Office of Chief Counsel
Internal Revenue Service

memorandum

CC:TEGE:GLGC:TL-N-1236-01
DSWeiner

date:

to: Director, Field Specialists, LMSB, [redacted]
Attn: Peggy Harbaugh

from: Area Counsel (TEGE), Great Lakes/Gulf Coast Area

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subject: [redacted]
Employment Tax Claims
Bonus Payments

This memorandum is in response to your request for our views concerning the additional information that [redacted] provided to you concerning its claims for refund that it filed claiming refund of employment taxes paid on bonuses paid to its employees. This memorandum should not be cited as precedent.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

ISSUE

Whether the additional facts presented by [redacted] concerning the bonuses it paid to its employees under the terms of its collective bargaining agreement show that the payments were not wages for employment tax purposes.

CONCLUSION

The bonuses were wages subject to employment taxes. The additional facts do not change our prior opinion that the bonuses were wages for employment tax purposes.

FACTS

[redacted] provided to you additional points to consider concerning its claims for refund on the FICA and FUTA taxes paid on the bonuses paid to its employees.

- [redacted] provided that it was concerned that its Union employees might not ratify the [redacted] collective bargaining agreement despite a generous outcome to the bargaining. It wanted to provide an additional benefit to insure ratification. The purpose of the bonus was to induce the employees to ratify the agreement. It was not intended to compensate the employees for services they performed.

- It was concerned about the applicability of the Fair Labor Wage Act and the affect of the bonus on the overtime rate. If the bonus was considered to be wages and included in the overtime rate, the cost of the bonus would be much higher than the proposed bonus of $[redacted]. It stated that [redacted] and the [redacted] agreed that the bonus would not be wages.

- [redacted] alleged that the payment of the bonus was not contingent on the employee performing any services. An employee who joined [redacted]'s employment ranks on the day before the effective date of the agreement or left [redacted]'s employment ranks the day after the effective date of the agreement would still be entitled to received the bonus. The employee would have to have been on [redacted]'s employment roles for one day to get a bonus.

- [redacted] alleged that had the employees not ratified the agreement, they likely would have ceased being [redacted]'s employees.

- [redacted] newsletters described the payments as "first year up-front payment."

DISCUSSION

The additional facts provided by [redacted] do not change our opinion that the payments were wages for federal employment tax purposes. As we stated in our May 14, 2001 memorandum, [redacted]'s reliance on Rev. Rul. 58-145, 1958-1 C.B. 360, is misplaced. The ruling might allow the exclusion of a bonus from wages if the bonus is paid solely in consideration for signing the contract. Because the [redacted] employees were required to report to work to receive the bonuses, the ruling does not apply. The bonuses that [redacted] paid were wages.

The parties characterized the payments as not being wages to avoid overtime application. Their characterization for non-tax purposes does not control the taxability of the payments. Sections 3121(a) and 3306(b) contain definitions of wages for FICA and FUTA tax purposes.

While the bonuses may or may not have been wages for Fair Labor Standards Act purposes, they were wages for FICA and FUTA tax purposes.[1]

If you have any question, please call David Weiner at (312) 886-9225, ext. 331.

JUDITH M. PICKEN
Area Counsel (TEGE)

[1]29 U.S.C. § 207 computes overtime on the basis of the one and half times the employee's regular rate of pay. Sections 3121(a) and 3306(b) of the Internal Revenue Code define wages as all remuneration paid to an employee by an employer due to employment.

Office of Chief Counsel
Internal Revenue Service

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CC:TEGE:GLGC:TL-N-1236-01
DSWeiner

date:

to: SBSE Area Manager, Area 5, Detroit
Attn: Peggy Harbaugh, Group 1410

from: Area Counsel (TEGE), Great Lakes/Gulf Coast Area

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subject: [redacted]
Employment Tax Claims
Bonus Payments

This memorandum is in response to your request for our views concerning the claims for refund that [redacted] filed claiming refund of employment taxes paid on bonuses paid to its employees. This memorandum should not be cited as precedent.

DISCLOSURE STATEMENT

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ISSUE

Whether bonuses paid by an employer to employees where, under the terms of a collective bargaining agreement, the bonuses were required to be paid to all employees on the employer's employment rolls on the effective date of the agreement were wages for employment tax purposes.

CONCLUSION

The bonuses are wages subject to employment taxes since the employees must be on the employer's employment rolls to receive the bonus and since the bonuses appear to have been paid in consideration for past and future services.

FACTS

On or about [redacted], the [redacted] filed a claim for refund requesting refund of FICA taxes for the [redacted] quarter of [redacted]. In the explanation attached to the claim, [redacted] stated that it overpaid FUTA taxes for [redacted], but it apparently did not file a claim for refund of FUTA taxes.

On or about [redacted], [redacted] filed a claim for refund requesting refund of FICA taxes for the [redacted] quarter of [redacted]. In the explanation attached to the claim, [redacted] again stated that it overpaid FUTA taxes, but it apparently did not file a claim for refund of FUTA taxes for [redacted].

In the last quarters of [redacted] and [redacted], [redacted] paid a one time lump sum bonus of $[redacted] to each of its unionized employees. [redacted] treated the payment of the bonuses as wages. It withheld FICA taxes and income tax withholding from the payments. It paid FICA and FUTA taxes on the amounts of the bonuses.

[redacted] was required to pay the bonus to each employee under the provisions of the applicable collective bargaining agreements that [redacted] entered into with its workers' unions. The agreements provided that [redacted] pay a $[redacted] bonus to each represented employee on [redacted]'s active employment roll as of the effective date of the agreement. The bonus was to be paid to an employee whether or not the employee voted for ratification of the agreement and whether or not the employee continued performing services for [redacted].

In its claims for refund, [redacted] argued that the bonuses did not constitute wages for employment tax purposes since it did not pay the amounts to the employees in consideration for the performance of services by the employees. It claimed that it paid the bonuses in consideration for the employees (through the union) ratifying the collective bargaining agreement. Further, [redacted] alleged that the bonuses were not wages subject to employment taxes based upon the Service's ruling on signing bonuses, Rev. Rul. 58-145, 1958-1 C.B. 360.

In its claims for refund, [redacted] estimated the amounts of overpaid taxes. In making the estimates, [redacted] assumed that none of the employees received wages in excess of the wage base for determining OASDI portion of FICA taxes. It stated that it was in the process of determining the correct amount of the overpaid FICA taxes.

Although [redacted] certified on the Forms 941C attached to the claims that it complied with the requirements of Treas. Reg. § 31.6402(a)-2 by obtaining employee consents and statements, it stated in its explanation attached to the claim that it was in the process of obtaining the required consents and statements.

DISCUSSION

Under the provisions of I.R.C. § 3121(a), wages subject to employment taxes generally is all remuneration for employment.

The taxpayer cites Rev. Rul. 58-145, 1958-1 C.B. 360, for support of its position that the signing bonuses it paid were not wages. In the ruling, a baseball team paid a signing bonus to a baseball player for signing his first contract. The ruling presented two types of signing bonuses. With the first type of bonus, the contract provisions did not require the performance of subsequent services. The Service ruled that this type of signing bonus was not remuneration for services and was not "wages" subject to employment taxes.[1] With the second type of bonus, the bonus was paid to a baseball player conditioned on continued employment of the player with the team. The Service ruled that this type of bonus was subject to the employment taxes.

The Service revisited the signing bonus issue in Rev. Rul. 69-424, 1969-2 C.B. 15. In that ruling, the Service held that the amounts paid to a college on behalf of a professional ball player under a *"College Scholarship Plan"* were wages subject to income tax withholding, FICA taxes, and FUTA taxes. Under the *College Scholarship Plan,* the player agreed to play baseball for three months for a specified monthly remuneration paid directly to the player's college. The baseball team was relieved of its obligation under the Plan if the player failed to report for spring training at the direction of the club. The Service concluded that since payment of the amount was contingent on the employee reporting for work, the bonus was not solely in consideration for signing a contract.

The contract that [redacted] and its unionized employees entered into obligated [redacted] to pay the bonuses to those employees who were on its rolls on the effective date of the contract. Since [redacted] employees were required to have reported for work on or before that date in order to receive the bonus, the bonuses paid

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[1]The Service only ruled on income tax withholding treatment in the ruling, but the definitions of wages for FICA and FUTA taxes are the same as the definition for income tax withholding.

by [redacted] clearly did not meet the narrow conditions required under Rev. Rul. 58-145 to avoid employment taxation. Since the employees were required to be on the employment rolls to receive the bonus, [redacted]'s bonus plan is more like the plan described in Rev. Rul. 69-424.

In addition, the fact that almost all of the bonuses were paid to existing employees meant that [redacted] would be hard pressed to show that the bonuses were not paid as compensation for the employees' past or future services.[2] The bonuses appeared to be substitutes for either forgone past pay increases or a lower pay raise in the current agreement. A substitute for taxable wages constitutes taxable wages. The bonus was compensation for services, and was not solely compensation for ratifying the union agreement.

Since receipt of the bonuses was contingent on the employee being on [redacted]'s employment rolls and since the employees had provided past and future services for [redacted], the bonuses were wages subject to employment taxes. Since the bonuses were wages, we would recommend that the claims for refund be denied.

We note that [redacted] failed to accurately compute the amounts that it was claiming. It used estimates in it claims. If you decide to allow any part of the claims, [redacted] must provide the accurate amounts of the tax that it and its employees overpaid.

Regarding FUTA claims, although [redacted] has not filed formal FUTA claims, it mentioned overpaid FUTA taxes in the explanations it attached to its claims. These claims may be considered to be informal claims. Assuming that [redacted] filed its [redacted] Form 940 timely, the claim was not timely.[3] The [redacted] claim would be

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[2]There is a factual question concerning those employees who were hired on or before the effective date of the agreement, but had not yet reported for work. Whether or not these workers were entitled to bonuses is not clear from [redacted]'s explanation that it attached to its claim. However, receipt of bonuses by these workers does not change our conclusion that the bonuses are wages since the workers were required to be on [redacted]'s employment rolls to receive the bonuses.

[3]If [redacted] filed its Form 940 timely, it filed it on or before [redacted]. Applying the limitations period provided by I.R.C. § 6511(a), the taxpayer must have filed its claim for refund within the later of three years of the filing of the return or two years of payment of the tax. The limitations period expired on [redacted], a date prior to the filing of the

timely to cover the [redacted] FUTA taxes. [redacted] would need to provide additional information concerning any overpaid FUTA taxes for [redacted], if you decide to allow any refund of FUTA taxes for [redacted]. If you deny the FICA claims, you choose to also deny the FUTA claims: the [redacted] claim for not being filed prior to the expiration of the limitations period and the [redacted] claim since there are no overpaid FUTA taxes. You can also choose to ignore the FUTA claims (which is our recommendation).

[redacted] also stated in its claim that it has not met the requirements of Treas. Reg. § 31.6402(a)-2, regarding employee consents and statements. Prior to allowing any part of these claims, [redacted] must (1) either reimburse the affected employees for their overpaid taxes or obtain consents from the affected employees and (2) obtain the required statements from the employees concerning the filing of claims.

If you have any question, please call David Weiner at (312) 886-9225, ext. 331.

JUDITH M. PICKEN
Area Counsel (TEGE)

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claim.