

Internal Revenue Service

Department of the Treasury
Washington, DC 20224

Number: **200720017**

Release Date: 5/18/2007

Index Number: 61.30-00, 3101.00-00,
3111.00-00, 3121.01-00,
3301.00-00, 3306.02-00,
3401.01-00, 3402.00-00

[Third Party Communication:
Date of Communication: Month DD, YYYY]

Person To Contact: _____, ID No.

Telephone Number: _____

Refer Reply To:
CC:ITA:B05
PLR-152644-06
Date:
February 09, 2007

Legend

Taxpayer =

State A =

Policy =

Modified Policy =

Dear _____ :

This is in response to your request for a private letter ruling dated November 6, 2006, submitted by the authorized representatives of Taxpayer. Rulings are requested below concerning Taxpayer’s income tax withholding and employment tax obligations with respect to leave transferred by employees of Taxpayer to other employees of Taxpayer under the Policy currently maintained by Taxpayer. Similar rulings are also requested concerning leave transferred pursuant to the Modified Policy currently being considered by Taxpayer for implementation.

FACTS

Taxpayer is a publicly traded healthcare services company with facilities in numerous states. Taxpayer’s accounting period is the calendar year, and it uses the accrual method of accounting for maintaining its books and records and for filing its federal tax returns. Taxpayer’s corporate headquarters is in State A.

Taxpayer maintains various programs under which its employees accrue paid leave time that may be used for various reasons, including vacation, personal days and sick days. Employee requests for time off must request be approved by Taxpayer. If a request is approved, but the employee lacks sufficient hours of paid leave time under the applicable paid leave program at the time leave is to begin, the employee will not receive pay for the time off.

Taxpayer currently maintains Policy pursuant to which employees are allowed to surrender accrued hours of paid leave ("Donor Employee") for the benefit of other employees who need more time off than they have accumulated personally ("Recipient Employee"). Under Policy as currently in effect, an eligible employee may request additional paid leave if the employee experiences a medical emergency, is caring for a spouse or child in the event of a medical emergency, or needs extended time off following the death of a parent, spouse or child. To be eligible to receive surrendered leave under Policy, an employee must be employed by Taxpayer for at least 90 days and must be eligible to accrue paid leave time under the applicable paid leave program. Policy defines "medical emergency" as a major illness or other medical condition (e.g., heart attack, cancer, etc) that requires a prolonged absence from work, including intermittent absences that are related to the same illness or condition. In order to receive surrendered paid leave time, an eligible employee must have exhausted all of his or her own paid leave time, must complete a written request and authorization form, and must have the scheduled time off or leave of absence approved by Taxpayer. The Donor Employee also must complete an authorization form, which must be approved by Taxpayer, before leave can be surrendered. Leave time must be donated to a specific employee who is eligible to receive donated leave time under the Policy (i.e., the Recipient Employee). Policy also includes restrictions on the amount and type of paid leave time that may be surrendered by a Donor Employee. Once surrendered, paid leave hours cannot be returned to the Donor Employee, but will remain available for use by the specific Recipient Employee.

If a Recipient Employee receives paid leave hours under the Policy from a Donor Employee with a different pay rate, the leave time is converted based on the Recipient Employee's pay rate, so that the dollar value of the surrendered leave remains the same, but leave taken by the Recipient Employee is always paid at the Recipient Employee's regular rate of pay. For example, if Donor Employee is regularly paid \$15.00 per hour and surrenders eight hours of paid leave to a Recipient Employee who is regularly paid \$10.00 per hour, the Recipient Employee will receive 12 hours of paid leave, paid at \$10.00 per hour (8 hours x \$15.00 = \$120 value, and \$120.00 value/ \$10.00 per hour = 12 hours).

Taxpayer is considering whether to implement certain modifications to Policy ("Modified Policy") that would allow eligible employees who experience "catastrophic casualty losses" due to terrorist attack, fire or other natural disaster (i.e., hurricane, flood, tornado or other highly destructive storm) to request surrendered paid time off as well. For

purposes of the Modified Policy, a “catastrophic casualty loss” would include severe damage to or destruction of the employee’s primary residence, which requires immediate action by the employee to secure the premises. The Modified Policy may permit employees to donate leave hours to a leave “bank” in the event of a terrorist attack, natural disaster or public health crisis that affects a large number of employees. Leave hours donated to the bank would be available on a first-come, first-served basis, to affected employees whose leave donation requests are approved. The leave bank would be available only for a limited period of time following the crisis event.

Taxpayer is requesting the following four rulings:

- (1) Payments made under the Policy as currently in effect are reportable in the Recipient Employee’s gross income under § 61 of the Internal Revenue Code (the “Code”) and are subject to withholding taxes under §§ 3401, 3121 and 3306 of the Code at the time the Recipient Employee receives the payment.
- (2) Under the Policy as currently in effect, the Recipient Employee who receives the payments with respect to the paid leave time surrendered by the Donor Employee is the sole individual subject to withholding and income tax liability at the time the payment is made, and the Donor Employee who surrendered the paid time off is not subject to income or withholding tax liability, either at the time he or she applies to donate the leave hours or at the time a payment is made by Taxpayer to the Recipient Employee in connection with the surrendered paid leave time.
- (3) Payments made under the Modified Policy after implementation of the proposed changes to the Policy are made are reportable in the Recipient Employee’s gross income under § 61 and are subject to withholding taxes under §§ 3401, 3121 and 3306 at the time the Recipient Employee receives the payment.
- (4) Under the Modified Policy, the Recipient Employee who receives the payments with respect to the paid leave time surrendered by the Donor Employee is the sole individual subject to withholding and income tax liability at the time the payment is made, and the Donor Employee who surrendered the paid time off is not subject to income or withholding tax liability, either at the time he or she applies to donate the leave hours or at the time a payment is made by Taxpayer to the Recipient Employee in connection with the surrendered paid leave time.

LAW AND ANALYSIS -- GROSS INCOME ISSUE

Section 61 of the Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including compensation for services.

A basic principle of tax law is that a taxpayer's assignment to another person of his or her right to receive compensation for personal services does not relieve the taxpayer of the tax liability on the assigned income. See Lucas v. Earl, 281 U.S. 111, 50 S. Ct. 241,

74 L. Ed. 731 (1930), and Helvering v. Eubank, 311 U.S. 122, 61 S. Ct. 149, 85 L. Ed. 81, 1940-2 C.B. 209 (1940), 1940-2 C.B. 209. However, this general “assignment of income” rule does not apply to certain situations involving employer-sponsored leave plans. One situation involves bona fide employer-sponsored (medical) leave-sharing arrangements. Another involves certain qualified employer-sponsored major disaster leave-sharing plans.

The first exception to this general assignment of income rule involves the bona fide employer-sponsored (medical) leave-sharing arrangement described in Rev. Rul. 90-29, 1990-1 C.B. 11. Under the plan in the ruling, employees who suffer medical emergencies may qualify to receive leave surrendered to the employer by other employees or leave deposited by its employees in an employer sponsored leave bank. The ruling holds that the amounts paid by the employer to a leave recipient pursuant to the plan are includable in the gross income of the recipient under § 61 of the Code as compensation for services provided by that recipient to the employer. Rev. Rul. 90-29 further concludes that these amounts are considered “wages” for employment tax purposes, including the Federal Insurance Contributions Act (“FICA”), the Federal Unemployment Tax Act (“FUTA”), the Railroad Retirement Tax Act (“RRTA”), and the Railroad Unemployment Repayment Tax (“RURT”), and for income tax withholding purposes, unless otherwise excluded by a specific provision of the Code. The revenue ruling also holds that an employee who surrenders leave to the employer or deposits leave in the leave bank does not realize any income and incurs no deductible expense or loss either upon surrender or deposit of the leave or its use by the recipient employee.

Another exception involves qualified employer-sponsored major disaster leave-sharing plans such as plans that involve amounts paid pursuant to a leave-sharing plan to assist employees affected by a major disaster declared by the President of the United States. Notice 2006-59, 2006-28 I.R.B. 60, provides that the Internal Revenue Service will not assert that a leave donor who deposits leave into an employer-sponsored leave bank under a major disaster leave-sharing plan that meets the requirements set forth in Notice 2006-59 realizes income or has wages, compensation, or rail wages with respect to the deposited leave, provided that the plan treats payments made by the employer to the leave recipient as “wages” for purposes of FICA, FUTA, and income tax withholding, and as “compensation” for purposes of RRTA and “rail wages” for purposes of RURT, unless excluded therefrom under a specific provision of the Code. A leave donor may not claim an expense, charitable contribution, or loss deduction on account of the deposit of the leave or its use by a leave recipient. Notice 2006-59 defines “major disaster” to mean (a) a major disaster as declared by the President under § 401 of the Stafford Act, 42 U.S.C. § 5170, that warrants individual assistance or individual and public assistance from the federal government under that Act, or (b) a major disaster or emergency as declared by the President pursuant to 5 U.S.C. § 6391, in the case of employees described in that statute.

In this case, Recipient Employees under the Policy as currently in effect are limited to those employees who experience a medical emergency, care for a spouse or child in the event of a medical emergency, or need extended time off following the death of a parent, spouse or child. The Policy defines “medical emergency” as a major illness or other medical condition (e.g., heart attack, cancer, etc) that requires a prolonged absence from work, including intermittent absences that are related to the same illness or condition. The facts surrounding Policy as currently in effect in this case are close to the facts surrounding the employer-sponsored (medical) leave-sharing arrangement described in Rev. Rul. 90-29. We therefore conclude that, under the facts presented and the representations made, the payments made under the Policy as currently in effect are includible in the Recipient Employee’s gross income under § 61 of the Code. Such payments are not includable in the Donor Employee’s gross income under § 61.

However, Modified Policy with the changes proposed above is distinguishable from the narrow exceptions described above. Because Modified Policy provides a Recipient Employee with paid leave during a time that he or she is facing a catastrophic casualty loss that may or may not involve a personal or family medical emergency, Modified Policy is not limited to a medical emergency leave program. Consequently, it is not within the scope of employer-sponsored (medical) leave-sharing arrangement described in Rev. Rul. 90-29. Modified Policy is also outside the scope of qualified employer-sponsored major disaster leave-sharing plans that meet the requirements of Notice 2006-59 because it is not designed to be limited specifically to aid the victims of a “major disaster” as declared by the President of the United States.

Because the Modified Policy does not meet any of the exceptions described above, the tax consequences to Donor Employees who transfer leave pursuant to the Modified Policy will be governed by the assignment of income doctrine. Applying the doctrine to the facts here, we conclude that a Donor Employee's assignment of his or her right to receive vacation and other similar accrued paid leave under the Modified Policy will not relieve the Donor Employee of the income tax liability on the assigned leave. Therefore, a Donor Employee must include the cash value of any vacation and other similar accrued paid leave that the Donor Employee transfers pursuant to the Modified Policy in his or her gross income under § 61 as compensation for services provided by that employee to Taxpayer.

LAW AND ANALYSIS -- EMPLOYMENT TAX ISSUE

Generally, every employer making payment of “wages” must withhold federal income tax pursuant to § 3402 of the Code. For income tax withholding purposes, the term “wages” means all remuneration for services performed by an employee for his employer unless a specific exemption under § 3401(a) applies. In general, income tax is withheld from an employee’s wages when the wages are actually or constructively paid to the employee. See Treas. Reg. § 31.3402(a)-1. Federal Insurance Contribution Act (FICA) taxes are imposed on employees and employers under §§ 3101 and 3111,

respectively. Employers have a duty to collect the employee's share of FICA taxes under § 3101 by withholding the amount of the tax from the employee's "wages." The term "wages" for purposes of FICA means, with certain exceptions, all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash. See § 3121(a). Typically, wages are subject to FICA tax when they are actually or constructively paid to the employee. See Treas. Reg. § 31.3121(a)-2. Additionally, the employer must pay an excise tax (FUTA tax) on the total "wages" the employer pays to an employee. The term "wages" for purposes of FUTA is similar to the FICA wage definition. See § 3306(b). Again, FUTA taxes are imposed when an employee is actually or constructively paid. See Treas. Reg. §§ 31.3301-2, 31.3301-3(b) and 31.3301-4.

As noted above, the amounts an employer pays to an employee who receives paid leave pursuant to a bona fide employer sponsored (medical) leave-sharing plan, like the one in Rev. Rul. 90-29, are includible in that employee's gross income under § 61 of the Code, and they are considered "wages" of that employee for employment tax purposes (unless otherwise excluded by the Code). Moreover, pursuant to Rev. Rul. 90-29, an employee who surrenders leave to the employer or deposits leave into a leave bank maintained by the employer does not realize any income.

Because the Policy in this case is a bona fide employer sponsored (medical) leave-sharing plan similar to the one described in Rev. Rul. 90-29, we conclude that the payments made by Taxpayer to a Recipient Employee with respect to the paid leave time surrendered by the Donor Employee under the Policy are includable in the Recipient Employee's gross income under § 61 of the Code, and that they should be treated as "wages" of the Recipient Employee for employment tax purposes. Therefore, such payments made by Taxpayer to the Recipient Employee are subject to the tax withholding requirements and taxes provided by §§ 3402, 3101, 3102, 3111, 3121, and § 3301, respectively, at the time of payment. .

Moreover, in accordance with Rev. Rul. 90-29, the Donor Employee who surrenders leave under the Policy does not have income under § 61 of the Code, and thus is not treated as the recipient of "wages" subject to employment taxes in connection with the surrendered leave. The Donor Employee therefore is not subject to any withholding or employment tax obligations relating to the payments.

However, the Modified Policy, as proposed, does not qualify as a bona fide (medical) leave-sharing plan or a qualified major disaster leave-sharing plan. Therefore, the cash value of the surrendered paid leave is includable in the Donor Employee's gross income under § 61 of the Code, and thus should also be treated as the "wages" of the Donor Employee for employment tax purposes. Accordingly, these wages are subject to the tax withholding requirements and taxes provided by §§ 3402, 3101, 3102, 3111, 3121, and § 3301, respectively.

In addition, the Recipient Employee who receives payments of surrendered paid leave under the Modified Policy is not treated as the recipient of “wages” subject to employment tax. The Recipient Employee is not subject to any withholding or employment tax obligations relating to the payments. However, with respect to whether the Recipient Employee has gross income under § 61 of the Code for reasons other than compensation for services provided to Taxpayer, we note that under section 4.02(1) of Rev. Proc. 2006-3, 2006-1 I.R.B. 122, 129, the Service ordinarily will not issue letter rulings on any matter in which the determination is primarily one of fact. Because the reasons that Donor Employees of Taxpayer may transfer paid leave under the Modified Policy is primarily one of fact, we cannot express an opinion regarding the federal income tax consequences of the subject payments to the Recipient Employees who receive the cash value of the surrendered paid leave under the Modified Policy.

HOLDINGS

We hold that payments with respect to surrendered paid leave under the Policy, as currently in effect, made to a Recipient Employee are includable in the Recipient Employee’s gross income under § 61 of the Code and are “wages” subject to withholding taxes under §§ 3401, 3121 and 3306 at the time the Recipient Employee receives the payment. Moreover, the Recipient Employee who receives the payments with respect to the surrendered paid leave is the sole individual subject to withholding and income tax liability at the time the payment is made. The Donor Employee who surrendered the paid leave is not subject to income tax liability or withholding tax liability, either at the time he or she applies to donate the leave hours or at the time a payment is made by Taxpayer to the Recipient Employee in connection with the surrendered paid leave time.

We further hold that payments with respect to surrendered paid leave under the Modified Policy, after the implementation of the changes contemplated by Taxpayer, are includible in the Donor Employee’s gross income under § 61 of the Code and are “wages” subject to withholding taxes under §§ 3401, 3121 and 3306. The Donor Employee is the sole individual subject to wage withholding tax liability at the time the payment is made.

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.

We express no opinion, except as specifically ruled above, as to the federal income tax treatment of the transaction under any other provisions of the Code and regulations that may be applicable or under any other general principles of federal income taxation. Neither is any opinion expressed as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction(s) that are not specifically covered by the above ruling.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

The rulings contained in this letter are based upon information and representations submitted by Taxpayer and accompanied by a penalty of perjury statement 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 yours,

William A. Jackson
Branch Chief, Branch 5
Office of Associate Chief Counsel
(Income Tax & Accounting)