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Internal Revenue Service Department of the Treasury

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Refer Reply to:
OP:E:EP:T**

Date: JUL 20 1999

Attn: **********
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Legend:

State A = **********
Employer M = **********
Group B
Employees = **********
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Plan X = **********
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Resolution A= **********
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Dear M**********

This is in response to your ruling request dated February 23, 1999, 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:

State A has established various pension plans, including Plan X, which are qualified under section 401(a) of the Code. Employer M, an agency of State A, is a participating employer in Plan X. Group B Employees are required to contribute to Plan X.

Pursuant to Resolution A, Employer M will pick up, i.e., assume and pay, the mandatory employee contributions of Group B Employees in lieu of such employees paying such contributions. In addition, Group B Employees will have no option to receive the picked-up contributions in cash instead of having such contributions paid to Plan X. Resolution A was adopted by the Employer M Board of Trustees February 23, 1999.

Based on the aforementioned facts, you request a ruling that contributions made by Group B Employees to Plan X which are picked up by Employer M under the provisions of Resolution A will not be included in the gross income of the Group B Employees for federal income tax purposes.

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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 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 request, Resolution 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 contribution by Group B Employees and that Group B Employees may not elect to receive such contributions directly.

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Accordingly, we conclude with respect to your ruling request that the amounts picked 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 Group B 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 Group B 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.

This ruling applies only if the effective date for the commencement of the pick-up cannot be any earlier than the later of the date Resolution 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 slaary increases, or a combination of both.

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 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).

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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.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd
Chief, Employee Plans
Technical Branch 2

Enclosures:
Deleted Copy of this Letter
Notice of Intention to Disclose