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Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

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, ID No.

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Refer Reply To:
CC:EEE:EB:HW
PLR-104673-19

Date:
August 13, 2019

TY:

Legend

Plan =

Dear :

This responds to your letter, dated February 15, 2019, submitted by your authorized representative, requesting rulings regarding a prior Private Letter Ruling (8250058), dated September 15, 1982, that discussed the tax treatment of the Plan's "unfunded" benefit program, the details of which are set forth below, as well as the tax treatment of distributions of excess reserves in the Plan.

In the first request, the Plan asks that we reconsider Private Letter Ruling 8250058 to determine whether vacation benefit amounts paid to employees of employers that have not contributed to the Plan (unfunded benefits) will constitute "wages" for purposes of sections 3121(a) (Federal Insurance Contributions Act (FICA) taxes), 3306(b) (Federal Unemployment Tax Act (FUTA) taxes), and 3401(a) (Federal income tax withholding) of the Internal Revenue Code (Code), and whether these amounts should be reported on Form W-2 by the Plan.

In the second request, the Plan asks whether additional, discretionary payments from the Plan's surplus to employees (supplemental distributions) will affect the exempt status of the Plan. Similar to the first request, the Plan also asks whether these supplemental distributions constitute "wages" for FICA, FUTA, and Federal income tax withholding purposes and whether these amounts should be reported on Form W-2.

The facts, as represented, are as follows.

The Plan is an organization described in section 501(c)(9) of the Code. Under the Plan, employers are required to contribute a specified amount for each hour worked by each of their employees. Employers' payments to the Plan are due in regular monthly installments. The Plan maintains records of the payments received with respect to the work performed by each employee and credits these payments to a vacation account for such employee. Sums credited to vacation accounts for work performed from March 1 of each year to the last day of February of the following year are distributed twice a year, on or about July 1 and December 1 of the succeeding calendar year, by checks or direct deposit for the employees who request to receive their vacation benefits.

Upon termination of the Plan, any and all money remaining therein, after payment of all expenses, is required to be paid out to the persons entitled to it until such money is exhausted. If the Plan is amended or terminated, no portion of the contributions under the Plan may revert to or become recoverable by any of the employers, any signatory association, any individual employer, the union, or any local union or district council.

For the purpose of funding vacation benefits with respect to hours of work of employees for whom contributions have not been received, the Plan created an unfunded benefit program that distributes the appropriate amount of benefits to employees of delinquent employers upon proof that those employees actually worked the number of hours for which benefits are claimed, that the unpaid amount is uncollectible after reasonable efforts by the Plan, and that there is no collusion between the employees and the employer. Funding for the unfunded benefit program is derived from interest earned on deposits of the Plan, liquidated damages paid to the Plan by delinquent employers, and forfeitures made by employees who failed to claim benefits and whose benefits, therefore, have reverted to the Plan. The facts indicate that the employers that do not contribute to the Plan nonetheless agreed to treat these unfunded benefits as wages at the time services are performed and correspondingly withhold FICA and Federal income taxes with respect to the amounts that should have been contributed to the fund from employees' cash wages unrelated to the vacation benefit.

The Plan previously requested a Private Letter Ruling on the tax treatment of this program. We issued Private Letter Ruling 8250058 on September 15, 1982, concluding that the unfunded benefits constitute "other benefits," under section 501(c)(9) of the Code, that the unfunded benefit distributions are "wages" for all Federal employment tax purposes at the time the distributions are includable in a recipient's gross income under section 83, that the Plan is responsible for withholding Federal income tax on the distributions because the Plan has control over the wage payments under section 3401(d)(1), and that the Plan must generally report the distributions on Form W-2.

In the present Private Letter Ruling request, the Plan newly proposes to make supplemental distributions to employees from its reserve funding. These supplemental

distributions would be in addition to employees' existing entitlements to benefit distributions from the Plan. The Plan proposes to pay out these supplemental distributions to employees in proportion to vacation benefits that employees are entitled to receive based on services they perform for employers that participate in the Plan.

The Plan has requested four rulings:
(1) That the conclusions in Private Letter Ruling 8250058 be reconsidered, more specifically that the Plan is not responsible for FICA, FUTA, and Federal income tax withholding with respect to the unfunded benefits it pays to employees, and that the Plan does not have to report unfunded benefits on Form W-2;
(2) That the supplemental distributions will not affect the exempt status of the Plan;
(3) That the supplemental distributions do not constitute wages subject to FICA, FUTA, and income tax withholding; and
(4) That the Plan is not required to issue Form W-2 by reason of the supplemental distributions.

The tax consequences of a transfer of property in connection with the performance of services are governed by section 83 of the Code. Section 83(a) provides the general rule that if, in connection with the performance of services, property is transferred to any person other than the person for whom the services are performed, the excess of (1) the fair market value of such property (determined without regard to any restriction other than a restriction which, by its terms, will never lapse) at the first time the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over (2) the amount (if any) paid for such property, shall be included in the gross income of the person who performed such services in the first taxable year in which the rights of the person having the beneficial interest in such property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable.

Section 1.83-1(a) of the Income Tax Regulations provides that property transferred to an employee is not taxable under section 83(a) of the Code until it has been transferred (as defined in section 1.83-3(a) of the regulations) to such person and becomes substantially vested (as defined in section 1.83-3(b)) in such person.

Section 1.83-3(a) of the regulations provides that a transfer of property occurs when a person acquires a beneficial ownership interest in such property (disregarding any lapse restriction, as defined in section 1.83-3(i)).

Section 1.83-3(b) of the regulations provides that for purposes of section 83 of the Code and the regulations thereunder, property is substantially nonvested when it is subject to a substantial risk of forfeiture and is nontransferable. Property is substantially vested for such purposes when it is either transferable or not subject to a substantial risk of forfeiture.

Section 1.83-3(c) of the regulations provides that a substantial risk of forfeiture exists where rights in property that are transferred are conditioned, directly or indirectly, upon the future performance, or refraining from performance, of substantial services by any person.

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

Generally, every employer making payment of wages must withhold federal income tax pursuant to section 3402 of the Code. For income tax withholding purposes, the term "wages" means all remuneration for services performed by an employee for the employer unless a specific exception under section 3401(a) applies. In general, income tax is withheld from an employee's wages when the wages are actually or constructively paid to the employee. See section 31.3402(a)-1 of the regulations. FICA taxes are imposed on employees and employers under sections 3101 and 3111 of the Code, respectively. Under section 3102, employers have a duty to collect the employee's share of FICA taxes under section 3101 by withholding the amount of the tax from the employee's wages. For purposes of FICA and FUTA, the term "wages" means, with certain exceptions, all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. See sections 3121(a) and 3306(b). Typically, wages are subject to FICA and FUTA tax when the wages are actually or constructively paid to the employee. See sections 31.3121(a)-2, 31.3301-2, 31.3301-3(b), and 31.3301-4 of the regulations.

"Vacation allowances" are "wages" for all Federal employment tax purposes. See sections 31.3121(a)-1(g), 31.3306(b)-1(g) and 31.3401(a)-1(b)(3) of the regulations (relating to FICA, FUTA, and Federal income tax withholding, respectively).

Under section 3401(d) of the Code, the term "employer" generally means the person for whom an individual performs any service of whatever nature as the employee of such person. Under section 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. Section 31.3401(d)-1(f) of the regulations 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 section 3401(d)(1) of the Code. However, Otte v.

United States, 419 U.S. 43 (1974), holds that a person who is an employer under section 3401(d)(1) is also the employer for purposes of FICA tax withholding under section 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 section 3111, which imposes FICA excise tax on employers, and for purposes of section 3301, which imposes the FUTA tax on employers. See, e.g., In re Armadillo Corp., 561 F.2d 1382 (10th Cir. 1977).

Section 6051(a) of the Code generally provides that every person required to deduct and withhold from an employee a tax under section 3101 (FICA) or section 3402 (Federal income tax withholding), or who would have been required to deduct and withhold a tax under section 3402 if the employee had claimed no more than one withholding exemption, or every employer engaged in a trade or business who pays remuneration for services performed by an employee, shall furnish to each such employee a written statement showing certain specific items, including the name of such person and the total amount of wages.

Section 6051(c) of the Code further provides that the statement required to be furnished shall contain such other information and be in such form as the Secretary may by regulations prescribe. Section 31.6051-1 of the regulations generally provides that if an employer pays wages subject to Federal income tax withholding or FICA tax to an employee during the calendar year, the employer must provide the employee with a Form W-2.

Section 501(c)(9) of the Code provides that an entity is a voluntary employees' beneficiary association to the extent that it provides payment of life, sick, accident, or other benefits to the members of the voluntary employees' beneficiary association. Section 1.501(c)(9)-3(d) of the regulations clarifies that "other benefits" only include benefits that are similar to life, sick, or accident benefits.

Therefore, based solely on the facts presented, we rule as follows.

In Private Letter Ruling 8250058, we determined that an unfunded benefit was a "vacation allowance" and find no different or additional facts or circumstances in the current submission that would warrant altering this analysis. In reaching this conclusion, we noted that eligibility and qualification for both the unfunded benefit and the regular, "funded" vacation benefit were similarly conditioned upon an employee establishing that he or she performed services in the employment of a participating employer. We determined that employees completely relinquish their contractual right to a "funded" vacation benefit as a condition precedent to their receipt of an unfunded benefit paid from the Plan. Based upon these determinations, we concluded that the unfunded benefit was not merely a gratuitous payment by the Plan. In effect, the unfunded benefit was, and continues to be, a "vacation allowance" and, thus, "wages" within the meaning of sections 3121, 3306, and 3401 of the Code.

In order for funding of the unpaid hours of an employee by the Plan to occur, the program requires that the Board of Trustees, or its duly authorized agents, after having taken all reasonable steps to collect the unfunded benefit, determine that such unfunded benefit, in whole or in part, is uncollectible and no collusion exists between the employee and the delinquent employer with respect to the benefits claimed. At the time when the Board of Trustees, or its duly authorized agents, approves the claim for payment, the assets to be used to fund the employee's claim are set aside in trust for the benefit of the employee. Accordingly, at that time the benefit is taxable under section 83 of the Code to the extent of the employee's beneficial, substantially vested interest in the trust property. When the benefit is taxable under section 83, it is considered actually paid for Federal employment tax purposes.

It has been suggested that because the unfunded benefit is paid from amounts that have been previously taxed as "wages" to the recipients, the benefit cannot be subject to Federal employment taxes again. On the contrary, when an employer fails to contribute its employee's vacation benefit to the Plan, there is no transfer of property under section 83 of the Code. Accordingly, there is no actual or constructive payment to the employee. In the absence of an actual or constructive payment, no employment taxes are required to be withheld or paid. The Plan pays unfunded benefits from interest earned on the Plan's assets, liquidated damages received, and forfeited benefits, and an employee does not have any beneficial ownership interest in such property prior to when the Board of Trustees, or its duly authorized agents, approves a claim for payment and sets aside assets for the benefit of that employee. At that time, under section 83, the unfunded benefit becomes taxable to the employee as a transfer of property to the extent of the employee's beneficial, substantially vested interest in the trust assets. An employer's failure to contribute to the Plan on its employee's behalf does not control the tax withholding requirements for payments that have not been taxed previously as "wages."

Regarding the treatment of the supplemental distributions, the facts indicate that employees will not receive a substantially vested interest in the excess reserve funds prior to actual payment of the supplemental distribution. Accordingly, the supplemental distributions are not taxed under section 83 of the Code and are, instead, taxable at the time of actual or constructive payment. However, to the extent that the employees receive a substantially vested beneficial ownership interest in the excess reserve funds prior to actual or constructive payment, the excess reserve funds will be taxable to employees under section 83 at the time the employees receive a substantially vested beneficial ownership interest in the excess reserve funds. In addition, the supplemental distributions are "wages" for purposes of FICA, FUTA, and Federal income tax withholding and do not fall within an exception. To participate in the Plan, employees are required to perform services for their respective employers and the supplemental distributions are determined based on the services that these employees performed for their respective employers. Thus, the supplemental distributions constitute remuneration

for employment and are, therefore, “wages” within the meaning of sections 3121, 3306, and 3401.

Accordingly, we conclude that the unfunded benefit and supplemental distribution payments are “wages” for all relevant Federal employment tax purposes at the time that the unfunded benefit is includible in the gross income of the recipient under section 83 of the Code and at the time the supplemental distribution payment is actually or constructively paid. See, e.g., section 31.3121(a)-2 of the regulations.

Moreover, because the Plan, and not the employers, has the sole right to determine both an employee’s qualification for, and the amounts of the unfunded benefit and supplemental distribution, the Plan has “control” (within the meaning of section 3401(d)(1) of the Code) of the payment of wages for Federal income tax withholding purposes and is, therefore, the section 3401(d)(1) employer. Accordingly, the Plan is the employer for purposes of FICA, FUTA, and income tax withholding. The plan must generally deduct and withhold FICA and Federal income tax from unfunded benefits and supplemental distributions paid to employees. It is also generally responsible for the excise portion of FICA tax under section 3111 and FUTA contributions under section 3306.

Because the Plan is generally required to deduct taxes under sections 3101 and 3402 of the Code, the Plan must generally furnish the recipients of unfunded benefits or supplemental distributions with a Form W-2 under section 6051 and the regulations thereunder.

The final issue to consider is the effect of the supplemental distributions on the Plan’s exempt status. Determining if the supplemental distributions will affect the Plan’s exempt status depends on whether the benefits they provide constitute “other benefits” within the meaning of section 501(c)(9) of the Code and section 1.501(c)(9)-3(d) or (e) of the regulations.

In order for a “vacation allowance” to be considered appropriate “other benefits,” it must be distinguished from a savings arrangement, which is a nonqualifying benefit under section 1.501(c)(9)-3(f) of the regulations. An appropriate “vacation allowance,” therefore, is one provided in the manner described in example (1) of section 1.501(c)(9)-3(g). This includes compliance with the rules governing withholding income and FICA taxes. In order to make a supplemental distribution, the facts indicate that the Plan allocates supplemental distribution amounts in proportion to known “vacation allowance” over a reasonable period of time. If the Plan adheres to these requirements, its exempt status will not be adversely affected by the operation of the unfunded benefits program, as addressed in Private Letter Ruling 8250058, or by the supplemental distributions.

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

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

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Sincerely,

Kevin Knopf
Senior Technician Reviewer, Health & Welfare Branch, Office of Associate Chief Counsel (Employee Benefits, Exempt Organizations, and Employment Tax)

cc: