Uniform Issue List 414.01-00

Internal Revenue Service

199932055

Department of the Treasury

Washington, DC 20224

Person to Contact:

XXXXXXXX
XXXXXXXXX
XXXXXXXXX

Telephone Number:

Refer Reply to:
OP:E:EP:T:1
Date:

MAY 19 1999

Legend:

State A = XXXXXXXX

Employer M = XXXXXXXX

Plan X = XXXXXXXXXX

Re: Ruling Request on behalf of XXXXXXX

Dear Sir/Madam:

This is in response to correspondence dated June 22, 1998, as supplemented by a facsimile dated March 4, 1999, in which you requested a private letter ruling concerning the federal income tax treatment under section 414(h)(2) of the Internal Revenue Code and of certain contributions to Plan X.

You submitted the following facts and representations. Employer M is a political subdivision of State A. State A established Plan X for employees of State A and its political subdivisions. Plan X is qualified under section 401(a) of Internal Revenue Code (the "Code"). Participation in Plan X is mandatory for all current active eligible employees and future employees. By a resolution dated June 26, 1998, Employer M resolved to "pick up" the mandatory employee contributions to Plan X on behalf of its employees. The resolution specifically states that the employee contributions will be paid by the employer in lieu of contributions being paid by the employee.

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Pursuant to the above-referenced resolution, the pick up was effective July 1, 1998, at which time Employer M began making the contributions directly to Plan X in lieu of employees making such contributions. Employees do not have the option of receiving the pick up contribution in cash instead of having the contribution paid directly to Plan X.

Based on the foregoing facts and representations, you request a private letter ruling that the proposed pick up satisfies the requirements of section 414(h)(2) of the Code and therefore employees may exclude from current gross income for federal income tax purposes contributions made by Employer M to Plan X on their behalf.

Section 414(h)(2) of the Code provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if: (1) such contributions are made to a plan determined to be qualified under section 401(a), (2) the plan is established by a state government or a political subdivision thereof and (3) the contributions are picked up by the employer.

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.

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), 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 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.

In order to satisfy Revenue Rulings 81-35 and 81-36 with respect to particular contributions, Revenue ruling 87-10, 1987-1 C.B. 136 provides that the required specification of designated employee contributions must be completed before the period to which such contributions relate. If not, the designated employee contributions being paid by the employer are actually employee contributions paid by the employee and recharacterized at a later date. Thus, the retroactive specification of designated employee contributions that are paid by the employing unit, i.e., the retroactive "pick-up" of designated employee contributions by a governmental employer, is not permitted under section 414(h)(2) of the Code.

The resolution adopted by Employer M satisfies the criteria set forth in Revenue Rulings 81-35 and 81-36 (1) that the contributions, although designated as employee contributions, are to be made by Employer M in lieu of contributions by the employees, and (2) that the employees may not elect to receive such contribution amounts directly.

Accordingly, we conclude that the proposed pick up Plan satisfies the requirements of section 414(h)(2) of the Code. Because the amounts picked up by Employer M satisfy the requirements of section 414(h)(2) of the Code, they will be treated as employer contributions, and will not be included in the gross income of employees in the year in which such contributions are made.

The effective date for the commencement of any proposed pick-up cannot be any earlier than the later of the date the final resolution is signed or the date it is put into effect. Therefore, the above ruling applies to contributions picked up by Employer M on or after July 1, 1998.

Employer M has not requested a ruling and the Internal Revenue Service reaches no conclusion in this letter as to the status of Plan X as a governmental plan within the meaning of section 414(d) of the Code.

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This ruling is based on the assumption that Plan X 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).

Sincerely yours,

John Swieca
Chief, Employee Plans
Technical Branch 1

Enclosures:
Copy of this letter
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Notice 437

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