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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
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APR 1 2003

T:EP:RA:T2

Attn: xxxxx

Legend:

State A	= xxxxx
Statute A	= xxxxx
Employer M	= xxxxx
Group B Employees	= xxxxx
Plan X	= xxxxx
Ordinance Y	= xxxxx

Dear Mr. xxxxx:

This letter is in response to a request, dated March 26, 2002, as supplemented by correspondence dated February 27, 2003, that you submitted for a private letter ruling concerning the federal income tax treatment of certain contributions to Plan X under section 414(h)(2) of the Internal Revenue Code.

You have submitted the following facts and representations:

Employer M, a unit of local government, is a fire protection district within State A, and is governed by a three-member elected Board of Trustees. Employer M is

responsible for providing fire suppression, fire safety/education, and emergency medical/rescue services to residents within its jurisdiction.

Article 4 of Statute A provides that in each municipality, as defined therein, the city council or board of trustees, as the case may be, shall establish and administer a firefighters' pension fund for the benefit of its firefighters and their beneficiaries. Article 4 further provides that any fire protection district having any full-time paid firefighters is included in the definition of a "municipality". Also, rules for the administration of such a pension fund are set forth in Article 4.

In accordance with Statute A, Employer M established Plan X for the benefit of its Group B Employees. You represent that Plan X meets the qualification requirements of section 401(a) of the Code.

Section 4-118.1 of Statute A provides that each Group B Employee shall be required to contribute a percent of his or her salary to Plan X. Section 4-118.2 of Statute A provides that a municipality as defined in section 4-103, such as Employer M, may pick up the contributions required by section 4-118.1. If a municipality decides not to pick up the contributions, the required contributions shall continue to be deducted from the salary of Group B Employees. If contributions are picked up, they shall be treated as employer contributions in determining the tax treatment under the Code; however, the municipality shall continue to withhold federal and state income taxes based upon these contributions until the Internal Revenue Service or the Federal courts rule that pursuant to section 414(h) of the Code, these contributions shall not be included as gross income of the Group B Employees until such time as they are distributed or made available. Employer M shall pay these contributions from the same source of funds which is used to pay the salaries of the Group B Employees. Employer M may pick up these contributions by a reduction in the cash salary of the Group B Employee, or by an offset against a future salary increase, or by a combination of both. To effectuate the pick up as provided for in the above provisions, Employer M, on February 8, 2002, adopted and passed Ordinance Y.

Ordinance Y provides that Group B Employee contributions made to Plan X shall be paid by Employer M on behalf of all Group B Employees; that the payment of the Group B Employees' contribution picked up by Employer M shall be made by reducing the amount of the compensation payable to such employees and making payment of such amount directly to Plan X; that the contributions, although designated as employee contributions, are being paid by Employer M in lieu of contributions by the Group B Employees; and that the Group B Employees do not have the option of choosing to receive the contributed amounts directly instead of having them paid by Employer M to Plan X.

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

1. That the mandatory contributions picked up by Employer M on behalf of the Group B Employees participating in Plan X will be treated as employer contributions for federal income tax purposes.

2. That the mandatory contributions picked up by Employer M on behalf of the Group B Employees participating in Plan X will not be considered gross income to the Group B Employees until the amounts are distributed or otherwise made available to the Group B Employees.

3. That the mandatory contributions picked up by Employer M on behalf of the Group B Employees participating in Plan X will not constitute wages from which federal income taxes must be withheld.

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' 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 Code section 414(h)(2) 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 applicability of 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 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 case, Ordinance Y as adopted by Employer M meets the criteria of Rev. Rul. 81-35 and Rev. Rul. 81-36 by providing, in effect, that required contributions made to Plan X by the Group B Employees shall be picked up and assumed by Employer M and paid to Plan X in lieu of contributions by the Group B Employees. Ordinance Y further provides that no Group B Employee shall have the option of receiving the contributed amounts directly instead of having them paid by Employer M to Plan X.

With respect to ruling requests 1, 2 and 3, we conclude that the mandatory contributions that are picked up by Employer M on behalf of Group B Employees who participate in Plan X shall be treated as employer contributions and will not be considered gross income to the Group B Employees in the year such amounts are contributed to Plan X. These amounts will be includible in the gross income of the Group B Employees or their beneficiaries in the taxable year in which they are distributed to the extent that the amounts represent contributions made by Employer M. 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 of the date Ordinance Y was signed, or the date Ordinance Y is put in effect. This ruling is based on Ordinance Y that was signed by the president of the Board of Trustees of Employer M on February 8, 2002.

In accordance with Rev. Rul. 87-10, this ruling does not apply to any contribution to the extent it relates to compensation earned before the later of the effective date of Ordinance Y or the date the pick-up is put into effect.

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.

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 directed only to the taxpayer who 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 letter has been sent to your authorized representative in accordance with a power of attorney on file in this office.

If you have any questions please contact xxxxx, Badge # xxxxx, T:EP:RA:T2 at xxxxx .

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 letter ruling
Form 437

cc:
xxxxx
xxxxx
xxxxx