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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

U.I.L. 414.09-00

DEC 23 2002

T:EP:RA:T2

XXXXXXXXXXX
XXXXXXXXXXX
XXXXXXXXXXX

Attn: XXXXXXX

Legend:

State A = ***

Group B Employees = ***

Board C = ***

Employer M = ***

Plan X = ***

Code S = ***

Resolution T = ***

Dear ***:

This letter is in reply to a request for a letter ruling dated ***, as supplemented by correspondence dated ***, ***, and ***, submitted on your behalf by your authorized representative, regarding the federal incomes tax treatment of certain contributions made to Plan X under section 414(h)(2) of the Internal Revenue Code ("Code").

The following facts and representations have been submitted:

Employer **M,** a government employer and political subdivision in State A, established and created Plan X for the benefit of Group B Employees. Plan X is codified in Code S. You represent that Plan X meets the qualification requirements set forth under section

401(a) of the Code and the related trust is exempt from tax under section 501(a) of the Code.

Pursuant to Section 8.2 of Plan X, all Group B Employees participating in Plan X are required to contribute one percent (1%) of their gross monthly wages to Plan X. Section 8.2 of Plan X further states that these contributions are made by payroll deduction on a per day basis excluding overtime.

On June 11, 2002, Board C, under the signature of its President, passed Resolution T, which amends Article VIII of Plan X. Resolution T provides that Employer **M** will pick up the required Group B Employees' contributions (member's required contributions) in accordance with Section 8.4 of Plan X. Resolution T also provides that the Group B Employees' contributions, although designated as employee contributions will, effective July 1, 2002, be paid by Employer **M** in lieu of contributions by the Group B Employees. Further, Resolution T provides that a Group B Employee will not have the option of choosing to receive the member's required contributions directly, or to have them paid by Employer **M** to Plan X.

Section 8.4 was added to Plan X and provides that, effective July 1, 2002, Employer M shalt pick up each Group B Employee's required contributions. No Group B Employee shall have the option of choosing to receive the required contributions directly, or to have them paid by Employer M to Plan **X.** A corresponding reduction in the Group B Employee's salary shall be made in the amount of the picked up required contribution. The required contributions, although designated as Group B Employee contributions, are being paid by Employer **M** in lieu of contributions by the Group B Employee.

According to Resolution T, effective July 1, 2002, all contributions made to Plan X by Group B Employees are to be treated as pick up contributions.

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

1. That the required contributions to Plan X which are "picked up" by Employer **M** pursuant to the terms of Section 414(h)(2) of the Code do not constitute gross income to Group B Employees for federal income tax purposes.

2. That the "picked up" contributions to Plan X are not considered wages for Group B Employees for federal income tax withholding purposes.

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.

Revenue Ruling 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 provisions 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 employees until such time as they are distributed to the employees.

Revenue Ruling 81-35,1981-1 C.B. 255, and Revenue Ruling 81-36,1981-1 C.B. 255, provided 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 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 or to have them paid by the employer to the plan. Furthermore, it is immaterial, for purposes of the application of section 414(h)(2) of the Code, whether the 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 pick up.

In this case, Plan X satisfies the requirements of Rev. Rul. 81-35 and Rev. Rul. 81-36. Resolution T provides that Employer M will pick up the required Group B Employees' contributions (member's required contributions) in accordance with Section 8.4 of Plan X. Resolution T also provides that the Group B Employees' contributions, although designated as employee contributions will be paid by Employer M in lieu of contributions by the Group B Employees. Further, Resolution T provides that a Group B Employee will not have the option of choosing to receive the member's required contributions directly, or to have them paid by Employer M to Plan X.

Further, Section 8.4 of Plan X also meets the requirements of Rev. Rul. 81-35 and Rev. Rul. 81-36. Section 8.4 of Plan X provides that Employer **M** shall pick up each Group B Employee's required contributions. No Group B Employee shall have the option of choosing to receive the required contributions directly, or to have paid by Employer **M** to Plan X. A corresponding reduction in the Group B Employee's salary shall be made in the amount of the picked up required contribution. The required

contributions, although designated as Group B Employee contributions, are being paid by Employer M in lieu of contributions by the Group B Employee.

Therefore, with respect to your first ruling request, we conclude that the required contributions made by the Group B Employees to Plan X that are picked up by Employer M pursuant to Section 8.4 of Plan X and Resolution T are picked up contributions within the meaning of section 414(h)(2) of the Code and as such will not be includible in the gross income of the Group B Employees until such amounts are distributed from Plan X to the extent that these amounts represent contributions made by Employer M. These amounts will be includible in the gross income of the Group B Employees (or their beneficiaries) in the year in such amounts are distributed to the extent that they represent amounts contributed by Employer M.

With respect to your second ruling request, since we have determined that the picked up contributions made pursuant to Section 8.4 of Plan X and Resolution T are to be treated as employer contributions, we conclude that these contributions are excepted from wages as defined in section 3401(a)(12)(A) of the Code for federal income tax withholding purposes. Therefore, no withholding of federal income tax is required in the taxable year in which they are contributed to Plan X.

For purposes **of** the application of section 414(h)(2) of the Code, 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.

These rulings are based on the assumption that Plan X meets the requirements for qualification 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 Contributions Act. No opinion is expressed as to whether the contributions in question are paid pursuant to a "salary reduction agreement" within the meaning of section 3121(v)(1)(B) of the Code.

This ruling applies, only if the effective date for the commencement of the pick up is no earlier than the later of the date Resolution T was signed, or the date the pick up as is put into effect.

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

A copy of this ruling has been sent to your authorized representatives in accordance with a power of attorney on file in this office.

If you have any questions, please contact ***, T:EP:RA:T:2 at ***.

Sincerely yours,

signed) JOYCE E. FLOYD

Joyce E. Floyd
Manager, Employee Plans
Technical Group 2
Tax Exempt and Government Entitles Division

Enclosures:
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Notice 437