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Department of the Treasury

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Legend:

- Trust =
- Plan =
- Qualified Plan =
- Fund =

Dear :

This is in response to your letter dated November 19, 1998, as amended by your letters of April 15, 1999 and May 4, 1999, requesting rulings on the application of employment taxes to benefits under the Trust and Plan.

FACTS

The Qualified Plan is a multiemployer defined benefit plan under section 401(a) of the Internal Revenue Code (the "Code"), established pursuant to the collective bargaining agreements ("CBAs") between various local unions and employers. Benefits under the Qualified Plan are limited in accordance with section 415.

The Trust has also been established pursuant to the CBAs to provide make-up benefits to employees and their survivors ("retirees") whose benefits under the Qualified Plan are reduced as a result of section 415. In accordance with the terms of the Trust, the trustees have adopted the Plan, a nonqualified plan that describes the terms and conditions for receiving make-up benefits from the Trust. The individual trustees of the Trust are also the trustees of the Qualified Plan, but this is not a legal requirement.

The Fund is a holding account for contributions made by the employers under the CBAs to pay for benefits under the Qualified Plan and under the Plan. Each

employer makes monthly contributions to the Fund based upon the hours of service performed during the preceding month by its employees who are covered by the CBAs. The contributions are not made for the benefit of the particular employees and are made without regard to whether any particular employee is or will be entitled to benefits under the Plan. An employee who is entitled to receive a benefit under the Plan will receive the benefit regardless of whether any of the employers for whom the employee worked has made contributions to the Fund. Thus, it is very likely that an employer will make contributions that will be used to pay benefits to an employee who never performed services for the employer.

Benefits under the Plan are based in part on the amount by which a retiree's Qualified Plan benefits for the previous year were reduced as a result of section 415. However, the trustees have the authority to determine the amount of benefits actually paid, taking into account the funding needs of the Qualified Plan and the amount of funds available for the Plan.

The trustees may decide not to authorize payment of the full amount of make-up benefits because there are insufficient funds available. The trustees may authorize payment of make-up benefits for the current year and prior years if benefits for prior years have not been paid. The trustees may also authorize payments for amounts expected to be made up in future years and to cover the retiree's share of any FICA taxes due on the benefits. The trustee may also condition benefits on the retiree's employment status in the industry covered by the CBAs. In no event will the amount of make-up benefits be greater than the total contributions made by the employers whose CBAs authorize contributions to Plan. Employers play no part in determining the amount of make-up benefits or which employees will be entitled to benefits under the Plan.

Once the amount of benefits is determined, the trustees will direct the transfer of funds from the Fund to the Trust in the amount of the benefits, to be allocated to accounts for particular retirees and to be paid out to the retirees as soon as possible thereafter. No amounts will be accumulated within the Trust. Under the terms of the Trust, employers cannot recover payments made to the Trust. Nor do the employers have the power to control the use of the funds in the Trust. In addition, the employers do not have administrative powers with respect to the use of the funds in the Trust.

LAW AND ANALYSIS

Income Tax Treatment

Because employers cannot recover payments made to the Trust, do not have the power to control the use of Trust funds, and do not have administrative powers with respect to the use of the funds in the Trust, the Trust is a nonexempt trust under section 402(b) of the Code and not a grantor trust.

Section 402(b) of the Code provides that the value of an employee's interest in a nonexempt employees' trust is included in the gross income of the employee in accordance with section 83, that is, when the interest becomes substantially vested.

Section 83(a) of the Code provides rules for the taxation of property transferred in connection with the performance of services. Section 83(a) provides that the excess of the fair market value of the property at the time the property becomes substantially vested, over the amount paid for the property, will be included as compensation in the gross income of the person who performed the services in the taxable year in which the property becomes substantially vested. Property is substantially vested when it is either transferable or not subject to a substantial risk of forfeiture.

Section 1.83-3(e) of the Income Tax Regulations provides that, for purposes of section 83 and the regulations thereunder, the term "property" includes real and personal property other than either money or an unfunded and unsecured promise to pay money or property in the future. Property also includes a beneficial interest in assets (including money) that are transferred or set aside from the claims of creditors of the transferor, for example, in a trust or escrow account.

