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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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Attention: **********

LEGEND:

State A = **********
Employer M = **********
Local B = **********
Local C = **********
Local D = **********
Plan X = **********
Statute Y = **********
Resolution I = **********
Resolution J = **********
Resolution K = **********

Dear **********

This is in response to a ruling request dated ********** as supplemented by additional correspondence dated **********, submitted by you, concerning the federal income tax treatment of certain pick up contributions, under section 414(h)(2) of the Internal Revenue Code ("Code"), to Plan X.

The following facts and representations have been submitted:

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Employer M, a city in State A established Plan X for the benefit of certain employees of Employer M. Employer M established Plan X pursuant to State A general Statute Section 7-148©(5) which empowers State A municipalities to provide for and establish pension systems for employees.

Plan X is a defined benefit pension plan and Employer M has represented that Plan X satisfies the applicable requirements of section 401(a) of the Internal Revenue Code. Plan X has not received a favorable determination letter from the Internal Revenue Service.

Bargaining and nonbargaining unit members of Local B, Local C and Local D, make mandatory contributions from 2 ¼% to 8% of compensation depending on the percentage negotiated by each bargaining unit.

Resolutions I, J and K provide that mandatory employee contributions on behalf of bargaining and nonbargaining unit members of Local B, Local C, Local D, respectively will be picked up and paid by Employer M to Plan X.

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

1. That contributions to Plan X will be treated as employer contributions picked up by Employer M within the meaning of Code section 414(h)(2) for federal income tax purposes.

2. That the contributions will not be included in the employee's gross income in the year of contribution, but will instead be included in the employee's gross income at the time such amounts are distributed or otherwise made available to the employee.

3. Picked -up contributions will not constitute wages under section 3401(a)(12)(A) of the Code for federal income tax withholding purposes.

Section 414(h)(2) of the Code provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if: (1) such contributions are made to a plan determined to be qualified under section 401(a); (2) the plan is established by a state government or a political subdivision thereof; and (3) the contributions are picked up by the employer.

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.

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The federal income tax treatment to be accorded contributions that 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 Director of Finance 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 Director of Finance 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), the Director of Finance'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 amounts directly instead of having them paid by the employer to the pension plan.

In order to satisfy Revenue Rulings 81-35 and 81-36 with respect to particular contributions, Revenue Ruling 87-10, 1987-1 C.B. 136 provides that the required specification of designated employee contributions must be completed before the period to which such contributions relate. If not, the designated employee contributions being paid by the employer are actually employee contributions paid by the employee and recharacterized at a later date. Thus, the retroactive specification of designated employee contributions are paid by the employing unit, i.e., the retroactive "pick-up" of designated employee contributions by a governmental employer, is not permitted under section 414(h)(2) of the Code.

Resolutions I, J and K as adopted by Employer M satisfies the criteria set forth in Revenue Rulings 81-35 and 81-36 (1) that the contributions, although designated as employee contributions, are to be made by Employer M in lieu of contributions by the employees, and (2) that the employees may not elect to receive such contribution amounts directly.

Accordingly, we conclude that with regards to Resolution I, effective **********, no part of the contributions picked-up by Employer M as the employer of the employees included in Plan X is gross income to the employees for federal income tax treatment; the contributions, whether picked-up by payroll deduction, offset against future salary

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increases, or both, and though designated as employee contributions, will be treated as employer contributions for federal income tax purposes; and such contributions will not constitute wages from which federal income taxes must be withheld.

Accordingly, we conclude that with regards to Resolution J, effective ********** no part of the contributions picked-up by Employer M as the employer of the employees included in Plan X is gross income to the employees for federal income tax treatment; the contributions, whether picked-up by payroll deduction, offset against future salary increases, or both, and though designated as employee contributions, will be treated as employer contributions for federal income tax purposes; and such contributions will not constitute wages from which federal income taxes must be withheld.

Accordingly, we conclude that with regards to Resolution K, effective **********, no part of the contributions picked-up by Employer M as the employer of the employees included in Plan X is gross income to the employees for federal income tax treatment; the contributions, whether picked-up by payroll deduction, offset against future salary increases, or both, and though designated as employee contributions, will be treated as employer contributions for federal income tax purposes; and such contributions will not constitute wages from which federal income taxes must be withheld.

Employer M has not requested a ruling and 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(h) of the Code.

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.

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).

If you have any questions, please contact ********** at **********.

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This ruling is directed solely 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.

Sincerely,

Alan Pipkin, Manager
Employee Plans Technical Group 4

Enclosures:
Copy of this letter
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Notice 437

cc: