Internal Revenue Service

Department of the Treasury

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Washington, DC 20224

SIN 414.09-00

Contact Person:

Telep

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Date T:EP:RA:T4

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**LEGEND:**

**Village A =**

**State B =**

**Plan X =**

**Group C Employees =**

**Statute T =**

**Dear**

**This letter is in response to a request for a private letter ruling dated and supplemented by additional correspondence dated and submitted on your behalf by your authorized representative, regarding the federal income tax 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:**

**That Village A is a Municipality duly organized under the laws of State B. Statute T provides that a Municipality shall establish and administer Plan X, funded in part by employee contributions, and that Village A may pick up the employee contributions made by Group C Employees to Plan X. On , Village A voted to proceed with a government "pick up" plan as established under the laws of State B, whereby employee contributions to a governmental plan are "picked up" by Village A within the meaning of section 414(h)(2) of the Code.**

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Village A has prepared and is prepared to adopt, a resolution providing for procedures to fund Plan X within the meaning of section 414(h) (2) of the Code. Under the resolution, Village A shall pick up contributions made by Group C Employees to Plan X in accordance with the laws of State B. Group C Employees will not be given the option to receive cash in lieu of contributions. Village A asserts that Plan X meets the qualification requirements of section 401(a) of the Code.

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

Contributions made to Plan X, pursuant to the laws of State B, that are picked up by Village A, as allowed under both the laws of state B and section 414(h) (2) of the Internal Revenue Code, shall not be included as gross income of the Group C Employees, pursuant to section 3401(a) (12) (A) of the Code, until such time as they are distributed.

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-l C.B. 255, and Revenue Ruling 81-36, 1981-l 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.

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.

The resolution adopted by Village A satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 because it specifies that the contributions to Plan X are to be made by Village A in lieu of contributions by Group C Employees and that Group C Employees may not elect to receive such contributions directly instead of having such contributions paid by Village A to Plan X.

Accordingly, we conclude that the contributions picked up by Village A and paid by Village A to Plan X satisfy the requirements of section 414(h)(2) of the Code and shall not be included in the gross income of Group C Employees in the year in which such amounts are contributed and the picked up contributions are not wages within the meaning of section 3401(a) (12) (A) of the Code. These amounts will be includible in the gross income of Group C Employees or their beneficiaries only in the taxable year in which they are distributed, to the extent that the amounts represent contributions made by Village A.

For purposes of the application of section 414(h) (2) of the Code, it is immaterial whether Village A picks up contributions through a reduction in salary, an offset against future salary increases, or a combination of both.

These rulings apply only if the effective date for the commencement of any proposed pick up is not 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 X meets the requirements for qualification under section

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401(a) of the Code at the time of the proposed contributions and distributions.

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 letter is being sent to your authorized representative in accordance with a power of attorney on file in this office.

Sincerely yours,

John G. Riddle, Jr.
Manager, Employee Plans
Technical Group 4
Tax Exempt and Government
Entities Division

Enclosures:
Deleted copy of letter ruling
Notice 437

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