Section 1.83-3(f) of the regulations provides that property transferred to an employee in recognition of the performance of services is considered transferred in connection with the performance of services within the meaning of section 83. Thus, a transfer of property is subject to section 83 whether such transfer is in respect of past, present, or future services.

Payments from the Fund to the Trust that are allocated to retirees' accounts are included in the gross incomes of the respective retirees because the retirees' rights in their respective accounts are substantially vested at the time of transfer within the meaning of section 83(a) of the Code.

Employment Tax Treatment

Tax under the Federal Insurance Contributions Act (FICA) consists of an employee share under section 3101 and an employer share under section 3111. In general, the employer is required to withhold the employee share from wages when paid and to pay the employer share with respect to wages when paid. FICA taxes include two components: old-age, survivors and disability insurance ("OASDI") under sections 3101(a) and 3111(a) and hospital insurance ("Medicare") under sections 3101(b) and 3111(b).

Section 3121(a) defines wages for FICA purposes. Section 3121(a)(1) excludes from wages for OASDI purposes remuneration from the employer that exceeds the wage base under section 230 of the Social Security Act. Section 3121(a)(14) excludes from wages any payment to the survivor or estate of a former employee after the

calendar year in which the employee died.

Section 3121(v)(2) provides special rules for applying FICA to a nonqualified deferred compensation plan. Under section 3121(v)(2)(A), any amount deferred under such a plan is taken into account for FICA purposes as of the later of when the services are performed or when there is no substantial risk of forfeiture of the rights to the amount. Under section 3121(v)(2)(B), any amount taken into account as wages (and the income attributable thereto) shall not thereafter be treated as FICA wages. Section 3121(v)(2)(C) defines "nonqualified deferred compensation plan" as any plan or other arrangement for deferral of compensation other than a plan described in section 3121(a)(5). The Plan is not any of the types of plans described section 3121(a)(5).

Regulations under section 31.3121(v)(2)-1 deal with the application of section 3121(v)(2). Section 31.3121(v)(2)-1(g) provides that the regulations are generally effective January 1, 2000. For periods before January 1, 2000, an employer may rely on a reasonable, good faith interpretation of section 3121(v)(2), and an employer that has complied with section 31.3121(v)(2)-1(a) through (f) will be deemed to have determined FICA tax liability and satisfied FICA withholding requirements in accordance with a reasonable, good faith interpretation of section 3121(v)(2).

Section 31.3121(v)(2)-1(a)(1) describes the general timing rule that wages are taken into account for FICA purposes when actually or constructively paid. Section 31.3121(v)(2)-1(a)(2) describes the special FICA timing rule for wages under a nonqualified deferred compensation plan. Section 31.3121(v)(2)-1(a)(2)(v) provides that, if remuneration under a nonqualified deferred compensation plan does not constitute wages under section 3121(a), the remuneration is not taken into account for FICA purposes under either the general or special timing rule.

Section 31.3121(v)(2)-1 provides rules for account balance plans and nonaccount balance plans. Under section 31.3121(v)(2)-1(e)(4), an amount deferred under a nonaccount balance plan is not required to be taken into account as wages until the first date on which all of the amount deferred is reasonably ascertainable (the resolution date) and the amount to be taken into account as of the resolution date is determined in accordance with section 31.3121(v)(2)-1(c)(2). An amount deferred is considered to be reasonably ascertainable on the first date on which the amount, form, and commencement date of the benefit payments attributable to the deferred amounts are known and the only actuarial or other assumptions regarding future events or circumstances needed to determine the amount deferred are interest and mortality.

Under section 31.3121(v)(2)-1(c)(2), the amount deferred under a nonaccount balance plan is the present value of the future payment or payments, determined as of the date the amount deferred is required to be taken into account as wages under section 31.3121(v)(2)-1(e). Thus, if an amount deferred is taken into account as of the

resolution date, present value is determined as of the resolution date. Under section 31.3121(v)(2)-1(c)(2)(ii), present value is the value as of the specified date of an amount or series of amounts due thereafter, where each amount is multiplied by the probability that the condition or conditions on which payment is contingent will be satisfied and is discounted according to an assumed rate of interest to reflect the time value of money. That section includes further detail for determining present value.

Section 31.3121(v)(2)-1(e)(5) provides a rule of administrative convenience, under which an employer may treat an amount deferred as required to be taken into account on any date that is later than, but within the same calendar year as, the actual date on which the amount deferred is otherwise required to be taken into account under section 31.3121(v)(2)-1(e).

Section 31.3121(v)(2)-1(f) provides several alternative methods for withholding and depositing FICA tax on wages subject to section 3121(v)(2). Section 31.3121(v)(2)-1(f)(3) describes the lag method under which an amount deferred, plus interest, may be treated as wages paid by the employer and received by the employee, for purposes of withholding and depositing FICA tax, on any date that is no later than three months after the date the amount is required to be taken into account in accordance with section 31.3121(v)(2)-1(e).

Section 3402 of the Code requires every employer making a payment of wages to withhold income tax therefrom. Section 3401(a) of the Code defines “wages” for income tax withholding purposes as all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain specified exceptions. Rev. Rul. 79-305, 1979-2 C.B. 350, holds that the value of property transferred to an employee under section 83(a) of the Code constitutes wages for purposes of section 3401(a) at the time the substantial risk of forfeiture on the property lapses. Thus, an amount transferred to a nonexempt employees’ trust that constitutes a property transfer under section 83(a) is wages under section 3401(a).

Section 3401(d)(1) provides that if the person for whom an individual performs or performed services as an employee does not have control of the payment of wages for those services, the term “employer” (except for purposes of the definition of “wages”) means the person having control of the payment of wages.

In Otte v. United States, 419 U.S. 43 (1974), 1975-1 C.B. 329, the Court considered the withholding responsibilities of a trustee in bankruptcy who had paid wages to the former employees of the bankrupt employer. The Court held that the trustee in bankruptcy was an employer under section 3401(d) of the Code because of his control over the payment of wages and was thus responsible to withhold income taxes. The Court held also that the trustee was the employer for purposes of withholding FICA from the wages under section 3102. While noting that the FICA

withholding provisions do not define “employer,” the Court stated that the term is not to be given a narrower construction for FICA withholding than for income tax withholding.

In In re Armadillo Corporation, 561 F.2d 1382 (10th Cir. 1977), aff'g 410 F. Supp. 407 (D. Colo. 1976), the court considered the liability of a trustee in bankruptcy for the employer's portion of the FICA tax under section 3111 with respect to wage payments, in addition to FICA and income tax withholding. The trustees argued that they were not liable for the employer's taxes because no employment relationships existed between the trustees and the recipients of the wages. The court rejected that argument and applied the holding of Otte to support the trustees' liability for the employer's taxes. See also In re The Laub Baking Company v. United States, 642 F.2d 196 (6th Cir. 1981).

Based upon the information submitted and the applicable law, we rule as follows.

1. The Trust is the employer under section 3401(d)(1) for purposes of FICA and income tax withholding with respect to benefits under the Plan and Trust. However, in applying section 3121(a)(1), a separate wage base applies to each portion of the benefit that is attributable to services for a separate employer.
2. The amount of a retiree's benefit under the Plan becomes reasonably ascertainable for FICA purposes when the amount is determined by the trustees of the Trust and the present value of that amount is generally to be taken into account under section 3121(v) at that time, subject, however, to the Trust's use of alternatives under the regulations, such as the rule of administrative convenience under section 31.3121(v)(2)-1(e) or the lag method under section 31.3121(v)(2)-1(f)(3).
3. Benefits payable to an employee's surviving spouse or other beneficiary that become reasonably ascertainable after the close of the calendar year in which the employee dies are excluded from FICA wages under section 3121(a)(14).
4. Amounts transferred to the Trust and allocated to individual accounts are wages under section 3401(a).

Except as specifically ruled on above, no opinion is expressed as to the federal tax consequences of the transaction described above under any other Code provision. This ruling is directed only to the taxpayer who requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. In accordance with the Powers of Attorney on file with this office, a copy of this letter is being sent to each of your authorized representatives.

Sincerely yours,
 JERRY E. HOLMES
 Chief, Branch 2
 Office of the Associate

7

Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure:

Copy for 6110 purposes

cc: