Internal Revenue Service

Department of the Treasury

Washington, DC 20224

200007035

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Contact Person:

Telephone Number:

In Reference to:
OP:E:EP:T:1

Date:
NOV. 23, 1999

EIN:

LEGEND:

State A =
Employer M =

Plan X =
County A =
County B =
County C =

Gentlemen:

This is in response to a request submitted on your behalf by your authorized representative on May 25, 1999, for a private ruling letter concerning the federal income tax treatment of certain contributions to Plan X under section 414(h)(2) of the Internal Revenue Code ("Code").

In support of the ruling request the following facts and representations have been submitted:

Employer M was incorporated in August 1965 to plan, coordinate and administer programs designated to combat poverty in Counties A, B, and C of State A. Employer M participates in Plan X, the pension system for employees of State A, its agencies, instrumentalities, and political subdivisions.

In 1999 the State A legislature enacted legislation permitting employers participating in Plan X to pick up employee contributions as described in section 414(h)(2) of the Code. Pursuant to the newly enacted state law, Employer M adopted a resolution on May 25, 1999. The resolution provides that Employer M shall pick up the retirement contributions required to be made by the employee and will treat the mandatory contributions as paid by the employer in lieu of such contributions being paid by the employee, and

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that the employee will not have the option of receiving the pick-up contributions in cash instead of having the contribution paid to the retirement plan.

Based on the facts described above, Employer M requests the following rulings under section 414(h) of the Code:

1. That the mandatory contributions made by participants and picked up by Employer M under Plan X will be treated as employer contributions for federal income tax purposes.

2. That the mandatory contributions made by participants and picked up by Employer M under Plan X will not be included in the current gross income of the employees for federal income tax purposes.

3. That the mandatory contributions of participants picked up by Employer M under Plan X will not constitute wages subject to federal income tax withholding.

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) 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' 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

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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 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.

The terms of Plan X and the resolution adopted on May 25, 1999, by Employer M satisfy the criteria set forth in Revenue Rulings 81-35 and 81-36 because the contributions, although designated as employee contributions, are to be made by Employer M in lieu of contributions by the employees; and the employees may not elect to receive such contribution amounts directly.

Accordingly, we conclude that the mandatory employee contributions made by participants and picked up by Employer M will, for federal income tax purposes, be treated as employer contributions and not be included in the gross income of the employees in the taxable year

contributed, and will not constitute wages subject to federal income tax withholding under section 3401(a)(12)(A) of the Code.

The ruling applies only to contributions specified in the resolution adopted on May 25, 1999. The effective date for the commencement of the pickup of the mandatory contributions cannot be earlier than the later of May 25, 1999, or the date the resolution is put into effect.

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. 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).

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.

This ruling is directed only to the taxpayer who requested it. Section 6110(c)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Sincerely yours,

John Swieca
Chief, Employee Plans
Technical Branch 1

Enclosures:
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Notice of Intention to Disclose