Internal Revenue Service

Department of the Treasury

Washington, DC 20224

U.I.L. 414.09-00

Contact Person: 199913050

In Reference to:

Date:

JAN 7 1999

Legend

State A =
Employer M =
Group B Employees =

Plan X =
Bill A =

This is in response to a ruling request dated September 9, 1998, submitted on your behalf by your authorized representative, concerning the federal income tax treatment, under section 414(h)(2) of the Internal Revenue Code ("Code"), of certain contributions to Plan X.

The following facts and representations have been submitted by your authorized representative:

Employer M, a political subdivision of State A, has been a participating employer in Plan X, a defined benefit plan which has been determined to be qualified under section 401(a) of the Code. Plan X was established for the benefit of certain of its eligible employees, including Group B Employees. Plan X was established in accordance with the statutes of Employer M, the relevant parts of which have been incorporated by reference.

Pursuant to section 7.1 of Plan X, employees of Employer M who are participants in Plan X are required to contribute a specified percentage of their compensation to Plan X as a condition of employment. Pursuant to Bill A, Employer M

employees who participate in Plan X, in lieu of such employees paying such contributions. In addition, such employees will have no option to receive the picked-up contributions in cash instead of having such contributions paid to Plan X. Bill A was passed by the County Council of Employer M and signed into law on April 4, 1998.

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

1. That no part of the mandatory contributions picked up by Employer M on and after May 8, 1998, will be included in the gross income of the Group B Employees for federal income tax purposes.

2. That the mandatory contributions picked up by Employer M on and after May 8, 1998, although designated as employee contributions will be treated as employer contributions for federal income tax purposes.

3. That contributions picked up by Employer M on and after May 8, 1998, will not constitute wages from which federal income taxes must be withheld.

4. That contributions picked up by Employer M on or after May 8, 1998, will not be included in the gross income of the employee until distributed.

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), 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.

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 request, Bill A, satisfies the criteria set forth in Rev. Rul. 81-35 and Rev. Rul. 81-36. It provides that Employer M will make contributions in lieu of contributions by Group B Employees and that the Group B Employees may not elect to receive such contributions directly.

Accordingly, we conclude with respect to ruling requests numbers 1, 2, 3, and 4 that the amounts picked up by Employer M on behalf of the Group B employees who participate in Plan X shall be treated as employer contributions and will not be includible in the Employees' gross income in the year in which such amounts are contributed for federal income tax treatment. These amounts will be includible in the gross income of the Employees or their beneficiaries only 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 cannot be any earlier than the later of the date Bill A was signed or the date the pick-up is put into effect.

For purposes of the application of section 414(h)(2) of the Code, it is immaterial whether an employer picks up contributions through a reduction in salary, an offset against future salary increases, or a combination of both.

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.

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).

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

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd
Chief, Employee Plans
Technical Branch 2

Enclosures:
Copy of this letter
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