Uniform Issue List: 414.09-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224 200147055

AUG 27 2001

T:EP:RA:T1

Attn: XXX

Legend:

Employer A	=XXXX
State B	=XXXX
Group C employees	= XXXX
Plan X	=XXXXX
Statute D	=XXXXX

Dear XXXX:

This is in response to a ruling request dated XX, as supplemented by additional correspondence dated XX, from your authorized representative, concerning the pick up of certain employee contributions to Plan X under section 414(h)(2) of the Internal Revenue Code (the "Code").

The following facts and representations have been submitted:

Statute D of State B requires Employer A to establish a pension plan for certain of its Group C employees in conformity with the provisions set forth in Statute D. Pursuant to Statute D, Employer A, a municipality of State B, sponsors Plan X for the benefit of certain of its Group C employees. Plan X, a defined benefit pension plan, meets the qualification requirements of Code section 401(a). Participation in Plan X is elective on the part of Group C employees.

251

Under Statute D, Employer A is required to withhold a certain percentage of the salary of each employee who participates in Plan X and pay the amount withheld directly to Plan X. Statute D allows Employer A to reduce the current salary of Plan X participants and pay the mandatory employee contribution directly to Plan X in lieu of contributions by the individual participants.

Statute D also allows a municipality in State B to pick up and pay the mandatory employee contributions to Plan X pursuant to section 414(h) of the Code. The municipality shall pay these contributions from the same source of funds which is used to pay the salaries of Plan X participants. If contributions are picked up, Statute D provides that they shall be treated as employer contributions for Federal income tax purposes.

Pursuant to the above statutory provisions, the City Council for Employer A passed a resolution dated May 1, 2000. which provides, in part, that : Employer A shall pick up the mandatory contribution to Plan X; Employer A shall reduce eligible employees' current salaries by the amount picked up by Employer A; Employer A shall cease to withhold Federal and State income taxes on the picked up contributions; and eligible employees shall not be given the option to receive cash directly in lieu of contributions to Plan X.

Based on the foregoing facts and representations, you have requested the following rulings:

1. that the mandatory employee contributions "picked up" by Employer A shall be excluded from the gross income of Plan X participants until distributed; and

2. that the "picked up" contributions paid by Employer A are not wages for Federal income tax withholding purposes and Federal income tax need not be withheld on the "picked up" contributions.

Code section 414(h)(2) provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if such contributions are made to a plan described in Code section 401(a), established by a state government or a political subdivision thereof, or any agency or instrumentality of any one of the foregoing, 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 Code section 414(h)(2) 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. Rev. Rul. 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

252

distributed to the employees. The revenue ruling held further that under the provisions of Code section 3401 (a)(12)(A), the school districts 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 Code 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.

Employer A's resolution satisfies the criteria set forth in Code section 414(h)(2), Revenue Ruling 81-35, and Revenue Ruling 81-36 by providing that Employer A will pick up and make contributions to Plan X in lieu of contributions by eligible employees and that no employee will have the option of receiving such amount directly in cash instead of having it contributed to Plan X.

Accordingly, we conclude the amounts picked up by Employer A for Group C employees shall be treated as employer contributions and will not be includable in employees' gross income for the taxable 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 Code section 3401(a)(12)(A) for Federal income tax withholding purposes. Therefore, no withholding of Federal income tax is required from employees' salaries with respect to such picked up amounts.

The effective date for the commencement of any proposed pick up cannot be any earlier than the later of the date the above resolution is signed or put into effect.

This ruling is based on the assumption that Plan X will be qualified under Code section 401(a) 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 Code section 3121(v)(l)(B).

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

A copy of this ruling is being sent to your authorized representative pursuant to a power of attorney on file in this office. Should you have any questions pertaining to this ruling, you may contact XXX.

Sincerely yours,

John Swieca

John Swieca,
Manager, Employee Plans
Technical Branch 1
Tax Exempt and Government
Entities Division

Enclosures:
Deleted Copy of the Ruling
Notice 437

cc: XXX, Attorney At Law

254