



TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

200520036

U.I.L. 0414.09-00

FEB 22 2005

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ATTN: *****

LEGEND:

State A = *****
Plan X = *****
University B = *****
Board C = *****
Statute Q = *****
Statute R = *****
Statute S = *****
Statute T = *****
Statute U = *****
Statute W = *****
Resolution R = *****
Group B
Employees = *****
Plan Y = *****
Plan Z = *****

200520036

Dear *****:

This letter is in response to a request for a private letter ruling dated May 14, 2001, revised by letter dated January 24, 2002 and supplemented by letters dated July 18, 2002, January 3, 2003, March 21, 2003, June 18, 2003 and June 20 2003, submitted on your behalf by your authorized representative, concerning whether Plan X is a governmental plan under section 414(d) of the Internal Revenue Code (the "Code") and the federal income tax treatment of certain contributions to Plan X under section 414(h)(2) of the Code.

The following facts and representations have been submitted:

University B was created as the State A Agricultural and Mechanical College by an act of the legislature of State A on [REDACTED]. The statutory provisions governing the operation and administration of University B are codified at Statute Q of the State A Revised Code. Statute R of the State A Revised Code describes the general powers of State A universities. University B provides public educational services within State A. Section 3335.01 of Statute Q provides that the leading object of University B shall be, without excluding other scientific and classical studies, and including military tactics, to teach such branches of learning as are related to agriculture and mechanical arts. Statute R provides that a state university means a public institution of higher education, which is a body politic and corporate. University B is specifically designated as a State A university of higher education by State A statutes.

Section 3335.02 of Statute Q provides that the government of University B shall be vested in Board C, a board of eleven trustees, who shall be appointed by the governor of State A with the advice and consent of the State A senate. Two of the eleven trustees shall be students at University B. The student members of Board C have no voting power on the board. Except for the terms of the student members, terms of office for Board C members shall be nine years. Section 3335.09 of Statute Q provides that Board C shall elect, fix the compensation of, and remove, the president and such number of professors, teachers, and other employees of University B as are necessary. Board C shall also fix and regulate the course of instruction and prescribe the extent and character of experiments to be made at University B. Statute R provides that the board of trustees, such as Board C, of any university which receives any state funds in support thereof, shall have full power and authority on all matters relative to the administration of such university. Further, section 3335.08 of Statute Q specifically provides

that Board C may adopt bylaws, rules, and regulations for the government of University B.

Section 3335.07 of Statute Q provides that in its annual report Board C shall state the condition of University B, the amounts of receipts and disbursements and for what the disbursements were made, the number of professors, officers, teachers, and other employees, and the position and compensation of each, the number of students in the several departments and classes, and the course of instruction pursued in each, an estimate of the expenses for the ensuing year, etc. The annual report is filed with the secretary of the interior and the secretary of agriculture of the United States government.

Section 3335.10 of Statute Q provides that Board C shall have general supervision of all lands, buildings, and other property belonging to University B, and the control of all expenses therefore, but shall not contract debt not previously authorized by the State A general assembly. Section 3335.13 provides that the title for all lands for use by University B shall be made in fee simple to State A, and that no title shall be taken by State A for use of University B until the attorney general for State A is satisfied that it is free from all defects and encumbrance.

Section 3335.14 of Statute Q provides that the State A attorney general shall be the legal adviser of Board C and shall institute and prosecute all suits in its behalf. Statute R also provides that the State A attorney general shall be the attorney for each State A college and university and shall provide legal advice in all matters relating to its powers and duties.

Section 3333.01 of Statute S creates the State A Board of Regents that has oversight authority of all State A universities. The governor of State A with the advice and consent of the State A senate appoints the nine members of the Board of Regents. In addition to the members appointed by the governor of State A, the chairman of the education committee of the State A senate and the chairman of the education committee of the State A house of representatives shall be non-voting, ex officio members of the board. The duties of the Board of Regents include the study of state policy in the field of higher education and formulation of a master plan of higher education for State A. The Board of Regents also reviews appropriation requests of the public community colleges and the state colleges and universities and submits to the office of budget and management and the chairpersons of the finance committees of the house of

representatives and senate its recommendations in regard to the biennial higher education appropriations for the state, including appropriations for individual state colleges and universities and public community colleges.

