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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

AUG 03 2011

SE:T:EP:RA:T1

Uniform Issue List: 414.09-00

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Attn: **********

Legend:

State A..... **********

University B..... **********

Statute C ..... **********
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Group D Employees..... **********
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Plan X..... **********
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Plan Y..... **********
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Dear **********

This is in response to a letter dated **********, as supplemented by correspondence dated **********, in which you request rulings under section 414(h)(2) of the Internal Revenue Code (the "Code"). You submitted the following facts and representations in connection with this request.

Plan X is a retirement plan which provides benefits for Group D Employees of University B, a public university of State A, and their beneficiaries. Plan X, effective January 1, 2011, is a new defined contribution plan intended to be qualified under Code

section 401(a) and is a governmental plan under section 414(d). With the exceptions noted in Section 3.2 of Plan X, the Group D Employees who participate in Plan Y will be eligible to participate in Plan X. Plan Y is a non-elective defined contribution 403(b) plan maintained by University B that originally provided for employer contributions of 11% of the first $9,000 of compensation and 15% of compensation above $9,000. As of January 1, 2011, the employer contribution under Plan Y was reduced to 10% of the participant's compensation.

Under Plan X, participants will be required to make a contribution of 4% of compensation to Plan X. Only participant contributions will be made to Plan X. University B, through resolution by its Board of Trustees adopted at its meeting on May 28, 2010, has taken formal action providing that contributions required of participants in Plan X, although designated as employee contributions, will be paid by University B in lieu of employee contributions and treated as employer contributions, beginning January 1, 2011, the initial effective date of Plan X.

Group D Employees of University B will be required to participate in Plan X. Participants do not have the option of choosing to receive the contributed amounts directly and may not make a cash or deferred election with respect to such amounts. It is expected that participants in Plan X will be entitled to receive a distribution of their account balance under the plan upon the occurrence of certain events including death, disability, and termination of employment.

University B is governed by its Board of Trustees which has authority under Statute C of State A to establish compensation and retirement programs for faculty and staff.

Based on the above facts and representations, you request the following rulings that:

(1) For federal income tax purposes, mandatory contributions made by participants into Plan X and picked up by University B will not be currently included in the gross income of the participants on whose behalf the pick-up is made, and

(2) Mandatory contributions made by participants into Plan X and picked up by University B will not constitute wages subject to federal income tax withholding.

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 determined to be qualified under section 401(a) of the Code, 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.

Rev. Rul. 2006-43, 2006-35 I.R.B. 329, amplifying and modifying Rev. Rul. 81-35, 1981-1 C.B. 255, and Rev. Rul. 81-36, 1981-1 C.B. 255, and Rev. Rul. 87-10, 1987-1 C.B. 136, describes the actions required for a state or political subdivision thereof, or an agency or instrumentality of any of the foregoing, to "pick-up" employee contributions to

a plan qualified under section 401(a) of the Code so that the contributions are treated as employer contributions pursuant to section 414(h)(2) of the Code. Specifically, Rev. Rul. 2006-43 provides that a contribution to a qualified plan established by an eligible employer (i.e., a governmental employer) will be treated as picked-up by the employing unit under section 414(h)(2) of the Code if two conditions are satisfied:

1) First, the employing unit must specify that the contributions, although designated as employee contributions, are being paid by the employer. For this purpose, the employing unit must take formal action to provide that the contributions on behalf of a specific class of employees of the employing unit, although designated as employee contributions, will be paid by the employing unit in lieu of employee contributions. A person duly authorized to take such action with respect to the employing unit must take such action. The action must apply only prospectively and be evidenced by a contemporaneous written document (e.g., minutes of a meeting, a resolution, or an ordinance.)
2) Second, the pick-up arrangement must not permit a participating employee from and after the date of the effective date of the "pick-up" to have a cash or deferred election right within the meaning of section 1.401(k)-1(a)(3) of the Income Tax Regulations with respect to designated employee contributions. Thus, for example, no participating employee may be given the right to opt out of the pick-up arrangement described in section 414(h)(2) of the Code, or to receive the contributed amounts directly instead of having them paid by the employing unit to the plan.

Rev. Rul. 2006-43 applies even if the employer picks up contributions through either a reduction in salary or an offset against future salary increases.

The federal income tax treatment to be afforded 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 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 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 order to comply with Revenue Ruling 81-35 and Revenue Ruling 81-36, with respect to particular contributions, Revenue Ruling 87-10, 1987-1 C.B. 136 provides the required specification of designated employee contributions must be completed before the period to which such contributions relate. If not, the designated employee contributions being paid by the employer are actually employee contributions paid by the employee and recharacterized at a later date. The retroactive specification of designated employee contributions as paid by the employing unit, i.e., the retroactive "pick up" of designated employee contributions by a governmental employer, is not permitted under section 414(h)(2) of the Code. Thus, employees may not exclude from current gross income designated employee contributions to a qualified plan that relate to compensation earned for services rendered prior to the date of the last governmental action necessary to effect the pick up.

In this case, Plan X satisfies the criteria set forth in Revenue Ruling 2006-43, Revenue Ruling 81-35 and Revenue Ruling 81-36 by specifically providing that University B shall pick up the mandatory contributions of Group D Employees to Plan X; that such contributions, although designated as employee contributions, shall be paid (picked up) by University B in lieu of contributions by Group D Employees; and that Group D Employees will not be given the option of choosing to receive the contributed amounts directly instead of having them paid by University B to Plan X.

With respect to ruling requests one and two, we conclude that the mandatory contributions made by the Group D Employees to Plan X and picked up by University B shall be treated as employer contributions and will not be included in the current gross income of the Group D Employees for federal income tax purposes in the year in which contributions are made to Plan X. These amounts will be includible in the gross income of the Group D Employees or their beneficiaries only in the taxable year in which they are distributed, to the extent they represent contributions made by University B. 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 University B will constitute wages for federal income tax withholding purposes in the taxable year in which they are contributed to Plan X.

This ruling applies only if the effective date for the commencement of the pick-up is not earlier than the later of the date the Board resolution is signed and adopted by University B, or the date the pick-up is put into effect.

No opinion is expressed as to the federal tax consequences of the transaction

described above under any other provisions of the Code.

The above rulings are based on the assumption that Plan X is qualified under Code section 401(a) and its related trust exempt from tax under section 501(a) at all relevant times.

No opinion is expressed as to whether the amounts picked up by University B 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 specific taxpayer that requested it. Code section 6110(k)(3) provides that it may not be used or cited by others as precedent.

Pursuant to a power of attorney on file with this office, a copy of this ruling has been sent to your authorized representative.

Should you have any questions or concerns regarding this letter, please contact **********(ID No. *********) at (***) ***-****. Please address all correspondence to **********.

Sincerely yours,

Carlton A. Watkins

Carlton A. Watkins, Manager
Employee Plans Technical Group 1