**Internal Revenue Service**

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Person To Contact:
, ID No.

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Refer Reply To:
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Date:
September 25, 2015

Legend

City A =
State B =
Plan C =
Plan D =
City Code E =
Ordinance F =
Ordinance G =
Ordinance H =

Dear :

This letter responds to your February 2, 2012 ruling request, submitted by your authorized representatives, as supplemented by correspondence dated May 23, 2013, July 31, 2013, May 13, 2015, July 20, 2015, and September 18, 2015, in which you ask whether certain designated employee contributions to Plan C and Plan D can be "picked up" under section 414(h) of the Internal Revenue Code (the "Code").

You submitted the following facts and representations under penalties of perjury in support of your request.

City A is a political subdivision of State B. City A contributes amounts to both Plan C and Plan D to provide retirement benefits for eligible employees of City A. Plan C and Plan D are both governmental defined benefit plans under section 414(d) and are both qualified under section 401(a). Both Plan C and Plan D provide for employee contributions that are deducted from salary and "picked up" by City A under section 414(h)(2). The pick-up of the employee contributions under Plan C was first effective

. Under Plan D, the pick-up of the employee contributions was first effective .

**FACTS: PLAN C**

Plan C provides retirement benefits for certain employees of City A. Participants in Plan C make employee contributions in different amounts according to two tiers under Plan C. This ruling request involves only employees covered by Tier I.

Section of City Code E defines "employee contributions" as those contributions to Plan C that are deducted from an employee's salary and credited to an employee's individual account. Section of City Code E states that City A will pick up and contribute the employee contributions on behalf of employees to Plan C. Section states that the employee contributions will be treated as employer contributions for Federal income tax purposes and will be made by City A in lieu of employee contributions. Section states that an employee has no option to directly receive the contributions made by City A instead of having the contributions paid to Plan C.

Section of City Code E establishes the contribution rates for participants in Tier I of Plan C. Paragraph (b) of this section states that all participants in Tier I of Plan C will contribute 7 percent of salary by salary deduction beginning , through the earlier of or the date the is fully paid.

In addition to the 7 percent of salary required to be contributed by all participants in Tier I of Plan C, as noted in the immediate paragraph above, section of City Code E requires additional employee contributions ("Mandatory Additional Contributions") to be made to Plan C by certain members. On , City A adopted Ordinance F which amended City Code E to require that members, who are covered by certain Memoranda of Understanding ("MOUs"), will contribute an additional 2 percent of compensation by salary deduction retroactive to , through , and 4 percent of compensation beginning on , and ongoing. This provision is now section .

On , City A adopted Ordinance G to amend City Code E retroactively to add two additional categories of members required to make Mandatory Additional Contributions to Plan C. Paragraph (c)(2) of section states that, effective , members subject to other specific MOUs will contribute by salary deduction 4 percent of compensation. Paragraph (c)(3) states that members who are subject to other specific MOUs and members who are non-represented employees, including elected officials, will contribute 2 percent of compensation by salary deduction, retroactive to , and 4 percent of compensation beginning

and ongoing.

Section of City Code E also states that, in consideration for making the Mandatory Additional Contributions, such members will receive the benefit set forth in section of City Code E. The City Administrative Officer will notify Plan C and the Controller of the specific MOUs that require members to contribute as provided in section and will also provide Plan C and the Controller with the names of all members who are non-represented employees, including elected officials. Because the benefit conferred by section of City Code E is a vested benefit, a member who is employed in a position requiring the payment of Mandatory Additional Contributions to Plan C will continue to make Mandatory Additional Contributions to Plan C as long as he or she is a member, notwithstanding that he or she may subsequently transfer to a position that does not require the payment of the Mandatory Additional Contributions. Section of City Code E states that a member who makes Mandatory Additional Contributions, as provided in section , will obtain a vested right to the increase in the maximum medical plan premium subsidy at an amount no less than the dollar increase in the premium.

Section of City Code E states that the health and welfare programs under Plan C, including the medical plan premium subsidy and administrative costs, will be provided solely from the section 401(h) account established under section .

Section of City Code E states that all employee contributions paid pursuant to this section will be deposited into each member's account in Plan C, and that City A will pick up all employee contributions payable by salary deduction pursuant to this section as provided in sections through of City Code E.

City A represents that all of the Mandatory Additional Contributions are deducted by payroll deduction each payroll period pursuant to section of City A's Charter and deposited into members' individual retirement accounts in Plan C pursuant to subsection of City Code E. City A further represents that no portion of the Mandatory Additional Contributions is deposited to the members' 401(h) accounts.

With respect to whether the Mandatory Additional Contributions that are deducted by payroll deduction are subject to taxes under the Federal Insurance Contributions Act (FICA), you represent that City A is exempt from social security taxes.

**FACTS: PLAN D**

Plan D provides retirement benefits for certain employees of City A. Participants in Plan D make employee contributions in different amounts according to several different tiers under Plan D. Pursuant to sections through of City Code E, these contributions are picked up by City A.

Section of City Code E provides for a separate account for the purpose of paying benefits for health, medical, hospital, or other medical plans as authorized under the programs established by City Code E. The account is established pursuant to section 401(h).

On , City A adopted Ordinance H, which amended section of City Code E and added section . The opening paragraph of Ordinance H states that its purpose is to provide for the vesting of retiree health benefit increases to members of Plan D in exchange for the voluntary payment of additional employee contributions ("Voluntary Additional Contributions"). Section provides for the freezing of health insurance premium subsidies and reimbursements as of , for members of Plan D with certain exceptions. One exception is for employees who irrevocably elect to make Voluntary Additional Contributions to Plan D. Section of City Code E states, in part, that members who irrevocably elect to make Voluntary Additional Contributions will, in exchange, have vested rights to receive the maximum amount of annual increases in subsidies or reimbursements for retiree health benefits.

Section of City Code E states that members of Plan D who are represented by an employee union that has entered into a written agreement with City A to provide for the election specified therein, or members not represented by an employee union, may irrevocably elect to make Voluntary Additional Contributions to his or her tier of Plan D by salary deduction at the rate of 2 percent of salary. The Voluntary Additional Contributions are deposited into each member's individual contribution account under Plan D and are paid on a post-tax basis until the Internal Revenue Service (IRS) issues a ruling that such contributions can be picked up by City A. Section of City Code E further states that the obligation to make Voluntary Additional Contributions terminates on the earliest of retirement, 25 years, or termination of participation in City A's Deferred Retirement Option Plan.

Section of City Code E also states that the right to irrevocably elect to make Voluntary Additional Contributions is limited to a 45-day period. If a member fails to make an election within the 45-day period, the member is assumed to have irrevocably elected not to make the Voluntary Additional Contributions and the freeze under section applies.

On , City A notified employees covered by section of City Code E about the election procedures for the additional employee contributions, and provided employees with an election form and a revocation form. The election period ended on . The latest that any employee could return a revocation notice was .

With regard to whether the Voluntary Additional Contributions payable by salary deduction to Plan D are subject to taxes under FICA, you represent that City A is

exempt from social security taxes, but that the Voluntary Additional Contributions to Plan D, which are being paid on an after-tax basis, are subject to Medicare taxes.

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

1. The Mandatory Additional Contributions picked up by City A and deposited into Plan C pursuant to section of City Code E for payroll dates beginning on (for amounts authorized by Ordinance F) and (for amounts authorized by Ordinance G) satisfy the requirements of section 414(h)(2) and are not subject to income tax or employment tax withholding.

2. The Mandatory Additional Contributions made to Plan C are not includible in any employee's gross income under the assignment of income doctrine.

3. The Voluntary Additional Contributions picked up by City A pursuant to section of City Code E for payroll dates after (i) the receipt of the private letter ruling ("PLR") requested herein and (ii) any applicable actions required by such PLR are completed by City A and any collective bargaining units, that are deposited into Plan D, satisfy the requirements of section 414(h)(2) and are not subject to income tax or employment tax withholding.

4. The Voluntary Additional Contributions made to Plan D are not subject to a cash or deferred arrangement under §1.401(k)-1(a)(3).

5. The Voluntary Additional Contributions made to Plan D are not includible in any employee's gross income under the assignment of income doctrine.

Section 414(h)(1) states 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) states 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, states 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) 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.

Section 1.401(k)-1(a)(3)(v) states that a cash or deferred arrangement does not include a one-time irrevocable election made no later than the employee's first becoming eligible under the plan or any other plan or arrangement of the employer that is described in section 219(g)(5)(A), to have contributions equal to a specified amount or percentage of the employee's compensation (including no amount of compensation) made by the employer on the employee's behalf to the plan and a specified amount or percentage of the employee's compensation (including no amount of compensation)

divided among all other plans or arrangements of the employer for the duration of the employee's employment with the employer.

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 states 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) City 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) City 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 City 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, City A adopted Ordinance F on , which requires certain Tier I employees to make Mandatory Additional Contributions to Plan C in

amounts authorized by Ordinance F. Similarly, City A adopted Ordinance G on , which requires other Tier I employees to make Mandatory Additional Contributions to Plan C in amounts authorized by Ordinance G. Sections through of City Code E state that City A picks up employee contributions to Plan C, including the Mandatory Additional Contributions required by Ordinance F and Ordinance G. Thus, with respect to Plan C, City A has both specified in sections through of City Code E that the contributions, although designated as employee contributions, are being paid by the employer in lieu of contributions by the employee and has taken formal action with respect to the pick-up of the contributions by adopting Ordinance F on and Ordinance G on . In addition, because the Mandatory Additional Contributions are mandatory, employees do not have the option of choosing to receive the contributed amounts directly, and the employees do not have a cash or deferred election right with respect to the contributions. Accordingly, the Mandatory Additional Contributions picked up by City A and deposited into Plan C pursuant to section of City Code E for payroll dates beginning on June 3, 2011 (for amounts authorized by Ordinance F) and (for amounts authorized by Ordinance G) satisfy the requirements of section 414(h)(2).

Regarding whether the Mandatory Additional Contributions are subject to income tax and employment tax withholding, section 402(a) generally states 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) states 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.

In the present case, because the Mandatory Additional Contributions that are made in accordance with Ordinance F and Ordinance G and picked up by City A will be made pursuant to a valid pick-up arrangement, they will be treated as employer contributions. Therefore, pursuant to section 402(a) and §1.402(a)-1(a)(1)(i), the picked-up employee contributions to Plan C will not be included in gross income of the member for federal income tax purposes until distributed to the member. Furthermore, consistent with Revenue Ruling 77-462, and in accordance with section 3401(a)(12)(A), the picked-up employee contributions to Plan C are excluded from wages for purposes of the collection of income tax at the source on wages.

You represent that City A is not subject to social security taxes. Accordingly, the Mandatory Additional Contributions are also not subject to withholding for social

security. However, as discussed below, they may be subject to withholding for Medicare taxes.

In general, all payments of remuneration by an employer for services performed by an employee are subject to taxes under 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).

In addition, 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 are made pursuant to a salary reduction agreement for FICA tax purposes.

With respect to your second requested ruling, section 6.11 of Revenue Procedure 2015-1, 2015-1 I.R.B. 21, states, in pertinent part, that a letter ruling will not be issued with respect to an issue that is clearly and adequately addressed by statute, regulations, decision of a court, revenue rulings, revenue procedures, notices, or other authority published in the Internal Revenue Bulletin. We have determined that the question of whether the Mandatory Additional Contributions to Plan C are includible in an employee's income under the assignment of income doctrine is clearly and adequately addressed in publicly available guidance. Accordingly the IRS declines to rule on this request.

With respect to your third and fourth ruling requests, on , City A adopted Ordinance H, which added section to City Code E and which states that members of Plan D who are covered by certain MOUs or non-represented employees (the "Covered Employees") may irrevocably elect to make Voluntary Additional Contributions to their respective tiers of Plan D by salary deduction at the rate of 2 percent of salary. The Voluntary Additional Contributions are deposited into each

member's individual contribution account under Plan D, and will be paid on a post-tax basis until the IRS issues a ruling that such contributions can be picked up by City A pursuant to the provisions of sections through of City Code E.

Section of City Code E also provides that the right to irrevocably elect to make Voluntary Additional Contributions is limited to a 45-day period. If the member fails to make an election within the 45-day period, the member is assumed to have irrevocably elected not to make the Voluntary Additional Contributions. You represent that the election period has expired.

In the present case, the Covered Employees are current employees that had the right to irrevocably elect to make, or not make, the Voluntary Additional Contributions to Plan D. Therefore, because the Voluntary Additional Contributions are elective, rather than mandatory, contributions, Covered Employees were given the option of choosing to receive the contributed amounts directly instead of having them paid by City A to Plan D. Accordingly, pursuant to Revenue Ruling 81-35, the Voluntary Additional Contributions may not be picked up by City A under section 414(h)(2). The Voluntary Additional Contributions are therefore included in employee's income and are subject to income tax and employment tax withholding to the same extent as employees' wages.

In addition, had the pick-up been implemented at the time that the employees were given the election whether or not to make Voluntary Additional Contributions, the employees would have been given the choice between receiving cash or having City A make Voluntary Additional Contributions to Plan D on a pre-tax basis, and the election would have been a cash or deferred election within the meaning of §1.401(k)-1(a)(3).

With respect to your fifth requested ruling, section 6.11 of Revenue Procedure 2015-1, states, in pertinent part, that a letter ruling will not be issued with respect to an issue that is clearly and adequately addressed by statute, regulations, decision of a court, revenue rulings, revenue procedures, notices, or other authority published in the Internal Revenue Bulletin. We have determined that the question of whether the Voluntary Additional Contributions to Plan D are includible in an employee's income under the assignment of income doctrine is clearly and adequately addressed in publicly available guidance. Accordingly the IRS declines to rule on this request.

This ruling is based on the assumption that Plan C and Plan D satisfy the qualification requirements set forth in section 401(a) and each Plan 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, we are sending a copy of this letter to your authorized representatives.

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: