

ID: CCA_2012101813255232

Number: **201302031**

Release Date: 1/11/2013

Office:

UILC: 3121.00-00

From:

Sent: Thursday, October 18, 2012 1:25:58 PM

To:

Cc:

Subject: RE: Window benefits

We didn't think of this aspect of the question, but it looks like you are making a good point.

Section 31.3121(v)(2)-1(b)(4)(iv)(A) provides that vacation benefits, sick leave, compensatory time, disability pay, severance pay and death benefits do not result from the deferral of compensation for purposes of section 3121(v)(2), even if those benefits constitute wages within the meaning of section 3121(a).

I do not think that this regulation applies with respect to the employee's entitlement to a lump sum payment of annual leave that is then deferred, because at that point vacation benefits are not being deferred in the usual sense because the employee is not retaining any right to vacation.

I also do not think the annual leave payments are window benefits. A window benefit is defined by the regulations as an early retirement benefit, retirement-type subsidy, social security supplement, or other form of benefit made available by an employer for a limited period of time (no greater than one year) to employees who terminate employment during that period or to employees who terminate employment during that period under specified conditions. The regulations also provide that a window benefit will not be considered a window benefit if an employer establishes a pattern of repeatedly providing for similar benefits in similar situations for substantially consecutive limited periods of time.

As the write-up you provided noted, the deferral of the accumulated vacation leave is not a window benefit because the employees were entitled to a lump sum payment of this benefit at retirement regardless of their election to participate in the early retirement program. The deferral of the payment of amount of the accumulated vacation leave also is not window pay because the accumulated vacation leave is not offered for a limited period of time but provide on a continuous basis to employees who retire. It is questionable whether the payout of the accumulated vacation leave over the five years versus immediate payout of the vacation leave is even a benefit. Receipt of the accumulated vacation leave payment over 5 years would generally be considered to be worth less than immediate receipt of the leave payment upon retirement. The deferral of the leave payment will also generally make the program less costly to the employer. Whether it is beneficial to the employee would depend on the tax rates of the employee over the 5-year period, which cannot be determined at the outset of the payments. Also, the regulations about a pattern of repeatedly providing the benefits would mean the accumulated vacation leave is not a window benefit because the lump sum annual leave is offered continuously.

Therefore, we agree that section 3121(v)(2) should apply to the portion of the early retirement program that is the deferral of the accumulated vacation leave, and FICA tax would apply in the first year to the accumulated vacation leave payments to be received when the employee committed to the early retirement program.

You could also argue that a portion of the \$ payments essentially relates to the fact that accumulated vacation leave is being deferred from the lump sum the employee would otherwise be entitled to at retirement, and thus that portion would be part of a nonqualified deferred compensation plan relating to the accumulated vacation leave. Essentially I would view the accumulated annual leave payment plan as being NQDC account balance plan beginning with the full amount of the accumulated annual leave in year 1 and a certain amount (representing reasonable interest) from the discounted flow of \$ payments being allocated to the accumulated annual leave deferral plan to bring it up to the full amount of the accumulated annual leave, that would be taxable in year one. Thus, the full amount of the accumulated vacation leave should be included in FICA wages in year one not the discounted stream of five payments. How is the employee otherwise being paid for the fact that he or she is not receiving the annual leave upon retirement but over five years, which means it is worth considerably less than the lump sum? Although the amount of the vacation leave pay outs were only, in total, about one fourth of the total years of service payout, you could argue that part of the years of service payout was to get the employee to agree to the five year payout of vacation leave.