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

200221058

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

U.I.L. 414.09-00

FEB 27 2002

T:EP:RA:T2

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Attn: XXXXXXXXX

Legend:

State A	= ***
Employer M	= ***
Plan X	= ***
Board D	= ***
Group B Employees	= ***
Statute T	= ***

This letter is in reply to a request for a letter ruling dated April 10, 2001, made on your behalf by your authorized representative, concerning the federal income tax treatment of certain contributions made to Plan X under section 414(h)(2) of the Internal Revenue Code ("Code").

The following facts and representations have been submitted:

Statute T authorizes the establishment of Plan X by Employer M, an instrumentality of State A. Statute T provides that a board, such as Board D, may establish an optional retirement program under which contracts providing retirement and death benefits may be purchased for its employees. Section B of Statute T provides, in pertinent part, that an optional retirement plan, such as Plan X, established under this section shall be designated as a qualified governmental plan under sections 401(a) and 414(d) of the Code, and a qualified pick up plan as defined in section 414(h)(2).

Section H of Statute T provides, in pertinent part, that although designated as employee contributions, all Group B Employees' contributions made to Plan X shall be picked up and paid by Employer M in lieu of contributions by the Group

B Employees. The contributions picked up by Employer M may be made through a reduction in the employee's salary or an offset against future salary increases, or a combination of both. The Group B Employees participating in Plan X do not have the option of choosing to receive the contributed amounts directly instead of Employer M paying such amounts to Plan X.

Pursuant to the authority contained in Statute T, Employer M established Plan X. Plan X, a defined contribution plan, was executed by Board D on behalf of Employer M on March 31, 2001. Plan X was established by Employer M effective July 1, 2001. Plan X is intended to qualify under section 401(a) of the Code and constitute a governmental plan under section 414(d). In addition, Plan X is also intended to be a qualified plan within the meaning of section 414(h)(2). Employer M has requested a determination letter from the Internal Revenue Service as to the qualification of Plan X under section 401(a).

Section 1.19 of Plan X provides that contributions made by a Group B Employee under this plan are picked-up by Employer M within the meaning of section 414(h)(2) of the Code and pursuant to Section H of Statute T. Section 1.19 of Plan X further provides that these Group B Employee contributions are made in lieu of contributions by the Group B Employee and that the Group B Employee does not have the option of choosing to receive the contributed amounts directly instead of having those contributions paid by Employer M to Plan X. Section 4.1 of Plan X provides that each Group B Employee shall make a contribution to Plan X in an amount equal to 2.17 percent of the Group B Employee's compensation.

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

1. That the required Group B Employee contributions to Plan X that are "picked up" by Employer M within the meaning of section 414(h) of the Code will be excluded from the Group B Employee's gross income.

2. That the "picked up" contributions to Plan X will not be considered wages for federal income tax withholding purposes, and therefore federal income taxes need not be withheld from the "picked up" contributions.

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) or 403(a) of the Code, established by a state government or political subdivision thereof, or by any agency or instrumentality of any of the foregoing, where the contributions of employing units are designated as employee contributions, the contributions so picked up shall be treated as employer contributions.

Revenue Ruling 77-462, 1977-2 C.B. 358, addresses the federal income tax treatment of contributions picked up by the employer within the meaning of section 414(h)(2) of the Code. In Rev. Rul. 77-462, the employer school district agreed to pick up the required contributions of the eligible employees under the plan. The revenue ruling held that under the provisions of section 3401(a)(12)(A) of the Code, the school district's picked–up contributions to the plan are excluded from wages for purposes of the Collection of Income Tax at Source on Wages, and no federal income tax withholding is required from employees' salaries with respect to the said picked-up contributions. The revenue ruling further held that the school district's picked-up contributions are excluded from the gross income of employees until such time as they are distributed to the employees.

Revenue Ruling 81-35, 1981-1 C.B. 255, and Revenue Ruling 81-36, 1981-1 C.B. 255, provided guidance as to whether contributions will be considered as "picked up" by the employer. Both revenue rulings establish that the following two criteria must be satisfied: (1) the employer must specify that 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 have an option of choosing to receive the contributed amounts directly or to have them paid by the employer to the plan.

In Revenue Ruling 87-10, 1987-1 C.B. 136, the 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 must be completed before the period to which such contributions relate.

In this case, Plan X satisfies the requirements of Rev. Ruls. 81-35 and 81-36. Section 1.19 of Plan X provides that Group B Employees' contributions are made to Plan X in lieu of contributions by the employees and that the Group B Employee does not have the option of choosing to receive the contributed amounts directly instead of having those amounts paid by Employer M to Plan X. Further, Statute T, which provides the statutory authority for the establishment of Plan X by Board D on Employer M's behalf, provides that all Group B Employees' contributions made to Plan X, although designated as employee contributions, shall be picked up and paid by Employer M in lieu of contributions by the Group B Employees. Statute T further provides that the Group B Employees participating in Plan X do not have the option to receive the contributed amounts directly instead of Employer M paying such amounts to Plan X. Statute T also provides Employer M may pick up these contributions through a reduction in the Group B Employee's salary or an offset against future salary increases, or a combination of both.

Therefore, with respect to your first ruling request, we conclude that the required contributions made by the Group B Employees to Plan X that are picked

up by Employer M pursuant to section 1.19 of Plan X and Section H of Statute T are picked up contributions within the meaning of section 414(h)(2) of the Code and as such will not be includible in the gross income of the Group B Employees until such amounts are distributed from Plan X to the extent that these amounts represent contributions made by Employer M. These amounts will be includible in the gross income of the Group B Employees (or their beneficiaries) in the year in such amounts are distributed to the extent that they represent amounts contributed by Employer M.

With respect to your second ruling request, since we have determined that the picked up contributions made pursuant to section 1.19 of Plan X and Statute T are to be treated as employer contributions, we conclude that these contributions 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 in the taxable year in which they are contributed to Plan X.

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.

In accordance with Rev. Rul. 87-10, this ruling does not apply to any contribution to the extent that it relates to compensation earned before the later of the effective sate of the relevant statute, or the date the pick up election under Plan X is effective.

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 contributions in question are paid pursuant to a "salary reduction agreement" within the meaning of section 3121(v)(1)(B) of the Code.

The effective date for the commencement of any proposed pick up cannot be any earlier than the latest of the implementation of the proposed pick up program by Employer M or the date it is put in effect.

This letter ruling is directed only to the taxpayer that 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 ruling 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 ***, T:EP:RA:T:2 at ***.

Sincerely yours,
(signed) JOYCE E. FLOYD

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

Enclosures:
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