

Rev. Rul. 90-72, 1990-2 CB 211

Rev. Rul. 90-72, 1990-2 CB 211 -- IRC Sec. 3401 [CAUTION: This Rev Rul revokes Rev Rul 77-347, 1977-2 CB 362.]

Reference(s): Code Sec. 3401;

Tax treatment of supplemental unemployment compensation benefits.

This revenue ruling provides that supplemental unemployment compensation benefits (SUB pay) must be linked to the receipt of state unemployment compensation and must not be received in a lump sum in order to be excludable from the definition of wages for Federal Insurance Contributions Act and Federal Unemployment Tax Act purposes. SUB pay must also meet the same criteria in order to be excludable from the definition of compensation for Railroad Retirement Tax Act purposes. Rev. Rul. 65-251 amplified and Rev. Rul. 77-347 revoked in part.

ISSUES

Are payments made to employees under Plans (1), (3), and (5) described below wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and federal income tax withholding? Are payments to railroad employees under Plans (2), (4), and (6) described below compensation for purposes of the Railroad Retirement Tax Act (RRTA)?

FACTS

Plan (1). Company X established a trust to fund its obligations under a plan (Plan (1)). The trust qualifies for exemption from federal income tax as a supplemental unemployment compensation benefit (SUB) trust described in section 501(c)(17) of the Internal Revenue Code. Plan (1) provides weekly benefits to former employees involuntarily separated from the service of Company X due to a plant closing, layoff, or reduction in force. Benefits paid under the plan are designed to supplement the receipt of state unemployment compensation and are not payable in the form of a lump sum.

Eligibility for benefits under Plan (1) depends upon a former employee meeting certain prescribed conditions following temporary or permanent separation from employment with Company X. Under the terms of the plan, a worker on layoff or former employee must be unemployed and must 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: (1) the employee is ineligible for state unemployment compensation benefits because the employee has insufficient wage credits under the state law, (2) the employee has exhausted the duration of benefits under the state law, or (3) the employee has not met the waiting period required under state law. Even in these three situations, in order to receive benefits under the plan, the employee must be otherwise eligible for state unemployment compensation.

In addition, under Plan (1), the duration of benefits depends in part on the fund level and the employee's seniority; benefits are not attributable to the rendering of any particular services; and no employee has any right, title, or interest in the fund until such employee is qualified and eligible to receive benefits.

Plan (2). Company X also established a plan (Plan (2)) and trust identical to those described in Plan (1), except that the benefits paid under the plan are paid to railroad employees and are designed to supplement the receipt of benefits under the Railroad Unemployment Insurance Act (RUIA).

Plan (3). Company Y established a plan (Plan (3)) and trust identical to those described in Plan (1), except that the benefits paid under the plan are paid in a lump sum, rather than in the form of periodic payments.

Plan (4). Company Y also established a plan (Plan (4)) and trust identical to those described in Plan (3), except that the benefits paid under the plan are paid to railroad employees and are designed to supplement the receipt of benefits under the Railroad Unemployment Insurance Act (RUIA).

Plan (5). Company Z established a trust to fund its obligations under a plan (Plan (5)). The trust qualifies for exemption from federal income tax as a SUB trust described in section 501(c)(17) of the Code. The plan provides benefits to former employees involuntarily separated from the service of Company Z. Other than requiring an involuntary separation from employment with Company Z, the plan places no conditions on the former employees' eligibility to receive benefits under the plan.

Plan (6). Company Z also established a plan (Plan (6)) and trust identical to those described in Plan (5), except that the benefits paid under the plan are paid to railroad employees.

LAW AND ANALYSIS

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) of the Code, relating to federal income tax withholding, contains a similar definition.

Section 3402(o) of the Code extends 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 operations, or other similar conditions, but only to the extent such benefits are includible in the employee's gross income. The definition of SUB pay under section 3402(o) is not applicable for FICA or FUTA purposes. For FICA and FUTA purposes, SUB pay is defined solely through a series of administrative <pg 212> pronouncements published by the Service.

Section 3231(e)(1) of the Code defines the term "compensation" for RRTA purposes as any form of money remuneration paid to an individual for services rendered as an employee to one or more employers, also with certain limited exceptions.

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

Section 3201(a) and (b) of the Code (the tier I and tier 2 taxes, respectively) impose on the income of each railroad employee a tax equal to a specified percentage of the compensation received during any calendar year by such employee for services rendered by such employee.

Section 31.3401(a)-l(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.

Rev. Rul. 56-249, 1956-1 C.B. 488, 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, but only if the payments are designed to supplement the receipt of state unemployment compensation.

Rev. Rul. 56-249 holds that benefits paid to individuals by trustees of a trust created pursuant to the provisions of a SUB plan are not wages for FICA, FUTA, or federal income tax withholding purposes. 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; (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; and (8) no employee has any right, title, or interest in the fund until such employee is qualified and eligible to receive benefits.

Subsequent revenue rulings have broadened the scope of Rev. Rul. 56-249. Rev. Rul. 58-128, 1958-1 C.B. 89, concludes that the wage conclusions in Rev. Rul. 56-249 would be the same if the plan had been unilaterally instituted by the employer. Rev. Rul. 60-330, 1960-2 C.B. 46, further concludes that the fact that benefits are not paid from a trust does not alter the conclusion of Rev. Rul. 56-249.

Rev. Rul. 71-408, 1971-2 C.B. 340, holds that payments to employees pursuant to an agreement with a union upon the termination of their employment due to the discontinuance of the company's operations constitute wages for FICA, FUTA, and federal income tax withholding purposes. The payments described in Rev. Rul. 71-408 do not meet the eligibility factors described in Rev. Rul. 56-249 and are not designed to provide a supplement to unemployment compensation.

Rev. Rul. 77-347, 1977-2 C.B. 362, amplifies and modifies Rev. Ruls. 56-249 and 58-128. Rev. Rul. 77-347 provides that benefits under a plan do not have to be tied to state unemployment compensation benefits in order for the benefits to constitute SUB pay for FICA, FUTA, and federal income tax withholding purposes.

Rev. Rul. 65-251, 1965-2 C.B. 395, holds that certain lump sum separation and severance allowances paid to laid-off employees in the railroad industry constitute compensation for RRTA purposes and wages for income tax withholding purposes.

HOLDINGS

The portion of Rev. Rul. 77-347 concluding that benefits do not have to be linked to state unemployment compensation in order to be excluded from the definition of wages for FICA and FUTA tax purposes is inconsistent with the underlying premises for the exclusion and is therefore hereby revoked. This action restores the distinction between SUB pay and dismissal pay by re-establishing the link between SUB pay and state unemployment compensation set forth in Rev. Rul. 56-249. 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, benefits provided in the form of a lump sum are not considered linked to state unemployment compensation for this purpose, and are therefore not excludable from wages as SUB pay.

The definition of compensation for RRTA purposes is similar to the definition of wages for FICA purposes. Therefore, the same conclusions apply for RRTA purposes.

In view of the foregoing, benefits provided under the plans described above are treated as follows:

Plan (1). Benefits paid under Plan (1) are designed to supplement the receipt of state unemployment compensation and are not wages for purposes of the FICA and FUTA taxes. Under section 3402(o), benefits paid under Plan (1) are treated as wages for purposes of federal income tax withholding.

Plan (2). Benefits paid under Plan (2) are designed to supplement the receipt of unemployment compensation under the RUIA and are not compensation for purposes of the RRTA.

Plans (3) and (5). Benefits paid under Plans (3) and (5) are wages for FICA, FUTA, and federal income tax withholding purposes.

Plans (4) and (6). Benefits paid under Plans (4) and (6) are compensation for RRTA purposes. These holdings also apply to plans similar in all material respects to <pg 213> Plans (1), (2), (3), (4), (5), and (6) that are not funded by trusts or are maintained pursuant to a collective bargaining agreement.

EFFECT ON OTHER REVENUE RULINGS

The portion of Rev. Rul. 77-347 that concludes that SUB pay does not have to be tied to state unemployment benefits in order to receive non-wage treatment for purposes of the FICA and FUTA taxes is revoked. Also, Rev. Rul. 65-251, 1965-2 C.B. 395, is amplified.

PROSPECTIVE APPLICATION

Under the authority of section 7805(b) of the Code, this revenue ruling applies to benefits paid on or after January 1, 1991, pursuant to a plan described above. For such plans maintained pursuant to a collective bargaining agreement in effect on September 4, 1990, this revenue ruling applies to all benefits paid after the later of January 1, 1991, or the date on which the particular collective bargaining agreement expires.