Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
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Person To Contact:
, ID No.
Telephone Number:

Refer Reply To:
CC:TEGE:EB:QP1
PLR-T-103159-15
Date:
July 01, 2015

Legend:

Employer A =
Plan B =
City C =

Dear :

This letter is in response to your ruling request, dated April 23, 2010, as supplemented by correspondence dated April 16, 2015, May 4, 2015, May 7, 2015, June 1, 2015, and June16, 2015, submitted by your authorized representative, concerning the "pick up" of certain designated employee contributions to Plan B under 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 A is a medical center owned by City C. You have represented that Employer A is a governmental entity.

Employer A adopted Plan B on April 22, 2010, intending it to be effective as of January 1, 2011. However, Employer A did not implement Plan B while it sought this ruling. By resolution of the Board of Trustees of Employer A (the "Board"), duly adopted by the Board on June 15, 2015, Plan B was amended and restated, effective as of January 1, 2016.

Plan B is a defined contribution plan, and is represented to be qualified under section 401(a), and a governmental plan under section 414(d). The Plan B document consists

of a specimen document and an adoption agreement. The amendment and restatement of Plan B, effective as of January 1, 2016, was implemented through the execution of a new adoption agreement. Pursuant to its terms, Plan B will be funded through a trust (or a custodial account or annuity contract described in section 401(f)) for the exclusive benefit of participants and their beneficiaries. Plan B received a favorable determination letter from the IRS on March 19, 2012.

Plan B provides that only Senior Management employees of Employer A (Vice Presidents and President and CEO) ("Eligible Employees") are eligible to participate in Plan B. Plan B imposes no age or service requirements.

On March 22, 2010, the Board adopted a resolution authorizing Employer A to pick up designated contributions made to Plan B by Eligible Employees who are participants. The resolution also provides that the contributions of Eligible Employees in Plan B that are picked up by Employer A under section 414(h) will be paid by Employer A on behalf of the Eligible Employees, and that the Eligible Employees will not have the option of receiving such picked-up contributions in cash instead of having the contributions made to Plan B. As noted above, Employer A did not implement Plan B or the associated pick-up while it sought this ruling.

In connection with the amendment and restatement of Plan B, the Board adopted resolutions on June 15, 2015, providing that Employer A shall pick up contributions to Plan B (as amended and restated effective January 1, 2016) that are made pursuant to salary reduction contributions from Eligible Employees. Moreover, the June 15, 2015 resolutions reiterate that the participants in the amended and restated Plan B will not have the option of receiving such contributions in cash instead of having them contributed to the amended and restated Plan B.

The adoption agreement with respect to Plan B, as amended and restated effective January 1, 2016, states that, for purposes of the designated employee contributions that will be picked up by Employer A under the terms of Plan B (hereinafter referred to as "Mandatory Contributions") an Eligible Employee shall become a participant as of the first day of the month coinciding with or next following the date on which the Eligible Employee met all requirements for participation. The amended and restated adoption agreement additionally provides that for an employee who is an Eligible Employee on December 31, 2015, participation shall commence on January 1, 2016.

Under Plan B, Mandatory Contributions are mandatory contributions that all Eligible Employees must make if required under the adoption agreement. Plan B further provides that Mandatory Contributions are picked up by Employer A in accordance with section 414(h)(2) and are treated as employer contributions for federal income tax purposes, but are considered wages for purposes of FICA.

The adoption agreement with respect to Plan B, as amended and restated effective January 1, 2016, provides that, as of the effective date of an Eligible Employee becoming a participant in Plan B, Mandatory Contributions will be made to Plan B at a fixed rate of 7.5% of compensation. The amended and restated adoption agreement also states that the fixed percentage shall be applied only to the compensation earned during an Eligible Employee's period of participation. Furthermore, the adoption agreement mandates that the Mandatory Contribution will remain in effect for the duration of that participant's employment with Employer A as an Eligible Employee.

The adoption agreement with respect to Plan B additionally provides that, for each plan year, each Eligible Employee may elect to make Voluntary Contributions. Plan B defines Voluntary Contribution as a contribution made to Plan B by an Eligible Employee on an after-tax basis pursuant to the election of the Eligible Employee. An Eligible Employee's election to make Voluntary Contributions remains in effect until revoked or completion of a superseding Voluntary Contribution election.

You request the following rulings:

(1) The provisions of Plan B regarding the pick-up of Mandatory Contributions satisfy the requirements of section 414(h)(2).
(2) The Mandatory Contributions made by Eligible Employees pursuant to salary reduction and picked up by Employer A in accordance with section 414(h)(2) will be treated as employer contributions for federal income tax purposes.
(3) No part of the Mandatory Contributions picked up by Employer A in accordance with section 414(h)(2) will be includible by Eligible Employees as gross income for federal income tax purposes in the year of contribution.

With respect to your first and second requested rulings, section 414(h)(1) provides that any amount contributed to an employees' trust described in section 401(a) shall not be treated as having been made by the employer if it is designated as an employee contribution.

Section 414(h)(2) 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)) has been described 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. Revenue Ruling 77-462 further held that, under the provisions of section 3401(a)(12)(A), 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). 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.

Section 1.401(k)-1(a)(3)(i) of the Income Tax Regulations 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: (A) provide an amount to the employee in the form of cash (or some other taxable benefit) that is not currently available, or (B) contribute an amount to a trust, or provide an accrual or other benefit under, a plan deferring the receipt of compensation.

