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

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

20150906

DEC 04 2014

Uniform Issue List: 414.00-00, 414.09-00

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Legend:

State A	=	xxxxxxxxxxxxxxxxxx
System B:	=	xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx
Plan C	=	xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx
Statute D	=	xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx
Statute E	=	xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx
Amendment F	=	xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx
Category G Employees	=	xxxxxxxxxxxxxxxxxx xxxxxxxxxxxxxxxxxx

Dear xxxxxxxxxx:

This letter is in response to correspondence dated December 23, 2013, as supplemented by correspondence dated November 24, 2014, submitted on behalf of System B by its authorized representative, in which a request for a letter ruling was submitted with respect

to the federal income tax consequences of certain contributions to, and distributions from, Plan C, as amended by Statute E and Amendment F.

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

In 2013, the State A Legislature enacted Statute D, which established Plan C, a defined contribution plan. Pursuant to Statute D, as amended by Statute E, all Category G Employees elected or appointed on or after January 1, 2014 must participate in Plan C. Plan C is a governmental plan described in section 414(d) of the Code, and is intended to be a retirement plan qualified under section 401(a) of the Code. A favorable determination letter was issued by the Internal Revenue Service with respect to Plan C on October 15, 2014.

Plan C requires a salary reduction contribution (hereinafter referred to as a "Mandatory Employee Contribution") on behalf of each participant equal to 8% of the participant's compensation (as defined under the Plan). In addition, Plan C mandates an employer contribution equal to 6% of each participant's compensation. Plan C limits such salary reduction and employer contributions as required under section 415 of the Code.

Statute D, as amended by Statute E, provides that, although designated as participant contributions, all participant contributions made to Plan C shall be picked up and paid by the employer in lieu of contributions made by the participant. The Statute further provides that all participant contributions that are picked up by the employer under Plan C shall be treated as employer contributions under section 414(h) of the Code, shall be excluded from the participants' gross income for federal and state income tax purposes, and are includable in the gross income of the participants or their beneficiaries only in the taxable year in which they are distributed. The Statute also explicitly states that a Plan C participant does not have the option of choosing to receive the contributed amounts directly instead of the employer paying the amounts to Plan C.

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

1. The Mandatory Employee Contributions made by Category G Employees' to Plan C that are picked up by the employing units will be treated as employer contributions under section 414(h)(2) of the Internal Revenue Code (the "Code").

2. A distribution of the amounts picked up on behalf of the affected employees, either through a retirement pension, lump sum payment or otherwise, will be considered a distribution of employer contributions taxable at time of receipt by the employees as prescribed by section 402 of the Code.

3. Under section 3401(a)(12)(A) of the Code, the picked-up contributions will be treated as employer contributions to a plan qualified under section 401(a) and will be excluded from wages for purposes of collection of income tax at source on wages.

Section 401(a) of the Code provides that a trust created or organized in the United States and forming a part of a qualified stock bonus, pension, or profit sharing plan of an employer constitutes a qualified trust only if the various requirements set out in section 401(a) of the Code are met.

Section 1.401(k)-1(a)(3) of the Income Tax Regulations (the "Regulations") generally defines a cash or deferred election as any direct or indirect election (or modification of an earlier election) by an employee to have the employer either: (1) provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available, or (2) contribute an amount to a trust, or provide an accrual or other benefit under, a plan deferring the receipt of compensation.

Section 402(a) of the Code generally provides that any amount actually distributed to any recipient by any employees' trust described in section 401(a) of the Code, which is exempt from tax under section 501(a) of the Code, shall be taxable to the recipient, in the taxable year of the distribution, under section 72 of the Code (relating to annuities).

Section 1.402(a)-1(a)(1)(i) of the Regulations provides that if an employer makes a contribution for the benefit of an employee to a trust described in section 401(a) of the Code for the taxable year of the employer which ends within or with a taxable year of the trust for which the trust is exempt under section 501(a) of the Code, the employee is not required to include such contribution in his or her income except for the year or years in which such contribution is distributed or made available to him or her.

Section 414(h)(1) of the Code provides that any amount contributed to an employees' trust described in section 401(a) of the Code shall not be treated as having been made by the employer if it is designated as an employee contribution.

Section 414(h)(2) of the Code provides that, for purposes of section 414(h)(1), in the case of any plan established by the government of any State or political subdivision thereof, or by any agency or instrumentality of any of the foregoing, or a governmental plan described in the last sentence of section 414(d) (relating to plans of Indian tribal governments), where the contributions of employing units are designated as employee contributions but where any employing unit picks up the contributions, the contributions so picked up shall be treated as employer contributions.

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, 1981-1 C.B. 255, and Revenue Ruling 81-36, 1981-1 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.

Revenue Ruling 2006-43, 2006-35 I.R.B. 329, amplifying and modifying Revenue Ruling 81-35, Revenue Ruling 81-36, and Revenue Ruling 87-10, describes the actions required for a state or political subdivision of a state, or an agency or instrumentality of either, 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). Specifically, Revenue Ruling 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 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.

Revenue Ruling 2006-43 states that the pick-up rules expressed in Revenue Ruling 81-35 and Revenue Ruling 81-36 apply even if the employer picks up contributions through a reduction in salary or through an offset against future salary increases.

In the present case, consistent with the requirements stated in Revenue Ruling 81-35, Revenue Ruling 81-36, and Revenue Ruling 2006-43, with respect to a valid pick-up arrangement under section 414(h)(2) of the Code, Statute D, as amended by Statute E, as enacted by the State A Legislature, explicitly states that the Mandatory Employee Contributions made on behalf of each Category G Employee under Plan C, although designated as participant contributions, shall be picked up and paid by an employer into Plan C. The Statute further provides that all participant contributions that are picked up by the employer under Plan C shall be treated as employer contributions under section 414(h) of the Code,

In further satisfaction of the requirements of Revenue Ruling 81-35, Revenue Ruling 81-36, and Revenue Ruling 2006-43, Statute D, as amended by Statute E provides that a participant does not have the option of choosing to receive the Mandatory Employee Contribution amounts directly instead of having the employer pay such amounts into Plan C. Accordingly, as required under the Revenue Rulings, Plan C does not permit a participating employee from on 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 Regulations with respect to any designated employee contributions.

Moreover, each participating employer's obligation to pick up the Mandatory Employee Contributions on behalf of each Plan C participant exists before the participant earns any compensation for Plan C purposes. Therefore, there can be no retroactive pick-up of designated employee contributions by the employer under Plan C in contravention of Revenue Ruling 87-10.

Based on the foregoing, we conclude as follows:

1. With respect to ruling request one, the Mandatory Employee Contributions made to Plan C on behalf of Category G Employees that are picked up by the employing units will be treated as employer contributions under section 414(h)(2) of the Code.

2. With respect to ruling request two, and in accordance with the holding in Revenue Ruling 77-462, a distribution of the amounts picked up on behalf of the affected employees, either through a retirement pension, lump sum payment or otherwise, will be considered a distribution of employer contributions taxable at the time of receipt by the employees as prescribed by section 402 of the Code.

3. With respect to ruling request three, because we determined that the Mandatory Employee Contributions picked up by the employer under Plan C are excluded from the employees' gross income until such time as such amounts are distributed, pursuant to Revenue Ruling 77-462, under section 3401(a)(12)(A) of the Code, the picked-up contributions will be treated as employer contributions to a plan qualified under section 401(a) and will be excluded from wages for purposes of collection of income tax at source on wages.

No opinion is expressed as to the federal tax consequences of the transactions described above under any other provisions of the Code.

This ruling is based on the assumption that Plan C satisfies the qualification requirements set forth in section 401(a) of the Code, and constitutes a governmental plan within the meaning of section 414(d) of the Code, at all relevant times.

This ruling is directed only to the specific taxpayers that requested it. Section 6110(k)(3) of the Code 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 letter ruling is being sent to your authorized representative.

Should you have any questions or concerns regarding this ruling, please contact xxxxxxxx (I.D. Number (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: xxxxxxxxxxxxxxxxxxx
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