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

T:EP:RA:T4

MAR 3 2003

UIL: 414.00-00

Legend:

City X =

District Y =

State C =

Plan Z =

Local F =

Resolution A =

Dear

This letter is in response to your request for a private letter ruling dated , as supplemented by a letter dated , submitted on your behalf by your authorized representative, concerning the federal income tax treatment of mandatory employee contributions that will be picked up by District X under section 414(h)(2) of the Code.

Your representative has submitted the following facts and representations:

District Y is the one of the fire districts for City X. Special Act of State C established District Y on . Plan Z was established to provide pension benefits for all uniformed and investigatory fire district positions of District Y. Plan Z was established

on pursuant to Special Act of State Y. Plan Z is a defined benefit plan which includes two basic service benefit formulas, plus a disability benefit, and survivorship options. The board of trustees of Plan Z is composed of members appointed under a home rule ordinance of District Y adopted on .

Pursuant to a collective bargaining agreement between District Y and Local F that was ratified on , District Y will receive mandatory employee contributions that will be picked up by District Y pursuant to section 414(h)(2) of the Code.

Additionally, Resolution A was adopted by District Y to provide that it will contribute to Plan Z the amount required to be contributed by each participating employee of Local F, and such contribution shall be obtained by reducing the compensation otherwise payable to a participating employee. Each participating employee is required to contribute an amount equal to the appropriate percentage of compensation (as set forth in the collective bargaining agreement between District Y and Local F) and each participating employee cannot receive such amount directly instead of having such amount contributed to Plan Z.

Plan Z has not received a determination from the Internal Revenue Service that it is a qualified retirement plan under section 401(a) of the Internal Revenue Code (the Code). However, District Y represents that Plan Z meets the requirements of section 401(a) of the Code.

Based on the above facts, you request:

1. A determination that Plan Z qualifies as a government plan within the meaning of section 414(d) of the Code.

2. That mandatory contributions to Plan Z picked-up by District Y on behalf of participating employees, even though designated as employee contributions, will be treated as employer contributions.

3. That such mandatory contributions will not be included in the gross income of those participating employees until distributed or otherwise made available to those employees.

4. That District Y as employer of the above participating employees will not be required to withhold any amounts of federal income tax with respect to the contributions picked-up on behalf of such employees.

With respect to your ruling requests, section 414(d) of the Code provides that a "governmental plan" means a plan established and maintained for its employees by the government of the United States, by the government of any state or political subdivision thereof, or by any agency or instrumentality of any of the foregoing.

Revenue Ruling 88-49, 1989-1 C.B. 117, provides that a plan will not be considered a governmental plan merely because the sponsoring organization has a relationship with a governmental unit or some quasi-governmental power. One of the most important factors to be considered in determining whether an organization is an agency or instrumentality of the United States or any state or political subdivision is the degree of control that the federal or state government has over the organization's everyday operations. Other factors include: (1) whether there is specific legislation creating the organization; (2) the source of funds for the organization; (3) the manner in which the organization's trustees or operating board are selected; and, (4) whether the applicable governmental unit considers the employees of the organization to be employees of the applicable governmental unit. Although all of the above factors are considered in determining whether an organization is an agency of the government, the mere satisfaction of one or all of the factors is not necessarily determinative.

Special Act of State C created Plan Z and provides that Plan Z is an instrumentality of District Y. District Y is funded primarily by the imposition of tax assessments on the citizens residing in that district, as empowered by the laws of State C. The Board of Fire Commissioners of District Y is elected annually by the citizens of District Y, according to the rules set-forth in the "Home Rule Ordinance" of District Y. All eligible participants in Plan Z are employees of District Y, and are considered government employees by City X. As such, we can conclude that District Y is an agency or instrumentality of State C and City X. Thus, Plan Z is a governmental plan within the meaning of section 414(d) of the Code.

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 that 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. Furthermore, it is immaterial, for purposes of the application of section 414(h)(2) of the Code, whether District Y picks-up contributions through a reduction in a 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.

Resolution A as adopted by District Y satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 because it provides that District Y will "pick-up" mandatory employee contributions to Plan Z and specifies that such picked-up contributions, although designated as employee contributions are being paid by the employer in lieu of contributions by participating employees and that the participating employees may not elect to receive such contributions directly instead of having such contributions paid by District Y to Plan Z.

Accordingly, we conclude that:

1. That Plan Z qualifies as a government plan under section 414(d) of the Code.

2. That contributions, whether picked-up by salary reduction, offset against future salary increases, or both, and though designated as employee contributions, will be treated as employer contributions.

3. That no part of mandatory contributions picked-up by District Y on behalf of participating employees will be includible in the gross income of the employees for purposes of federal income tax treatment until such time as distributed from Plan Z.

4. That contributions picked up by District Y will not constitute wages from which federal income tax must be withheld.

The effective date for the commencement of the pick-up will not be any earlier than the later of the date the resolution is signed or the date it is put in effect.

These rulings are based on the assumption that Plan Z meets the requirements for qualification under section 401(a) of the Code at the time of the contributions.

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) of the Code.

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 on file with this office.

Sincerely yours,

Alan Pipkin, Manager
Employee Plans Technical Group 4
Tax Exempt and Government Entities Division

Enclosures:
Deleted Copy of Letter
Notice 437

cc:

cc: