TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

201351032

SEP 18 2013

SE:T:EP:RA:T2

Uniform Issue List: 414.00-00, 414.09-00

Attention:

Legend:

Employer A =

Committee B =

Labor Organization C =

State X =

Plan 1 =

Plan 2 =

Resolution N =

Ordinance R =

Statute S =

Date 5 =

Date 6 =

Date 7 =

Dear :

This letter is in response to your ruling request, dated September 7, 2010, submitted by your authorized representative, that contributions "picked up" by Employer A and made to Plan 1 on behalf of certain eligible employees of Employer A who participate in Plan 1 will not be included in the gross income of the employees under section 414(h)(2) of the Internal Revenue Code ("Code"), and that the transfer of assets from the accounts of participants in Plan 2 to Plan 1 will not result in taxable distributions under section 402(a) of the Code.

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

Employer A approved a collective bargaining agreement ("CBA") with Labor Organization C. The CBA provides that Employer A and Labor Organization C will implement a pension plan for certain eligible employees of Employer A, effective Date 6, and the participating employees will make mandatory pre-tax contributions to the plan equal to 8 percent of their annual salary. Employer A began deducting the 8 percent employee contributions from eligible employees' pay on Date 6. On Date 7, Employer A adopted Ordinance R, which amends the Employer A Code to add Statute S, which sets forth the provisions of Plan 1, effective as of Date 6. Plan 1 is a qualified plan, within the meaning of section 401(a) of the Code, and a governmental plan within the meaning of section 414(d) of the Code.

Employer A has elected to treat the mandatory participant contributions of 8 percent of their annual salary under Plan 1 as being picked up by Employer A under section 414(h)(2) of the Code. On Date 5, Committee B, the governing body of Employer A, adopted Resolution N providing that contributions made by the eligible employees to Plan 1 in connection with their participation in Plan 1 will be picked up by Employer A under section 414(h)(2).

Resolution N provides, in part:

1. Employer A shall pick up the 8 percent contribution required to be made by the participants of Plan 1 and shall consider this amount to be an employer contribution for Federal tax purposes; therefore, the participants will not have access to these funds;

2. The participants' contribution, although designated as an employee contribution, shall be paid (picked up) by Employer A pursuant to section 414(h)(2) of the Code;

3. The participants will not be given the option of choosing to receive the contributed amounts directly in lieu of having them paid by Employer A to Plan 1.

Statute S requires all eligible employees of Employer A to participate in Plan 1 as a condition of their employment, and to make mandatory contributions equal to 8 percent of compensation. Eligible employees do not have the ability to opt in or out of Plan 1. Although the 8 percent contributions are designated as employee contributions, such amounts are paid (picked up) by the employer in lieu of contributions by the employee.

The participants' contributions that are picked up by Employer A, as described in section 414(h)(2) of the Code, are deducted from the pay of the contributing participants as salary reduction contributions, and are paid by Employer A to the Trustees of Plan 1. Each participant's 8 percent mandatory contribution to Plan 1 is separately accounted for, but made a part of the accrued benefit of such participant.

Prior to the effective date of Plan 1, Employer A had adopted Plan 2 for the benefit of Employer A employees, including employees that later became eligible to participate in Plan 1. Plan 2 is a money purchase pension plan that is qualified under section 401(a) of the Code.

Pursuant to Statute S, Committee B authorized the transfer of account balances attributable to Employer A contributions from Plan 2 to Plan 1. Statute S also provides that an eligible employee may elect to receive credit for service prior to Date 6 by agreeing to transfer his or her employer contribution account from Plan 2 to Plan 1. All eligible employees have executed an irrevocable election to so transfer their accounts and to receive past service credit.

Plan 2 provides that its assets may be transferred to another plan only if the benefits which would be received by a participant, in the event of a termination of the transferee plan immediately following the transfer, are at least equal to the benefits the participant would have received if the transferor plan terminated immediately before the transfer. The employer contribution accounts that are expected to be transferred from Plan 2 to Plan 1 will be 100 percent vested. Thus, benefits that would be received by a participant, in the event of a termination of Plan 1 immediately following the transfer, shall be at least equal to the benefits the participant would have received if Plan 2 terminated immediately before the transfer.

You request the following rulings:

1. The mandatory contributions made by participants and picked up by Employer A will not be included in the current gross income of the participants for federal income tax purposes.

2. The mandatory contributions of participants picked up by Employer A will not constitute wages subject to federal income tax withholding.

3. The trustee-to-trustee transfer of assets from a participant's Plan 2 account to Plan 1 shall not be deemed to be an actual distribution to the participant of the amounts transferred and as a result shall not be subject to taxation at the time of

the transfer under section 402(a) of the Code and will not result in the imposition of an early distribution penalty under section 72(t) of the Code.

4. The amounts transferred from a participant's Plan 2 account shall not be treated, for purposes of the limits on benefits and contributions under sections 415(b) and 415(c) of the Code, either as part of the annual benefits accrued or as annual additions for the year of the transfer, and further shall not be treated as employee contributions made to purchase permissive service credit that are subject to the requirements and limitations of section 415(n) of the Code.

Section 72(t) of the Code provides for an additional tax on any amount received from a "qualified retirement plan" (as defined in section 4974(c), which includes plans described in section 401(a)). The additional tax for the taxable year in which such amount is received is equal to 10 percent of the portion of such amount which is includible in gross income, except where such income is distributed on or after an employee attains the age of 59½, or on account of one or more exceptions provided for under section 72(t)(2) of the Code.

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 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 411(c)(2)(B) of the Code provides that, in the case of a defined benefit plan, the accrued benefit derived from contributions made by an employee as of any applicable date is the amount equal to the employee's accumulated contributions (as defined in section 411(c)(2)(C) of the Code) expressed as an annual benefit commencing at normal retirement age, using an interest rate which would be used under the plan under section 417(e)(3) of the Code (as of the determination date).

Section 411(e) of the Code provides that section 411, with the exception of certain requirements of sections 401(a)(4) and 401(a)(7) in effect on September 1, 1974, does not apply to governmental plans, as defined in section 414(d) of the Code.

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.

Section 415(a)(1)(A) of the Code provides that a defined benefit plan is not a qualified plan if the plan provides for the payment of benefits with respect to a participant which exceed the limitation of section 415(b) of the Code.

Section 415(a)(1)(B) of the Code provides that a defined contribution plan is not a qualified plan if contributions and other additions made to the plan with respect to any participant in a taxable year exceed the limitation of section 415(c) of the Code.

Section 415(n) of the Code generally provides that if an employee makes contributions to purchase permissive service credit under a defined benefit governmental plan, the plan may satisfy the section 415 limits either by treating the accrued benefit derived from all such contributions as an annual benefit in applying the section 415(b) limit, or by treating the contributions as annual additions for purposes of section 415(c).

Section 415(n)(3) defines "permissive service credit" as service credit:

(i) recognized by the governmental plan for purposes of calculating a participant's benefit under the plan,

(ii) which such participant has not received under such governmental plan, and

(iii) which such participant may receive only by making a voluntary additional contribution, in an amount determined under such governmental plan, which does not exceed the amount necessary to fund the benefit attributable to such service credit.

Section 1.415(b)-1(b)(1)(ii) of the Income Tax Regulations ("Regulations") provides that an annual benefit, for purposes of determining the section 415(b) limitation, does not include the annual benefit attributable to either employee contributions or rollover contributions (as described in sections 401(a)(31), 402(c)(1), 403(a)(4), 403(b)(8), 408(d)(3), and 457(e)(16) of the Code), determined pursuant to the rules of section 1.415(b)-1(b)(2) of the Regulations. Section 1.415(b)-1(b)(1)(ii) further provides that the treatment of transferred benefits is determined under the rules of section 1.415(b)-1(b)(3) of the Regulations.

Section 1.415(b)-1(b)(2)(iii) of the Regulations provides that, in the case of mandatory employee contributions, as defined in section 411(c)(2)(C) of the Code and section 1.411(c)-1(c)(4) of the Regulations (or contributions that would be mandatory employee contributions if section 411 applied to the plan), the annual benefit attributable to those contributions is determined by applying the factors applicable to mandatory employee contributions as described in in sections 411(c)(2)(B) and (C) of the Code and regulations promulgated under section 411 to those contributions to determine the amount of a straight life annuity commencing at the annuity starting date, regardless of whether the requirements of sections 411 and 417 of the Code apply to the plan,

Section 1.415(b)-1(b)(2)(v) of the Regulations provides that the annual benefit attributable to rollover contributions from an eligible retirement plan, as defined in section 402(c)(8)(B) of the Code (for example, a contribution received pursuant to a direct rollover under section 401(a)(31)(A) of the Code), is determined in the same manner as the annual benefit attributable to mandatory employee contributions if the plan provides for a benefit derived from the rollover contribution (other than a benefit derived from a separate account to be maintained with respect to the rollover contribution and actual earnings and losses thereon). Thus, in the case of rollover contributions from a defined contribution plan to a defined benefit plan to provide an annuity distribution, the annual benefit attributable to those rollover contributions for purposes of section 415(b) is determined by applying the rules of section 411(c) as described in paragraph (b)(2)(iii) of this section, regardless of the assumptions used to compute the annuity distribution under the plan and regardless of whether the plan is subject to the requirements of section 411 and 417. Accordingly, in such a case, if the plan uses more favorable factors than those specified in section 411(c) to determine the amount of annuity payments arising from rollover contributions, the annual benefit under the plan would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c).

Section 1.415(b)-1(b)(3)(ii) of the Regulations provides that if a distributable benefit is transferred to a defined benefit plan from either a defined contribution plan or a defined benefit plan, the amount transferred is treated as a benefit paid from the transferor plan, and the annual benefit provided by the transferee defined benefit plan does not include the annual benefit attributable to the amount transferred (determined as if the transferred amount were a rollover contribution subject to the rules of section 1.415(b)-1(b)(2)(v) of the Regulations). Section 1.415(b)-1(b)(3)(ii) further states that the rule described in the preceding sentence applies regardless of whether the requirements of section 411 of the Code apply to the plan and, in the case of a transfer from a defined contribution plan that is not subject to the requirements of section 411 (such as a governmental plan) to a defined benefit plan, the rule applies even if the participant's benefits are not distributable from the defined contribution plan at the time of the transfer.

Revenue Ruling 67-213, 1967-2 C.B. 149, involves the transfer of funds attributable to employer contributions directly from the trust forming a part of a qualified pension plan to the trust forming part of a qualified stock bonus plan. The revenue ruling provides, in part, that if funds are transferred from one qualified plan to another, without being made available to the participants, no taxable income will be recognized to the participants by reason of such a transfer. The revenue ruling further provides that since the funds are not considered as having been made available to the participants, they continue to be funds derived from employer contributions and do not constitute employee contributions even though they are fully vested.

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 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 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 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 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 this case, the pick-up of mandatory participant contributions equal to 8 percent of each participant's salary under Plan 1 satisfies the criteria set forth in Revenue Ruling 81-35, Revenue Ruling 81-36, Revenue Ruling 87-10, and Revenue Ruling 2006-43. Committee B, the governing body of Employer A, formally adopted Resolution N, which provides that the mandatory participant contributions under Plan 1, although designated as employee contributions, shall be paid (picked-up) by Employer A pursuant to section 414(h)(2) of the Code. According to the represented facts, Plan 1 is a qualified plan under section 401(a) of the Code, and a governmental plan within the meaning of section 414(d) of the Code. Resolution N specifies that such designated employee contributions will be picked up by Employer A under section 414(h)(2) of the Code before the period to which such contributions relate. Therefore, Resolution N does not provide for a retroactive pick-up of designated employee contributions under Plan 1 by the employer. Statute S requires all eligible employees of Employer A to participate in Plan 1 as a condition of their employment, and to make mandatory contributions equal to 8 percent of compensation. Therefore, eligible employees do not have the ability to opt in or out of Plan 1. In addition, in accordance with Resolution N, participants shall not have the option of choosing to receive any portion of such mandatory employee contributions in cash instead of having them paid directly by Employer A to Plan 1.

Additionally, under the represented facts, pursuant to Statute S, Committee B authorized the transfer of account balances attributable to Employer A contributions from Plan 2 to Plan 1. Statute S further provides that an eligible employee may elect to receive credit for service prior to Date 6 by agreeing to transfer his or her employer contribution account from Plan 2 to Plan 1. Plan 2 and Plan 1 are both qualified plans and, even though participants may elect to transfer their employer contribution accounts from Plan 2 to Plan 1, the transferred amounts are not being made available to the participants. Accordingly, pursuant to Revenue Ruling 67-213, the trustee-to-trustee transfer of assets from a participant's Plan 2 account to Plan 1, in order to purchase past service credit under Plan 1, is not deemed to be an actual distribution to the participant of the amounts transferred. Therefore, such amounts are not subject to

taxation at the time of the transfer under section 402(a) of the Code. Furthermore, as the amounts transferred will not be includible in the participants' gross income at the time of transfer, such transfer will not result in the imposition of an early distribution penalty under section 72(t) of the Code.

For purposes of the limitation of section 415(b) of the Code, the amount of an elective transfer from a participant's Plan 2 account to Plan 1, in order to purchase past service credit under Plan 1, is treated, under section 1.415(b)-1(b)(3)(ii) of the Regulations, as a benefit paid from Plan 2, and the annual benefit provided by Plan 1 does not include the annual benefit attributable to the amounts transferred from Plan 2 (determined as if the transferred amount was a rollover contribution subject to the rules of section 1.415(b)-1(b)(2)(v) of the Regulations). Under section 1.415(b)-1(b)(2)(v) of the Regulations, the annual benefit under Plan 1 attributable to such a transfer from Plan 2, for purposes of section 415(b), is determined by applying the rules of section 411(c) of the Code, as described in section 1.415(b)-1(b)(2)(iii) of the Regulations as if the benefit were attributable to mandatory employee contributions. Under section 1.415(b)-1(b)(2)(iii) of the Regulations, the annual benefit under Plan 1 attributable to such a transfer from Plan 2 is determined by applying the factors applicable to mandatory employee contributions, as described in sections 411(c)(2)(B) and (C) of the Code (and regulations promulgated under section 411), as if the benefit was attributable to mandatory employee contributions, in order to determine the amount of a straight life annuity commencing at the annuity starting date. As further stated in section 1.415(b)-1(b)(2)(v) of the Regulations, if Plan 1 uses more favorable factors than those specified in section 411(c) to determine the amount of annuity payments arising from such transfers from Plan 2, the annual benefit under Plan 1, for purposes of section 415(b), would reflect the excess of those annuity payments over the amounts that would be payable using the factors specified in section 411(c).

As regards the purchase of past service credit under Plan 1 using amounts transferred from Plan 2, section 415(n) of the Code provides that if an employee makes contributions to purchase permissive service credit under a defined benefit governmental plan, the plan may satisfy the section 415 limits either by treating the accrued benefit derived from all such contributions as an annual benefit in applying the section 415(b) limit, or by treating the contributions as annual additions for purposes of section 415(c). However, for purposes of section 415(n), section 415(n)(3)(A)(iii) defines the term "permissive service credit" as service credit that a participant may receive only by making a voluntary additional contribution. Under the represented facts, the amounts transferred from Plan 2 to Plan 1 are attributable to employer contributions. Pursuant to Revenue Ruling 67-213, the trustee-to-trustee transfers from Plan 2 to Plan 1 are not treated as distributions from Plan 2 followed by participant contributions to Plan 1. Rather, because such amounts are not made available to the participants, the amounts continue to be treated as funds derived from employer contributions and do not constitute employee contributions. Accordingly, even though participants may elect such transfers, the amounts transferred from Plan 2 to Plan 1 do not constitute "voluntary additional contributions" used to purchase "permissive service credit" for purposes of section 415(n). Therefore, the requirements and limitations of section

415(n), relating to the purchase of permissive service credit, do not apply to the amounts participants elect to transfer from Plan 2 to Plan 1 in order to purchase past service credit under Plan 1.

With respect to ruling request one, we conclude that the mandatory employee contributions that are picked up by Employer A under section 414(h)(2) of the Code shall be treated as employer contributions for federal income tax purposes. Accordingly, similar to the holding in Revenue Ruling 77-462, we conclude that the mandatory contributions made by participants and picked up by Employer A will not be included in the current gross income of the employees for federal income tax purposes until such time as such amounts are distributed.

With respect to ruling request two, because we determined that the mandatory employee contributions picked up by Employer A under Plan 1 are excluded from the employees' gross income until such time as such amounts are distributed, we further conclude, in accordance to Revenue Ruling 77-462, that under the provisions of section 3401(a)(12)(A) of the Code, the mandatory contributions of participants picked up by Employer A will not constitute wages subject to federal income tax withholding.

With respect to ruling request three, we conclude that the trustee-to-trustee transfer of assets from a participant's Plan 2 account to Plan 1 shall not be deemed to be an actual distribution to the participant of the amount transferred, and as a result shall not be subject to taxation at the time of the transfer under section 402(a) of the Code, and will not result in the imposition of an early distribution penalty under section 72(t) of the Code.

With respect to ruling request four, we conclude that the amounts transferred from a participant's Plan 2 account to Plan 1, for purposes of purchasing past service credit under Plan 1, shall not be treated, for purposes of the limit on benefits under section 415(b), as part of the annual benefit accrued for the year of transfer, except to the extent the annual benefit under Plan 1 attributable to such amounts transferred from Plan 2 is determined using more favorable factors than those specified in section 411(c) of the Code. We further conclude that the amounts transferred from a participant's Plan 2 account to Plan 1 will not be treated, for purposes of the limits on contributions under section 415(c) as annual additions for the year of transfer. Finally, we conclude that the amounts transferred from a participant's Plan 2 account to Plan 1 will not be treated as employee contributions made to purchase permissive service credit that are subject to the requirements and limitations of section 415(n) of the Code.

No opinion is expressed as to the extent, if any, that the annual benefit under Plan 1 attributable to amounts that are transferred from Plan 2 is determined using more favorable factors than those specified in section 411(c) of the Code.

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 1 and Plan 2 are qualified under section 401(a) of the Code and are governmental plans within the meaning of section 414(d) of the Code at the time of the proposed contributions and distributions.

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.

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 at ( ) . 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: