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May 13, 2011

Legend

Taxpayer =

Covered Employees =

Survivors =

Dear :

This responds to Taxpayer's request for rulings about the federal tax consequences of a proposed distribution under §§ 3121, 3306, 3401, and 6041 of the Internal Revenue Code.

Taxpayer is a public institution. This year it proposes to distribute cash to Covered Employees or their Survivors. None of the Covered Employees or their Survivors has any reason to believe that they are entitled to the distribution.

Section 61(a)(1) provides that gross income means all income from whatever source derived, including compensation for services.

Under these facts, Taxpayer is making the distribution to the Covered Employees (or their Survivors) for services the Covered Employees rendered to Taxpayer. Thus, the cash distribution that each Covered Employee or Survivor receives is compensation income to that recipient under § 61.

Sections 3101 and 3111 impose FICA taxes on “wages,” as that term is defined in § 3121(a), with respect to “employment,” as that term is defined in § 3121(b). FICA taxes consist of the Old-Age, Survivors and Disability Insurance tax (social security tax) and the Hospital Insurance tax (Medicare tax). These taxes are imposed on both the employer and employee. Sections 3101(a) and 3101(b) impose the employee portions of the social security tax and the Medicare tax, respectively. Sections 3111(a) and 3111(b) impose the employer portions of the social security tax and the Medicare tax, respectively.

The term “wages” is defined in § 3121(a) for FICA purposes as all remuneration for employment, with certain specific exceptions. Section 3121(b) defines “employment” as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions.

Section 31.3121(a)-1(b) of the Employment Tax Regulations provides that the term “wages” means all remuneration for employment unless specifically excepted under § 3121(a). Section 31.3121(a)-1(c) provides that the name by which the remuneration for employment is designated is immaterial. Section 31.3121(a)-1(d) provides that generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages. With respect to services performed within the United States, § 31.3121(b)-3(b) defines employment as services performed by an employee for an employer, unless specifically excepted under § 3121(b).

Section 31.3121(a)-1(i) provides that remuneration, unless specifically excepted, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

Section 3402(a), relating to Federal income tax withholding, generally requires every employer making a payment of wages to deduct and withhold upon those wages a tax determined in accordance with prescribed tables or computational procedures. The term “wages” is defined in § 3401(a) for Federal income tax withholding purposes as all remuneration for services performed by an employee for his employer, with certain specific exceptions. Section 31.3401(a)-1(a)(2) provides that the name by which remuneration for services is designated is immaterial. Section 31.3401(a)-1(a)(3) provides that the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages.

Section 31.3401(a)-1(a)(5) provides that remuneration for services, unless specifically excepted by statute, constitutes wages even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them.

The term “wages” and “employment” have been interpreted by the Supreme Court. In *Social Security Board v. Nierotko*, 327 U.S. 358 (1946), the Supreme Court upheld a circuit court’s holding that “back pay” awarded by the National Labor Relations Board upon the reinstatement of a wrongfully discharged employee constituted “wages” for purposes of benefits under the Social Security Act. The Supreme Court reached this conclusion even though the back pay related to a period during which the petitioner did not perform any service. In so holding, the Supreme Court stated that the term “employment” is to be interpreted “to import the breadth of coverage” consistent with the purposes of the Social Security Act. *Id.* at 365. The Supreme Court also stated that “service” as used in the Social Security Act “means not only work actually done, but the entire employer-employee relationship for which compensation is paid to the employee by the employer.” *Id.* at 365-366.

The FICA’s statutory and regulatory scheme and the Supreme Court’s analysis in *Nierotko* provide the basis for determining whether payments employers make to employees are wages subject to FICA taxes.

Taxpayer's cash distribution to Covered Employees are includible in gross income. The cash distribution is made only to Covered Employees and is dependent upon and arises out of the employer-employee relationship, and thus, is compensation. As compensation to the Covered Employees arising out of the employer-employee relationship for services rendered, the payments are remuneration for employment resulting in wages under § 3121 subject to FICA taxes unless a specific exception applies, such as the FICA exception for payments made by an employer to a survivor or the estate of a former employee after the calendar year in which the employee died under § 3121(a)(14). Wages are required to be reported under both §§ 6041 and 6051 on Form W-2. See § 1.6051-1 (requiring furnishing Form W-2 to employee); § 1.6041-2(a) (requiring wages to be reported on a Form W-2).

To the extent Taxpayer makes a cash distribution to a Survivor in the same calendar year as the death of the employee, the cash distributions are generally subject to FICA taxes and should be reported in box 3, social security wages, and box 5, Medicare wages and tips, on Form W-2 issued in the name of the employee with the social security number of the employee. Taxpayer must report social security and Medicare taxes withheld in boxes 4 and 6, respectively. If the cash distribution is made after the calendar year of the death of the employee, the distribution is not subject to FICA taxes and the payment should not be reported as social security wages or Medicare wages on a Form W-2. Irrespective of when after death the cash distribution is made, Taxpayer must also report the payment to the Survivors in box 3, Other income, on Form 1099-MISC, in accordance with § 6041, as discussed below.

Taxpayer's cash distributions to the Covered Employees are, also, wages under § 3401 for purposes of collection of income tax at source and should be reported in box 1 and the Federal income tax withheld reported in box 2 of the Form W-2. However, to the

extent Taxpayer pays the cash distributions that were earned but unpaid prior to the Covered Employee's death to a Survivor, in either the year of death or after the year of death, the requirements of § 6041 will apply and the distribution will not be reported in box 1 of Form W-2 and will not result in any Federal income tax withholding to be reported in box 2 of the Form W-2. See Rev. Rul. 86-109, 1986-2 C.B. 196.

Section 6041(a) and § 1.6041-1(a)(1)(i) provide, with exceptions not applicable here, that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income, aggregating \$600 or more in the taxable year must file an information return with the Internal Revenue Service. By § 6041(d), the payor is required to furnish an information statement to the payee. For payments of \$600 or more, § 1.6041-1(d)(2) requires a payor to report on Forms 1096 and 1099.

The § 6041 information reporting requirement applies to payments made during the calendar year to another person of "fixed or determinable income." Section 1.6041-1(a). Section 1.6041-1(c) provides that income is fixed when paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.

Information reporting requirements may also apply to payments made by the United States or a state or their political subdivisions. Section 1.6041-1(i) provides, in part, that information returns on Forms 1096 and 1099 of payments made by a state, or political subdivision, agency or instrumentality thereof, shall be made by the officer or employee of such state or political subdivision, agency or instrumentality thereof, having control of such payments or by the officer or employee appropriately designated to make such returns.

Each distribution that Taxpayer, which is described in § 1.6041-1(i), pays to a Survivor is gross income to that Survivor that is fixed in amount under § 1.6041-1(c). Because the amount of a distribution that Taxpayer makes to a Survivor is includible in the Survivor's gross income, Taxpayer is subject to the information reporting requirements of § 6041(a) and (d) for a distribution payment if the aggregate of the distribution payment and other payments of fixed or determinable income that Taxpayer makes to that Survivor during a calendar year are \$600 or more.

The rulings contained in this letter are based upon information and representations that Entity submitted under penalties of perjury. 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.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

Taxpayer must attach to any income tax return to which it is relevant a copy of this letter or, if it files its returns electronically, a statement providing the date and control number of this letter ruling.

This ruling is directed only to the taxpayer requesting 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, we are sending a copy of this letter to your authorized representative.

Sincerely,

Michael J. Montemurro  
Chief, Branch 4  
Office of Associate Chief Counsel  
(Income Tax & Accounting)

cc: