

**Internal Revenue Service**

Department of the Treasury  
Washington, DC 20224

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3402.00-00

Person To Contact:

Telephone Number:

Refer Reply To:  
CC:TEGE:EB:EC  
PLR-111250-15

Date:  
August 28, 2015

City =  
Plan =  
State X =  
Date 1 =  
Year 1 =  
Agreement =

Dear \_\_\_\_\_ :

This is in response to a letter submitted by your authorized representative requesting a private letter ruling. Specifically, you requested a ruling that certain contributions to Plan are not income to City employees at the time of contribution under section 61 of the Internal Revenue Code (Code), and are not wages subject to employment taxes under sections 3121 and 3402 of the Code.

City contributes amounts to Plan to provide retirement benefits for eligible employees of City. Plan is a governmental plan as defined in section 414(d) of the Code, and is qualified under section 401(a).

Under a contract between City and Plan, the City and City's employees are required to make contributions to Plan. Since Date 1, City has picked up the employees' required contributions pursuant to section 414(h)(2). Beginning in Year 1, City and its employees entered into Agreement under which a percentage of employees' statutorily fixed salaries were to be used to pay a portion of City's required employer contributions to Plan. Thus, the City is paying required employee contributions under the pick-up arrangement, and employees are paying the City's required contributions from their salaries pursuant to the Agreement. You request a ruling that contributions made by the City's employees under the Agreement are employer contributions, and thus are not income until distributed to the employees. In addition, you request a ruling that the City is not required to withhold Federal income taxes from these contributions under section

3402 of the Code and that the contributions are not wages under section 3121 of the Code.

Initially, the City requested a ruling that the employee contributions under the Agreement were pick-up contributions under section 414(h)(2). Prior to the submission of this letter ruling request, the Employee Plans Rulings and Agreements group of the Tax-Exempt and Government Entities Division determined that the contributions made pursuant to the Agreement do not qualify as employer contributions under section 414(h)(2) of the Code. In response, the City revised its request and now seeks the ruling described herein.

Section 61(a) of the Code defines “gross income” as income from any source, including any compensation for services.

Section 402(a) of the Code provides, in general, that an amount actually distributed by any employees' trust described in section 401(a) that is exempt from tax under section 501(a) is taxable to the distributee in the year it is distributed under section 72 (relating to annuities).

Section 1.402(a)-1(a)(1)(i) of the Income Tax Regulations provides that an employee is not required to include in income a contribution made by an employer to a trust described in section 401(a) of the Code in a year in which the trust is exempt under section 501(a).

Section 414(h)(1) of the Code provides that any amount contributed to an employees' trust described in section 401(a) is not treated as having been made by the employer if it is designated as an employee contribution. Under section 414(h)(2), however, if the contributions of employing units are designated as employee contributions, but an employing unit picks up the contributions, the contributions so picked up are treated as employer contributions.

Sections 3101 and 3111 of the Code impose FICA taxes on “wages.” The term “wages” is defined in section 3121(a) for FICA purposes as all remuneration for employment, with certain specific exceptions not relevant here. Section 3121(b) defines “employment” as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions not relevant here.

Section 3402(a) of the Code, relating to income tax withholding, generally requires every employer making a payment of wages to deduct and withhold upon those wages a tax determined in accordance with prescribed tables or computational procedures. The term “wages” is defined in section 3401(a) for Federal income tax withholding purposes as all remuneration for services performed by an employee for his employer, with certain specific exceptions not relevant here.

The Supreme Court has long established the rule that income must be taxed to the person who earns it. Commissioner v. Culbertson, 337 U.S. 733, 739-40 (1949). In Lucas v. Earl, 281 U.S. 111 (1930), a husband and wife executed a contract whereby one-half of the husband's future earnings was assigned to the wife. The Court held that the husband's entire earnings were includible in his gross income in the year earned even though there was a valid contract between the husband and wife and the husband did not physically receive one-half of the earnings in cash. The Court stated:

There is no doubt that the statute could tax salaries to those who earned them and provide that the tax could not be escaped by anticipatory arrangements and contracts however skillfully devised to prevent the salary when paid from vesting even for a second in the man who earned it. That seems to us the import of the statute . . . .

Application of this rule is not limited to cases in which the assignor assigned income to a closely related party. In United States v. Basye, 410 U.S. 441 (1973), the Court applied this rule in a case in which a medical partnership elected to have a nonprofit health plan foundation pay part of the partnership's compensation to a retirement trust.

In Rev. Rul. 67-351, 1967-2 C.B. 86, pursuant to a collective bargaining agreement between a union and a group of employers, a vacation plan and trust are established for the benefit of the employees. The agreement provides that the employers will pay into the trust a specified amount for each hour worked by qualified employees. An individual account is established for each qualified employee by the trustees of the trust. The individual employee's interest in the amount in his vacation account is fully vested and nonforfeitable from the time the money is paid by his employer. The collective bargaining agreement further states that payments by the employer shall be a part of the wages due to the employees. The ruling explains that the contributions to the trust should be regarded as constructive payments of compensation to the employees, and thus the contributions to the trust are treated as made by the employees rather than by the employers. The ruling concludes that the payments to the trust are compensation income to the employees at the time they are made to the trust. Further, the ruling concludes that the payments to the trust are wages for FICA and Federal income tax withholding purposes.

Therefore, based solely on the facts presented and the representations made, we conclude that contributions made to the Plan under the Agreement are employee contributions and are therefore includable in City employees' gross incomes under section 61 of the Code at the time of contribution. Furthermore, as employee contributions, the payments are subject to Federal income tax withholding at the time of contribution and are subject to FICA taxes at the time of contribution unless the maximum wage limitation provided by section 3121(a)(1) applies.

Except as expressly provided herein, no opinion is expressed or implied as to the

Federal tax consequences of the facts described above under any other provision of the Code.

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

The ruling contained in this letter is based upon information and representations submitted by 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.

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

Sincerely,

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John B. Richards  
Senior Technical Reviewer, Executive  
Compensation (Employee Benefits)  
(Tax Exempt & Government Entities)

Enclosures:  
Copy of letter  
Copy for section 6110 purposes