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Person To Contact:
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Telephone Number:

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Date:
November 07, 2006

In re: Letter Ruling Request Regarding Supplemental Unemployment Benefit Compensation

Company =
Plan =

Union =
Date x =
Year =
State =
Percentage =

Dear .:

This is in reply to your letter requesting a ruling regarding the federal employment tax consequences of payments made under a plan ("the Plan") providing benefits to laid-off employees. Specifically, you have requested rulings concerning whether the Plan is a supplemental unemployment benefit (SUB) plan and whether benefits paid pursuant to the Plan are wages subject to taxes imposed under the Federal Insurance Contributions Act (FICA) and the Federal Unemployment Tax Act (FUTA).

According to the information you submitted, the Company and the Union agreed to establish the Plan, effective date x. The Plan is designed to provide benefits for eligible employees in the event of an employment layoff. Pursuant to the Plan, eligible employees are defined as non-probationary employees who are actively employed as of the date of layoff, and have completed 90 calendar days of employment since the most recent day of hire. Eligible employees include employees who are on jury duty, bereavement leave, scheduled Paid Time Off, or Spontaneous Paid Time Off. Employees who are on probation may participate in the Plan on the date probation is completed. Layoff is defined in the Plan as a reduction in the working force for an

unknown or indefinite duration which results in the need to suspend employment. Layoffs commenced in the 4th quarter of Year due to weak Company sales. Additionally, the Plan permitted full-time employees to volunteer, one time only, to be laid off for the duration of the layoff or until recalled in seniority order.[1]

The terms of the Plan require that participating employees apply for and receive any available State and/or federal[2] unemployment benefits in order to be eligible to receive layoff benefits under the Plan. Failure by an employee to apply for State and/or federal unemployment benefits will result in non-payment of benefits under the Plan. However, the Plan does permit otherwise eligible employees to apply for layoff benefits in other limited circumstances where the employee has been denied State unemployment benefits, such as where the employee had insufficient credits to qualify for State unemployment benefits, had exhausted the duration of State unemployment benefits, was serving jury duty or was receiving pay for military service, or where it is determined that although State unemployment benefits have been denied, it would be contrary to the intent of the Plan to deny layoff benefits (e.g., in cases where the employees were full-time students, or were receiving medical disability.). Since the inception of the Plan, no benefits have been paid to laid-off employees who are ineligible to receive State unemployment benefits because they are serving jury duty or receiving military pay.

Benefits under the Plan will be reduced by any State unemployment benefits received by an employee and by the amount of all other benefits in the nature of compensation or remuneration from other employers for such weeks. Plan benefits do not reduce, cancel, or disqualify the recipients from simultaneously receiving State unemployment benefits.

The Plan's benefit is a weekly payment made to a laid-off employee in an amount which, when added to any State unemployment benefit, will not exceed Percentage of the employee's base rate plus a cost of living adjustment (i.e., COLA) and, if applicable, shift premium and seven day operation premium in effect on the last day at work prior to layoff. No layoff benefits will be paid in the event of work stoppage or any fault attributable to the employee. Lump sum payments are not paid under the Plan.

Benefits under the Plan will be paid for the duration of the layoff, but not more than the accumulation of 70 weeks for employees with five or more years of seniority during any three-year period or 52 weeks for employees with less than five years of seniority during any three-year period. State unemployment benefits will be paid for 26 weeks after a

[1] Once the number of employees who volunteered for layoff had been determined, employees were laid off on a plant-wide basis by classification according to seniority with the most junior employee being laid off first and continuing in the ascending order of their seniority.

[2] Although the Plan states that employees must apply for and receive both State and federal unemployment benefits, eligibility for benefits under the Plan has effectively been based solely on eligibility for and receipt of State unemployment benefits.

one-week waiting period. Therefore, an employee may continue to receive benefits under the Plan after their State unemployment benefits are exhausted.[3]

Under the Plan, so long as the employee is found eligible for State unemployment benefits, the "waiting week" under the State system will be treated as part of the layoff period and employees who qualify for State unemployment compensation will receive layoff benefits for that week. However, if an employee works during any portion of a work day, he/she will not be considered to be laid-off for such day for purposes of the Plan, except as provided below.

