



OFFICE OF  
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
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MEMORANDUM FOR WENDY CAMPBELL  
Section 218 Coordinator

FROM: Jerry E. Holmes, Branch Chief  
CC:BEO:2

SUBJECT: Senior Work Program

State =

Statute =

Limit =

You have inquired about the employment tax consequences of amounts earned pursuant to a State Statute under which senior citizens can provide services to municipalities in exchange for partial abatement of their property tax liabilities. The Statute allows municipalities to establish a program under which senior citizens can provide services in exchange for a reduction in their property taxes up to the Limit, at an hourly rate not to exceed the State's minimum wage. The workers are termed "volunteers." The amount of the property tax reduction under the Statute is not considered income or wages for purposes of State income tax withholding, unemployment compensation or workmen's compensation. The workers are treated as employees, however, for purposes of municipal tort liability.

LAW

Sections 3101 and 3111 of the Internal Revenue Code (the Code) impose Federal Insurance Contributions Act (FICA) taxes on the wages paid by employers to employees with respect to employment. In general, all payments of remuneration by an employer for services performed by an employee are subject to FICA taxes, unless the payments are specifically excepted from the term "wages" or the services are specifically excepted from the term "employment."

"Wages" are defined as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, with certain enumerated exclusions. "Employment" means any service, of whatever nature, performed by an employee for the person employing him, with certain enumerated exclusions. "Employee" is defined as any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. Code section 3121(d)(2).

Generally, the medium in which the remuneration is paid is immaterial. It may be paid in cash or in something other than cash. Remuneration paid in items other than cash must be computed on the basis of the fair value of the items at the time of payment. Section 31.3121(a)-1(e), Employment Tax Regulations.

Section 3121(a)(6) provides an exclusion from wages for FICA purposes for the employee portion of FICA tax paid by the employer without deduction from the employee's wages, but only in the cases of domestic service in the private home of the employer and agricultural labor. In other words, if an employer pays the employee portion of the FICA tax on behalf of an employee, that amount is additional wages to the employee for FICA purposes. See Rev. Proc. 81-48, 1981-2 C.B. 623, attached, for the formula used to calculate the additional wages.<sup>1</sup>

For purposes of Federal income tax withholding, "wages" means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash. Code section 3401(a). For purposes of withholding, the term "employee" includes an officer or employee of a state or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing. Code section 3401(c).

For purposes of withholding, the regulations state that the term "wages" includes the amount paid by an employer on behalf of an employee on account of any tax imposed upon the employee by any taxing authority, including the tax imposed by section 3101, *i.e.*, the employee portion of the FICA tax. Section 31.3401(a)-1(b)(6), Employment Tax Regulations. Implicit in this provision is the assumption that an employer's payment of the employee portion of FICA taxes

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<sup>1</sup>For taxes paid prior to January 1, 1981, an employer's payment of the employee's portion of FICA tax was excluded from the employee's wages for FICA purposes. Former section 3121(a)(6)(A). This provision was amended by section 1141 of the Omnibus Budget Reconciliation Act of 1980, Pub. L. 96-499, 1980-2 C.B. 509, to provide an exclusion from wages for payment of FICA tax only for domestic service and agricultural labor. This amendment is indicative of the fact that an employer's payment of an employee's FICA tax liability is additional wages to the employee in the absence of a specific exclusion.

without deducting it from the employee's wages constitutes additional income to the employee. See Rev. Proc. 81-48 §3.06.

Code section 3306(c)(7) provides that taxes under the Federal Unemployment Tax Act (FUTA) do not apply to compensation for services in the employ of a state, any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned by one or more states or political subdivisions.

Code section 6051(a) requires information reporting from every person required to deduct and withhold the employee portion of the FICA tax from an employee. The requirement applies to all payments subject to FICA tax, regardless of the amount. The information is reported on Form W-2.

The Supreme Court case of Old Colony Trust Co. v. Commissioner, 279 U.S. 716 (1929), dealt with the issue of whether an employer's payment of an employee's tax obligation was income to the employee, holding in the affirmative. Satisfaction of the tax obligations of another person in consideration of employment constitutes income to that person.

## ANALYSIS

The state tax treatment of the amounts in question is not determinative of the federal tax treatment. While state law governs the nature of legal interests and rights created under state law, "the federal tax consequences pertaining to such interests and rights are solely a matter of federal law." Forest v. Commissioner, 97-1 U.S.T.C. (CCH) ¶50,118 (1st Cir. 1996), aff'd T.C. Memo. 1995-377; Delancy v. Commissioner, 99 F.3d 20 (1st Cir. 1996), aff'd T.C. Memo. 1995-378, citing Brabson v. U.S., 73 F.3d 1040, 1044 (10th Cir. 1996). The fact that the workers are called "volunteers" is not determinative, as the tax forgiveness is clearly provided in consideration of the work done. See the Certificate of Completion of Volunteer Services attached to the incoming request.

The Old Colony case dealt with income tax inclusion. If the income is also wages for FICA purposes, however, FICA taxes would apply. This conclusion would depend upon whether the workers are employees under the common law rules. Section 3121(d)(2).

While we do not have enough facts to support an analysis of this issue, we think it is virtually certain that temporary, minimum wage workers hired to work off their property tax liability will be employees, not independent contractors. The fact that compensation will be limited to the State minimum wage suggests that clerical or other routine work will be assigned to the workers, suggesting employment status. The nature and purpose of the work involved suggests that these workers are not engaging in an independent trade or business: they are not working

independently without supervision, not offering their services to the public, and do not have a possibility of economic loss. Rather they will be working under the direction of the municipalities. If the workers are employees, their compensation will therefore be wages subject to FICA taxes, even though it is not paid in cash.

The amount of wages will be equal to the value of the tax liability forgiven plus the value of the employee portion of the FICA tax paid by the employer but not deducted from the wages of the employee. Section 31.3401(a)-1(b)(6), Employment Tax Regulations. Since the workers will not receive any cash from which to withhold the employee portion of the FICA tax, the employer will most likely have to pay this tax, which will be additional wages to the employee for both FICA and income tax purposes. Alternatively, the employers can seek reimbursement of the employee FICA tax from the workers.

Given that taxpayers can work off their tax liability only up to the Limit, the personal exemption amount will exceed the workers' earnings, so generally no withholding will be required. The municipalities should require their employees to complete Forms W-4. The municipalities are also required to file Forms W-2, reporting all wages from which FICA is withheld.

## CONCLUSION

Since the workers in question are most likely employees, amounts they earn will be wages subject to FICA tax. Since the workers will receive no cash wages from which the employer can withhold, the employer will be required to pay both portions of the FICA tax, unless the employer seeks reimbursement from the workers. If the employer does not seek reimbursement of the employee FICA paid, this portion will be additional wages to the employee and subject to additional FICA and income tax. FUTA tax is not applicable to employees of state and local governments. Income tax withholding is potentially applicable, though the Limit on earnings is less than the exemption amount. There is an information reporting requirement applicable to all wages subject to FICA.

If you have any questions, please call Elizabeth Edwards of this office at (202) 622-6040.