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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

U.I.L. 414.09-00

JUL 8 2004

Attn.:

T:EP:RA:T2

LEGEND:

County A =

State B =

Plan X =

Group N Employees =

Proposed Resolution O =

Dear :

This is in response to a ruling request submitted by your authorized representative dated June 23, 2003, as supplemented by correspondence dated May 18, 2004, May 20, 2004, June 10, 2004, and June 24, 2004, with respect to the federal income treatment of certain contributions to Plan X under section 414(h)(2) of the Internal Revenue Code (the "Code").

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

County A is a political subdivision of State B and the governmental employer of Group N Employees. Effective December 24, , County A established Plan X for the benefit of its Group N Employees. Plan X was approved as to form by the Counsel for County A. County A represents that Plan X meets the qualification requirements set forth in Code section 401(a) and its associated trust is tax exempt under Code section 501(a).

County A added a pick-up feature designed to qualify under section 414(h)(2) of the Code to Plan X. Pursuant to section I, "Employee Contributions" of Appendix B, eligible Group N Employees have a one-time irrevocable option to contribute ten percent of their salary on a pre-tax basis to Plan X by submitting a valid election agreement on or before September 15, 2001. Eligible Group N Employees hired after or designated as eligible Group N Employees subsequent to September 15, 2001, must make the one-time irrevocable election by submitting a valid election agreement within 60 days from the later of the date of hire or the date of designation as an eligible Group N Employee. Contributions under Section I shall be "picked up" and deemed to be employer contributions in accordance with section 414(h)(2) of the Code. County A represents that the effective date of the above pick-up provision was May 15, 2001.

In a letter dated June 24, 2004, submitted on your behalf by your authorized representative, certain additional information was submitted to the Internal Revenue Service for consideration in your request for a ruling.

First, a proposed resolution, Resolution O, drafted by the Board of Supervisors of County A to implement the pick up of employee contributions, recognizes that County A maintains Plan X and desires to pick up the employee contributions to Plan X pursuant to Code section 414(h)(2). Proposed Resolution O specifically provides that County A will pick up the Group N Employee contribution made to Plan X, pursuant to the provisions of Plan X and Code section 414(h)(2), and although the contributions are designated as Group N Employee contributions, County A will pay such contributions in lieu of contributions by the Group N Employees. Proposed Resolution O further provides that the Group N Employees participating in Plan X will not have the option of choosing to receive the contributions that are picked up directly in lieu of having them paid by County A to Plan X.

Second, an amendment has been proposed to Plan X (Withdrawal Provisions, Appendix B) that would eliminate the withdrawal privileges associated with pre-tax contributions. Specifically, the proposed amendment provides that pre-tax contributions may not be withdrawn prior to a termination of a Group N Employee's employment.

Based upon the aforementioned facts and representations, you request the following rulings:

1. That the mandatory employee contributions to Plan X, which are picked for those eligible Group N 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 excludable from the current gross income of such

employees.

2. That the picked-up contributions to Plan X are not considered to be wages of employees as defined in section 3401(a)(12)(A) of the Code 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) of the Code, established by a state government or 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 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; 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 C.B. 255. These revenue rulings established that the following two criteria must be met: (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 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 order to satisfy Revenue Ruling 81-35 and Revenue Ruling 81-36 with respect to particular contributions, Revenue Ruling 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. 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. Thus, employees may not exclude from current gross income designated employee contributions to a qualified plan that relate to compensation earned for services rendered prior to the date of the last governmental action necessary to effect the pick up.

In this case, Proposed Resolution O satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 by specifically providing that County A will pick up the Group N Employee contributions made to Plan X, and although these contributions are designated as employee contributions, County A will pay such contributions in lieu of contributions by the Group N Employees. Proposed Resolution O further provides that Group N Employees participating in Plan X will not have the option of choosing to receive the contributions that are picked up directly in lieu of having them paid by County A to Plan X.

With respect to your first and second ruling requests, we conclude, assuming Proposed Resolution O is adopted and implemented as proposed, that the mandatory Group N Employee contributions to Plan X, that are picked up for those eligible Group N Employee pursuant to an irrevocable written election, although designated as employee contributions, will be treated as employer contributions that are picked up by County A within the meaning of Code section 414(h)(2) and will not be includable in the Group N Employees' gross income for federal income tax purposes in the year in which they are contributed to Plan X. These amounts will be includable in the gross income of the Group N Employees or their beneficiaries in the taxable year in which they are distributed, to the extent they represent amounts contributed by County A. Because we have determined that the picked up amounts 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 addition, no part of the amounts picked up by County A will constitute wages for federal income tax withholding purposes in the taxable year in which they are contributed to Plan X.

Revenue Ruling 87-10 provides that employees may not exclude from current gross income designated employee contributions that relate to compensation earned for services prior to the date of the last governmental action necessary to effect and implement the pick up arrangement. In accordance with Rev. Rul. 87-10, the conclusions reached in this ruling do not apply to any pick up contributions to Plan X to the extent the pick up contributions relate to compensation earned before the date of the last governmental action necessary to effect and implement the pick up arrangement as described in Proposed

Resolution O that the Service has concluded contains the necessary specifications of Revenue Ruling 81-35 and Revenue Ruling 81-36. This ruling is limited to the pick up of Group N Employees' contributions subsequent to the adoption and implementation of Proposed Resolution O and does not express an opinion as to the validity of the pick up of Group N Employees' contributions prior to the adoption and implementation of Proposed Resolution O.

These rulings apply only if the effective date for the commencement of any proposed pick up as described in Proposed Resolution O is not earlier than the later of the date Proposed Resolution O is adopted by County A, the date Proposed Resolution O become effective, or the date the pick up is put into effect. This ruling is based on County A adopting Proposed Resolution O as submitted with your correspondence dated June 24, 2004.

This ruling is based on the condition that a Group N Employee who makes a one-time irrevocable election to participate in the pick up arrangement of Plan X within County A's prescribed election period may not subsequently alter or amend this election to participate in the pick up arrangement. This ruling is also based on the condition that a Group N Employee who makes a one-time irrevocable election to not participate in the pick up arrangement of Plan X within County A's prescribed election period may not subsequently alter or amend this election to not participate in the pick up arrangement. Further, a Group N Employee who fails to elect to make an affirmation election to participate in the pick up arrangement of Plan X within County A's prescribed election period is deemed to have elected to not participate in that arrangement. This deemed election to not participate in the pick up arrangement is treated as the one-time irrevocable election for such Group N Employee and, for purposes of this ruling and the conclusions reached under Code section 414(h)(2), may not be subsequently altered or amended.

This ruling is based on Proposed Resolution O submitted with your correspondence dated June 24, 2004 and the proposed amendment to Appendix B submitted with correspondence dated June 24, 2004, only to the extent that such amendment, once executed by Employer A, prospectively removes the withdrawal privileges associated with pre-tax contributions. No opinion is expressed as to the status of Plan X or of the consequences of this provision prior to County A adopting and executing the above amendment.

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)(1)(B).

This ruling only addresses the pick up treatment of contributions under Code section 414(h)(2) subsequent to the adoption and implementation of Proposed Resolution O. This ruling does not express an opinion as to the qualified status of Plan X under Code section 401(a), nor the effective date of the proposed amendment to Appendix B that relates to the withdrawal of pre-tax contributions. The determination as to whether Plan X, including the proposed amendment, is qualified under Code section 401(a) is within the jurisdiction of the Employee Plans Determinations Office of the Internal Revenue Service.

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 is being sent to your authorized representative in accordance with a Power of Attorney (Form 2848) on file in this office.

If you have any questions, please contact SE:T:EP:RA:T2,

Sincerely yours,

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:
Deleted copy of letter ruling
Form 437