Section 3333.07 of Statute S describes the restrictions on state colleges and universities and outlines their cooperation with the Board of Regents. Section 3333.07 provides, in general, that University B, as an institution of higher education that receives state assistance, shall submit to the State A Board of Regents such accounting of the expenditure of state funds at such time and in such manner as the Board of Regents prescribes. Further, the Board of Regents must approve all new branches or academic centers and new degree programs offered by University B. University B must get the approval of the Board of Regents before it can acquire property by eminent domain.

Section 3345.72 of Statute R provides that each state university or college, within thirty days after the end of each calendar quarter, submit a report to the Board of Regents, the State A director of budget and management, the legislative budget office of the legislative service commission, and the chairpersons and ranking minority members of the finance committees of the house of representatives and the senate of State A. Section 3345.72 also requires that each state university and college prepare at the end of each fiscal year a statement consistent with audit requirements prescribed by the auditor of the state and submit the financial statement to the auditor of the state within four months after the end of the fiscal year. Statute T provides that the auditor of State A shall audit all public offices of State A. University B was established by the laws of State A and is within the definition of a public office and is therefore subject to audit by the State A auditor. The State A auditor, however, generally delegates the audit of University B to a firm of certified public accounts. On an annual basis, audited financial statements must be submitted to the State A auditor within four months after the end of the fiscal year.

Section 3333.07 of Statute S provides that colleges, universities and other institutions of higher education which receive state assistance, but are not supported primarily by the state, shall submit to the State A Board of Regents such accounting of the expenditure of state funds at such time and in such form as the board prescribes. Pursuant to section 3333.07 no institution of higher education shall establish a new branch or academic center or offer a new

degree or establish a new degree program without the approval of the board.

You represent that University B receives 36.31 percent of total operating and non-operating revenue from Federal and State A Funds. The financial statements of University B become part of State A's financial statements. All appropriations of State A funds for University B go through the State A Board of Regents. In each state budget, the State A legislature appropriates a certain amount of funding for both continuing operation and capital projects for all State A universities based on the request made by the Board of Regents.

Statute U provides for the classification of State A employees as classified or unclassified for purposes of the State A civil service rules. Subsection (A) provides a list of positions that are treated as unclassified service. Included in that subsection are certain employees of colleges and universities. You represent that University B also has employees in both the classified and unclassified civil service categories and all such employees are considered by State A to be state employees. Additionally, Group B Employees are entitled to accrue sick leave in accordance with the terms of Statute U.

Statute W was added to the State A Revised Code by the State A legislature. Statute W provides, in part, that an alternative retirement program is established for the purpose of providing to academic or administrative employees of a State A public institution of higher education the opportunity of participating in an alternative retirement plan as an alternative to participating in a State A retirement system. Statute W delegates to the board of trustees of each public institution of higher education the authority to establish an alternative retirement system. Statute W further provides that the employer is the sponsor of each alternative retirement plan offered under this chapter. Each alternative retirement plan offered under this program to academic or administrative employees electing to participate shall be a defined contribution plan that provides retirement and death benefits through investment options.

Statute W contains the relevant guidelines for the operation and administration of alternative retirement plans offered by public institutions of higher education in State A and specifies the participation rules with respect to participating in an alternative retirement plan offered by a State A public institution of higher education. For

example, if an eligible employee does not make an election to participate in an alternative retirement plan that is established by a public institution of higher education for its employees within an election period, that employee is deemed to have elected to participate in the State A sponsored retirement plan that is applicable to that employee's position. Statute W also provides that an election, once made, is irrevocable and that an employee who makes an election to participate in an alternative retirement plan shall be barred from claiming or purchasing service credit under any other State A retirement system for the period of that person's employment during which the election is in effect and that if an employee terminates employment at one State A public institution of higher education and is subsequently employed by another State A public institution of higher education in a position for which an alternative retirement plan is available for under Statute W, the person may make another election under this division.

