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DEPARTMENT OF THE TREASURY
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR PATRICE SADOWSKI
SECTION 218 COORDINATOR, NEW JERSEY DISTRICT

FROM: Harry Beker
Branch Chief Branch 6 CC:EBEO:BR6

SUBJECT: Workmen's Compensation Benefits

This Field Service Advice responds to your memorandum dated February 11, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND

Statute =

State =

ISSUE

Whether amounts received by an employee under the Statute are subject to income and employment taxes.

CONCLUSION

The full amount received under the Statute is excludable from the employee's gross income under section 104(a)(1) of the Internal Revenue Code (the Code). However, the amounts are nevertheless subject to Federal Insurance Contributions Act (FICA) taxes to the extent they exceed the amount awarded under the State's workmen's compensation law.

WTA-N-104310-00

LAW AND ANALYSIS

The Statute provides:

Whenever any employee, entitled to sick leave under this chapter, is absent from his post of duty as a result of a personal injury caused by an accident arising out of and in the course of his employment, his employer shall pay to such employee the full salary or wages for the period of such absence for up to one calendar year without having such absence charged to the annual sick leave or the accumulated sick leave ... Salary or wage payments provided in this section shall be made for absence during the waiting period and during the period the employee received or was eligible to receive a temporary disability benefit ... Any amount of salary or wages paid or payable to the employee pursuant to this section shall be reduced by the amount of any workman's compensation award made for temporary disability.

Section 61 of the Code provides that gross income means all income from whatever source derived, including compensation for services.

Section 104(a)(1) of the Code states that, generally, gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations states that section 104(a)(1) excludes from gross income amounts that are received by an employee under a workmen's compensation act or under a statute in the nature of a workmen's compensation act that provides compensation to employees for personal injuries or sickness incurred in the course of employment. However, section 104(a)(1) does not apply to a retirement pension or annuity to the extent that it is determined by reference to the employee's age or length of service, or the employee's prior contributions, even though the employee's retirement is occasioned by an occupational injury or sickness. Section 104(a)(1) also does not apply to amounts which are received as compensation for a nonoccupational injury or sickness nor to amounts received as compensation for an occupational injury or sickness to the extent that they are in excess of the amount provided in the applicable workmen's compensation act or acts.

WTA-N-104310-00

In Rev. Rul. 83-91, 1983-1 C.B. 38, the taxpayer was awarded benefits by the state workmen's compensation commissioner. The taxpayer was also entitled to disability retirement benefits under a statute in the nature of a workmen's compensation act that exceeded the workmen's compensation award. The taxpayer elected to receive the larger retirement benefit in lieu of the payment from the workmen's compensation commission. The entire amount of the disability retirement benefit was excludable from the taxpayer's gross income.

You believe the Statute is distinguishable from the provision considered in Rev. Rul. 83-91 because the taxpayer in the revenue ruling could choose either the workmen's compensation benefits or the disability retirement benefits. On the other hand, under the Statute, because the payments are reduced by the amount of any workmen's compensation award, you believe the Statute makes payments "in excess of the amount provided in the applicable workmen's compensation act or acts" and therefore should be taxable.

However, Rev. Rul. 83-91, holds that if disability payments are made pursuant to a statute in the nature of a workmen's compensation act, those payments are not subject to the limitation in section 1.104-1(b) of the regulations that provides that the exclusion is disallowed to the extent that the amounts received are in excess of the amounts receivable under the applicable workmen's compensation acts. The limitation in the regulation merely denies exclusion under section 104(a)(1) to the extent that amounts received are in excess of the amounts provided by the regular workmen's compensation act or by a statute in the nature of a workmen's compensation act, whichever is the basis for the exclusion in the particular case. It does not apply to limit the exclusion of payments made under a statute in the nature of a workmen's compensation act to the amount allowable under the state's general workmen's compensation statute.

Rev. Rul. 83-91 also cites to Rev. Rul. 59-269, 1959-2 C.B. 39, which states that, "[T]he limitation [i.e., amounts in excess of the amount provided in the applicable workmen's compensation act or acts] ... does not apply to statutes in the nature of workmen's compensation which give recovery in lieu of or supplemental to workmen's compensation which may be in excess of that received under the ordinary workmen's compensation act." [Emphasis added]

The Statute limits payments to employees who are absent from work due to personal injury arising out of and in the course of employment and amounts paid are not determined by reference to the employee's age, length of service or prior contributions. The Statute is therefore a statute in the nature of a workmen's

WTA-N-104310-00

compensation act. Accordingly, the full amount received under the Statute is excludable from gross income under section 104(a)(1) of the Code.¹

A finding that amounts received under a statute in the nature of a workmen's compensation act are excludable from gross income does not, of course, address the issue of whether those amounts are "wages" subject to FICA taxes under section 3121 of the Code. We note that the recent PLR concerning the Statute only addressed income tax withholding and did not address employment taxes in any way.

Sections 3101 and 3111 of the Code provide for FICA taxes on employees and employers, respectively. The FICA tax is based on a percentage of wages received or paid with respect to employment. These taxes include the Social Security and Medicare taxes imposed on both the employer and the employee.

Section 3121(a) of the Code provides, generally, that for FICA 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. Section 3121(a)(2)(A) provides that the term does not include the amount of any payment on account of sickness or accident disability, but, in the case of payments made to an employee or any of his dependents, excludes only payments which are received under a workmen's compensation law.

Section 3121(b) of the Code provides generally, that the term "employment" means any service, of whatever nature, performed by an employee.

Section 3121(b)(7) of the Code excepts from the definition of the term "employment" service performed in the employ of a State, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby, with certain exceptions. Section 3121(b)(7)(E) provides that service included under an agreement entered into pursuant to section 218 of the Social Security Act is considered "employment." Section 3121(d)(4) provides that the term "employee" includes any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

The flush language at the end of section 3121(a) of the Code provides that nothing in the regulations prescribed for purposes of chapter 24 of the Code (relating to

¹This conclusion is consistent with that reached in a recent Private Letter Ruling (PLR) concerning the Statute. A PLR is directed only to the taxpayer on whose behalf it was requested and, under section 6110(k)(3) of the Code, may not be used or cited as precedent.

WTA-N-104310-00

income tax withholding) which provides an exclusion from "wages" as used in that chapter shall be construed to require a similar exclusion from "wages" in the regulations prescribed for FICA purposes.

Section 3121(a)(4) of the Code provides that the term "wages" for FICA tax purposes does not include any payment on account of sickness or accident disability, or medical or hospitalization expenses in connection with sickness or accident disability, made by an employer to, or on behalf of, an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for such employer.

In the absence of any explicit FICA tax exclusion pertaining to amounts received under a statute in the nature of a workmen's compensation act, payments made under the Statute (in excess of the State's workmen's compensation award) must be considered wages for FICA tax purposes until such time as an employee has been absent from work and qualifies for the exclusion provided in section 3121(a)(4) of the Code. (i.e., after the expiration of 6 calendar months).

However, where an employee receives a workmen's compensation award under the State's workmen's compensation law and those amounts are either returned to or retained by the employer, the payments are treated as payments under the workmen's compensation act and are not subject to FICA wages under section 3121(a)(2)(A) of the Code.²

Please call if you have any further questions.

HARRY BEKER

²There are other exceptions to the definition of "wages" for FICA tax purposes listed in section 3121(a). All of the provisions of section 3121(a) should be considered to determine if any apply.