TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

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

Release Number: **201415011**
Release Date: 4/11/2014
Date: January 13, 2014

Uniform Issue List
61.00-00
104.00-00
152.00-00
501.09-00
3401.00-00

Contact Person:

Identification Number:

Telephone Number:

Employer Identification Number:

Legend:

State =

Dear :

This is in response to your ruling request dated December 13, 2010 as to the federal tax consequences of the proposed transactions under the Internal Revenue Code and Federal Tax Regulations.

FACTS:

Trust describes itself as a Voluntary Employees' Beneficiary Association trust, exempt from taxation under § 501(a) of the Internal Revenue Code as an organization described under § 501(c)(9), created to fund the Voluntary Employees' Benefit Association Heath Reimbursement Arrangement ("Plan").

Members of the Plan consist of employees and retirees (collectively "Participants" individually "Participant") of participating governmental entities employers in State. Trust is 100% funded by contributions from these governmental entities employers; Participants do not contribute to Trust.

Pursuant to Trust, Plan provides health reimbursement arrangement ("HRA") benefits limited to "Qualified Health Care Benefits" which are defined as follows: "Qualified Health Care Benefits

must be a reimbursement for health benefits as defined by § 213(d) and excludable from income under §§ 105 and 106, as amended time after time." Beneficiaries include Participants, their eligible spouses, dependents and children as determined under § 105(b).

Plan also provides HRA benefits to domestic partners of Participants who qualify as dependent pursuant to § 152(a) (determined without regard to subsections (b)(1), (b)(2), and (d)(1)(B) and Treas. Reg. § 1.501(c)(9)-3(a). Plan proposes to continue to provide HRA benefits to domestic partners who qualify as dependents pursuant to § 152(a). Trust states that it will, via a Third Party Administrator ("TPA"), follow TPA protocols and the Internal Revenue Service ("Service") regulatory guidelines to make sure these dependent domestic partners qualify as a "dependent" as defined under § 152 prior to receiving HRA benefits. Pursuant to Trust, this qualification process includes (1) participant's attestation (2) investigation by TPA and finally (3) verification pursuant to the Service guidelines.

Trust now proposes to begin to extend HRA benefits to domestic partners of Participants who are non-dependents within the meaning of § 152 and Treas. Reg. § 1.501(c)(9)-3(a). Trust states that the total amount of all impermissible benefits Trust will pay/provide in any Plan year, inclusive of the benefits to domestic partners who are not dependents under § 152 and associated taxes will not exceed three percent (3%) of the total benefits Trust will pay in any Plan year of Trust's operation. Trust also states that "[s]o far, the only impermissible benefits that the Trust would be providing, if any, would consist only of the benefits to domestic partners who are not dependents under IRC § 152." Last, Trust states that the total amount of benefits Trust will provide to domestic partners who are not dependents in any Plan year of Trust's operation is a de minimis amount.

Presently, Plan's documents defines the term "Dependent" as Participant's spouse, dependent, or child (who as of the end of the taxable year has not attained age 27) as determined under § 105(b). If Plan is permitted to begin to provide HRA benefits to non-dependent domestic partners, Trust represents that Plan will redefine the term "Dependent" "as soon as administratively possible" to "also include a Participant's non-dependent domestic partner and their coverage shall be subject to the terms and limitations of such ruling and any other applicable provision of law."

Plan's responsibility shall include the enrollment of participants, the processing, administration and payment of benefits, and the maintenance of Plan's records. Plan, not the employers, will determine the amount of the HRA coverage Participants and their beneficiaries can receive. Plan will also maintain claims payments.

Trust recognizes "that where the domestic partner is not a tax-qualified dependent of the participant, the value of the domestic partner's health coverage would constitute income and wages to the participant." For employment taxes purposes, Trust will be deemed the employer with respect to any amounts considered wages because of a Participant's non-dependent domestic partner's coverage. Accordingly, Trust will report the income tax withholding. In addition, out of the Participant's account, Trust would pay the employer portion of the FICA tax, Participant's portion of the FICA tax, and the FUTA taxes that may result because of the Participant's election to receive non-dependent domestic partner's coverage.

Xxxxxxxxxx Xxxxxxxxxxxxxxx Xxxxxxxxx

Further, Trust also:

> [R]ecognizes that if the requested rulings are issued and domestic partner coverage includes payment out of the [P]articipant's account of the employer and employee portions of the FICA tax and the payment of the FUTA tax and the income tax withholding on the coverage and the [Plan] "gross-up" the value of the coverage in conformity with Rev. Proc. 81-48, 1981-2 C.B. 623 to reflect the payment of (a) the participant's portion of the FICA, and (b) the income tax withholding attributable to the amount included in the participant's income, the [Plan] must include as part of the value of the coverage for tax purposes an amount equal to the gross-up.

Trust represents that it will issue Form W-2 to Participants who elect non-dependent domestic partner's coverage. This W-2 will reflect the imputed value of the HRA benefits as wages inclusive of any FICA taxes and withheld taxes Trust will pay on a Participant's behalf.

RULINGS REQUESTED:

Based on the above facts, Trust requests the following ruling:

1. Whether Trust's tax-exempt status under § 501(c)(9) will not be jeopardized if permissible benefits are provided to Participants' domestic partners who are dependents within the meaning of § 152 (determined without regard subsections (b)(1), (b)(2) and (d)(1)(B) thereof) and Treas. Reg. § 1.501(c)(9)-3(a).

2. Whether Trust's tax-exempt status under § 501(c)(9) will not be jeopardized if Trust provides HRA benefits to Participants' domestic partners who are not dependents within the meaning of § 152 and Treas. Reg. § 1.501(c)(9)-3(a), as long as the total amount of all impermissible benefits provided, inclusive of the benefits to domestic partners who are not dependents under § 152 (and associated taxes) is three percent (3%) or less of the total amount of benefits paid to all Plan's Participants and beneficiaries in any plan year.

3. Whether the HRA coverage Trust provides to a domestic partner who is a dependent of a Participant within the meaning of § 152 is not includible in the Participant's gross income and is not wages for employment tax purposes.

4. Whether the fair market value of the HRA coverage, as determined under Notice 2002-45 Part VII, Trust provides to a domestic partner who is not a dependent of a Participant within the meaning of § 152 is includable in the income of the Participant under § 61 and is wages for FICA, FUTA and income tax withholding purposes. The amount of employee FICA and the amount of income tax withholding attributable to the HRA coverage that is paid by the Plan on the Participant's behalf is also includable in the Participant's income and is wages for employment tax purposes. Therefore, the grossed-up amount determined under Rev. Proc. 81-48 is the amount includable in the gross income of the Participant by reason of the HRA coverage for a domestic partner

and is the amount of the participant's wages for FICA, FUTA and income tax withholding purposes and is to be reported via W-2.

5. Whether the gross income of a Participant and domestic partner who is not a dependent of the Participant within the meaning of § 152 will not include any amount received by, or on behalf of or with respect to the domestic partner as payment or reimbursement of HRA benefits under the Plan to the extent that the fair market value of the HRA coverage provided to the domestic partner is included in the gross income of the participant pursuant to the provisions of § 104(a)(3).

6. Whether Trust is the employer under § 3401(d)(1) for purposes of the employment taxes on the amount of wages that results from HRA coverage provided to a participant's domestic partner who is not a dependent within the meaning of § 152. Thus, Trust is required to withhold income tax and the employee portion of the FICA tax. Trust must also pay the employer portion of the FICA tax and the FUTA tax.

7. Whether for purposes of determining the amount of income tax to withhold, the wages paid by the § 3401(d)(1) employer are considered separately from wages paid by the common law employer.

8. Whether under Announcement 85-113, Trust may treat the HRA benefit coverage provided on an annual basis for purposes of income tax withholding, FICA and FUTA.

RULINGS 1 AND 2

LAW AND ANALYSIS

Section 104(a)(3) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not included in the gross income of the employee, or (B) are paid by the employer).

Section 105(a) provides that, except as otherwise provided in § 105, amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in the gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includable in the gross income of the employee, or (2) paid by the employer.

Section 105(b) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213(relating to medical expenses) for any prior taxable year, gross income does not include the amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in § 213(d)) of the taxpayer, his spouse, and his dependents (as

defined in § 152, determined without regards to subsection (b)(1), (b)(2), and (d)(1)(B), thereof, and any child of the Taxpayer as defined in § 152(f)(1) who as of the end of the taxable year has not attained age 27').

Section 106 provides that the gross income of an employee does not include employer provided coverage under an accident or health plan.

Section 152(a) defines the term "dependent" to include, among others, any of the following individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer: sons and daughters; stepsons and stepdaughters; nieces and nephews; aunts and uncles; in-laws; and an individual (other than the spouse) who, for the taxable year, has as his/her principal place of abode the home of the taxpayer and is a member of the taxpayer's household.

Section 152(f)(2) defines the term "child" as a son, daughter, stepson or step daughter, of the taxpayer, an eligible foster child of the taxpayer or a legally adopted individual or an individual who is lawfully placed with the taxpayer for legal adoption.

Section 501(c)(9) provides for the exemption from federal income tax of voluntary employees' beneficiary associations providing for the payment of life, sick, accident, or other benefits to the members of such association or their dependents or designated beneficiaries if no part of the net earnings of such association inures (other than through such payments) to the benefit of any private shareholder or individual.

Treas. Reg. § 1.106-1 provides that the gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in § 152.

Treas. Reg. § 1.501(c)(9)-3(a) provides that, for purposes of § 501(c)(9), dependent means the member's spouse; any child of the member or the member's spouse who is a minor or a student; any other minor child residing with the member; and any other individual who an association, relying on information furnished to it by a member, in good faith believes is a person described in § 152(a). It also provides that the life, sick, accident or other benefits provided by a VEBA must be payable to its members, their dependents, or their designated beneficiaries and that a VEBA is not operated for the purpose of providing life, sick, accident, or other benefits unless substantially all of its operations are in furtherance of the provision of such benefits. Further, an organization is not described in § 501(c)(9) if it systematically and knowingly provides benefits (of more than a de minimis amount) that are not permitted by paragraphs (b), (c), (d), or (e) of this section.

Treas. Reg. § 1.501(c)(9)-3(b) detail the types of benefits that a tax-exempt VEBA may provide as well as who is eligible to receive the benefits. These benefits include life, sick and accident, and certain other benefits ("permissible benefits").

In ruling request number 1, Trust requests that Trust's tax-exempt status under § 501(c)(9) will not be jeopardized if permissible benefits are provided to Participants'

domestic partners who are dependents within the meaning of § 152 (determined without regard subsections (b)(1), (b)(2) and (d)(1)(B) thereof) and Treas. Reg. § 1.501(c)(9)-3(a).

The term "dependent" is defined to include, among others, the following: sons and daughters; stepsons and stepdaughters; nieces and nephews; aunts and uncles; in-laws; and an individual (other than the spouse) who, for the taxable year, has as his/her principal place of abode the home of the taxpayer and is a member of the taxpayer's household and half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer. See IRC § 152(a).

Trust states that it already provides HRA benefits to domestic partners of Participants who meet the definition of "dependent" as provided under § 152 and plans to continue to provide HRA benefits to these dependent domestic partners. Trust will, via a TPA, follow TPA protocols and the Service regulatory guidelines to make sure that these domestic partners qualify as a "dependent" as defined under § 152 before they can receive HRA benefits.

RULING 1 CONCLUSION

Because Trust provides HRA benefits to domestic partners who qualify as "dependents" under § 152 after verification that such domestic partners qualify as dependents (or a "child" who as of the end of the taxable year has not attained age 27), Trust will not jeopardize its § 501(c)(9) tax-exempt status.

In ruling request number 2, Trust requests a ruling that Trust's tax-exempt status under § 501(c)(9) will not be jeopardized if Trust provides HRA benefits to Participants' domestic partners who are not dependents within the meaning of § 152 and Treas. Reg. § 1.501(c)(9)-3(a), as long as the total amount of impermissible benefits Trust will pay/provide in any Plan year, inclusive of the benefits to domestic partners who are not dependents under § 152 and associated taxes will not exceed three percent (3%) of the total benefits Trust will pay in any Plan year of Trust's operation.

An organization will not qualify for tax-exempt status as an organization described under § 501(c)(9) if it knowingly provides benefits of more than a de minimis amount that are not permitted under paragraph (b), (c), (d), or (e) of Treas. Reg. § 1.501(c)(9)-3. See Treas. Reg. § 1.501(c)(9)-3a.

Trust proposes to begin to provide HRA benefits to domestic partners who are not dependents within the meaning of § 152. Trust states that the total amount of all impermissible benefits Trust will pay/provide in any Plan year, inclusive of the benefits to domestic partners who are not dependents under § 152 and associated taxes will not exceed three percent (3%) of the total benefits Trust will pay in any Plan year of Trust's operation. For now, the only impermissible benefits Trust would be providing, if any, would consist only of the benefits to domestic partners who are not dependents under § 152. Trust further states that the total amount of benefits Trust will provide to domestic partners who are not dependents in any Plan year of Trust's operation is a de minimis amount.

Xxxxxxxxxx Xxxxxxxxxxxxxxx Xxxxxxxxx

RULING 2 CONCLUSION

Trust represents that the total amount Trust will expend to provide impermissible benefits to domestic partners who are not dependents pursuant to § 152 in any year of Trust's operation as far as all impermissible benefits provided, inclusive of the benefits to domestic partners who are not dependents under § 152 (and associated taxes) would not exceed three percent (3%), an amount Trust represents is a de minimis amount), therefore, Trust's § 501(c)(9) tax-exempt status will not be jeopardized.

RULINGS 3 AND 5

LAW AND ANALYSIS

Section 61(a)(1) and Treas. Reg. § 1.61-21(a)(3) provide that, except as otherwise provided in subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Treas. Reg. § 1.61-21(a)(3) provides that a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services.

Treas. Reg. § 1.61-21(b)(1) provides that an employee must include in gross income the fair market value of the fringe benefit. In general, fair market value, under the principles set forth in Treas. Reg. § 1.61-21(b)(2), is determined on the basis of the amount that an individual would have to pay for the particular fringe benefit in an arm's length transaction. Where the particular coverage provided to the individual is group medical coverage, the amount includible in the employee's gross income is the fair market value of the group medical coverage.

Treas. Reg. § 1.105-5(a) provides that an accident or health plan is an arrangement for payment of amounts to employees in the event of personal injuries or sickness.

Section 106 provides that "gross income of an employee does not include employer-provided coverage under an accident or health plan."

Treas. Reg. § 1.106-1 provides, "The gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in § 152.

Section 104(a)(3) provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the

employer which were not included in the gross income of the employee, or (B) are paid by the employer.

Section 105(a) provides that, except as otherwise provided in § 105, "amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer."

Section 105(b) provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under § 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in § 213(d)) of the taxpayer, his spouse, and his dependents (as defined in § 152, determined without regard to subsection (b)(1), (b)(2), and (d)(1)(B), thereof) and any child (as defined in § 152(f)(1)) of the taxpayer who as of the end of the taxable year has not attained age 27.

Reimbursements received through an employer-provided accident or health plan are not excludible from the employee's gross income under § 105(b) unless the reimbursements are for medical expenses incurred by the employee, his or her spouse, his or her dependents, or child as defined in § 152(f)(1). However, reimbursements that are not excludible under § 105(b) may be excludible under § 104(a)(3) if they are attributable to employer contributions that were included in the employee's income.

RULINGS 3 AND 5 CONCLUSION

As to ruling request number 3, based on the facts presented and authorities cited above, the HRA coverage provided to a domestic partner who is a dependent of a Participant within the meaning of § 152 (or child as defined in § 152(f)(1)), is not includible in the Participant's gross income.

As to ruling request number 5, pursuant to § 104(a)(3) and based on the facts presented and authorities cited above, neither the Participant nor the Participant's non-dependent domestic partner will include any amount received as payment or reimbursement of HRA benefits on behalf of or with respect to the non-dependent domestic partner to the extent that the fair market value of the HRA coverage provided to the non-dependent domestic partner was included in the gross income of the Participant.

RULING 4

LAW AND ANALYSIS

Section 61(a)(1) and Treas. Reg. § 1.61-21(a)(3) provide that, except as otherwise provided in subtitle A of the Code gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Xxxxxxxxxx Xxxxxxxxxxxxxxx Xxxxxxxxx

Treas. Reg. § 1.61-21(a)(3) provides that a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services.

Treas. Reg. § 1.61-21(a)(4) provides that, in general, a taxable fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. Thus, a fringe benefit may be taxable to a person even though that person did not actually receive the fringe benefit. If a fringe benefit is furnished to someone other than the service provider, such benefit is considered as furnished to the service provider, and use by the other person is considered use by the service provider.

Treas. Reg. § 1.61-21(b)(1) provides that an employee must include in gross income the fair market value of the fringe benefit. In general, fair market value, under the principles set forth in Treas. Reg. § 1.61-21(b)(2), is determined on the basis of the amount that an individual would have to pay for the particular fringe benefit in an arm's-length transaction. In the case of group medical coverage, the amount includible in the individual's gross income is the fair market value of the group medical coverage.

Section 3402 provides that, except as otherwise provided, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary of the Treasury.

Section 3401(a) provides that, with certain enumerated exceptions, the term "wages" as used in § 3402 means all remuneration (other than fees paid to a public official) for services performed by an employee for his or her employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash.

Rev. Rul. 56-632, 1965-2 C.B. 101, holds that benefits excluded under § 106 are not subject to income tax withholding. However, health benefits that are included in income are wages for withholding purposes.

Sections 3101 and 3111 (FICA) provide for a tax on employees and employers which is a percentage of wages (as defined in § 3121(a)) paid with respect to employment. Section 3301 (FUTA) imposes on every employer a tax equal to a percentage of wages (as defined in § 3306(b)) paid by the employer during the calendar year with respect to employment. Sections 3121(a) and 3306(b) provide, with certain exceptions, that for FICA and FUTA purposes, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash.

Under §§ 3121(a)(1) and 3306(b)(2), wages for FICA and FUTA purposes do not include amounts paid to or on behalf of an employee or his dependents under a plan covering a class or classes of employees and their dependents on account of medical or hospitalization expenses. Health benefits provided to persons other than the employee or his dependents are not excluded from FICA or FUTA wages under these provisions.

Payment of the employee portion of FICA by the employer without withholding from the employee's wages is itself wages for purpose of FICA, FUTA, and income tax withholding. The

employee's stated wages must therefore be grossed up to reflect the additional amount that results from the employer's payment of the employee FICA. The employee's stated wages must also be grossed up to reflect the additional amount that results from the employer's payment of income tax withholding in the same calendar year as the wages are paid without withholding from the employee's wages. See Rev. Rul. 58-113, 1958-1 C.B. 362. Rev. Proc. 81-48, 1981-2 C.B. 623, provides a formula for determining the amount of the grossed up wages in these circumstances.

RULING 4 CONCLUSION

The fair market value of the coverage provided by Plan to a non-dependent domestic partner of a Participant within the meaning of § 152 is includible in the gross income of the Participant under § 61, and is wages for FICA, FUTA, and income tax withholding purposes. The amount of employee FICA attributable to the coverage that is paid by Plan on a Participant's behalf that is not withheld from the Participant's wages is also includible in the Participant's income, and is wages for employment tax purposes. The amount of income tax withholding attributable to the coverage that is paid by Plan on the Participant's behalf in the same calendar year as the wages are paid that is not withheld from the Participant's wages is also includible in the Participant's income and is wages for employment tax purposes. Therefore, the gross-up amount determined under Rev. Proc. 81-48 is the amount includible in the gross income of Participants by reason of the health coverage for a non-dependent domestic partner and is the amount of Participants' wages for FICA, FUTA, and income tax withholding purposes. Such amount is to be reported on the Form W-2 provided to Participants.

RULING 6

LAW AND ANALYSIS

Under § 3401(d), the term "employer" generally means the person for whom an individual performs any service of whatever nature as the employee of such person. Under § 3401(d)(1), however, if the person for whom the individual performs the services does not have control of the payment of the wages for such services, the term "employer" means the person having control of the payment of such wages. Treas. Reg. § 31.3401(d)-1(f) provides that the term "employer" means the person having legal control of the payment of the wages. For example, where wages are provided by a trust and the person for whom the services were performed has no legal control over the payment of such wages, the trust is the employer.

Neither the FICA nor the FUTA provisions of the Code contain a definition of employer similar to the definition contained in § 3401(d)(1). However, Otte v. United States, 419 U.S. 43 (1974), holds that a person who is an employer under § 3401(d)(1) is also the employer for purposes of FICA withholding under § 3102. Circuit courts have applied the Otte holding to conclude that the person having control of the payment of the wages is also the employer for purposes of § 3111, which imposes FICA excise tax on employers, and for purposes of § 3301, which imposes the FUTA tax on employers. See e.g., In re Armadillo Corp., 561 F.2d 1382 (10th Cir. 1977).

Trust is responsible for the enrollment of Participants, the processing, administration, payment

of benefits, and the maintenance of Plan's records. The Trust is liable to pay any benefits payable under the Plan. It is the Trust, not the Participant's employer, which determines the amount of HRA coverage to which any Participant is entitled at any point (or for any period of time). Similarly, it is the Trust, not the employer that maintains records regarding eligible dependents and claims payments. The trustees of the Trust formulate policies, practices and procedures to carry out the funding of the Plan. Thus, we conclude that the Trust has legal control of the payment of the wages (that is the fair market value of the coverage provided) and is the employer for purposes of § 3401(d)(1) with respect to these wages.

RULING 6 CONCLUSION

Trust is the employer under § 3401(d)(1) for purposes of the employment taxes on the amount of wages that result from the HRA coverage provided to a Participant's non-dependent domestic partner. Thus, Trust is required to withhold income tax and the employee portion of the FICA tax on such wages. Trust must also pay the employer portion of the FICA tax and the FUTA tax.

RULING 7

LAW AND ANALYSIS

Treas. Reg. § 31.3402(g)-1(a)(1) provides that an employee's remuneration may consist of regular wages and supplemental wages, and that supplemental wages are wages paid by an employer that are not regular wages. Supplemental wages include wage payments made without regard to an employee's payroll period, but also may include payments made for a payroll period. The regulations provide that imputed income for health coverage for a non-dependent is supplemental wages. The regulations also provide that amounts that are described as supplemental wages in the definition in the regulations are supplemental wages regardless of whether the employer has paid the employee any regular wages during either the calendar year of the payment or any prior calendar year.

Treas. Reg. § 31.3402(g)-1(a)(2) provides that if a supplemental wage payment, when added to all supplemental wage payments previously made by one employer (as defined under the regulations) to an employee during the calendar year, exceeds $1,000,000, the rate used in determining the amount of withholding on the excess (including any excess which is a portion of a supplemental wage payment) shall be equal to the highest rate of tax applicable under section 1 of the Code for such taxable years beginning in such calendar year. This flat rate shall be applied without regard to whether income tax has been withheld from the employee's regular wages, without allowance for the number of withholding allowances claimed by the employee on Form W-4, "Employee's Withholding Allowance Certificate," without regard to whether the employee has claimed exempt status on Form W-4, without regard to whether the employee has requested additional withholding on Form W-4, and without regard to the withholding method used by the employer. Withholding under Treas. Reg. § 31.3402(g)-1(a)(2) is referred to as mandatory flat rate withholding.

If the supplemental wages paid to an employee by an employer (as defined in the regulations)

during a calendar year do not exceed $1,000,000, then the amount of income tax withholding is determined under the rules provided in Treas. Reg. § 31.3402(g)-1(a)(6) and (7). These paragraphs describe two procedures for withholding on supplemental wages: the aggregate procedure and optional flat rate withholding.

An employer applies the aggregate procedure described in Treas. Reg. § 31.3402(g)-1(a)(6) by using the withholding tables applicable to the payroll period with respect to which the employer is calculating the income tax withholding liability on the supplemental wages. The supplemental wages, if paid concurrently with wages for a payroll period, are aggregated with the wages paid for such payroll period. If not paid concurrently, the supplemental wages are aggregated with the wages paid or to be paid within the same calendar year for the last preceding payroll period or for the current payroll period, if any. The amount of tax to be withheld is determined as if the aggregate of the supplemental wages and the regular wages constituted a single wage payment for the regular payroll period.

The aggregate procedure can be used to determine the amount of income tax to be withheld with respect to any payment of supplemental wages, except to the extent that mandatory flat rate withholding applies. See Treas. Reg. § 31.3402(g)-1(a)(6). However, optional flat rate withholding may only be used under certain conditions.

Treas. Reg. § 31.3402(g)-1(a)(7) provides that an employer may use optional flat rate withholding on supplemental wages if three conditions are met:

1. The wage payment or portion of the payment is not subject to mandatory flat rate withholding under Treas. Reg. § 31.3402(g)-1(a)(2);

2. The supplemental wages are either not paid concurrently with regular wages or are separately stated on the payroll records of the employer; and

3. Income tax has been withheld from regular wages of the employee during the calendar year of the payment of the supplemental wages or the preceding calendar year.

Treas. Reg. § 31.3402(g)-1(a)(1)(i) specifically includes imputed income for health coverage for a non-dependent as an example of supplemental wages. Amounts included as supplemental wages under the definition in the regulations are supplemental wages regardless of whether the employer has paid the employee any regular wages during either the calendar year of the payment or any prior calendar year. Because the imputed income for health coverage for a non-dependent is supplemental wages, the Trust must determine income tax withholding under the rules for supplemental wage withholding.

If the Trust has paid only supplemental wages and no regular wages, the Trust may not use the optional flat rate method with respect to the imputed income for health coverage for non-dependents because one of the three requirements set forth in Treas. Reg. § 31.3402(g)-1(a)(7)(i) has not been met. In determining whether the Trust has withheld income tax from regular wages paid to employees during the calendar year or the preceding calendar year, the Trust may not consider any wages paid by the common law employer. The Trust has not withheld income tax from regular wages paid to employees during the calendar year or the

preceding calendar year. Therefore, the Trust must use the aggregate procedure to determine the amount of income tax withholding on the imputed income for health coverage for non-dependents.

CONCLUSION

For purposes of determining the amount of income tax to withhold, the supplemental wages paid by the § 3401(d) employer are considered separately from wages paid by the common law employer.

RULING 8

LAW AND ANALYSIS

Guidelines for the reporting of and withholding on the value of taxable noncash fringe benefits are provided in Announcement 85-113. Under Announcement 85-113 employers may elect, for employment tax and withholding purposes, to treat taxable noncash fringe benefits as paid on a pay period, quarterly, semi-annually, annually, or on another basis, provided that the benefits are treated as paid no less frequently than annually. For example, an employer may treat the annual value of noncash fringe benefits as wages paid in December of each year and use the annual withholding table in Circular E (Publication 15, Employer's Tax Guide).

CONCLUSION

Under Announcement 85-113, the Trust may treat the coverage as provided on an annual basis for purposes of employment tax withholding.

RULINGS:

Based on the information submitted, we rule as follows:

1. The Trust's tax-exempt status under § 501(c)(9) will not be jeopardized if permissible benefits are provided to Participants' domestic partners who are dependents within the meaning of § 152 (determined without regard subsections (b)(1), (b)(2) and (d)(1)(B) thereof) and Treas. Reg. § 1.501(c)(9)-3(a) and any child of the Participant as defined in § 152(f)(1) who as of the end of the taxable year has not attained age 27.

2. The Trust's tax-exempt status under § 501(c)(9) will not be jeopardized if HRA benefits are provided to Participants' domestic partners who are not dependents within the meaning of § 152 and Treas. Reg. § 1.501(c)(9)-3(a), as long as the total amount of all impermissible benefits provided, inclusive of the benefits to domestic partners who are not dependents under § 152 (and associated taxes) is three percent (3%) or less of the total amount of benefits paid to all Plan Participants and beneficiaries in any Plan year.

Xxxxxxxxxx Xxxxxxxxxxxxxxx Xxxxxxxxx

3. The HRA coverage provided to a domestic partner who is a dependent of the Participant within the meaning of § 152 (or child as defined in § 152(f)(1), is not includible in the Participant's gross income and is not wages for employment tax purposes.

4. The fair market value of the coverage provided by the Plan to a non-dependent domestic partner of a Participant within the meaning of § 152 is includible in the gross income of the Participant under § 61, and is wages for FICA, FUTA, and income tax withholding purposes. The amount of employee FICA attributable to the coverage that is paid by the Plan on the Participant's behalf that is not withheld from the Participant's wages is also includible in the Participant's income and is wages for employment tax purposes. The amount of income tax withholding attributable to the coverage that is paid by the Plan on the Participant's behalf in the same calendar year as the wages are paid that is not withheld from the Participant's wages is also includible in the Participant's income and is wages for employment tax purposes. Therefore, the gross-up amount determined under Rev. Proc. 81-48 is the amount includible in the gross income of the Participant by reason of the health coverage for a non-dependent domestic partner and is the amount of the Participant's wages for FICA, FUTA, and income tax withholding purposes. Such amount is to be reported on the Form W-2 provided to the Participant.

5. Neither the Participant nor the Participant's domestic partner who is not a dependent within the meaning of § 152 will include any amount received as payment or reimbursement of HRA benefits to the extent that the fair market value of the HRA coverage provided to the domestic partner was included in the gross income of the Participant pursuant to § 104(a)(3).

6. The Trust is the employer under § 3401(d)(1) for purposes of the employment taxes on the amount of wages that result from the HRA coverage provided to a Participant's non-dependent domestic partner. Thus, the Trust is required to withhold income tax and the employee portion of the FICA tax on such wages. The Trust must also pay the employer portion of the FICA tax and the FUTA tax.

7. For purposes of determining the amount of income tax to withhold, the supplemental wages paid by the § 3401(d) employer are considered separately from wages paid by the common law employer.

8. Under Announcement 85-113, the Trust may treat the coverage as provided on an annual basis for purposes of employment tax withholding, FICA and FUTA.

This ruling will be made available for public inspection under section 6110 of the Code after certain deletions of identifying information are made. For details, see enclosed Notice 437, *Notice of Intention to Disclose.* A copy of this ruling with deletions that we intend to make available for public inspection is attached to Notice 437. If you disagree with our proposed deletions, you should follow the instructions in Notice 437.

This ruling is directed only to the organization that requested it. Section 6110(k)(3) provides that it may not be used or cited by others as precedent.

Xxxxxxxxxx Xxxxxxxxxxxxxxx Xxxxxxxxx

This ruling is based on the facts as they were presented and on the understanding that there will be no material changes in these facts. This ruling does not address the applicability of any section of the Code or regulations to the facts submitted other than with respect to the sections described. Because it could help resolved questions concerning your federal income tax status, this ruling should be kept in your permanent records.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

In accordance with the Power of Attorney currently on file with the Internal Revenue Service, we are sending a copy of this letter to your authorized representative.

Sincerely,

Theodore R. Lieber
Manager, Exempt Organizations
Technical Group 3

Enclosure
Notice 437