

Washington, DC 20224

Person to Contact:

Telephone Number:

Refer Reply to:

OP:E:EP:T:4

Date: APR - 6 1999

Attn:

Legend:

State A =

Employer M =

Plan X =

Group B Employees =

Ladies and Gentlemen:

This letter is in response to a request for a private letter ruling dated June 22, 1998, as supplemented by a letter dated November 9, 1998, 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, a political subdivision of State A, has established Plan X for the benefit of Group B Employees. Plan X provides for mandatory employee contributions and satisfies the qualification requirements under section 401(a) of the Code.

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Pursuant to a resolution, adopted May 12, 1998, Employer M has agreed to pick up (assume and pay) the mandatory employee contributions of Group B Employees to Plan X in lieu of Group B Employees paying such contributions. In addition, Group B Employees do not have the option of receiving the contributed amounts directly instead of having such contributions paid to Plan X.

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

1. That no part of the mandatory contributions picked up by Employer M as the employer of Plan X members who participate in Plan X be constituted as gross income to Plan X members for federal income tax treatment.

2. That the 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 for federal income tax purposes.

3. That the contributions picked up by Employer M will not constitute wages from which 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) of the Code, 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.

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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 amounts directly instead of having them paid by the employer to the pension plan. Furthermore, 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.

The resolution adopted by Employer M satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 because it specifies that Employer M will assume and pay mandatory employee contributions to Plan X in lieu of contributions by Group B Employees and that Group B 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 the amounts picked up by Employer M on behalf of Group B Employees shall be treated as employer contributions and will not be includible in such Group B Employees' gross income in the year in which such amounts are contributed. These amounts will be includible in the gross income of such Group B Employees or their beneficiaries only in the taxable year in which such amounts are distributed to them.

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 B Employees' salaries with respect to such picked-up contributions. For purposes of the application of section 414(h)(2) of the Code, it is immaterial whether Employer M picks up contributions through a reduction in salary, an offset against future salary increases, or a combination of both.

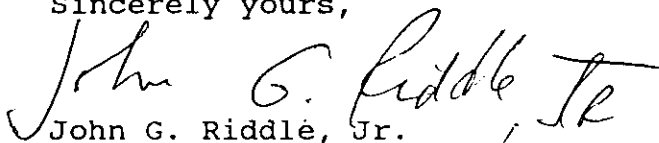
The effective date for the commencement of the proposed pick-up as specified in the aforesaid resolution cannot be any earlier than the later of the date the resolution is signed or the date it is put into effect.

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 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) of the Code.

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

Sincerely yours,



John G. Riddle, Jr.
Chief, Employee Plans
Technical Branch 4

Enclosures:
Deleted copy of letter
Notice 437

cc: