Private Letter Ruling 9734035 (8/22/1997)

Date: May 22, 1997

Refer Reply to: CC:EBEO:2-PLR-252102-96

LEGEND:

Corporation =

Union =

Dear

This is in reply to your letter requesting a ruling regarding the federal employment tax consequences of a plan (“the Plan”) intended to be a supplemental unemployment benefits plan. You have requested rulings concerning whether the Plan is a supplemental unemployment benefit (SUB) plan and whether the benefits paid under the Plan are wages subject to the taxes imposed under the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (federal income tax withholding).

According to the information submitted, the current Plan arose through negotiations between the Corporation and the Union. The Plan is designed to provide eligible employees who are on layoff with supplemental unemployment benefits which are intended to supplement state unemployment compensation.

The original Plan was established between the Corporation's predecessor and the Union. The Plan has been periodically renewed and renegotiated since that time, as part of the collective bargaining agreement negotiation process. You state that the Plan has always been designed to supplement state unemployment benefits payable to employees who are involuntarily laid off or terminated due to actions such as a reduction in force or the discontinuance of a plant or operation. In addition, according to your submission, the Plan has operated in such a manner that the Plan benefits do not generally reduce, cancel, or disqualify the recipients from simultaneously receiving state unemployment benefits.

The Plan is funded through the establishment of a SUB accrual account (“the Account”), a bookkeeping account under which all benefits provided for in the Plan are paid. The Corporation is required to make periodic credits to the Account, and the Account is reduced to reflect payment of benefits. If the Account is insufficient to pay Regular Benefits to employees with ten or more years of service, the Corporation is required to credit an additional amount to the Account, subject to a cap, sufficient to make payments to these employees. In addition, if the Account is insufficient to pay Regular Benefits to employees at locations covered by the Corporation Job Security Program, the Corporation is required to credit the Account in an amount sufficient to cover these payments. The SUB Plan provides for maximum funding limitations and provides for the calculation of the amount of the Corporation's contribution to the Account.

The Union renegotiated the prior Plan with the Corporation pursuant to negotiations for the collective bargaining agreement. The current Plan is similar in all material details to the prior Plan. Plan benefits fall into four classifications: Regular Benefits, Automatic Short Week Benefits, Separation Benefits, and Plant Closing Benefits. The Plan provides that no employee shall have any right, title, or interest in or to any of the monies represented by the Account, or in or to any of the Corporation credits thereto.

The Board of Administration of the Plan exercises ultimate responsibility for the administration of the Plan and for determining the eligibility of employees for benefits. The Board shall consist of three members appointed by the Union and three members appointed by the Corporation. However, the Corporation shall carry out the administrative functions necessary for operation of the Plan and make all initial determinations of eligibility for Plan benefits. The Board of Administration shall be presumed conclusively to have approved determinations of eligibility by the Corporation unless the employee affected shall file a timely appeal therefrom with the Board.

To be eligible for Regular Benefits, an employee must be on layoff. In general, an employee is considered to be “on layoff” if the layoff is due to an involuntary separation resulting from a reduction in force, the discontinuance of a plant or operation, or the permanent shutdown of a plant, department, or subdivision thereof. An employee is not eligible for benefits if the employee quits, was suspended, was discharged, or in certain other circumstances.

The duration of Regular Benefit payments is based upon an employee's seniority, and, in some cases, the level of the Account. The amount of Regular Benefits, subject to certain maximums, is computed according to a formula which is based on the employee's after-tax pay, state unemployment benefits, and certain other compensation.

The Regular Benefits can be grouped into four categories for purposes of analysis as SUB benefits:

(a) Regular Benefits that are contingent on actual receipt of state unemployment compensation (An employee applying for a Regular Benefit is required to bring in the employee's state unemployment compensation check to confirm that the employee actually received a state benefit.);

(b) Regular Benefits that are contingent on receipt of state unemployment compensation but for the fact that the employee (1) does not have sufficient employment to be covered under the state system, (2) has exhausted state unemployment benefits, or (3) is serving a “waiting week” under the state system (or second waiting week enforced by the state occurring within less than fifty-two weeks since the employee's last waiting period);

(c) Regular Benefits that are contingent on receipt of state unemployment compensation but for the fact that (1) the employee failed to claim state unemployment benefits of less than $2.00, (2) the employee did not receive a benefit due to the pregnancy provisions of the state system, or (3) the employee was receiving certain types of military pay (Since the Corporation's inception as a new corporation, the total benefits paid under these provisions have accounted for far less than 1 percent of the total yearly payments made under the Plan.); and

(d) Regular Benefits that are contingent on receipt of state unemployment compensation but for the fact that (1) the employee is receiving other compensation in an amount that disqualifies the employee from receiving state benefits, (2) the employee refused an offer of work which the employee had the right to refuse under the collective bargaining agreement, or (3) the Board of Administration has waived the requirement for receipt of state benefits when benefits have been denied because the employee has refused to accept a minimum wage job. (Since the Corporation's inception as a new corporation, the total benefits paid under these provisions have accounted for far less than 1 percent of the total yearly payments made under the Plan.)

The Automatic Short Week Benefits (“ASWB payments”) are payable to employees with at least one year of service. Generally, an employee is eligible for ASWB payments if the employee worked less than a full work week, but did work at least part of the week (or received compensation for certain other specified reasons). ASWB payments may be made to employees in partial weeks immediately following full weeks in which Regular Benefits are paid, or to employees to make up for lost hours in weeks that do not immediately precede or follow a week in which Regular Benefits are paid. To receive ASWB benefits, an employee is required to be “on layoff” as defined in the Plan and to meet most other eligibility requirements for Regular Benefits.

Separation Payments under the Plan are available at the election of certain employees who have been on layoff for a continuous period of at least twelve months. An employee electing to receive a Separation Payment completely ceases to be an employee of the Corporation and has his or her seniority cancelled. The Plan provides that Separation Payments are payable only in a lump sum.

Plant Closing Benefits are available to employees meeting certain conditions who have been terminated due to the closing of certain plants listed in the Plan. In general, an employee who has lost his job as a result of the closing of certain enumerated plants will be entitled to payment of a guaranteed additional benefit for a certain period of time regardless of the level of the Account. Payments under these provisions are payable only after the Account is exhausted.

Sections 3121(a) and 3306(b) of the Code define the term “wages” for FICA and FUTA purposes, respectively, as all remuneration for employment, with certain limited exceptions. Section 3401(a), relating to federal income tax withholding, contains a similar definition.

Sections 31.3121(a)-1(b), 31.3306(b)-1(b) and 31.3401(a)- 1(a)(1) of the Employment Tax Regulations provide that the term “wages” means all remuneration for employment unless specifically excepted.

Sections 31.3121(a)-1(i), 31.3306(b)-1(i) and 31.3401(a)- 1(a)(5) of the regulations further provide that remuneration for employment, unless specifically excepted, constitutes wages even though at the time the remuneration is paid the individual is no longer an employee.

Section 3402(o) of the Code, as added by section 805(g) of the Tax Reform Act of 1969, P.L. 91-172, 1969-3 C.B. 10, extends federal income tax withholding to any supplemental unemployment compensation benefit paid to an individual, regardless of whether it would otherwise be considered wages. Section 3402(o)(2)(A) defines “supplemental unemployment compensation benefits” as amounts paid to an employee pursuant to a plan to which the employer is a party, because of an employee's involuntary separation from employment (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income.

Section 31.3401(a)-1(b)(4) of the regulations specifically provides that, for purposes of federal income tax withholding, any payments made by an employer to an employee on account of dismissal (i.e., involuntary separation from the service of the employer) constitute wages regardless of whether the employer is legally bound by contract, statute, or otherwise to make such payments. Although there are no similar provisions in the regulations relating to FICA and FUTA, the same conclusion generally applies. H.R. Rep. No. 1300, 81st Cong., 1st. Sess. 124 (1949), 1950-2 C.B. 255, 277, & 300. See also Rev. Rul. 90-72, 1990-2 C.B. 211, and Rev. Rul. 75-44, 1975-1 C.B. 15.

The definition of supplemental unemployment compensation benefits (“SUB pay”) under section 3402(o) of the Code has never dictated the proper tax treatment to be accorded to a payment for FICA or FUTA purposes. For FICA and FUTA purposes, SUB pay is defined solely through a series of administrative pronouncements published by the Service dating back to the 1950s, when SUB pay plans were first adopted.

