Internal Revenue Service

Department of the Treasury

Washington, DC 20224

Index Numbers: 61.00-00, 83.00-00, 162.00-00, 461.00-00, 3121.01-00, 3401.01-00

Number: **199945015**
Release Date: 11/12/1999

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Telephone Number:

Refer Reply To:
CC:EBEO:Br2-PLR-119612-97
Date:
August 10, 1999

Legend

Company =

Fund =

Union =

Trust Agreement =

Association =

Year X =

Dear Sir or Madam:

This is in reply to your request for a ruling on behalf of the Company and the Fund concerning certain income and employment tax consequences of the payment of contributions to and benefits paid from the Fund.

The facts submitted are that the Fund was established in Year X pursuant to a master collective bargaining agreement (“Agreement”) between the Association and Union. Company is a member of the Association.

The stated purposes of the Fund are to increase the job security and employment opportunities of Union members (''Employees'') while preserving and improving their wage and benefit levels. These purposes are achieved in two ways: (1) by providing

benefits and wage supplements to Union members employed by Association members ("Employers") who must compete with nonunion contractors for projects; and (2) by permitting Employers to compete more effectively with nonunion contracts by reducing their labor costs. To provide these benefits, the Agreement requires Employers to make irrevocable contributions to the Fund based on the hours worked by Employees. Employers who fail to make required contributions for two months must furnish a surety bond to the Fund. Contributions are allocated to an account in the Fund to provide wage supplements to employees.[1]

The Fund's governing instrument is the Trust Agreement. Under the Trust Agreement, an Employer can apply for financial assistance ("Credit") for a project (“Targeted Project”) if competing bidders for that project employ nonunion labor. Once a Credit is approved, amounts from the Fund up to the Credit amount are transmitted to the Employer based on the number of hours worked by Employees on the Targeted Project. The Employer uses the amounts received from the Fund, in combination with its own funds, to pay wages to the Employees working on the Targeted Project at the rates required under the Agreement, through the Employer’s payroll system. Amounts received from the Fund will include the employment tax and incidental administrative expenses incurred by the Employer with respect to the wage supplements. When the total amount received from the Fund equals the amount of the Credit approved for a Targeted Project, the Employer must continue to pay the Employees the required wage rates from its own funds. An Employer who is awarded a Credit may not transfer that Credit to any other project.

Although the Fund has one administrator appointed by the Union and one by the Association, all distributions from the Fund are approved solely by the Union. Generally, the amount of funds available for a Targeted Project is based on the Project's size and the Employer's aggregate benefit contributions for the prior three months. However, in special circumstances requiring prior approval, distributions may exceed an Employer's contributions. To conserve Fund assets, the Administrators may place a temporary moratorium on the granting of Credits.

The Trust Agreement provides that, except for overpayments of contributions, no Employer or Employee has any rights or interests (vested or otherwise) in the assets of the Fund. However, Credits or contributions may be assigned with the permission of the Trustees. Also, nothing in the Trust Agreement prohibits the return of contributions to the extent permitted by applicable law. If the Fund is terminated, the Trustees have sole control over the distribution of any remaining assets.

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[1] Employer contributions are also made to another account within the Fund for the purpose of offsetting an Employer’s obligation to contribute to various benefit plans provided for under the Agreement. Contributions to that account are not at issue in this ruling request,

You have requested several rulings concerning the tax consequences of contributions to and distributions from the Fund for the purpose of supplementing the hourly earnings of Members on the Targeted Projects: (1) Employer contributions to the Fund for this purpose are deductible as ordinary and necessary business expenses under section 162 of the Code when they are paid over to the Fund; (2) no portion of an Employer's contributions to the Fund is subject to the payment and withholding of income or employment tax pursuant to §§ 61, 3101, 3121, 3401, or 3402; (3) Fund distributions to supplement wages earned on Targeted Projects are includible in the income of each employee when received pursuant to section 61 of the Code, and are subject to employment and income tax withholding and payment by the Employer pursuant to §§ 3101, 3121, 3401, and 3402; (4) the Fund and its Trustees and Administrators will be "other persons" for the purposes of § 3505 of the Code and will not be personally liable for income and employment taxes withheld from amounts supplied to an Employer for distribution as hourly wage supplementation to its Employees, unless the Fund, a Trustee, or an Administrator had actual notice or knowledge that the Employer did not intend to or could not pay over such taxes on a timely basis.

Whether Contributions to Fund are Includible in Gross Income of Employee

Under § 83(a), if, in connection with the performance of services, property is transferred to any person other than the service recipient, the excess of the fair market value of the property, determined on the first day that the transferee's rights in the property are not subject to a substantial risk of forfeiture, over the amount paid for the property is included in the service provider's gross income for the taxable year which includes that day.

Stated differently, property is not taxable under § 83 until it is transferred to and substantially vested in the service provider (or beneficiary thereof). A "transfer" of property occurs when a person acquires a beneficial ownership interest in the property (disregarding any "lapse restriction," as defined in § 1.83-3(i) of the Income Tax Regulations). See § 1.83-3(a)(1). Property is "substantially vested" when it is either transferable or not subject to a substantial risk of forfeiture. See § 1.83-3(b).

Section 1.83-3(e) of the regulations provides that, for purposes of § 83 and the regulations thereunder, the term "property" includes real and personal property other than money or an unfunded and unsecured promise to pay money or property 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.

Applying the above rules to the circumstances of this case, we conclude that no transfer of property occurs for purposes of § 83 as a result of contributions made to the Fund. We reach this conclusion because, under the terms of the Trust Agreement, no employee has any rights or interests in the assets of the Fund, and because those

assets are held available and will be used to satisfy the Employers' obligations to pay wages under the Agreement.

Section 61 provides that gross income means all income from whatever source derived, unless excluded by law. Section 61(a)(1) specifies that compensation for services, including fees, commissions, fringe benefits, and similar items are included.

An employee has no rights to amounts in the Fund. The assets in the Fund are not credited to a specified employee's account or set apart for him or her in any way. Rather, an employee only obtains a right to a payment from Company after the performance of services for Company. Accordingly, an Employee has no income upon Company's contribution to the Fund under §§ 61 and 451; rather he or she has income when he or she receives remuneration from Company (including Fund distributions paid from the Company) for services performed.

Deductibility of Contributions to Fund by Company under § 162

Section 162 of the Code provides that a taxpayer may deduct all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 1.162-10(a) of the Income Tax Regulations further provides, in part, that amounts paid or incurred within the taxable year for dismissal wages, unemployment benefits, guaranteed annual wages, vacations, or a sickness, accident, hospitalization, medical expense, recreational, welfare or similar benefit plan (other than deferred compensation plans referred to in § 404 of the Code) are deductible under § 162(a) if they are ordinary and necessary expenses of the trade or business. Rev. Rul. 72-489, 1972-2 C.B. 89, holds that payments to a wage supplementation plan, pursuant to a collective bargaining agreement, are deductible. See also Rev. Rul. 58-238, 1958-1 C.B. 90 (contributions made to a joint apprenticeship and training trust fund which resulted from a collective bargaining agreement were deductible as ordinary and necessary business expenses); Rev. Rul. 74-51, 1974-1 C.B. 45 (payments to an education fund, as required under a collective bargaining agreement, are deductible under § 162 rather than § 170 because the payments were made by the taxpayer with a reasonable expectation of direct economic benefit, commensurate with the amount of the transfer); and Rev. Rul. 77-406, 1977-2 C.B. 56 (required contributions to a union fund for maintaining and operating a health facility for the benefit of the union membership and for maintaining group life insurance and medical insurance for covered union members and their families are the type of payments described in § 1.162-10 of the regulations).

Under the facts given in the present case, contributions to the Fund will relate to Company's regular conduct of business because the payments to the Fund will be based on the wages earned by Company's employees. Furthermore, the payments are required by a collective bargaining agreement which it negotiated and entered into with the Union that represents its employees. The collective bargaining agreement appears

to be the product of arm's length negotiation with the Union which, if followed, will benefit all parties concerned. Specifically, Company will benefit because the Fund will enable it to compete more effectively in the market place with contractors employing nonunion workers. Thus, the payments relate to the regular conduct of Company's trade or business. In addition, Company does not have any present or reversionary interest in the Fund. Therefore, Company's contributions to the Fund, a union fund to finance wage supplements pursuant to a collective bargaining agreement, are deductible as ordinary and necessary business expenses under § 162 of the Code.