University B is a public institution of higher education in State A and is an employer that is eligible to establish an alternative retirement plan for its Group B Employees in accordance with the terms of Statute W. University B acknowledged its desire to implement and establish Plan X, an alternative retirement plan for its Group B Employees in Resolution R. Plan X is a non-trusteed annuity plan providing for annual employee and employer contributions. You represent that Plan X meets the qualification requirements of Code section 401(a).

Resolution R provides the authorization for University B to establish Plan X in accordance with Statute W, and provides, in general, that University B will contribute to the provider selected by a Group B Employee an amount equal to the amount which University B would have contributed to the respective State A retirement system in which the Group B Employee would participate, less the amount specified in section 3305.06 of Statute W. Resolution R further provides that the amounts withheld through payroll deduction from the salary of a Group B Employee participating in Plan X are designated as being picked-up and paid by University B as employer contributions under Code section 414(h). Resolution R was certified as a true and accurate excerpt from the minutes of a Board C meeting held on February 5, 1999. Resolution R was signed by the Assistant Secretary of Board C.

Section 3.1 of Plan X provides that all eligible Group B Employees employed as of the date University B establishes

Plan X (the "Establishment Date") shall have a period of one hundred twenty days from such date in which to elect to participate in Plan X. Group B Employees who make such election shall participate in Plan X as of Plan X's establishment date. An eligible Group B employee whose employment commences after the Establishment Date (or an existing employee who becomes an eligible Group B Employee after the Establishment Date) shall have a period of ninety days (one hundred twenty days after April 1, 2001) from the date upon which the eligible Group B Employee first is credited with an hour of service, or for an existing employee, the date upon which the employee becomes an eligible Group B Employee, in which to elect to participate in Plan X. For a new employee, such election shall be effective on the Group B Employee's employment commencement date, and shall be irrevocable at the end of the ninety-day period for Group B Employees commencing employment prior to April 1, 2001; and shall be irrevocable when made for Group B Employees commencing employment on or after April 1, 2001. For an existing employee who become an eligible Group B Employee due to a change in position, references to employment commencement date and the date upon which the employee is first credited with an hour of service shall mean the date upon which the employee becomes an eligible Group B Employee. Group B Employees shall remain in Plan X as long as they are employees of University B.

Section 4.1 of Plan X provides that a Group B Employee who meets the eligibility requirements shall be deemed to have authorized University B to deduct from such Group B Employee's compensation, prior to its payment, a certain percentage of such employee's compensation, as a non-elective contribution to Plan X. The non-elective contribution percentage shall equal the percentage of the Group B Employee's compensation which, but for the election to participate in Plan X, would have otherwise been contributed to the State A retirement system (Plan X or Plan Y) that applies to the employee's position, provided that the non-elective contribution shall not be less than three percent. Section 4.1 further provides that the amount of the non-elective contribution shall be picked up by University B as provided for in Code section 414(h)(2) and that the Group B Employee shall not have the option to receive this picked up contribution directly and such contributions shall be paid by University B directly to the respective provider selected by the Group B Employee.

You represent that all Group B Employees of University B must participate in Plan X or one of State A's defined benefit plans. The State A defined benefit plans are Plan Y

and Plan Z. University B's faculty employees are covered by Plan Y. Plan Y provides that each employer, such as University B, shall annually contribute a certain percentage of each member's earnable compensation to Plan Y which shall be known as the "employer contribution". Plan Y also provides that each Group B Employee shall contribute eight percent of his earned compensation to the plan. Plan Y further provides that an employer, such as University B, may pick up such employee contributions. All faculty members of University B are participants in Plan Y, unless they make an election to participate in Plan X.

University B's Group B Employees not participating in Plan Y participate in Plan Z, unless they elect to participate in Plan X. Plan Z provides that each public employee who is a contributor to Plan Z shall contribute eight percent of the contributor's earnable salary to Plan Z. You represent that such contributions are picked up under Code section 414(h) (2).

You further represent that a Group B Employee's retirement contribution remains the same whether he or she elects to participate in Plan X, Plan Y or Plan Z. Statute W provides that the percentage contributed by the employee who elects to participate in an alternative retirement plan established by its employer shall be the percentage the employee would have otherwise been required to contribute to the State A retirement system (Plan Y or Plan Z) that applies to the employee's position.

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

1. Plan X forms a state retirement system within the meaning of Section 3121(b)(7)(F) of the Code.
2. That employees of University B are qualified participants in Plan X and will not be considered engage in employment for FICA purposes. Thus, wages paid to those employees will not be subject to the OASDI portion of the FICA tax.
3. That Plan X is a governmental plan within the meaning of section 414(d) of the Code.
4. Amounts picked up by University B of behalf of the Group B Employees participating in Plan X shall not be considered to be included in such employees' gross income for income tax purposes

until the time that the picked-up contributions are distributed.

5. Amounts picked up by University B, although designated as employee contributions, shall be treated as employer contributions for purposes of federal income taxation.
6. Amounts picked up by University B will be treated as employer contributions and thus, excepted from wages under section 3401(a)(12)(A) of the Code for purposes of federal income tax withholding.

Ruling requests number one and two are being handles by another office of the Internal Revenue Service in a separate letter ruling.

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 89-49, 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 or instrumentality of a government, the mere satisfaction of one or all of the factors is not necessarily determinative.

With respect to the first factor of Rev. Rul. 89-49, University B was created by an act of the legislature of State A on [REDACTED] University B's operating procedures are codified at Statute Q of the State A Revised Code. Plan X was established by University B pursuant to Statute W, which authorized the establishment of an

alternative retirement plan by state institutions of higher education as an alternative to participating in a State A retirement system. Thus, there is specific legislation creating University B and authorizing the establishment of Plan X by University B.

With respect to the second factor of Rev. Rul. 89-49, University B receives more than 36 percent of its operating and non-operating revenues from State A and Federal funds. This amount includes Federal and State A grants and contracts, State A share of instruction and line-item appropriations and State A capital appropriations. Plan X does not receive specific funding from State A. Plan X does, however, benefit indirectly from University B's direct appropriations from State A. Plan X is a contributory plan that is funded with contributions made by University B and Group B Employee contributions that are picked up by University B under section 414(h) of the Code.

With respect to the third factor of Rev. Rul. 89-49, State A exercises considerable control over University B through Board C and the State A Board of Regents. The governor of State A with the advice and consent of the State A senate appoints the members of Board C. The government of University B is vested in Board C. Section 3335.08 of Statute Q specifically provides that Board C may adopt bylaws, rules, and regulations for the government of University B. Pursuant to section 3335.09 of Statute Q, Board C may elect, fix the compensation of and remove the president and other professors, teachers and employees of University B. Board C also fixes and regulates the course of instruction at University B. Board C is responsible for the general supervision of the land, buildings and other property belonging to University B and controls all expenses therefore. Board C may not contract for debt not authorized by the State A general assembly. The title for all lands used by University B is held in fee simple by State A. University B does have the power of eminent domain but must get the Board of Regents' prior approval before it can acquire property by eminent domain. The attorney general of State A is the legal adviser and attorney of Board C and shall institute and prosecute all suits in its behalf and shall provide legal advice in all matters relating to its powers and duties.

The governor of State A with the advice and consent of the State A senate also appoints the State A Board of Regents. The Board of Regents has oversight authority over University B. Section 3345.72 of Statute R requires that Board C file quarterly and annual fiscal reports with the Board of

Regents. The Board of Regents reviews appropriation requests submitted by University B and submits recommendations with regard to appropriations to the office of budget and management and the finance committees of the house of representatives and senate of State A. The Board of Regents formulates a master plan for higher education in State A and no institution of higher learning may establish a new branch or academic center or offer a new degree or establish a new degree program with the approval of the Board of Regents.