The Service created an administrative exception for SUB pay with the issuance of Rev. Rul. 56-249, 1956-1 C.B. 488. Rev. Rul. 56-249 provides a limited exception from the definition of wages for FICA, FUTA, and federal income tax withholding purposes for certain payments made upon the involuntary separation of an employee from the service of the employer. The exception applies only if the payments are designed to supplement the receipt of state unemployment compensation and are actually tied to the receipt of state unemployment benefits.

The plan in Rev. Rul. 56-249 is specifically “designed to supplement State system unemployment benefits payable to certain former employees.” Employees must report to and register for employment with the state employment service. The plan also incorporates all of the state unemployment compensation law requirements designed to limit benefit payments to individuals who are “unemployed” and genuinely

available for any suitable work. The plan benefits are payable only after an employee is unemployed for “x” weeks. The plan benefits are paid in varying amounts and for varying periods depending, in part, on the amount of state unemployment benefits available. Finally, in a state where SUB pay does not reduce state unemployment benefits, the unemployed individual can not receive any other remuneration which would disqualify the individual from the state benefit, i.e., a plan payment is not SUB pay if the sum of that benefit and other remuneration from the employer disqualifies the recipient from receiving unemployment benefits in such a state. However, in very limited situations, the plan benefits disqualify the recipient from state unemployment benefits, thereby entitling the individual to the payment of a substitute benefit. However, the plan is designed in such a manner that the benefits generally do not disqualify the recipient from state unemployment benefits.

The ruling summarizes the following eight features of the plan: (1) benefits are paid only to unemployed former employees who are laid off by the employer; (2) eligibility for benefits depends upon meeting prescribed conditions after terminating employment with the employer; (3) benefits are paid by trustees of independent trusts; (4) the amount of weekly benefits payable is based upon state unemployment benefits, other compensation allowable under state laws, and the amount of straight-time weekly pay after withholding of all taxes and contributions; (5) the duration of the benefits is affected by the fund level and the employee's seniority; (6) the right to benefits does not accrue until a prescribed period after termination of employment; (7) the benefits are not attributable to the rendering of particular services by the recipient during the period of unemployment; and (8) no employee has any right, title, or interest in the fund until such employee is qualified and eligible to receive benefits. Revenue Ruling 56-249 concludes that the plan benefits do not constitute “wages” for purposes of FICA, FUTA, or federal income tax withholding. As seen from the ruling's historical context, the theory underlying the employment tax exclusion is that qualification for state unemployment benefits gives rise to the liability for the plan benefits.

Subsequent revenue rulings have broadened the scope of Rev. Rul. 56-249, but only to the extent that the plans in question are “similar in all material details” or are “substantially the same” as the plan in Rev. Rul. 56-249. If the plans are substantially the same or similar in all material details to the plan described in Rev. Rul. 56-249, then the absence of a single element may not be a material or controlling factor. The question is whether each plan's basic or fundamental purposes and conditions are the same as the purposes and conditions of the plan in Rev. Rul. 56-249. In Rev. Rul. 60-330, 1960-2 C.B. 46, accumulation of funds in a trust account does not alter the conclusion of Rev. Rul. 56-249.

In Rev. Rul. 90-72, 1990-2 C.B. 211, the Service continues to recognize an administrative wage exclusion, albeit modified, for SUB pay. Rev. Rul. 90-72 holds that SUB pay is excluded from “wages” for FICA and FUTA purposes only if the receipt of SUB pay is actually linked to the receipt of state unemployment compensation (i.e., the plan payments satisfy the plan's design and purpose of supplementing the receipt of state unemployment compensation). Furthermore, it holds that lump-sum payments are not linked to state unemployment compensation since the amount of the benefit received is the same regardless of the length of the individual's unemployment.

The facts of Rev. Rul. 90-72 describe six different plans and explain the appropriate treatment to be accorded to each plan. Of the six plans, two of the plans have features which resemble in whole or part, various features of the Corporation's Plan. Under plan (1), a company established a plan to provide weekly benefits to former employees involuntarily separated from service due to a plant closing, layoff, or reduction in force. The plan benefits are designed to supplement the receipt of state unemployment compensation and are not attributable to the rendering of any particular services. The benefits are not payable in the form of a lump sum. To fund its plan obligations, the company established a trust qualified under section 501(c)(17) of the Code as a SUB trust. The duration of the benefits depends in part on the fund level and the employee's seniority. No employee has any right, title, or interest in the fund until such employee is qualified and eligible to receive benefits.