However, the timing of deductions, including those allowable under § 162 of the Code is regulated under principles set forth in § 461 of the Code. Section 461(a) of the Code provides that the amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(1) of the Income Tax Regulations provides, in part, that under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid.

Section 1.461-1(a)(2) of the regulations provides, in part, that under the accrual method of accounting, a liability (as defined in §1.446-1(c)(1)(ii)(B)) is incurred, and generally is taken into account for federal income tax purposes, in the taxable year in which all the events have occurred that establish the fact of liability, the amount of the liability can be determined with reasonable accuracy, and economic performance has occurred with respect to the liability.

Section 461(h)(1) of the Code provides that for purposes of this title, in determining whether an amount has been incurred with respect to any item during any taxable year, the all events test shall not be treated as met any earlier than when economic performance with respect to such item occurs. Section 461(h) establishes general rules of thumb for determining when economic performance occurs. Section 461(h)(2)(B) provides, for example, that in the case of a liability of the taxpayer to provide property or services, economic performance occurs when the taxpayer provides such property or services. Rules for determining when economic performance occurs for property or services provided to the taxpayer, for the use of property by the taxpayer, or with respect to workers compensation or tort liabilities are also provided. The Income Tax Regulations at § 1.461-4(g) provide additional rules for determining when economic performance occurs with respect to other payment liabilities, including liabilities arising for breach of contract, violation of law, rebates and refunds, awards, prizes and jackpots, insurance, warranty and service contracts, and liabilities for taxes.

Section 1.461-4(g)(7) of the regulations generally provides that in the case of a taxpayer's liability for which economic performance rules are not provided elsewhere in

this section or in any other internal revenue regulation, revenue ruling or revenue procedure, economic performance occurs as the taxpayer makes payments in satisfaction of the liability to the person to whom the liability is owed.

Finally, § 1.461-4(g)(1) of the regulations provides that the term payment, as used in the context to define economic performance, has the same meaning as is used when determining whether a taxpayer using the cash receipts and disbursements method of accounting has made payment. Thus, for example, payment includes the furnishing of cash or cash equivalents and the netting of offsetting accounts.

In the present case, Company's liability to make payments to the Fund for wage supplementation is a payment liability (as opposed, for example, to a service liability, a liability to provide property, or a liability arising from the receipt or use of property). It is not, however, a payment liability of the type for which any specific provision or mention is made in the regulations. Therefore, the default provision at § 1.461-4(g)(7) of the regulations applies. As noted above, subsection (g)(7) provides that for this type of liability, economic performance occurs when payment is made to the person to whom the liability is owed. Under the Agreement, the Fund is the person to whom Company owes this liability to make payments. Thus with respect to each payment made by Company to the Fund, the liability is duly incurred by Company whether Company uses the accrual method or the cash receipts and disbursements method of accounting. The all events test for accrual is satisfied because the liability becomes fixed as union-member employees of Company earn wages and the amount of the liability, which is based on the number of hours worked by these employees, is determinable with reasonable accuracy. In addition, there is economic performance with respect to the payments to the Fund as the payments are made to the Fund which, pursuant to the collective bargaining agreement, is the person to whom the liability is owed.

Employment Tax Issues

Federal Insurance Contributions Act (FICA) taxes are imposed by §§ 3101 and 3111 on “wages” as that term is defined in section 3121(a). For FICA purposes, § 3121(a) broadly defines “wages” as all remuneration for employment, with certain specific exceptions.

Section 3301 under the Federal Unemployment Tax Act (FUTA) imposes a tax on every employer equal to a specified percentage of wages paid in the calendar year. For FUTA purposes, the term “wages” is broadly defined in § 3306(b) as all remuneration for employment with certain specific exceptions.

Section 3402(a), relating to the Collection of Income Tax at Source on Wages (income tax withholding), requires every employer making payment of wages to deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary. Section 3401(a) defines wages for income tax

withholding purposes as all remuneration for services performed by an employee for his employer with certain specific exceptions.

Section 31.3101-3 of the Employment Tax Regulations provides that the FICA employee tax attaches at the time that the wages are received by the employee. Section 31.3102-1(a) of the regulations provides that the employer shall make the collection of FICA employee tax by deducting or causing to be deducted the amount of the employee tax from such wages as and when paid. Section 31.3111-3 of the regulations provides that the FICA employer tax attaches at the time that the wages are paid by the employer. Section 31.3301-2 provides that the FUTA tax for any calendar year is measured by the amount of wages paid by the employer during such year with respect to employment. Section 31.3402(a)-1(b) provides that the employer is required to collect federal income tax by deducting and withholding the amount thereof from the employee's wages as and when paid, either actually or constructively.

Section 31.3121(a)-2 of the regulations, relating to the FICA, provides that in general, wages are received by an employee at the time that they are paid by the employer to the employee. Generally, wages are paid by an employer at the time that they are actually or constructively paid. Wages are constructively paid when they are credited to the account of or set apart for an employee so that they may be drawn upon by him at any time although not then actually reduced to possession. To constitute payment in such a case the wages must be credited to or set apart for the employee without any substantial limitation or restriction as to the time or manner of payment or condition upon which payment is to be made, and must be made available to him so that they may be drawn upon him at any time, and their payment brought within his own control and disposition. Section 31.3301-4 and section 31.3402(a)-1(b) contain similar language concerning when wages are paid for FUTA and federal income tax withholding purposes, respectively.

In the instant case, federal employment taxation would not apply upon the contribution by Employers to the Fund because contributions by Employers to the Fund are not includible in the income of Employees under § 61 or 83 and because an Employer's contribution to the Fund does not constitute a wage payment that has been actually or constructively received by an Employee.

Section 3401(d)(1) provides that, for purposes of income tax withholding, the term "employer" means the person for whom an individual performs or performed any service, of whatever nature, as the employee of such person, except that if the person for whom the individual performed the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of the definition of wages under § 3401(a)) means the person having control of the payment of the wages.

Section 31.3401(d)-1(f) of the regulations provides that if the person for whom the services are or were performed does not have legal control of the payment of the wages for such services, the term employer means (except for the purpose of the definition of wages), the person having such control. For example, where wages, such as certain types of pensions or retired pay, are paid 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.

Section 31.3401(d)-1(h) of the regulations provides that it is a basic purpose to centralize in the employer the responsibility for withholding, returning, and paying the tax, and for furnishing the statements required under § 6051 and § 31.6051-1 of the regulations. The special definitions of the term employer in paragraphs (e), (f), and (g) of this section are designed solely to meet special or unusual situations. They are not intended as a departure from the basic purpose.

Neither the FICA nor the FUTA statute contains a definition of employer similar to the definition contained in § 3401(d)(1), relating to income tax withholding. However, Otte v. United States, 419 U.S. 43 (1974), 1975-1 C.B. 329, holds that a person who is an employer under § 3401(d)(1) is also an employer for purposes of FICA employee tax withholding under § 3102. The Otte decision has been extended to provide that the person having control of the payment of the wages is also an employer for purposes of § 3111, which imposes the employer portion of the FICA tax on employers, and § 3301, which imposes the FUTA tax on employers, provided the person meets the FUTA requirements in either § 3306(a)(1)(A), (a)(2)(A), or (a)(3). See In re Armadillo Corp., 410 F. Supp. 407 (D.Colo. 1976), aff'd, 561 F.2d 1382 (10th Cir. 1977); In re Laub Baking Co., 642 F.2d 196 (6th Cir. 1981); STA of Baltimore–ITA Container Royalty Fund v. United States, 621 F.Supp. 1567 (D. Md. 1985), aff'd 804 F.2d 296 (4th Cir. 1986).

Section 3505(a) provides that, for purposes of §§ 3102, 3202, 3402, and 3403, if a lender, surety, or other person, who is not an employer under such sections with respect to an employee or group of employees, pays wages directly to such employee or group of employees, or to an agent on behalf of such employee or employees, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) required to be deducted and withheld from such wages by such employer. Under § 3505(a), actual notice or knowledge that the employer does not intend to, or will not be able to make timely payment or deposit of employment taxes is not a requirement for liability under the statute. See United States v. Kennedy Construction Co. of NSB, Inc., 572 F.2d 492 (5th Cir. 1978); United States v. Arnold, 573 F.2d 605 (9th Cir. 1978). "Liability under § 3505(a) attaches as soon as payment is made directly to any employee, whether or not the payor is aware that the taxes should be deducted and withheld." Abrams v. United States, 333 F.Supp. 1134, 1147 (S.D. W.Va. 1971). The lender, surety, or other person must set aside the amount deducted and withheld and pay it over to the Service if the employer does not do so. Rev. Proc. 78-13, 1978-1 C.B. 591.

Section 3505(b) provides that if a lender, surety, or other person supplies funds to or for the account of an employer for the specific purpose of paying wages of the employees of such employer with actual notice or knowledge (within the meaning of § 6323(i)(1)) that such employer does not intend to or will not be able to make timely payment or deposit of the amounts of tax required by this subtitle to be deducted and withheld by such employer from such wages, such lender, surety, or other person shall be liable in his own person and estate to the United States in a sum equal to the taxes (together with interest) which are not paid over to the United States by such employer with respect to such wages. However, the liability of such lender, surety, or other person shall be limited to an amount equal to 25 percent of the amount so supplied to or for the account of such employer for such purpose.

Under Treas. Reg. § 31.3505-1(b)(1)(ii), the term "other person" is defined as any person who directly pays the wages or supplies funds for the specific purpose of paying the wages of an employee or group of employees of another employer. It does not include a person acting only as agent of the employer or as agent of the employees. Id.

Fund distributions will be used to pay employees wage supplements earned for work performed on a Targeted Project. These distributions will be based on actual hours worked by each Employee on the Targeted Project. Fund distributions will not be made until the Fund receives an accounting of the affected Employees' hours worked on the Targeted Project. The Fund represents in its ruling request that it will not make payments directly to Employees, but will instead transfer these wage supplements directly to the Company. Once the distributions are made to the Company by the Fund, the Fund will have no further control over the distributions. Moreover, it is represented that these distributions will include the employment tax and incidental administrative expenses incurred by the Company in paying wage supplements. Based on the material submitted, the Company is the employer for federal employment tax purposes with respect to the wage supplements that it pays to its employees. Thus, the Fund and its trustees and administrators qualify as "other persons" for purposes of § 3505.

CONCLUSIONS:

Based solely on the information submitted and the representations set forth above, it is held as follows:

(1) Company's contributions to the Fund, a union fund to finance wage supplements of union members, including those employed by Company, as required under a collective bargaining agreement, are deductible as ordinary and necessary business expenses under § 162 of the Code when paid to the Fund.

(2) No portion of the Company's contributions to the Fund is subject to FICA or federal income tax withholding pursuant to § 61, 3101, 3121, 3401, or 3402.

(3) Wage supplements paid by the Company to an Employee from Fund distributions are includible in the income of the Employee when received by the Employee pursuant to § 61 of the Code, and are subject to FICA taxes, FUTA taxes, and federal income tax withholding by the Company at the time of payment to the Employee.

(4) The Fund and its trustees and administrators qualify as “other persons,” for purposes of § 3505, who are not liable for an Employer’s failure to remit income and FICA taxes withheld from wages supplied by the Fund unless the Fund, its trustees, or its administrator has actual or constructive knowledge (within the meaning of § 6323(i)(1)) that the Employer did not intend to, or could not, pay over such taxes on a timely basis.

No opinion is expressed about the tax treatment of the above proposed transaction under any other provisions of the Internal Revenue Code, or about the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transaction that are not specifically addressed by the above ruling. In this ruling, we are not addressing the income tax consequences to the Company of distributions that are made from the Fund.

This ruling is directed only to the taxpayers who requested it. Section 6110(k)(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
Copy for section 6110 purposes