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) 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) if certain conditions are satisfied, including that 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 §1.401(k)-1(a)(3) with respect to designated employee contributions.

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.

Summarizing the requirements of Revenue Ruling 81-35, Revenue Ruling 81-36, Revenue Ruling 87-10, and Revenue Ruling 2006-43, in order to have a valid pick up arrangement:

(1) Employer A must specify that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee and the required specification of designated employee contributions must be completed before the period to which such contributions relate.
(2) Employer A must take formal action, through a person duly authorized to do so, 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. The action must apply only prospectively and be evidenced by a contemporaneous written document.
(3) An employee must not be given the option of choosing to receive the contributed amounts directly instead of having them paid by Employer A to the pension plan. Further, 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 §1.401(k)-1(a)(3) with respect to designated employee contributions.

In the present case, the facts represented state that the written provisions of Plan B and the adoption agreement explicitly mandate that the Mandatory Contributions be picked up by Employer A in accordance with section 414(h)(2), and that the Mandatory Contributions, although required to be made under the terms of Plan B by each Eligible Employee, will be paid (i.e., picked up) by Employer A. In addition, the Board formally adopted a resolution on June 15, 2015, authorizing Employer A to pick up the Mandatory Contributions under Plan B, as amended and restated effective January 1, 2016. Thus, the arrangement satisfies the first two requirements above.

With respect to the third requirement, pursuant to the Plan B adoption agreement, as amended and restated effective January 1, 2016, Mandatory Contributions to Plan B equal to 7.5% of compensation will be picked up by Employer A on behalf of every Eligible Employee, effective as of the date of the Eligible Employee's participation in Plan B. Therefore, because the Mandatory Contributions are designated, mandatory employee contributions, Eligible Employees are not given the option of choosing to receive the contributed amounts directly instead of having them paid by Employer A to Plan B. Moreover, because the Mandatory Contributions are non-elective, the pick-up arrangement under Plan B does not permit Eligible Employees from and after the effective date of the pick-up to have a cash or deferred election right within the meaning of §1.401(k)-1(a)(3) with respect to the designated employee contributions.

In addition, in accordance with Revenue Ruling 2006-43, the pick-up arrangement under Plan B does not fail to satisfy the requirements of section 414(h)(2) merely because the Mandatory Contributions are made by Employer A to Plan B on behalf of the Eligible Employees through a reduction in salary.

Consequently, based on the foregoing, we conclude that the provisions of Plan B, as amended and restated effective January 1, 2016, regarding the pick-up of Mandatory Contributions satisfy the requirements of section 414(h)(2); and, therefore, the Mandatory Contributions made by Eligible Employees pursuant to salary reduction and picked up by Employer A in accordance with section 414(h)(2) will be treated as employer contributions for federal income tax purposes.

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

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

As stated above, we have concluded, with respect to your second ruling request, that the Mandatory Contributions that are picked up by Employer A under Plan B, as amended and restated effective January 1, 2016, on behalf of Eligible Employees in accordance with section 414(h)(2) will be treated as employer contributions for federal income tax purposes. Accordingly, we further conclude, with respect to your third ruling request, that, pursuant to section 402(a), §1.402(a)-1(a)(1)(i), and Revenue Ruling 77-462, such Mandatory Contributions picked up by Employer A in accordance with section

414(h)(2) will not be includible by Eligible Employees as gross income for federal income tax purposes until these amounts are distributed or made available to them.

Notwithstanding the foregoing, all payments of remuneration by an employer for services performed by an employee are generally subject to taxes under the Federal Insurance Contributions Act (FICA) unless the payments are specifically excepted from the term "wages" or the services are specifically excepted from the term "employment." FICA taxes include social security and Medicare taxes. Section 3121(v)(1)(B) provides that, other than the social security tax wage base limitation, nothing in section 3121(a) excludes from the term "wages" any amount picked up as an employer contribution under section 414(h)(2) if the pick-up is pursuant to a salary reduction agreement (whether evidenced by a written instrument or otherwise). For these purposes, the term "salary reduction agreement" includes any salary reduction arrangement, regardless of whether there is approval or choice of participation by individual employees or whether such approval or choice is mandated by State statute. H.R. Conf. Rep. No. 861, 98th Cong. 2d Sess. 1415 (1984); see also *Public Employees' Retirement Board v. Shalala*, 153 F.3rd 1160 (10th Cir. 1998).

Therefore, under section 3121(v)(1)(B), if an employee's services are covered (included in employment) for social security tax purposes, pick-up contributions under section 414(h)(2) that are made pursuant to a salary reduction agreement are generally subject to social security taxes (unless the maximum wage base exception applies). Also, under section 3121(v)(1)(B), if an employee's services are covered (included in employment) for Medicare tax purposes, pick-up contributions under section 414(h)(2) that are made pursuant to a salary reduction agreement are subject to Medicare taxes (without any limit based on the amount of wages). This does not constitute a ruling on whether the pick-up contributions under Plan B are made pursuant to a salary reduction agreement for FICA tax purposes.

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

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Laura B. Warshawsky
Senior Tax Law Specialist
Qualified Plans Branch 2
(Tax Exempt and Government Entities)

cc: