TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

201317025

JAN 31 2013

Uniform Issue List: 414.00-00, 414.09-00

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T:EP:RA:T2

Legend:

State A	=	xxxxxxxxxxxxxx
Employer M	=	xxxxxxxxxxxxxx
Group N Employees	=	xxxxxxxxxxxxxx
Fund O	=	xxxxxxxxxxxxxx
Plan X	=	xxxxxxxxxxxxxx
Plan Y	=	xxxxxxxxxxxxxx
Statute C	=	xxxxxxxxxxxxxx
Section E	=	xxxxxxxxxxxxxx
Section F	=	xxxxxxxxxxxxxx
Section G	=	xxxxxxxxxxxxxx
Affidavit Z	=	xxxxxxxxxxxxxx

Dear xxxxxxxxxxxx:

This letter is in response to a ruling request, submitted by your authorized representative on your behalf, dated May 11, 2007, as supplemented by correspondence dated November 2 and December 11 and 21, 2007, July 10 and November 14, 2008, January 26, 2009, March 2, 2010, and November 25, 2012, with respect to the federal income tax treatment of certain contributions to a retirement plan pursuant to section 414(h) of the Internal Revenue Code (the "Code").

The following facts and representations are submitted under penalties of perjury in support of your request:

Employer M, a municipality of State A, contributes to Fund O, subject to the requirements of Statute C, on behalf of eligible Group N Employees to provide benefits under Plan X. It is represented that Plan X is a defined benefit plan that meets the requirements of section 401(a) of the Code and is a governmental plan within the meaning of section 414(d) of the Code. Sections E and F of Statute C provide that eligible employees may elect to participate in Plan Y, a defined contribution plan, in lieu of Plan X. However, in Affidavit Z, the Treasurer of Employer M stated that Group N Employees are not offered the opportunity to participate in Plan Y. Employer M further represents that Plan Y was never actually established by State A. Additionally, Employer M represents that it does not maintain any plan or arrangement described in Code section 219(g)(5)(A) other than Plan X.

Group N Employees participating in Plan X must contribute a stated percentage of salary to Fund O. Under section G of Statute C, Employer M may pick up such mandatory contributions that Group N Employees make under Plan X and, if picked up, such contributions shall be treated as employer contributions in determining tax treatment under the Code. Section G of Statute C further provides that the contributions of Group N Employees under Plan X may be picked up by a reduction in the cash salary of such employees or by an offset against a future salary increase or by a combination of a reduction in salary and offset against a future salary increase.

On May 20 , the governing body of Employer M passed a resolution, subject to Service approval, that Employer M would pick up the contributions Group N Employees are required to make under Plan X. On January , 20 , Employer M submitted a revised resolution for Service approval that details Employer M's intent to implement a pick-up arrangement under section 414(h) of the Code with respect to contributions Group N Employees are required to make under Plan X, and explicitly stating that Group N Employees shall not have the option of choosing to receive the contributed amounts as direct pay instead of having such contributions paid by Employer M to Fund O.

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

1. That the proposed contributions to Plan X, whether made by employee contribution, an offset against future salary increases, or a combination of both methods, are within the provisions of section 414(h) of the Code.
2. That no part of the pick-up by Employer M will constitute gross income to the employees on whose behalf the pick-up is made; and
3. That no part of the pick-up will constitute wages from which Employer M must deduct and withhold federal income tax.

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.

The federal income tax treatment to be afforded contributions that are picked up by the employer within the meaning of section 414(h)(2) of the Code has been developed in a series of revenue rulings. In Revenue Ruling 77-462, 1977-2 C.B. 358, 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 were excluded from the employees' gross income until such time as they were distributed to the employees. The revenue ruling further held that, under the provisions of section 3401(a)(12)(A) of the Code, the school district's contributions to the plan were excluded from wages for purposes of the collection of income tax at the source on wages. Therefore, no withholding was required for federal income tax purposes from the employees' salaries with respect to such picked-up contributions.

Revenue Ruling 81-35, 1981 C.B. 255, and Revenue Ruling 81-36, 1981 C.B. 255, 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 the required specification of designated employee contributions must be completed before the period to which such contributions relate. If not, the designated employee contributions 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.

Rev. Rul. 2006-43, 2006-35 I.R.B. 329, amplifying and modifying Rev. Rul. 81-35, 1981-1 C.B. 255, 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 ordinance).

2) Second, the pick-up arrangement must not permit a participating employee from and after 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 states that the pick-up rules expressed in Rev. Rul. 81-35 and Rev. Rul. 81-36 apply whether the employer picks up contributions through a reduction in salary or through an offset against future salary increases.

Plan X meets the conditions of all of the above. Employer M's proposed resolution specifies that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee. Furthermore, Employer M's proposed resolution expressly states an intention to implement a pick-up, and the provision for such pick-up does not permit a participating employee to have a cash or deferred election with regard to the designated employee contributions.

Accordingly, with respect to ruling request one, we conclude the mandatory employee contributions to Plan X, which are picked up by Employer M, whether made by employee contribution, an offset against future salary increases, or a combination of both methods, are within the provisions of section 414(h) of the Code.

Based on the above conclusion that the mandatory employee contributions to Plan X, which are picked up by Employer M, are within the provisions of section 414(h) of the Code, we further conclude that, as regards ruling request two, no part of such picked-up contributions will constitute gross income to the employees on whose behalf such contributions are made in the year contributed. Rather, these amounts will be included in the gross income of the employees or their beneficiaries only for the taxable year in which they are distributed.

Finally, with respect to ruling request three, we conclude that because 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. Therefore, no withholding of federal income tax is required from a Group N Employee's salary with respect to such picked-up contributions.

These conclusions are only applicable if the effective date for any proposed pick-up specified in a final resolution passed by Employer M with regard to Plan X is not earlier than the later of the date the final resolution is signed or the date it is put into effect.

No opinion is expressed as to the tax treatment of the transactions described herein under the provisions of any other section of either the Code or the regulations that may be applicable thereto.

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 letter 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 as precedent.

Pursuant to a power of attorney on file with this office, a copy of this letter ruling is being sent to your authorized representative.

If you wish to inquire about this ruling, please contact xxxxxxxxxxxxxxxx (I.D. Number xxxxxxx), at (xxx) xxx-xxxx. Please address all correspondence to SE:T:EP:RA:T3.

Sincerely yours,

Laura B. Warshawsky, Manager
Employee Plans Technical Group 3

Enclosures:
Deleted copy of this letter
Notice of Intention to Disclose

cc: xxxxxxxxxxxxxxxxxx
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