Laid-off employees may apply to be part of a Supplemental Worker program offered by the Company. If a laid-off employee returns to work as a Supplemental Worker, the Company views them as both a laid-off worker continuing to receive layoff benefits and a Supplemental Worker receiving wages. As a Supplemental Worker, an employee's hourly rate of pay will be based on his or her rate of pay as of the last day worked prior to layoff. Benefits under the Plan will be reduced by wages earned as a Supplemental Worker. Wages earned as a Supplemental Worker will be treated by the Company as though they were identical to wages earned from employment other than for the Company.

Employees must report all outside earnings to the Company. Layoff benefits under the Plan will continue to be paid during such period for the duration of the layoff, as long as the employee's earnings do not exceed Percentage of the employee's prior pay.

Payment of benefits under the Plan will cease upon the earlier of (1) the recall of the employee to active employment with the Company, (2) the termination of the employee's employment relationship with the Company, or (3) the exhaustion of the total benefit available to the employee pursuant to the Plan. Accordingly, layoff benefits do not cease and may continue to be paid even after State benefits have been denied because of outside earnings, or where Supplemental Worker pay exceeds the weekly benefit amount that would otherwise be paid if the employee were totally unemployed.

Benefits paid under the Plan can be grouped into five categories:

(a) Benefits that are paid to laid-off employees who are receiving State unemployment benefits and no other compensation from the Company;
(b) Benefits that are paid to laid-off employees who are ineligible to receive State unemployment benefits because the employee (1) does not have sufficient employment to be covered under the State system, (2) has exhausted State unemployment benefits, or (3) has not met the State's requisite waiting period

[3] However, if an employee's outside earnings are sufficiently high as to cause loss of State unemployment benefits for a particular week, the State unemployment benefit will be deferred and paid at a later date. Consequently, the payment of State unemployment benefits could be prolonged for longer than 26 weeks.

(provided the employee otherwise becomes eligible and receives State benefits once the waiting period expires),

(c) Benefits that are paid to laid-off employees who are ineligible to receive State unemployment benefits because the employee (1) was a full-time student or (2) was receiving medical disability payments (Since the inception of the Plan, the total benefits paid under the Plan to full-time students and medical disability recipients have accounted for less than 1% of the total benefits paid under the Plan and were therefore a de minimis percentage of the total benefits paid under the Plan.);

(d) Benefits that are paid to laid-off employees who are receiving State unemployment benefits and are also receiving earnings as a Supplemental Worker in an amount that does not disqualify the employees from receiving State unemployment benefits; and

(e) Benefits that are paid to laid-off employees who are ineligible to receive State unemployment benefits because the employee (1) is receiving earnings from an outside employer in an amount that disqualifies the employee from receiving State unemployment benefits, or (2) is receiving earnings as a Supplemental Worker in an amount that disqualifies the employee from receiving State unemployment benefits. Under the Plan, layoff benefits have been paid under these circumstances to only a small number of recipients.

All amounts paid under the Plan are from the general assets of the Company. The Company has responsibility for administering the Plan and has the exclusive right to determine eligibility for and the amount of any benefit payable under the Plan.

APPLICABLE LAW

Sections 3121(a) and 3306(b) of the Internal Revenue Code define the term “wages” for FICA and FUTA purposes, respectively, as all remuneration for employment, with certain limited exceptions. Section 3401(a), relating to federal income tax withholding, contains a similar definition.

Sections 31.3121(a)-1(b), 31.3306(b)-1(b) and 31.3401(a)-1(a)(1) of the Employment Tax Regulations provide that the term “wages” means all remuneration for employment unless specifically excepted. Sections 31.3121(a)-1(i), 31.3306(b)-1(i), and 31.3401(a)-1(a)(5) of the regulations further provide that remuneration from employment, unless specifically excepted, constitutes wages even though at the time the remuneration is paid the individual is no longer an employee.

