



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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MEMORANDUM FOR DISTRICT COUNSEL, ARKANSAS-OKLAHOMA DISTRICT,
OKLAHOMA CITY

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT:

This memorandum responds to your memorandum dated January 7, 2000, asking our advice concerning the above referenced case. This document is not to be cited as precedent.

ISSUE

Whether the debtor or the factor that purchased wage claims from the debtor's employees is liable for the employment taxes at issue in this case.¹

CONCLUSION

By purchasing the wage claims from the employees, the factor became responsible for the payment of wages and is the proper party to withhold and pay the employment taxes and report the wage payments.

FACTS

A factor purchased wage claims from employees of Chapter 11 debtor. The factor has filed a motion with the bankruptcy court to compel the debtor to pay the full amount of the factored wages. The debtor objected to the motion on the grounds that it must withhold employment taxes from the factored wages. You do not think

¹ The term "employment taxes" in this case refers collectively to the following: (1) the taxes imposed on employees and employers by the Federal Insurance Contributions Act (FICA), sections 3101 and 3111 of the Internal Revenue Code; (2) the tax imposed on employers by the Federal Unemployment Tax Act (FUTA), section 3301 of the Code; and (3) income tax withholding, section 3402 of the Code.

GL-700098-00

the debtor has any withholding requirement for the payment to the factor or for the factor's payments to the employees, and that the Service should be so advised.

LAW

FICA taxes are imposed on "wages," defined in Code section 3121(a) as including "all remuneration for employment" with certain specific exceptions. Under Code sections 3101 and 3111, FICA taxes are imposed on both the employee and the employer. FUTA taxes are also imposed on "wages," defined in Code section 3306(b) as including "all remuneration for employment" with certain specific exceptions.

FUTA taxes are imposed only on the employer. Federal income tax withholding is imposed under Code section 3402(a) on "wages," defined in section 3401(a) as including "all remuneration...for services performed by an employee for his employer" with certain specific exceptions.

Sections 31.3121(a)-1(i), 31.3306(b)-1(i), and 31.3401(a)-1(a)(5) of the Employment Tax Regulations, provide that for purposes of FICA, FUTA, and federal income tax withholding, remuneration for employment, unless such remuneration is specifically excepted, constitutes wages even though at the time it is 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 3401(d) of the Code provides, in part, that for purposes of income tax withholding, the term "employer" means the person for whom the individual performs or performed any service, of whatever nature, as the employee of such person, except that if the person for whom the individual performs or performed the services does not have control of the payment of wages for such services, the term "employer" (except for purposes of the definition of wages) means the person having control of the payment of wages.

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

GL-700098-00

Royalty Fund v. United States, 621 F. Supp. 1567 (D.C. Md. 1985), aff'd, 804 F.2d 296 (4th Cir. 1986).

ANALYSIS

The first step is to determine whether the payments in question are "wages" for purposes of the employment tax provisions (chapters 21, 23 and 24 of the Code). Under the facts, it is clear that the amounts received by the employee recipients are remuneration for services and therefore are wages.

Since the amounts in question are wages for employment tax purposes, the next step is to determine the party responsible for withholding and paying the related employment taxes - the debtor, which is the common-law employer, or the factor, which paid the wages.

In Otte, the trustee of a bankrupt employer paid wage claims, but did not withhold income tax or the employee share of FICA. The Supreme Court, in holding that the trustee was liable for both the withholding of tax and the filing of returns, stated that section 3401(d)(1) "... obviously was intended to place responsibility for withholding at the point of control." 419 U.S. 43, 50. The Court, relying on section 6051(a), further held that "... a person required to withhold must furnish the employee a written statement showing the wages subject to withholding and the amount withheld on account of each tax." 419 U.S. 43, 52. As stated above, the Otte decision has been extended to provide that the person having control of the payment of wages is also an employer for purposes of the employer share of FICA and for purposes of FUTA.

Relying on Otte, the Tenth Circuit Court of Appeals held in In re Armadillo Corp., 561 F.2d 1382 (10th Cir. 1977), that the trustee was in control of payment of the wages and therefore had responsibility for withholding and paying employment taxes. The court emphasized that "the fact that in bankruptcy payment of wage claims is effected by one other than the bankrupt former employer does not defeat any withholding requirement." Id. at 1385. By purchasing the wage claims from the employees, the factor in this case is responsible for the payment of wages and is the proper party to withhold and pay the employment taxes and report the wage payments.²

CONCLUSION

² We believe that the amount of the wages is the amount that the factor paid to the employees. We can provide further assistance on this issue if necessary.

GL-700098-00

Because the debtor does not have a duty to withhold any taxes from the payment to the factor, we agree with your conclusion that a referral to the Department of Justice to support the debtor's position in the bankruptcy litigation is not necessary. Our response has been coordinated with the Office of the Assistant Chief Counsel (Employee Benefits and Exempt Organizations).

If we can be of further assistance, please contact the attorney assigned to this matter at (202) 622-3620.