Internal Revenue Service

Department of the Treasury

Washington, DC 20224

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Index No.: 414.01-00

Person to Contact:

Telephone Number:

Refer Reply to:
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Date:
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EIN:

LEGEND:

State A =
Employer M =
Plan X =

County A =
County B =
County C =

Gentlemen:

This is in response to a request submitted on your behalf by your authorized representative on January 17, 2000, for a private ruling letter concerning the federal income tax treatment of certain contributions to Plan X under section 414(h)(2) of the Internal Revenue Code ("Code").

In support of the ruling request the following facts and representations have been submitted:

Employer M is a comprehensive community college serving the residents of Counties A, B, and C of State A. The college provides quality postsecondary credit programs leading to an associate degree or a certificate of proficiency, as well as documents of participation for community and continuing education courses.

State A has established various pension plans, including Plan X, which are qualified under section 401(a) of the Code. Employer M, an agency of State A, is a participating employer in Plan X. Employees of Employer M who participate in Plan are required to contribute to Plan X.

Pursuant to a resolution by the Board of Trustees of Employer M dated May 13, 1999 (the "Resolution"),

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Employer M will pick up, i.e., assume and pay, the mandatory employee contributions of employees of Employer M who participate in Plan X in lieu of such employees paying such contributions. In addition, employees of Employer M who participate in Plan X will have no option to receive the picked-up contributions in cash instead of having such contributions paid to Plan X.

Employer M requests a ruling that contributions made by employees of Employer M who participate in Plan X which are picked up by Employer M pursuant to the Resolution will not be included in the gross income of such employees for federal income tax 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) established by a state government or a political subdivision thereof 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' 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), 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, 1981-1 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 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 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.

The terms of Plan X and the Resolution satisfy the criteria set forth in Revenue Rulings 81-35 and 81-36 because the contributions, although designated as employee contributions, are to be made by Employer M in lieu of contributions by the employees; and the employees may not elect to receive such contribution amounts directly.

Accordingly, we conclude that contributions made by employees of Employer M who participate in Plan X which are picked up by Employer M under the provisions of the resolution will not be included in the gross income of such employees for federal income tax purposes in the year of contribution.

The ruling applies only to contributions specified in the Resolution. The effective date for the commencement of the pickup of the mandatory contributions cannot be earlier than the later of May 13, 1999, or the date the Resolution is put into effect.

The Internal Revenue Service reaches no conclusion in this letter as to the status of Plan X as a governmental plan within the meaning of section 414(d) of the Code. No opinion is expressed as to whether the

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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 being paid pursuant to a "salary reduction agreement" within the meaning of section 3121(v)(1)(B).

This ruling is based on the assumption that Plan X will be qualified under section 401(a) of the Code at the time of the pick-up contributions described above.

This ruling is directed only to the taxpayer who requested it. Section 6110(c)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

Sincerely yours,

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

Enclosures:
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Notice of Intention to Disclose