Section 31.3401(a)-1(b)(4) of the regulations specifically provides that, for purposes of federal income tax withholding, any payments made by an employer to an employee on account of dismissal (i.e., involuntary separation from the service of the employer) constitute wages regardless of whether the employer is legally bound by contract,

statute, or otherwise to make such payments. Although there are no similar provisions in the regulations relating to FICA and FUTA taxes, the same conclusion generally applies. H.R. Rep. No. 1300, 81st Cong., 1st. Sess. 124 (1949), 1950-2 C.B. 255, 277, & 300. See also Rev. Rul. 90-72, 1990-2 C.B. 211, Rev. Rul. 71-408, 1971-2 C.B. 340, and Rev. Rul. 75-44, 1975-1 C.B. 15.

The Service created an administrative exception for SUB pay with the issuance of Rev. Rul. 56-249, 1956-1 C.B. 488.[4] Rev. Rul. 56-249 provides a limited exception from the definition of wages for FICA tax, FUTA tax, and federal income tax withholding purposes for certain payments made upon the involuntary separation of an employee from the service of the employer. The exception applies only if the payments are designed to supplement the receipt of state unemployment compensation and are actually tied to the receipt of state unemployment benefits, and in three limited situations where the employee is ineligible to receive state unemployment benefits, viz., where the employee does not have sufficient employment to be covered under the state system, where the employee has exhausted the duration of state unemployment benefits, or where the employee has not met the requisite waiting period.

The plan in Rev. Rul. 56-249 is specifically "designed to supplement state system unemployment benefits payable to certain former employees." Employees must report to and register for employment with the state employment service. The plan also incorporates all of the state unemployment compensation law requirements designed to limit benefit payments to individuals who are "unemployed" and genuinely available for any suitable work. The plan benefits are payable only after an employee is unemployed for "x" weeks. The plan benefits are paid in varying amounts and for varying periods depending, in part, on the amount of state unemployment benefits available. Finally, in a state where SUB pay does not reduce state unemployment benefits, the unemployed individual cannot receive any other remuneration which would disqualify the individual from the state benefit, i.e., a plan payment is not SUB pay if the sum of that benefit and other remuneration from the employer disqualifies the recipient from receiving unemployment benefits in such a state. In very limited situations, the plan benefits

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[4] Section 3402 of the Code, as added by section 805(g) of the Tax Reform Act of 1969, P.L. 91-172, *1969-3 C.B. 10,* extends federal income tax withholding to any supplemental unemployment compensation benefit paid to an individual, regardless of whether it would otherwise be considered wages. Section 3402(o)(2)(A) defines “supplemental unemployment compensation benefits” as amounts paid to an employee pursuant to a plan to which the employer is a party, because of an employee’s involuntary separation from employment (whether or not such separation is temporary) resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar conditions, but only to the extent such benefits are includible in the employee’s gross income. The treatment of supplemental unemployment compensation benefits in section 3402(o) of the Code does not dictate the proper tax treatment to be accorded to a payment for FICA or FUTA tax purposes. For FICA and FUTA tax purposes, the treatment of SUB pay is governed by a series of administrative pronouncements published by the Service dating back to the 1950s, when SUB plans were first adopted. See also Rev. Rul. 90-72, 1990-2 C.B. 211.

disqualify the recipient from state unemployment benefits, thereby entitling the individual to the payment of a substitute benefit. However, the plan is designed in such a manner that the benefits generally do not disqualify the recipient from state unemployment benefits.

The ruling summarizes the following eight features of the plan: (1) benefits are paid only to unemployed former employees who are laid off by the employer; (2) eligibility for benefits depends upon meeting prescribed conditions after terminating employment with the employer; (3) benefits are paid by trustees of independent trusts; (4) the amount of weekly benefits payable is based upon state unemployment benefits, other compensation allowable under state laws, and the amount of straight-time weekly pay after withholding of all taxes and contributions; (5) the duration of the benefits is affected by the fund level and the employee's seniority; (6) the right to benefits does not accrue until a prescribed period after termination of employment; (7) the benefits are not attributable to the rendering of particular services by the recipient during the period of unemployment; and (8) no employee has any right, title, or interest in the fund until such employee is qualified and eligible to receive benefits. Revenue Ruling 56-249 concludes that the plan benefits do not constitute "wages" for purposes of FICA tax, FUTA tax, or federal income tax withholding.

Subsequent revenue rulings have broadened the scope of Rev. Rul. 56-249, but only to the extent that the plans in question are "similar in all material details" or are "substantially the same" as the plan in Rev. Rul. 56-249. If the plans are substantially the same or similar in all material details to the plan described in Rev. Rul. 56-249, then the absence of a single element may not be a material or controlling factor. The question is whether each plan's basic or fundamental purposes and conditions are the same as the purposes and conditions of the plan in Rev. Rul. 56-249.

In Rev. Rul. 60-330, 1960-2 C.B. 46, the Service amplified Rev. Rul. 56-249 and concluded that a plan's failure to provide for the accumulation of funds in a trust account does not alter the conclusion of Rev. Rul. 56-249.

In Rev. Rul. 80-124, 1980-1 C.B. 212, the Service emphasized that a payment qualifies as SUB pay under Rev. Rul. 56-249 only if the payment is “for a layoff that is involuntary on the part of the employee.”

In Rev. Rul. 90-72, 1990-2 C.B. 211, the Service continues to recognize an administrative wage exclusion, albeit modified, for SUB pay. Rev. Rul. 90-72 holds that SUB pay is excluded from "wages" for FICA and FUTA tax purposes only if the receipt of SUB pay is actually linked to the receipt of state unemployment compensation (i.e., the plan payments satisfy the plan's design and purpose of supplementing the receipt of state unemployment compensation). Furthermore, it holds that lump-sum payments are not linked to state unemployment compensation since the amount of the benefit received is the same regardless of the length of the individual's unemployment.

Therefore, to qualify as SUB pay for FICA and FUTA tax purposes, payments under a plan must be specifically designed to supplement state unemployment benefits and, under the terms of the plan, the employee must be unemployed and must meet the requirements necessary to receive state unemployment compensation benefits.

Accordingly, based solely on the information submitted, we rule as follows:

The Plan is a SUB plan because it is similar in all material respects to the plan described in Rev. Rul. 56-249, as modified by Rev. Rul. 90-72; i.e., the Plan is designed to supplement state unemployment benefits and the benefits are linked to the receipt of state unemployment compensation.

The following rulings apply to the various categories of payments under the Plan:

(a) Benefits that are paid to laid-off employees who are receiving State unemployment benefits and no other compensation from the Company are linked to the receipt of State unemployment benefits and are not wages for FICA and FUTA tax purposes.

(b) As in Rev. Rul. 56-249, the FICA and FUTA tax exclusion also extends to the benefits paid to laid-off employees who are ineligible to receive State unemployment benefits because (a) the employee does not have sufficient employment to be covered under the State system, (b) the employee has exhausted the duration of State unemployment benefits, or (c) the employee has not met the requisite waiting period (provided the employee otherwise becomes eligible and receives State benefits once the waiting period expires).

(c) As in Rev. Rul. 56-249, the FICA and FUTA exclusion also extends to the de minimis amount of benefits paid pursuant to the Plan that are not tied to State unemployment benefits (i.e., benefits paid to full-time students and laid-off workers receiving medical disability payments).

(d) Except as ruled below with respect to Supplemental Workers who are disqualified from receiving State unemployment benefits, this ruling does not address the tax treatment of benefits paid under the Plan to laid-off employees who receive earnings during the payroll period as a Supplemental Worker, while also receiving State unemployment benefits during such period.

(e) Benefits paid under the Plan are not excluded if they are made to employees who have been disqualified from State unemployment benefits because of other outside earnings or earnings as a Supplemental Worker. This category of payments made under the Plan is wages for FICA and FUTA tax purposes. However, due to the very small number of occurrences under this category, we conclude that this limited

exception does not affect the tax treatment of the layoff benefits paid under the Plan that are tied to the receipt of state unemployment benefits, as described above.

You have not requested a ruling with regard to the tax treatment of benefits paid under the Plan to employees who volunteered to be laid off.

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.

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, a copy of this letter is being sent to your authorized representative.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by penalty of perjury statements executed by an appropriate party. 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.

Sincerely,

Janine Cook
Branch Chief, Employment Tax
Branch 1
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt & Government
Entities)

Enclosures:

Copy of Letter

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