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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

U.I.L. 414.09-00

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OCT 31 2002

Attn: XXXXXXX

TEP RA T2

Legend

State A = ***

Group B Employees = ***

Statute R = ***

Plan X = ***

Employer M = ***

Resolution N = ***

Dear ***:

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

The following facts and representations have been submitted in support of your ruling request.

State A has established various pension plans, including Plan X. Employer M, an agency of State A, is a participating employer in Plan X. You represent that Plan X meets the qualification requirements set forth under section 401(a) of the Code.

Group B Employees who participate in Plan X are required to contribute to Plan X. Pursuant to Resolution N, Employer M will pick up the mandatory employee

contributions of Group B Employees who participate in Plan X in lieu of the employees paying such contributions. In addition, Group B Employees who participate in Plan X will have no option to receive the picked up contributions in cash instead of having such contributions paid to Plan X.

Statute R provides that government employers, such as Employer M, shall pick up within the meaning of section 414(h)(2) of the Code, employees' required contributions. Statute R permits Employer M to reduce the current salaries of Group B Employees by an amount that equals the contribution picked up by Employer M and paid to Plan X. These contributions may not be included as gross income until the pick-up amounts are distributed or made available.

Statute R further states that the picked up contributions are designated as employee contributions and shall be treated as employer contributions in determining tax treatment. To effectuate the pick-up as provided for in Statute R, Employer M, on April 11, 2002, passed Resolution N. The effective date of the pick up will be January 1, 2003.

Pursuant to Resolution N, Employer M will pick up, i.e., assume and pay, the Group B Employees contributions to Plan X in accordance with Statute R. The Group B Employees' salaries will be reduced by an amount equal to the amount picked up by Employer M. Group B Employees participating in Plan X will not be given the option to receive cash directly in lieu of having such contributions paid to Plan X.

Based on the aforementioned facts, you request the following ruling:

1. That employee contributions picked up by employer M shall be excluded from the current gross income of the Group B Employees until distributed.

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 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 the 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 this request, Resolution N satisfies the criteria set forth in Rev. Rul. 81-35 and Rev. Rul. 81-36, by providing, in effect, that Employer M will specify that contributions, although designated as employee contributions, are being paid by Employer M in lieu of contributions by Group B Employees. Under Resolution N, Group B Employees participating in Plan X will not have the option of choosing to receive the contributed amounts directly instead of having them paid by Employer M to Plan X.

Accordingly, we conclude that the employee contributions picked up by Employer M on behalf of the Group B Employees who participate in Plan X shall be treated as employer contributions and will not be includible in the Group B Employees' gross income in the year in which such amounts are contributed to Plan X. These amounts will be includible in the gross income of the Group B Employees or their beneficiaries only in the taxable year in which they are distributed, to the extent that the amounts represent contributions made by Employer M.

This ruling applies only if the effective date for the commencement of the pick-up is no earlier than the later of the date Resolution N is signed or the date the pick-up is put into effect.

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.

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 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)(B).

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.

If you have any questions, please contact ***, T:EP:RA:T:2 at ***.

Sincerely yours,

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

Enclosures:
Deleted copy of ruling letter
Notice of Intention to Disclose