199950041

Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Significant Index Number: 414.09-00

Contact Person:

Telephone Number:

In Reference to:

OP:E:EP:T:1

Date: 9/23/99

Attn:

Legend:

Employer A =

State B =

Plan X =

Dear :

This is in response to a ruling request dated June 10, 1999, as supplemented by correspondence dated September 13, 1999, concerning the pick up of certain employee contributions to Plan X under section 414(h)(2) of the Internal Revenue Code.

The following facts and representations have been submitted:

Employer A, an agency of State A, participates in Plan X, a defined contribution plan, for the benefit of its employees. The Plan requires mandatory employee contributions and is qualified under Code section 401(a).

Pursuant to a resolution dated June 10, 1999, Employer A has agreed to pick up, i.e., assume and pay, the mandatory employee contributions to Plan X, in lieu of employees paying such contributions. Eligible employees do not have the option to receive the picked up contributions in cash in lieu of having such contributions paid to Plan X.

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Based on the foregoing facts and representations, you have requested the following ruling:

No part of the contributions to Plan X picked up by Employer A on behalf of eligible employees will constitute taxable income to such employees in the year of the pick up.

Code section 414(h)(2) provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if such contributions are made to a plan described in Code section 401(a), established by a state government or a political subdivision thereof, or any agency or instrumentality of any one of the foregoing, which is wholly owned thereby, 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 Code section 414(h)(2) 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. Rev. Rul. 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 Code 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 Code section 414(h)(2) 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. Furthermore, it is immaterial, for purposes of the applicability of Code 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.

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Employer A's resolution satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 by providing that Employer A will make contributions in lieu of contributions by eligible employees and that no employee will have the option of receiving the contribution instead of having it contributed to Plan X.

Accordingly, we conclude that: the resolution adopted by Employer A satisfies the requirements of Code section 414(h)(2). Amounts picked up by Employer A for employees shall be treated as employer contributions and will not be includable in employees' gross income for the taxable year in which such amounts are contributed.

Because we have determined that the picked up amounts are to be treated as employer contributions, they are excepted from wages as defined in Code section 3401(a)(12)(A) for Federal income tax withholding purposes. Therefore, no withholding of Federal income tax is required from employees' salaries with respect to such picked up amounts.

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

For purposes of the application of Code section 414(h)(2), 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.

This ruling is based on the assumption that Plan X will be qualified under Code section 401(a) 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 the whether the amounts in question are paid pursuant to a "salary reduction agreement" within the meaning of Code section 3121(v)(1)(B).

This ruling is directed only to the taxpayer who requested it. Code section 6110(k) provides that it may not be used or cited by others as precedent.

Sincerely yours,

John Swieca,
Chief, Employee Plans
Technical Branch 1

Enclosures:
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