



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF THE CHIEF COUNSEL

August 4, 2011

Number: **2011-0074**
Release Date: 9/30/2011

GENIN-124978-11

UIL: 3121.01-12

Dear _____ :

I am writing in response to your letter dated June 3, 2011. In your letter, you asked about the employment tax treatment of health and welfare payments paid to the employees of a government contractor. I am providing the following general information letter which I hope will be useful to you.

Section 3121(a)(2) of the Internal Revenue Code (the Code) exempts from the definition of "wages" for Federal Insurance Contribution Act (FICA) taxes the amount of payment (including any amount an employer pays for insurance) made to, or on behalf of, an employee or any of their dependents for accident and health plans. Section 3306(b)(2) provides a similar exception for Federal Unemployment Tax Act (FUTA) tax purposes. If a payment is excluded from the definition of "wages," the employer does not have to withhold the employee portion of FICA tax under section 3102 of the Code, nor does the employer pay the employer's share of FICA tax under section 3111 of the Code. Additionally, the employer is not liable for FUTA tax on payments excluded from the definition of wages in section 3306(b) of the Code.

Revenue Ruling 75-241, 1975-1 C.B. 2316, involved a situation where a government contractor, while performing services under a government contract, was required to pay health and welfare benefits to its employees. In lieu of the health and welfare benefits, the contractor elected to discharge its obligation by paying the employees a cash amount. The employer was not required to verify that the employee used the cash amount to purchase health or welfare benefits. Because the contractor neither had a legal or contractual obligation to verify nor actually verified that the employees used the funds to purchase health or welfare benefits, the employee had complete control over

the disposition of the funds. Accordingly, these amounts were included in the employee's gross income and included as wages for purposes of FICA and FUTA.

If an employer makes payments directly to a carrier for the provision of health and welfare benefits for employees, these payments are excluded from "wages" for FICA and FUTA purposes per sections 3121(a)(2) and 3306(b)(2) of the Code. Conversely, if cash payments are made to employees in lieu of health and welfare benefits and the employee has complete control over the disposition of the cash payments, then those payments constitute "wages" for income tax withholding, FICA and FUTA purposes.

I hope this information is helpful. If you have any questions, please contact me or of my staff at () .

Sincerely,

Lynne Camillo
Branch Chief, Employment Tax Branch 2
(Exempt Organizations/ Employment Tax/
Government Entities)
(Tax Exempt and Government Entities)