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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

APR 12 2005

SE:T:EP:RA:T1

Uniform Issue List: 414.09-00

Attn:

Legend:

Board A =

State B =

Statute C =

Administrative Rule D =

Plan X =

Dear :

This is in response to a ruling request dated March 2, 2004, as supplemented by additional correspondence dated June 1, 2004, and July 27, 2004, from your authorized representative, concerning the pick up of employee contributions to Plan X under section 414(h)(2) of the Internal Revenue Code ("Code").

The following facts and representations have been submitted:

Plan X is a cost sharing multiple employer public employee retirement system that was created by the legislative body of State B in 1965 and began operating in 1967. Plan X is governed by Statute C. Plan X was created for the purpose of providing retirement, disability and statutory death benefits to members and their surviving spouses, children, and dependent parents. Membership in Plan X is mandatory under State B law for all full-time police officers employed by State B municipalities. Full-time firefighters employed by townships, municipalities, township joint fire districts, or other political subdivisions must become members of Plan X if satisfactory completion of an approved firefighter training course is required for employment.

Plan X is administered by Board A. Board A has the authority to adopt rules for the proper administration and management of Plan X pursuant to Statute C of State B.

Plan X is funded by employer and mandatory employee contributions; however, certain death benefits are state funded. Currently the contribution level for employee members is 10% of salary.

Plan X received a favorable determination letter regarding the qualified status of the Plan under Code section 401(a), dated November 7, 2002.

Pursuant to Administrative Rule D, promulgated by Board A, Board A has prepared a model pick-up resolution designed to be used by each participating employer that elects to pick up all or part of the employee contributions to Plan X including those employers who previously adopted a pick-up of the mandatory employee contributions to Plan X. The model resolution, which is completed by the employer before its adoption, provides: 1) effective as of (insert date) the (insert employer) has determined to pick up or continue to pick up (all/____%) of the ten percent mandatory contributions by the employees who are members of Plan X (through a payroll reduction and/or by paying the contributions on behalf of the employee); 2) no contributions prior to the adoption of the model resolution shall be picked up; 3) employees shall not be entitled to any option of choosing to receive the contributed amounts directly instead of having them paid by the (employer name) to Plan X; 4) the picked-up contributions, even though designated as employee contributions for state law purposes, are being paid by the employer in lieu of contributions by the employee; and 5) the picked-up contributions will not be included in the gross income of the employees for federal or state income tax withholding purposes, until distributed from Plan X.

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

1) No part of the contributions to Plan X that are picked up by participating employers on behalf of members who are required to contribute to Plan X pursuant to Statute C is includible in a member's gross income, for federal income tax purposes, in the year of contribution; provided the member's employer formally adopts an ordinance or resolution whereby the member is not given the option to receive the picked-up contributions directly, the employer agrees to directly pay the picked-up contributions to Plan X, and the pick-up treatment does not apply to contributions earned prior to the later of the date the ordinance or resolution is signed or made effective.

2) The picked-up contributions referred to in ruling request #1 will not constitute wages under Code section 3401(a)(12)(A) from which federal income taxes must be withheld.

3) The picked-up contributions referred to in ruling request #1 will not be treated as "annual additions" for purposes of Code section 415(c).

Code section 414(h)(2) provides that contributions, otherwise designated as employee contributions, shall be treated as employer contributions if such contributions are made to a plan described in Code section 401(a), established by a state government or a political subdivision thereof, or any agency or instrumentality of any one of the foregoing, 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 Code section 414(h)(2) 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. Rev. Rul. 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 Code 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 for federal income tax purposes 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 Code 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.

The above-described model resolution of Board A, designed to be adopted by participating employers, satisfies the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36 by providing that a participating employer will pick up and make contributions to Plan X in lieu of contributions by member employees. In addition, it states that no employee will have the option of receiving the contribution in cash instead of having such contribution paid to Plan X.

Accordingly, based on the above facts and representations, we conclude with respect to ruling request #1 and ruling request #2:

1) No part of the contributions to Plan X that are picked up by participating employers on behalf of members who are required to contribute to Plan X pursuant to Statute C is includible in a member's gross income, for federal income tax purposes, in the year of contribution; provided the member's employer formally adopts an ordinance or resolution whereby the member is not given the option to receive the picked-up contributions directly, the employer agrees to directly pay the picked-up contributions to Plan X, and the pick-up treatment does not apply to contributions earned prior to the later of the date the ordinance or resolution is signed or made effective. 2) The picked-up contributions referred to in ruling request #1 will not constitute wages under Code section 3401(a)(12)(A) from which federal income taxes must be withheld.

Regarding ruling request #3, section 1.415-3(d)(1) of the Income Tax Regulations states that, where a defined benefit plan provides for mandatory employee contributions, the annual benefit attributable to such contributions is not taken into account for purposes of applying the limitations on benefits described in Code section 415(b). Section 1.415-3(d)(1) further provides that the mandatory employee contributions are considered a separate defined contribution plan maintained by the employer that is subject to the limitations on contributions and other annual additions described in Code section 415(c). Employee contributions, however, that are picked up by participating employers pursuant to section 414(h)(2) are treated as employer contributions and, as such, are not annual additions to a separate defined contribution plan for purposes of Code section 415(c). Accordingly, with respect to the pick up of mandatory employee contributions paid to Plan X, we conclude that these picked-up contributions will not be treated as annual additions for purposes of Code section 415(c).

These rulings are conditioned on the participating employers adopting the model resolution of Board A without amendment. In order for the tax effects that follow from these rulings to apply to the member employees of a participating employer, the pick-up arrangement must be implemented by that participating employer in the manner described herein.

The effective date for the commencement of any proposed pick up as specified in the model resolution cannot be any earlier than the later of the date the model resolution is signed or put into effect.

This ruling is based on the assumption that Plan X is qualified under Code section 401(a) at all relevant times.

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 Code section 3121(v)(1)(B).

This ruling is directed only to the taxpayer that requested it. Code section 6110(k) provides that it may not be used or cited by others as precedent.

In accordance with the provisions of a power of attorney on file with this office, we are sending a copy of this ruling letter to your authorized representative.

If you have any questions, please call , SE:T:EP:RA:T1 (Badge #50-00751), at (202) 283-9610.

Sincerely yours,

Carlton A. Watkins

Manager
Employee Plans Technical Group 1

Enclosures:
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Notice 437

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