TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200423034

MAR 12 2004

UNIFORM ISSUE LIST: 414.00-00

SE:T:EP:RA:T3

Attn:

Legend:

City B =

Group B Employees =

Resolution M =

Plan X =

Dear

In letters dated November 12, 2003, and December 31, 2003, your authorized representative requested, on your behalf, a letter ruling concerning the federal income tax treatment of certain contributions to Plan X under section 414(h)(2) of the Internal Revenue Code.

The following facts and representations have been submitted:

Plan X was created by City B. Plan X, a defined benefit plan, is intended to meet the requirements of section 401(a) of the Code and is a governmental plan as specified in section 414(d) of the Code. Plan X was established and created for the benefit of Group B Employees.

Group B Employees who participate in Plan X are required to make mandatory contributions to Plan X as a percentage of the participant's salary as provided in the appropriate collective bargaining agreement. The pick up of Group B Employees' contributions would be accomplished pursuant to Plan X and Resolution M.

Pursuant to Resolution M, effective . City B agrees to pick up, i.e., assume and pay, the mandatory employee

contributions of Group B Employees to Plan X. Resolution M specifies that the contributions, although designated as employee contributions will be paid by City B in lieu of contributions by Group B Employees. Resolution M states that Group B Employees will not have the option of choosing to receive the contributed amounts directly instead of having them paid by City B to Plan X.

Based upon the aforementioned facts, you request a ruling that:

1. No part of the mandatory contribution picked up by City B will be constituted as gross income to the Group B Employees for federal income tax treatment for the taxable year in which the pick up is made.

2. The contribution whether picked up by salary reduction, offset against future salary increases, or both and though designated as Group B Employee contributions will be treated as employer contributions for federal income tax purposes.

3. The contribution picked up by City B will not constitute wages from which federal income tax will be withheld.

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' 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 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 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.

Pursuant to Resolution M, criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 is satisfied by providing, in effect, that City B will make contributions in lieu of Group B Employees' contributions and by providing that Group B Employees shall not be given the option to receive such contributions directly.

Accordingly, with respect to ruling requests 1 and 2, we conclude that the mandatory employee contributions picked up by City B on behalf of Group B Employees who are participants in Plan X, whether picked up by salary reduction, offset against future salary increases, or both, and although designated as Group B Employee contributions, will be treated as employer contributions for purposes of federal income taxation and will not be included in the Group B Employees' gross income for the 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 section 3401(a)(12)(A) of the Code for federal income tax withholding purposes. Therefore, with respect to ruling request 3, we conclude that no withholding of federal income tax is required from Group B Employees' salaries with respect to such picked-up contributions.

In accordance with Rev. Rul. 87-10, this ruling does not apply to any contribution to the extent it relates to compensation earned before the later of the effective date of the relevant statutes, the date the pick-up election is executed or the date it is put into effect.

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) of the Code.

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.

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

If you wish to inquire about this ruling, please contact I.D. # at Please address all correspondence to SE:T:EP:RA:T3.

A copy of this letter has been sent to your authorized representative in accordance with a Power of Attorney on file in this office.

Sincerely yours,

/s/ Frances V. Sloan

Frances V. Sloan, Manager
Employee Plans Technical Group 3

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