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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

AUG 26 2003

U.I.L. 414.09-00

T:EP:RA:T4

Legend
The Parent Corporation =
The Employer =
Statute P =
Statute S =
Plan X =

Proposed Amendment O =

State A =

Dear

This is in response to a ruling request dated as supplemented by correspondence dated 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.

Your authorized representative has submitted the following facts and representations:

The Parent Corporation was established on a hospital authority under Statute P. As a hospital authority, the Parent Corporation is a political subdivision of State A. The Parent has four subsidiaries. For purposes of this ruling letter, the Employer consists of the Parent Corporation and its subsidiaries.

Statute S allows the Parent Corporation hospital authority to establish and maintain its own retirement plan.

The Parent Corporation established Plan X, a money purchase plan, effective. Its four subsidiaries adopted Plan X. Certain employees of the Employer are eligible to participate in Plan X. Plan X serves as a substitute social security plan in accordance with section 3121(b)(7)(F) of the Code that is intended to qualify under section 401(a) for covered employees of the Employer. Plan X has received a favorable determination letter from the Service dated.

Section 4.02 of Plan X requires that each employee of the Employer contribute a certain percentage of their compensation to Plan X. The Employer proposes to amend Plan X to provide that employee contributions will be picked up by and contributed to Plan X. To effectuate the pickup of employee contributions as provided in Statute S, the Employer intends to adopt Proposed Amendment O.

Proposed Amendment O would amend Section 2.17(b) of Plan X to provide that "Employee Contribution" shall mean the amount of employee contributions which the Employer picks up (within the meaning of section 414(h)(2) of the Code and contributes to Plan X during the Plan year under section 4.02 of Plan X.

Section 4.02 of Plan X currently provides that "Each Eligible Employee" shall contribute to the Trust Fund for each Plan Year an amount equal to the current FICA rate multiplied by his compensation (as defined in Section 2.15 of Plan X subject to a maximum of of annual compensation) while eligible to participate in Plan X, subject to a maximum of ten percent; (10%). Proposed Amendment O would amend Section 4.02 of Plan X to further provide that, for each Eligible Employee, the Employer will assume and pay the Employee Contributions required under Section 4.02. The intent of Section 4.02, as amended by Proposed Amendment O, is to provide that the Employer will "pick up" within the meaning of Code section 414(h)(2) the employee contributions required by Section 4.02. Even though these contributions are designated as Employee Contributions for determining employee rights under Plan X and employee remuneration for services, the contributions will be paid by the Employer in lieu of contributions by Eligible Employees, and Eligible Employees will not have the option of choosing to receive the contributed amounts directly. Section 4.02, as amended by Proposed Amendment O, further provides that the Employee Contributions will be picked up beginning as of the date indicated in Section 4.02, which shall not occur prior to the formal adoption of Proposed

Amendment O, and that such pickup treatment will apply only to Employee Contributions made on or after such date.

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

1. The employee contributions to Plan X, which are picked up by the Employer are excluded from the current gross income of the eligible employees who participate in Plan X.

2. The employee contributions picked up by the Employer will not constitute wages from which taxes must be withheld under section 3401(a)(12)(A) of the Code, in the taxable year in which they are contributed to Plan X.

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 wihholding 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 Ruling 81-335 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, Proposed Amendment O satisfies the criteria set forth in Rev. Rul.81-35 and Rev. Rul. 81-36, by providing, in effect, that the Employer and its subsidiaries willl make contributions to Plan X in lieu of contributions by the eligible employees in Plan X. Under Proposed Amendment O, eligible employees participating in Plan X are not given the option to receive the contributed amounts directly in lieu of having such contributions paid by the Employer Plan X.

Accordingly, we conclude with respect to ruling requests numbers 1 and 2 that the amounts picked up by the Employer on behalf of the eligible employees who participate in Plan X shall be treated as employer contributions and will not be includible in the eligible 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 eligible employees or their beneficiaries in the taxable year in which they are distributed, to the extent that the amounts represent contributions made by the Employer. Because we have determined that the picked-up amounts are to be treated as employer contributions, they will not constitute 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 the Employer 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 is no earlier than the later of the date Proposed Amendment O is signed or the date the pick-up is put into effect. This ruling is based on Proposed Amendment O as set forth in your letter dated March 31, 2003.

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))(8).

These rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited by others as precedent.

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

If you have questions regarding this ruling, you may contact

Sincerely yours,

Employee Plans Technical Group 4

Enclosures:

Copy of deleted Ruling
Notice of Intention to Disclose (Notice 437)