Internal Revenue Service

Department of the Treasury

Uniform Issue List No: 414.09-00

Washington, DC 20224 200137068

Contact Person:

Telephone Number:

In Reference to: T:EP:RA:TG

Date: JUN 2 1 2001

Atten:

Legend:

'State A	=
Employer M	=
Plan N	=
Statute X	=
Resolution Y	=

Dear

This is in response to a request for a private letter ruling submitted on behalf of Employer M on January 4, 2001 and supplemented by additional correspondence submitted on May 21, 2001 concerning the federal income tax treatment of certain contributions to Plan N under section 414(h)(2) of the Internal Revenue Code ("Code").

The following facts and representations have been submitted:

Employer M is a municipality of State A. State A has expressly provided for the creation of a police pension fund by a "municipality" as defined in Article 3 of Statute X. Employer M makes contributions to Plan N subject to the requirements of Article 3 of Statute X. Police officer contributions are mandatory. Police officer mandatory contributions are made to Plan N through a reduction in salary. It is represented that Plan N is a qualified plan under section 401(a) of the Code

Article 3 of Statute X authorizes a municipality to pick up the police officers' required contributions to Plan N. If contributions are picked up, they shall be treated as employer contributions in determining tax treatment under the Code. The municipality may pick up these contributions by a reduction in cash salary of the police officer or by an offset against future salary increases or by a combination of a reduction in salary and offset against a future salary increase. If contributions are picked up they shall be considered for all

purposes of Article 3 of Statute X as police officers' contributions made prior to the time that the contributions were picked up.

Pursuant to Statute X, Employer M adopted Resolution Y on February 23, 2000, authorizing the pick up of its police officers' required contributions. The Resolution provides, in part, that (1) Employer M shall "pick up" police officers' contributions, and (2) that police officers will not be given the option to receive cash directly in lieu of contributions-to Plan N.

Based on the foregoing, the following rulings are requested:

(l)The mandatory employee contributions "picked up" by Employer M shall be excluded from the current gross income of Employer M's police officers until distributed or otherwise made available.

(2) The "picked up" contributions paid by Employer M are not wages for federal income tax withholding purposes and federal income taxes need not be withheld on the "picked up" contributions.

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) of the Code; (2) the plan is established by a state govermnent or political subdivision thereof; and (3) the contributions are picked up by the governmental employer.

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 Rev. Rul. 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. Rev. Rul. 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 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 the source of 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 Rev. Rul. 81-35, 1981-1 C.B. 255, and Rev. Rul. 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 employees 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 order to satisfy Rev. Ruls. 81-35 and 81-36 with respect to particular contributions, Rev. Rul. 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 as 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.

Resolution Y executed by Employer M satisfies the criteria set forth in Revenue Rulings 81-35 and 81-36 because it specifies: (1) that the police officers' required contributions are to be picked up by Employer M for its police officers and (2) that the police officers may not elect to receive such contribution amounts directly.

Accordingly, we conclude that:

In regard to ruling request number one, the police officer contributions picked up by Employer M and contributed to Plan N on behalf of its police officers will not be includible in the police officers' gross income for federal income tax purposes in the taxable year in which such amounts are contributed.

In regard to ruling request number two, because we have determined that the picked-up police officer contributions 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, in the taxable year in which they are contributed to Plan N.

These rulings apply only if the effective date for the commencement of any proposed pick-up as specified in Resolution Y, cannot be any earlier than the later of the date Resolution Y is executed or the date it is put into effect.

The above rulings are based on the assumption that Plan N 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 Contribution 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)(l)(B) of the Code.

This ruling is directed only to the taxpayer that requested it and applies only with respect to Plan N . Section 6110(k)(3) of the Code provides that this private letter ruling may not be used or cited by others as precedent.

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.

Richard Wickersham, Manager
Employee Plans Technical Guidance
Tax Exempt and Government Entities Division

Enclosures:
Deleted Copy of Letter
Notice of Intention to Disclose