. The mandatory contributions picked up by Employer M will not constitute wages from which federal income taxes 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 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 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 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, section 3.3 of Plan X and section 4 of Employer M's Joinder Agreement meet the criteria of Rev. Rul. 81-35 and Rev. Rul. 81-36 by providing, in effect, that required contributions made to Plan X by the Group B Employees shall be picked up and assumed by Employer M and paid to Plan X in lieu of contributions by the Group B Employees. Section 3.3 of Plan X and Section 4 of the Joinder Agreement further provide that no Group B Employee shall have the option of receiving the contributed amounts directly.

With respect to rulings requests 1, 2, 3 and 4, we conclude that Plan X, as adopted by Employer M, constitutes a pick up program that satisfies the requirements of section 414(h)(2) of the Code. The mandatory contributions that are picked up by Employer M on behalf of Group B Employees who participate in Plan X shall be treated as employer contributions and will not be considered gross income to the Group B Employees until distributed. These amounts will be includible in the gross income of the Group B Employees or their beneficiaries in the taxable year in which they are distributed to the extent that the amounts represent contributions made by Employer M. Because we have determined that the picked-up amounts are to be treated as employer contributions, they are excepted from wages as defined in section 3401(a)(12)(A) of the Code for federal income tax withholding purposes. In addition, no part of the amounts picked up by Employer M will constitute wages for federal income tax withholding purposes in the taxable year in which they are contributed to Plan X.

These rulings apply only if the effective date for the commencement of the pick-up is no earlier than the later of the date Plan X was executed and adopted by Employer M, or the date the pick-up is put in effect. This ruling is based on Plan X and Employer M's Joinder Agreement that was signed by the mayor of City A on June 13, 2001.

In accordance with Rev. Rul. 87-10, this ruling does not apply to any contribution to the extent it relates to compensation earned before the later of the effective date of Plan X or the date the pick-up is put into effect.

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.

These rulings are based on the assumption that Plan X will be qualified under section 401(a) of the Code at the time of the proposed contributions and distributions.

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.

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

If you have any questions please contact xxxxx, Badge #xxxxx, T:EP:RA:T2 at (202) xxxxx.

Sincerely yours,

**(signed) JOYCE E. FLOYD**

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

Enclosures:

Deleted copy of letter ruling  
Form 437

cc:

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