University B must submit a quarterly report to the Board of Regents and other State A officials. University B is subject to audit by the State A auditor. The audited financial statement is submitted to the State A auditor within four months after the end of the fiscal year.

With respect to the fourth factor of Rev. Rul. 89-49, Section 124.11 of Statute U provides that employees of colleges and universities are employees for purposes of the State A civil service rules. Further, section 124.38 of Statute U which establishes rules for sick leave for employees of State A, specifically includes employees of any state college or university. Thus State A considers the Group B Employees of University B to be state employees.

In view of the foregoing, we conclude that University B is an agency or instrumentality of State A. Since Plan X is a

plan established and maintained by University B for its employees, with respect to ruling request three, we conclude that Plan X 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) or a plan described in Code section 403(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.

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 R and Section 4.1 of Plan X satisfy the criteria set forth in Revenue Ruling 81-35 and Revenue Ruling 81-36. Resolution R specifically provides that the amounts withheld through payroll deduction from the salary of the Group B Employee are designated as being picked up and paid by University B as employer contributions and Section 4.1 of Plan X specifically provides that the Group B Employee does not have the option to receive this picked up contribution directly and such contributions shall be paid by University B directly to the respective investment provider selected by the Group B Employee.

Accordingly, with respect to rulings number four, five and six, we conclude that the amounts picked up by University B on behalf of the Group B Employees participating in Plan X pursuant to Resolution R and section 4.1 of Plan X shall not be included in the Group B Employees' gross income for income tax purposes until the time that the picked-up

contributions are distributed. These amounts will be included in the gross income of the Group B Employees or their beneficiaries in the year in which they are distributed from Plan X, to the extent they represent amounts contributed by University B. Furthermore, the amounts picked-up by University B pursuant to Resolution R and section 4.1 of Plan X, although designated as employee contributions, shall be treated as employer contributions for purposes of federal income taxation. Finally, because we have determined that the picked-up amounts are to be treated as employer contributions, such amounts 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 University B will constitute wages for federal income tax withholding purposes in the taxable year in which they are contributed to Plan X.

For purposes of the application of section 414(h)(2) of the Code, it is immaterial whether the employer 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 pick up is not any earlier than the later of the date Resolution R is signed and adopted by Board C on behalf of University B, or the date Plan X is put into effect by University B.

This ruling is based on the assumption that Plan X will meet the requirements for qualification under Code section 401(a) and Code section 403(a) at time of the contributions and distributions.

This ruling is also based on the condition that a Group B Employee who makes a one-time affirmative, irrevocable election to participate in Plan X within University B's prescribed election period may not subsequently alter or amend this election to participate in Plan X. This ruling is also based on the condition that a Group B Employee who fails to make an affirmative, irrevocable election to participate in Plan X during University B's prescribed election period, is deemed to have elected to participate in the State A retirement system (Plan Y or Plan Z) that applies to that employee's position. This deemed election to not participate in Plan X is treated as the one-time irrevocable election for such Group B Employee and, for purposes of this ruling and the conclusions reached in this ruling under Code section 414(h)(2), may not be subsequently altered or amended.

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No opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. Further, this ruling expresses no opinion as to the whether the pick up arrangements of Plan Y and Plan Z as they apply to University B and its Group B Employees meet the requirements of Code section 414(h)(2).

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 ruling is based on Resolution R that was submitted with your correspondence dated July 18, 2002, and Plan X, as adopted by University B pursuant to Resolution R.

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.

If you have any questions about this ruling, please contact
*****SE:T:EP:RA:T2.

Sincerely yours,

(signed) JOYCE E. FLOYD

Joyce E. Floyd, Manager
Employee Plans Technical Group 2

Enclosures:

Deleted copy of this letter
Form 437