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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

200502047

OCT 18 2004

Uniform Issue List: 414.08-00

SE:T:EP:RA:T4

Legend:

County A =

State B =

Plan X =

State B Statute =

Resolution O =

Date 1 =

Dear :

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

The following facts and representations have been submitted on your behalf:

Plan X was created by the State B General Assembly to provide retirement benefits for certain employees of State B. County A is an employer that participates in Plan X. Plan X is a contributory retirement system established for employees of State B, including employees of participating counties in State B. Plan X is administered and governed by a board of trustees created by the State B General Assembly.

Employee contributions in Plan X are mandatory and established under State B law. Participating employees must contribute two percent of annual salary. State law

permits employers who participate in Plan X to pick-up employee contributions, as per section 414(h)(2) of the Code.

By Resolution O, passed and adopted by the County Commissioners of County A on Date 1, it was determined that two percent of the annual salary of all eligible employees under the authority of County A would by picked-up by County A, in accordance with section 414(h)(2) of the Code. Eligible employees of County A are all full-time employees of that county. Employee contributions are paid, under this resolution, by County A (the employer) in lieu of such contributions being paid by the eligible employees. In addition, eligible employees under this resolution do not have the option of receiving the picked-up contribution in cash instead of having it paid to Plan X.

State Retirement System B will not accept pick-up contributions until the employer has obtained a favorable letter ruling from the IRS and the request has been approved by the Board of Trustees.

Based on the above facts and representations, Plan X requests the following rulings:

1. That mandatory contributions to Plan X picked-up by County A on behalf of the eligible employees will be treated as valid pick-up contributions under section 414(h)(2) of the Code.

2. That no part of the pick-up contributions will constitute gross income to eligible employees for federal tax purposes until distributed or otherwise made available to those employees.

3. That the contributions picked-up by County A will be treated as employer contributions for federal income tax purposes.

4. That the contributions picked-up by County A will not constitute wages from which federal income tax must be withheld in the taxable year in which contributed.

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) of the Code, established by a state government or political subdivision thereof, and are picked up by the employing unit.

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 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 and that, 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 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.

Revenue Ruling 87-10, 1987-1 C.B. 136, provides that in order to satisfy Revenue Rulings 81-35 and 81-36, the required specification of designated employee contributions must be completed before the period to which such contributions relate. Thus, employees may not exclude from current gross income designated employee contributions to a qualified plan that relate to compensation earned for services prior to the date of the last governmental action necessary to effect the employer pick up.

In this case, contributions to Plan X on behalf of eligible employees are mandatory, and satisfy the criteria of Revenue Rulings 81-35 and 81-36. The contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee. In addition, an eligible employee is not given the option of choosing to receive the contributed amounts directly in lieu of having them paid to Plan X. Furthermore, Revenue Ruling 77-462 provides that picked-up contributions are exempt from federal income tax withholding.

Accordingly, we conclude:

1. That mandatory contributions to Plan X picked-up by County A on behalf of eligible employees will be treated as valid pick-up contributions under section 414(h)(2) of the Code.

2. That no part of the picked-up contributions will constitute gross income to eligible employees for federal income tax purposes until distributed or otherwise made available to those employees.

3. That the contributions picked-up by County A will be treated as employer contributions for federal income tax purposes.

4. That the contributions picked-up by County A will not constitute wages from which federal income tax must be withheld in the taxable year in which contributed.

No opinion is expressed as to the tax treatment of the transaction described herein under the provisions of any other section of either the Code or regulations that may be applicable thereto.

These rulings are based on the assumption that Plan X is qualified under section 401(a) of the Code at the time of the proposed contributions and distributions.

In accordance with Revenue Ruling 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.

This letter 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 as precedent.

If you wish to inquire about this ruling, please contact [redacted], SE:T:EP:RA:T4, I.D. # [redacted], at [redacted].

Sincerely yours,

Donzell Littlejohn

Donzell Littlejohn, Manager
Employee Plans Technical Group 4

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

cc: [redacted]