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Internal Revenue Service

Department of the Treasury

Washington, DC 20224

U.I.L. 414.09-00

Person to Contact:
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Telephone Number:
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Refer Reply to:
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Date:
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Attn: **********

Legend
State A = **********
Plan X = **********
Employer M = **********
Resolution O = **********
Proposed Resolution P = **********
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****
Group N Employees = **********
Proposed Amendment R = **********
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Dear **********

This is in response to a ruling request dated January 31, 2001, as supplemented by letters dated April 11, 2001, and August 23, 2001, submitted on your behalf by your authorized representative, concerning the federal income tax treatment, under section 414(h)(2) of the Internal Revenue Code ("Code"), of certain contributions to Plan X.

The following facts and representations have been submitted by your authorized representative:

Employer M is a body corporate and public, duly organized and existing under the laws of State A. On November 22, 1999, Employer M passed Resolution O adopting Plan X, effective January 1, 2000, for the benefit of the Group N Employees. Plan X is a defined benefit pension plan. Plan X was established for the exclusive benefit of the Group N Employees. A Group N Employee is defined under Section 1.7 of Plan X to include any Covered Individual who is currently benefitting under Plan X and certain former Group N Employees who are eligible to receive a benefit under Plan X. Generally, any full-time sworn police officer is eligible to participate in Plan X.

Pursuant to Section 4.4(a)(1) of Plan X, Group N Employees are required to make mandatory contributions to Plan X equal to seven percent of their compensation. Section 4.4(a)(3) provides, among other things, that the contributions referred to in (a)(1) shall be picked up by Employer M pursuant to section 414(h)(2) of the Code, and that the contributions shall be deducted from the pay of the contributing Group N Employee as salary reduction contributions. Proposed Amendment R, which amends section 4.4 of Plan X, provides that the Group N

Employees have no option to choose to receive the contributions provided for in this section 4.4 directly instead of having the contributions paid by Employer M to Plan X. Section 1.4 of Plan X states that Plan X is intended to meet the qualification requirements set forth under section 401(a) of the Code.

Resolution O, which established Plan X, provides that Group N contributions, although designated as employee contributions, are being paid by Employer M in lieu of contributions by the Group N Employees pursuant to section 414(h)(2) of the Code. Proposed Resolution P provides that Employer M will make contributions equal to seven percent of the Group N Employees compensation and the Group N Employees do not have the option of choosing to receive the contributed amounts directly instead of having such contributions paid to Plan X.

Based on the aforementioned facts, you request the following rulings:

1. That the mandatory employee contributions made by the Group N Employees and picked up by Employer M under section 4.4 of Plan X will be treated as employer contributions for federal income tax purposes.

2. That the mandatory employee contributions made by the Group N Employees and picked up by Employer M under section 4.4 of Plan X will not be included in the current gross income of the Group N Employees for federal income tax purposes.

3. That the mandatory contributions of the Group N Employees picked up by Employer M will not constitute wages subject to federal income tax withholding.

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 determined to be qualified under 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' 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, 1981-1 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.

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.

In this request, Section 4.4 of Plan X and Proposed Amendment R, if adopted as proposed, satisfy the criteria set forth in Rev. Rul. 81-35 and Rev. Rul. 81-36, by providing, in effect, that Employer M will make contributions to Plan X in lieu of contributions by Group N Employees, and that the Group N Employees participating in Plan X have no option to receive any picked up contributions directly instead of having such contributions paid to Plan X. Further Resolution O and Proposed Resolution N also satisfy the criteria set forth in Rev. Rul. 81-35 and Rev. Rul. 81-36. Resolution O provides that the Group N Employees' contributions, although designated as employee contributions, are being paid by Employer M in lieu of contributions by the Group N Employees. Proposed Resolution N, if adopted as proposed, provides that the Group N Employees do not have the option of choosing to receive the contributed amounts directly instead of having such contributions paid to Plan X.

Accordingly, we conclude with respect to ruling requests numbers 1, 2, and 3, that the amounts picked up by Employer M on behalf of the Group N Employees who participate in Plan X shall be treated as employer contributions and will not be includible in the Group N Employees' gross income in the year in which such amounts are contributed for federal income tax purposes. These amounts will be includible in the gross income of the Group N Employees or their beneficiaries only in the taxable year in which they are distributed, to the extent that the amounts represent contributions made by Employer M to Plan X. 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 Employer M will constitute wages for federal income tax withholding purposes in the taxable year in which they are contributed to Plan X.

These rulings apply only if the effective date for the commencement of the pick-up is no earlier than the later the date specified in the adoption of the final resolution and amendment, or the date the pick-up is put into effect.

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 will be qualified under section 401(a) of the Code at the time of the proposed contributions and distributions.
This ruling is further based on Plan X and Resolution O as set forth in your letter dated January 31, 2001, and Proposed Amendment R and Proposed Resolution N as set forth in your letter dated August 23, 2001.

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)(1)(B).

These rulings are directed only to the taxpayer who requested them. Section 6110(k)(3) of the Code provides that they may not be used or cited by others as precedent.

A copy of this letter has been sent to your authorized representative in accordance with the power of attorney on file with this office.

Sincerely yours,

(signed) JOYCE E. FLOYD

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

Enclosures:
Deleted copy of this letter and Notice 437