Eligibility for benefits under plan (1) depends upon a former employee meeting certain prescribed conditions following temporary or permanent separation from employment. A laid-off worker or former employee must be unemployed and meet the requirements necessary to receive state unemployment

compensation benefits, except in three limited situations. The former employee may still receive benefits under the plan if the employee is ineligible under state law for unemployment compensation because: (a) the employee has insufficient wage credits, (b) the employee has exhausted the duration of the unemployment benefits, and (c) the employee has not met the requisite waiting period. Even in these three situations, the plan provides that the employee must otherwise be eligible for state unemployment compensation. Rev. Rul. 90-72 concludes that the benefits paid under plan (1) are designed to supplement the receipt of state unemployment compensation and are not wages for FICA and FUTA purposes.

The other plan in Rev. Rul. 90-72 which-is similar in some respects to the Corporation's plan is plan (3). Plan (3) and its underlying trust are identical to those described in plan (1) except that the benefits are paid in the form of a lump sum rather than periodic payments during the unemployment period. The ruling holds that these payments are wages for FICA and FUTA purposes because benefits paid in the form of a lump sum are not considered linked to state unemployment compensation for purposes of the SUB pay exception.

Three principles set forth in Rev. Rul. 90-72 are relevant in the instant ruling request. First, to qualify as SUB pay for FICA and FUTA purposes, payments under a plan must be specifically designed to supplement state unemployment benefits and, under the terms of the plan, the employee must be unemployed and must meet the requirements necessary to receive state unemployment compensation benefits. Second, Rev. Rul. 90-72 clarifies that the FICA and FUTA SUB pay exclusion was created solely through a series of administrative exclusions rather than by statute. In this regard, the ruling also clarifies that the FICA and FUTA exclusion has never been affected by the SUB pay definition under section 3402(o) of the Code. Finally, Rev. Rul. 90-72 holds that lump sum payments can never qualify for the administrative exclusion since they are not considered linked to state unemployment compensation. This is true since the receipt of supplemental unemployment benefits in the form of a lump sum rather than periodic payments allows the same amount of benefits to be received regardless of how long an individual remains unemployed.

Accordingly, based solely on the information submitted, we rule as follows with respect to benefits paid under the Plan:

- (1) Regular Benefits, Automatic Short Week Benefits, Separation Payments, and Plant Closing Benefits are subject to federal income tax withholding as wages.
- (2) The Plan is a SUB pay Plan because it is similar in all material respects to the plan described in Rev. Rul. 56-249, as modified by Rev. Rul. 90-72; i.e., the Plan is designed to supplement state unemployment benefits and the benefits are linked to the receipt of state unemployment compensation.
- (3) Regular Benefits paid on account of layoffs and tied to the receipt of state unemployment compensation are not wages for FICA and FUTA purposes. This exclusion also applies to Regular Benefits paid to laid off employees who are ineligible to receive state unemployment compensation because (a) the employee does not have sufficient employment to be covered under the state system, (b) the employee has exhausted the duration of state unemployment benefits, or (c) the employee has not met the requisite waiting period (provided the employee otherwise becomes eligible and receives state benefits once the waiting period expires).
- (4) As in Rev. Rul. 56-249, the FICA and FUTA exclusion also extends to the de minimis amount of Regular Benefits contained in the Plan that have no tie to state unemployment benefits. However, Regular Benefits are not excluded if they are made to individuals who (a) have found work with another employer which disqualifies the individual from state unemployment benefits, (b) have refused a job permitted under the Union agreement, or (c) have been granted a waiver by the Board of Administration of the requirement for receipt of state benefits when the benefits have been denied because the employee has refused to accept a minimum wage job.
- (5) Automatic Short Week Benefits are not wages for FICA and FUTA purposes if they are made to individuals who otherwise qualify for excludable Regular Benefits (i.e., if the Automatic Short Week Benefits immediately precede or follow a week in which an employee receives Regular Benefits). All other Automatic Short Week Benefits are wages for FICA and FUTA purposes.

- (6) Separation Payments continue to constitute wages for FICA and FUTA purposes.
- (7) Plant Closing Benefits continue to constitute wages for FICA and FUTA purposes.

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(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely yours,

Jerry E. Holmes
Chief, Branch 2
Office of the Associate
Chief Counsel
(Employee Benefits and
Exempt Organizations)

Enclosure

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