TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

201340026

JUL 0 9 2013

Uniform Issue List: 414.00-00, 414.09-00

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T:EP:RA:T3

Legend:

Employer A = XXX

State X = XXX

Plan Y = XXX

System Z = XXX

Statute M = XXX

Statute N = XXX

Section P = XXX

Date 1 = XXX

Dear XXX:

This letter is in response to your ruling request, dated December 8, 2011, submitted by your authorized representative, as supplemented by correspondence dated April 24, 2013, May 23, 2013, and June 26, 2013, 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 ("Code").

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

State X has established and maintains Plan Y pursuant to Statute M, for the benefit of certain police officers and firefighters employed by a city, county, town, village or police or fire district of State X who are not eligible to participate in a local pension plan. Plan Y is one of the plans offered under System Z, the State X retirement plan system for its employees. Plan Y is intended to qualify under section 401(a) of the Code.

On Date 1, the Governor of State X signed into law, as enacted by the State X legislature, Statute N. Statute N amended Statute M relating to Plan Y to provide that mandatory employee contributions currently being made to the Plan by certain employees will be picked up by participating employers (hereinafter referred to as "Participating Employers") and treated as employer contributions.

Section P of Statute N provides that each Participating Employer shall pick up member contributions that are required under Section P by its employees and shall do so by reducing the salary of those employees by the amount that each such employee is required to contribute. Further, Section P provides that a Participating Employer pays for pick up contributions in lieu of the member contributions and that these pick up contributions shall be treated as employer contributions in determining income tax treatment under section 414(h) of the Code. Section P additionally provides that for all other purposes, including the computation of retirement benefits and contributions by employers and employees, such pick-up contributions shall be deemed employee salary. Further, Section P states that the pick-up will not become effective until 60 days after System Z receives a favorable ruling.

For purposes of Section P, the term "member" means a person who is employed as a police officer or firefighter by any employer who first joins System Z on or after January 1, 20 . Section P requires each member to contribute three percent of annual wages to the Plan.

Based on the above facts and representations, you request a ruling that for federal income tax purposes, mandatory contributions, deducted from employees' salaries and contributed by the employer to Plan Y will be considered picked up by Participating Employers, and will not be currently included in the gross income of the participants on whose behalf the pick-up is made and 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.

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 ("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.

In this case, Plan Y satisfies the criteria set forth in Rev. Rul. 81-35, Rev. Rul. 81-36, and Rev. Rul. 2006-43, by specifically providing that Employer A shall pick up the mandatory contributions deducted from employees' salaries and contributed by the employer to Plan Y. Section P of Statute M specifies that the contributions, although designated as employee contributions, will be picked up by Employer A. Employer A took formal action by enacting Section P of Statute M, and the pick-up applies prospectively from the date 60 days after the date that Employer A receives this ruling. In addition, it has been represented that employees are required to participate in Plan Y, do not have the option of choosing to receive the contributed amounts directly instead of having them paid by Employer A to Plan Y, and may not make a cash or deferred election with respect to the contributions.

Accordingly, we conclude that for federal income tax purposes, mandatory contributions, deducted from employees' salaries and contributed by the employer to Plan Y, will be considered picked up by participating employers. In addition, we conclude that such mandatory contributions will not be currently included in the gross income of the participants on whose behalf the pick-up is made and will not constitute wages subject to federal income tax withholding.

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

This ruling is based on the assumption that Plan Y is qualified under section 401(a) of the Code.

This ruling is directed only to the specific taxpayer that requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited by others as precedent.

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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 XXX at (XXX) XXX-XXXX. Please address all correspondence to SE:T:EP:RA:T2.

Sincerely yours,

Jason E. Levine, Manager
Employee Plans Technical Group 2

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

cc:

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XXX