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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Significant Index No.: 414.00-00

OP:E:EP:T2

Contact Person:

Telephone Number:

In Reference to

Date:

DEC 0 3 1999

LEGEND

Employer A =

Resolution P =

Plan X =

Statute Y =

Dear

This is in response to your request for a private letter ruling dated , as supplemented by letters dated , and , submitted on your behalf by your authorized representative. In support of your request, you have submitted the following facts and representations.

Pursuant to Statute Y, Employer A has established Plan X for the benefit of its policemen. Statute Y provides that 9 percent of a policeman's salary shall be withheld and paid to Plan X. It is represented that Plan X meets the qualifications of section 401(a) of the Internal Revenue Code ("Code").

Recent amendments to Statute Y allow government employers, such as Employer A, to pay the mandatory employee contributions to Plan X in lieu of contributions by the police employees. These amendments become effective with respect to all compensation earned after December 31, 1981.

To effect the pick-up, Employer A has adopted Resolution P and proposes to provide employees with an irrevocable election form. Resolution P provides:

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(1) Employer A, in accordance with Statute Y, shall pick up the mandatory employee contributions now being paid to Plan X.

(2) The picked up contributions pursuant to section 414(h)(2) of the Code are to be treated as employer contributions for income tax purposes, and as such excluded from the current gross income of the members of Employer A's Police Force. The picked up contributions are not considered to be wages for purposes of federal income tax withholding and accordingly, federal income taxes need not be withheld on the picked up contributions. It is specified that the contributions, although designated as employee contributions, are being paid by Employer A in lieu of contributions by the employees.

(3) The payment of the employee's contribution picked up by Employer A shall be made by reducing the amount of compensation of the cash salary payable to employees by the amount of the contributions and by making payment of such amount directly by Plan X. Also, the employee does not have the option of choosing to receive the contributions directly instead of having them paid by Employer A to Plan X.

(4) The effective date of the pick-up shall be as soon as practical after receipt of a favorable ruling from the Internal Revenue Service providing that contributions paid by Employer A are not included as gross income of the employee until they are distributed or made available.

Pursuant to the election form, employees will be permitted a one-time irrevocable election to choose whether to make after-tax contributions to Plan X or to participate in the pick-up. A participant's failure to execute the election form within a 60-day period (or 90 days in the event the employee has been unable to acknowledge his election for reasons other than fault of his own) will be interpreted by Employer A as an election to participate in the pick-up.

Based on the above, you request the following letter rulings:

(1) The mandatory employee contributions to Plan X, which are picked up for those employees who so elect in an irrevocable written election, are "picked up" within the meaning of section 4 14(h)(2) of the Code, thereby rendering the picked up contributions excludible from the current gross income'of Employer A's police employees.

(2) The picked up contributions to Plan X are not considered to be wages of Employer A's police employees for federal income tax withholding purposes, and that, as such, 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 such contributions are made to a plan described in section 401(a) or 403(a) of the Code, established by a state government or political subdivision thereof, or by any agency or instrumentality of the foregoing, and are picked up by the employing unit.

Section 3401(a)(12)(A) of the Code, relating to the Collection of Income Tax at Source on Wages (chapter 24 subtitle C of the Code), excludes from the definition of "wages", remuneration paid on behalf of an employee to a trust described in section 401(a) that is exempt from tax under section 501(a) at the time of such payment.

Revenue Ruling ("Rev. Rul.") 77-462, 1977-2 C.B. 358, addresses the federal income tax treatment of contributions picked up by the employer within the meaning of section 414(h)(2) of the Code. In Rev. Rul. 77-462, the employer school district agreed to pick up the required contributions of the eligible employees under the plan. The revenue ruling held that under the provision of section 3401(a)(12)(A) of the Code, the school district's picked up contributions to the plan are excluded from wages for purposes of the Collection of Income Tax at Source on Wages, and no federal income tax withholding is required from employees' salaries with respect to the said picked up contributions. The revenue ruling further held that the school district's picked up contributions are excluded from the gross income of the employees until such time as they are distributed to the employees.

Rev. Rul. 81-35, 1981-1 C.B. 255, and Rev. Rul. 81-36, 1981-1 C.B. 255, provide guidance as to whether contributions will be considered as "picked up" by the employer. Both revenue rulings establish that the following two criteria must be satisfied: (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 have an option of choosing to receive the contributed amounts directly or to have them paid by the employer to the plan.

Rev. Rul. 87-10, 1987-I C.B. 136, held that governmental employees may not exclude from 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 (*i.e.*, the effective date of the pick up cannot precede the date of the last governmental action).

Resolution P specifies, in pertinent part: (1) the pick up of the employees' contributions pursuant to Statute Y will be effective as soon as practical after receipt of a favorable ruling from the Internal Revenue Service pursuant to section 414(h) of the Code, providing that such employer paid contributions are not included as gross income of the employee until they are distributed or made available; (2) that the payment of the employee's contribution picked up by Employer A shall be made by reducing the amount of the compensation of the cash salary payable

to employees by the amount of the contributions and by making payment of such amount directly to Plan X; (3) that contributions, although designated employee contributions, are being paid by the employer in lieu of contributions by the employee; and (4) that the employee does not have the option of choosing to receive the contributions directly instead of having them paid by the employer to the plan.

Based on the foregoing facts and representations, we conclude that the criteria set forth in Rev. Rul. 8 l-35 and Rev. Rul. 8 l-36 are satisfied because Employer A will pick up *(i.e.,* assume and pay) the mandatory employee contributions to Plan X in lieu of contributions by Employer A's employees who may not elect to receive such contributed amounts directly instead of having them paid by Employer A to Plan X.

Accordingly, we conclude that: (1) the mandatory employee contributions to Plan X, which are picked up for those employees who so elect in an irrevocable written election, are "picked up" within the meaning of section 414(h)(2) of the Code, thereby rendering the picked up contributions excludible from the current gross income of Employer A's police employees; and (2) the picked up contributions to Plan X are not considered to be wages of Employer A's police employees for federal income tax withholding purposes, and that, as such, federal income taxes need not be withheld on the picked up contributions.

These rulings apply only if the effective date of the proposed pick-up of contributions is not earlier than the later of the date Resolution P was signed or the date the pick-up is put into effect.

The above rulings are based upon the assumption that Plan X will be qualified under section 401 (a) of the Code at all relevant times.

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)(l)(B) of the Code.

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.

In accordance with a power of attorney on file with this off ice, a copy of this ruling is being sent to your authorized representative.

Sincerely yours,

(signature) JOYCE E. FLOYD

Joyce E. Floyd
Chief, Employee Plans
Technical Branch 2

Enclosures:
Deleted copy of letter ruling
Notice of intention to disclose

cc: