

Internal Revenue Service

Department of the Treasury

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Person to Contact:
Rebecca S. Wilson
Telephone Number:
202 622-6040
Refer Reply To:
CC:TEGE:EOEG:ET1-PLR-118113-99
Date:
11/17/2000

In Re:

Legend

Fund =
Union =

Trust Agreement =

Date A =

Dear :

This responds to your request for a ruling on behalf of the Fund, a self-insured multiemployer VEBA. You requested a ruling regarding the employment tax¹

¹ For purposes of this letter ruling, the term "employment tax" is used to refer 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) the requirement for collection of income tax at source on wages, section 3402 of the Code.

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consequences to the Fund of providing health coverage to nondependent, nonspousal domestic partners of employees of participating employers. You noted in your request that the Internal Revenue Service (IRS) has ruled that such coverage is wages to the employee for employment tax purposes and that a fund providing the coverage is the employer for employment tax purposes. See PLR 9850011 (Sept. 10, 1998). You requested a ruling whether the Fund, as the entity in control of providing the coverage, is the employer for purposes of employment taxes. You also requested a ruling regarding the effect of such coverage and related employment tax liabilities on the Fund's exempt status under section 501(c)(9) of the Internal Revenue Code.²

FACTS

The Fund is structured as a voluntary employees' beneficiary association (VEBA), as defined by section 501(c)(9) of the Internal Revenue Code (Code). The Service issued the Fund a determination letter on Date A.

Under the Trust Agreement, the Fund receives contributions from employers having collective bargaining agreements with the Union. Contributions to the Fund by employers are required under the terms of their respective collective bargaining agreements. Employer contributions are remitted to the Fund to support all benefit programs and to satisfy the administrative expenses of the Fund. An employer's contributions to the Fund remain the same regardless of whether a participant elects single or family coverage.

The Fund pays benefits from the general assets of the Fund. Contribution rates for each plan unit are calculated actuarially at the direction of the trustees to support the benefits for each respective plan unit, although the Fund's assets are pooled and the Fund is liable for all expenses of all of its constituent plan units.

The Fund's health coverage programs generally provide for payments to health care providers for the cost of medical, hospital, and dental care for participants and their dependents, as well as to eligible domestic partners. The Fund's payments to health care providers are made pursuant to the respective plan units' schedules of benefits or contracts with providers. In some cases, payments are made to a participant, dependent, or domestic partner as reimbursement for out-of-pocket expenses covered under the plan.

In some of the plan units, family health coverage is provided to domestic partners of electing plan participants. The Fund's domestic partner coverage entitles the eligible domestic partner of a plan participant and the domestic partner's dependent children to

² You have also requested an opinion from the Department of Labor on the application of the prohibited transaction rules of ERISA.

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the same health coverage as is available to all other plan participants and the spouses and dependent children of plan participants.

In one plan unit, all participants enrolling dependents, including domestic partners, must make premium payments. In the other plan units, plan participants do not pay any premiums for coverage, although there are certain co-payments and deductibles.

The plan documents covering the units define "eligible domestic partner." None of the state laws applicable to the units prohibit domestic partner relationships.

Each employer reports to the Fund the name, address, age, sex, and social security number of each employee covered under the collective bargaining agreement for whom contributions are made. Employers also report an employee's termination of employment to the Fund. The Fund conducts audits of the employers to verify that contributions are made in accordance with the terms of the respective collective bargaining agreements.

The Fund is fully responsible for the enrollment, processing, and administration of benefits. Employers do not receive any information regarding eligibility or coverage of particular employees, nor do employers receive any information regarding employees' elections for coverage of dependents or domestic partners.

The Fund assumes that a participant's domestic partner is not a dependent, as defined by Code section 152(a)(9), unless the participant establishes to the Fund that the domestic partner is a dependent. The Fund permits two alternative methods of establishing that a domestic partner is a dependent: (1) a participant provides his or her prior year's Form 1040 reflecting that the domestic partner has been claimed as a dependent or (2) a participant executes a written certification that the domestic partner qualifies as the participant's dependent in accordance with the support test promulgated by the IRS.

Specifically, the certification states that the participant and the participant's domestic partner reside in the same household during the participant's tax year, that the participant provides more than half of the domestic partner's support, and that, consistent with section 152(b)(5) of the Code, the relationship does not violate local law.

The Fund recognizes that where the domestic partner is not a dependent of the participant, the value of the domestic partner's health coverage is income and wages to the employee participant. The Fund also recognizes that, for purposes of employment taxes, the Fund is the employer with respect to any amounts considered wages as a result of a participant's election of domestic partner coverage. Accordingly, the Fund will pay and report the income tax withholding, the employer portion of the FICA tax, the participant's portion of the FICA tax, and the FUTA tax that may result from the participant's election of domestic partner coverage.

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The Fund's documents have been amended to provide that domestic partner coverage includes payment of the employer and employee portions of the FICA tax and the payment of the FUTA tax on the coverage. The Fund will "gross up" the value of the coverage in conformity with Rev. Proc. 81-48, 1981-2 C.B. 623, to reflect the payment of the participant's portion of the FICA attributable to the amount included in the participant's income. Thus, the Fund includes as part of the value of the coverage for tax purposes an amount equal to the gross-up.

The Fund uses, as the value of the domestic partner coverage, the projected fair market value of the Fund's health care coverage, as determined on an annual basis for purposes of determining the rates charged for COBRA coverage under section 4980B(f). Specifically, the domestic partner coverage is valued in accordance with the actuarially determined rates for individual or family COBRA coverage (as may be applicable, depending on the Plan Unit), less any payment that a Participant may be required to pay the Fund for domestic partner coverage.

The Fund will issue a Form W-2 to participants electing domestic partner coverage, reflecting as wages the imputed value of the coverage, including any FICA taxes paid by the Fund on the participant's behalf.

The Chief Financial Officer of the Fund has projected that the minimum annual cost of providing domestic partner coverage for all of the Fund's constituent units, including payment of the employment taxes, will be less than 2 percent of the Fund's annual benefit expenditures. The Chief Financial Officer has projected that the maximum annual cost of providing domestic partner coverage for all of the Fund's units, including payment of the employment taxes, will range between 2.88 percent and 3.31 percent of the Fund's annual benefit expenditures.

LAW AND ANALYSIS

Section 61(a)(1) of the Code and section 1.61-21(a)(3) of the regulations provide that, except as otherwise provided in subtitle A of the Code, gross income includes compensation for services, including fees, commissions, fringe benefits, and similar items.

Section 1.61-21(a)(3) of the regulations provides that a fringe benefit provided in connection with the performance of services shall be considered to have been provided as compensation for such services.

Section 1.61-21(a)(4) of the regulations provides that, in general, a taxable fringe benefit is included in the income of the person performing the services in connection with which the fringe benefit is furnished. Thus, a fringe benefit may be taxable to a person even though that person did not actually receive the fringe benefit. If a fringe

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benefit is furnished to someone other than the service provider, such benefit is considered as furnished to the service provider, and use by the other person is considered use by the service provider.

Section 1.61-21(b)(1) of the regulations provides that an employee must include in gross income the fair market value of the fringe benefit. In general, fair market value, under the principles set forth in section 1.61-21(b)(2) of the regulations, is determined on the basis of the amount that an individual would have to pay for the particular fringe benefit in an arm's-length transaction. In the case of group medical coverage, the amount includible in the individual's gross income is the fair market value of the group medical coverage.

Section 1.105-5(a) provides that an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness.

Section 106 of the Code provides that "gross income of an employee does not include employer-provided coverage under an accident or health plan."

Section 1.106-1 of the regulations provides, "The gross income of an employee does not include contributions which his employer makes to an accident or health plan for compensation (through insurance or otherwise) to the employee for personal injuries or sickness incurred by him, his spouse, or his dependents, as defined in section 152."

Section 105(e) of the Code provides that amounts received under an accident or health plan for employees will be treated as amounts received through accident or health insurance for purposes of sections 104 and 105.

Section 104(a)(3) of the Code provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts received through accident or health insurance (or through an arrangement having the effect of accident or health insurance) for personal injuries or sickness (other than amounts received by an employee, to the extent such amounts (A) are attributable to contributions by the employer which were not included in the gross income of the employee, or (B) are paid by the employer).

Section 105(a) of the Code provides that, except as otherwise provided in section 105, "amounts received by an employee through accident or health insurance for personal injuries or sickness shall be included in gross income to the extent such amounts (1) are attributable to contributions by the employer which were not includible in the gross income of the employee, or (2) are paid by the employer."

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Section 105(b) of the Code provides that except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical expenses) for any prior taxable year, gross income does not include amounts referred to in subsection (a) if such amounts are paid, directly or indirectly, to the taxpayer to reimburse the taxpayer for expenses incurred by him for the medical care (as defined in section 213(d)) of the taxpayer, his spouse, and his dependents (as defined in section 152 of the Code).

Employer-provided coverage under an accident or health plan for personal injuries or sickness incurred by individuals other than the employee, his or her spouse, or his or her dependents, as defined in section 152 of the Code, is not excludable from the employee's gross income under section 106 of the Code. In addition, reimbursements received by the employee through an employer-provided accident and health plan are not excludable from the employee's gross income under section 105(b) of the Code unless the reimbursements are for medical expenses incurred by the employee, his or her spouse, or his or her dependents, as defined in section 152. However, reimbursements that are not excludable under section 105(b) may be excludable under section 104(a)(3) if they are attributable to employer contributions that were included in the employee's income.

Section 152 of the Code defines the term "dependent" for purposes of subtitle A of the Code. Sections 152(a)(1) through (8) define dependent in terms of support and relationship. Those sections define a dependent as an individual who: (1) receives more than half of his or her support from the taxpayer, and (2) is related to the taxpayer as defined in sections 152(a)(1) through (8). It is not expected that a nonspousal domestic partner will meet the relationship tests under these sections.³

³ A nonspousal domestic partner cannot qualify as a spouse for purposes of the Code. Section 3 of the Defense of Marriage Act (P.L. 104-199) provides:

In determining the meaning of any Act of Congress, or of any ruling, regulation or interpretation of the various administrative bureaus or agencies of the United States, the word "marriage" means only a legal union between one man and one woman as husband and wife, and the word "spouse" refers only to a person of the opposite sex who is a husband or wife.

The Fund recognizes that the Defense of Marriage Act specifically prohibits the Service from treating a nonspousal domestic partner as a spouse under any Code provision.

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Section 152(a)(9) of the Code contains an alternative definition of dependent. That section defines dependent as an individual who: (1) receives more than half of his or her support from the taxpayer for the year, and (2) who has the home of the taxpayer as his or her principal abode and is a member of the taxpayer's household during the entire taxable year of the taxpayer. Section 152(b)(5) imposes an additional requirement. It provides that an individual is not considered a member of the taxpayer's household if the relationship between the individual and the taxpayer is in violation of local law.

Section 501(c)(9) of the Code describes a VEBA as an association that provides for the payment of life, sick, accident, or other benefits to its members or their dependents or designated beneficiaries. Section 1.501(c)(9)-3(a) of the regulations provides that the life, sick, accident or other benefits provided by a VEBA must be payable to its members, their dependents, or their designated beneficiaries. For purposes of section 501(c)(9), "dependent" means the member's spouse, any child of the member or the member's spouse who is a minor or a student, any other minor child residing with the member, and any other individual who an association, relying on information furnished to it by a member, in good faith believes is a person described in section 152(a). An organization is not described in this section if it systematically and knowingly provides more than a "de minimis" amount of impermissible benefits.

Section 1.501(c)(9)-3(c) of the regulations describes the term "sick and accident benefits" to mean amounts furnished to or on behalf of a member or a member's dependents in the event of illness or personal injury to a member or dependent.

A nondependent, nonspousal domestic partner is not a dependent within the meaning of section 1.501(c)(9)-3(a) of the regulations and section 152(a) of the Code. Under section 1.501(c)(9)-3(c) of the regulations, sick and accident benefits may not be provided to a member's other "designated beneficiaries" (individuals who are not a member's dependents). If a VEBA provides such benefits in violation of section 1.501(c)(9)-3(c), such benefits constitute nonqualifying benefits.

Section 1.501(c)(9)-3(a) of the regulations provides that a VEBA will lose its exempt status if it systematically and knowingly provides more than a "de minimis" amount of nonqualifying benefits. Thus, a VEBA may provide nonqualifying benefits as long as such benefits do not constitute more than an insubstantial amount of the VEBA's total benefits.

Section 3402 of the Code provides that, except as otherwise provided, every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary of the Treasury.

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Section 3401(a) of the Code provides that, with certain enumerated exceptions, the term "wages" as used in section 3402 means all remuneration (other than fees paid to a public official) for services performed by an employee for his or her employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash.

Rev. Rul. 56-632, 1956-2 C.B. 101, holds that benefits excluded under Code section 106 are not subject to income tax withholding. However, health benefits that are included in income are wages for withholding purposes.

Sections 3101 and 3111 of the Code (Federal Insurance Contributions Act (FICA)) provide for a tax on employees and employers which is a percentage of wages (as defined in section 3121(a)) paid with respect to employment. Section 3301 of the Code (Federal Unemployment Tax Act (FUTA)) imposes on every employer a tax equal to a percentage of wages (as defined in section 3306(b)) paid by the employer during the calendar year with respect to employment.

Sections 3121(a) and 3306(b) of the Code provide, with certain exceptions, that for FICA and FUTA purposes respectively, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. Under sections 3121(a)(1) and 3306(b)(1), for purposes of the OASDI portion of FICA⁴ and for FUTA purposes, respectively, the term "wages" does not include that part of the remuneration paid by an employer to an employee within any calendar year which exceeds the applicable annual wage base. Under sections 3121(a)(2) and 3306(b)(2), wages for FICA and FUTA purposes does not include amounts paid to or on behalf of an employee or his dependents under a plan covering a class or classes of employees and their dependents on account of medical or hospitalization expenses. Health benefits provided to persons other than the employee or his dependents are not excluded from FICA or FUTA wages under these provisions.

Payment of the employee portion of FICA by the employer without withholding from the employee's wages is itself wages for purposes of FICA, FUTA and income tax withholding. The employee's stated wages must therefore be grossed up to reflect the additional amount that results from the employer's payment of the employee FICA. Rev. Proc. 81-48 provides a formula for determining the amount of the grossed-up wages in these circumstances.

⁴ The wage base limitation under section 3121(a)(1) applies only to the old-age, survivors, and disability insurance (OASDI) portions of FICA under sections 3101(a) and 3111(a), not to the hospital insurance (Medicare) portions of FICA under sections 3101(b) and 3111(b).

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Under section 3401(d), the term "employer" generally means the person for whom an individual performs any service, of whatever nature, as the employee of such person. Under section 3401(d)(1), however, if the person for whom the individual performs the services does not have control of the payment of the wages for such services, the term "employer" means the person having control of the payment of such wages. Regulation section 31.3401(d)-1(f) provides that the term "employer" means the person having legal control of the payment of the wages. For example, where wages are provided 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.

Neither the FICA nor the FUTA provisions contain a definition of employer similar to the definition contained in section 3401(d)(1). However, Otte v. United States, 419 U.S. 43 (1974), holds that a person who is an employer under section 3401(d)(1) is also an employer for purposes of FICA withholding under section 3102. Circuit courts have applied the Otte holding to conclude that the person having control of the payment of the wages is also the employer for purposes of section 3111, which imposes FICA excise tax on employers, and for purposes of section 3301, which imposes the FUTA tax on employers. See, for example, In re Armadillo Corp., 561 F.2d 1382 (10th Cir. 1977).

The Fund is responsible for enrollment, processing, and administration of benefits. The trustees of the Fund determine the employers' contribution rates required to support the benefits for each plan unit. The Fund is liable for all expenses of all of its constituent plan units. Employers do not receive information regarding coverage of their employees. Thus, we conclude that the Fund has legal control of the payment of the wages (that is, the value of the coverage provided) and is the employer for purposes of section 3401(d)(1) of the Code with respect to these wages.

The employer under section 3401(d)(1) is responsible for income tax withholding generally, but is not the employer for purposes of section 3401(a), which defines wages for purposes of income tax withholding. Section 3401(a) also provides various exceptions to the term "wages" that depend on the nature of the employer. As a result, the determination of whether remuneration is wages under section 3401(a) is made on the basis of the common law employer, even if another party is the employer under section 3401(d)(1).

Similarly, although the Fund is the section 3401(d)(1) employer for purposes of the coverage provided by the Fund, the employee's common law employer is the employer for purposes of determining the amount of an employee's FICA and FUTA wages. Therefore, in applying the annual OASDI and FUTA wage bases under sections 3121(a)(1) and 3306(b)(1), wages from the employee's common law employer are

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taken into account. To the extent that, at the time the Fund treats the domestic partner health coverage as wages, the wages paid by the employee's common law employer in that year equal or exceed the OASDI or FUTA wage base, the coverage will not result in additional wages for OASDI or FUTA purposes.⁵

Section 31.3402(g)-1(a)(2) of the regulations provides, in part, that if supplemental wages are paid and tax has been withheld from the employee's regular wages, the employer may determine the tax to be withheld from supplemental wages by using a flat percentage rate of 20 percent, without allowance for exemption and without reference to any regular payment of wages. Section 13273 of the Revenue Reconciliation Act of 1993 (Pub. L. No. 103-66) increased the flat percentage rate of withholding on supplemental wage payments from 20 percent to 28 percent effective for payments made after December 31, 1993.

In Rev. Rul. 82-46, 1982-1 C.B. 158, City X and City Y both maintain eligible state deferred compensation plans under section 457 of the Code and pay plan benefits to their employees after termination of employment. Employees are also covered by regular retirement plans maintained by both cities. City X's regular retirement plan is administered by an insurance company which has control of the payment of benefits. The ruling holds that in the case of City X, since the insurance company has control of payments under the regular retirement plan, the insurance company and not City X is the "employer" for purposes of income tax withholding with regard to those wages. City X is the "employer" as to payments from its eligible state deferred compensation plan and should treat those payments as regular wages, not as supplemental wage payments. On the other hand, because City Y makes payments under both the retirement plan and the deferred compensation plan, it should treat the amounts paid employees under the deferred compensation plan as supplemental wage payments. Rev. Rul. 82-46 thus indicates that, in determining the method of withholding applicable to a payment of wages, wages paid by the common law employer are considered separately from those paid by the section 3401(d)(1) employer.

Guidelines for the reporting of and the withholding on the value of taxable noncash fringe benefits are provided in Announcement 85-113, 1985-31 I.R.B. 31. Under Announcement 85-113, employers may elect, for employment tax and withholding purposes, to treat taxable noncash fringe benefits as paid on a pay period, quarterly, semi-annually, annual, or other basis, provided that the benefits are treated as paid no less frequently than annually. For example, an employer may treat the annual value of noncash fringe benefits as wages paid in December of each year and use the annual withholding table in Circular E (Publication 15, Employer's Tax Guide).

⁵ The coverage will be wages for Medicare purposes because Medicare wages are not limited by section 3121(a)(1).

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RULINGS

Based on the facts submitted we conclude the following.

1. Health coverage provided to a domestic partner who is a dependent of the employee within the meaning of section 152 of the Code is not included in the employee's gross income and is not wages for employment tax purposes.
2. Because the dependent certification used by the Fund contains representations that the support test and the residency test of section 152(a)(9) are met and that the relationship between the participant and the domestic partner does not violate local law under section 152(b)(5), the Fund may rely on the dependent certification to establish that the domestic partner is a dependent of the participant for purposes of determining whether the domestic partner coverage is subject to income and employment taxes.
3. The excess of the fair market value of the coverage provided by the Fund to a domestic partner who is not a dependent of the employee within the meaning of section 152 of the Code, over the amount paid by the employee for such coverage, is includible in the income of the employee under section 61 and is wages for FICA, FUTA and income tax withholding purposes. The amount of employee FICA attributable to the coverage that is paid by the Fund on the employee's behalf is also includible in the employee's income and is wages for employment tax purposes. Therefore, the grossed-up amount determined under Rev. Proc. 81-48 is the amount includible in the gross income of the employee by reason of the health coverage for a domestic partner and is the amount of the employee's wages for FICA, FUTA and income tax withholding purposes.
4. The Fund is the employer under section 3401(d)(1) of the Code for purposes of the employment taxes on the amount of wages that results from the coverage provided to an employee's nondependent domestic partner. Thus, the Fund is required to withhold income tax and the employee portion of the FICA tax. The Fund must also pay the employer portion of the FICA tax and the FUTA tax.
5. The wages paid by the common law employer are considered in determining whether an employee has exceeded the wage bases under sections 3121(a)(1) and 3306(b)(1) for purposes of the OASDI portion of the FICA and for purposes of the FUTA taxes. For purposes of determining the amount of income tax to withhold, the wages paid by the 3401(d)(1) employer are considered separately from wages paid by the common law employer. See Rev. Rul. 82-46.
6. Under Announcement 85-113, the Fund may treat the coverage as provided on an annual basis for purposes of income tax withholding, FICA, and FUTA.

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7. The Fund's operations with respect to health coverage provided to nondependent, nonspousal domestic partners will be no more than de minimis within the meaning of section 1.501(c)(9)-3(a) of the regulations. The provision of coverage therefore will not adversely affect the Fund's exempt status under section 501(c)(9) of the Code.

Under section 4.02(1) of Rev. Proc. 2000-3, 2000-1 I.R.B. 103, 111, this office does not ordinarily rule on fact issues, such as the determination of fair market value. Accordingly, we are unable to issue a ruling that approves your method of determining the value of the domestic partner health coverage.

Except as stated above, no opinion is expressed concerning the federal tax consequences to the Fund under any section of the Code. 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.

You must attach a copy of this letter ruling to any tax return to which it is relevant. We enclose a copy for that purpose. We are informing the TE/GE customer service office of this ruling. Because this letter could help resolve any questions about the Fund's exempt status, a copy should be kept in the Fund's permanent records. In case of questions about this letter, please contact the person listed in the heading of the letter. For other matters, including questions about reporting requirements, please contact the TE/GE customer service office.

Sincerely,

Patricia M. McDermott
Branch Chief
Office of Division Counsel/Associate
Chief Counsel
(Tax Exempt and Government Entities)

Enclosures (2):
Copy of this letter
Copy for section 6110 purposes

cc:

TE/GE customer service office