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INTERNAL REVENUE SERVICE
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OFFICE OF THE CHIEF COUNSEL

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The Honorable Steny H. Hoyer
Member, U.S. House of Representatives
6500 Cherrywood Lane
Suite 310
Greenbelt, MD 22070

Attention:

Dear Representative Hoyer:

I am responding to your inquiry dated March 8, 2017, on behalf of your constituent, . raised questions about Federal Insurance Contributions Act (FICA) taxes imposed on his nonqualified deferred compensation plan annuity payments.

I appreciate your concerns about an employer's employment tax obligations. Although we cannot comment on specific taxpayer situations, I can provide the following general information.

The law imposes FICA taxes on the wages employers pay to employees for employment [Internal Revenue Code (Code) sections 3101 and 3111]. FICA tax is comprised of two separate taxes, Old-Age, Survivors and Disability Insurance (social security) taxes and Hospital Insurance (Medicare) taxes, which are imposed separately on employees and employers.

Code section 3101 imposes on an employee a tax equal to a percentage of wages received for employment (the employee's share of FICA tax). Section 3111 imposes on an employer an excise tax equal to a percentage of wages the employer pays for employment (the employer's share of FICA tax). Section 3102 requires an employer to collect the employee's share of FICA tax under section 3101 by withholding the amount of the tax from wages paid.

Generally, wages are subject to FICA tax when employers actually or constructively pay the wages to employees. However, a special rule applies for wages deferred under a “nonqualified deferred compensation plan”.

A nonqualified deferred compensation plan is an arrangement between an employer and an employee to pay the employee compensation in the future. Nonqualified deferred compensation plans are generally unfunded arrangements. This means the employer’s promise to pay the deferred compensation benefits in the future is not secured in any manner. Therefore, amounts deferred are subject to claims by the employer’s creditors. Thus, the risk that an employee may not receive any benefits in the future is an inherent feature of nonqualified deferred compensation plans.

Generally, an employer must withhold the employee share of FICA and pay the employer share of FICA on amounts deferred under a nonqualified deferred compensation plan as of the later of:

- (1) The date on which the employee performs the services that create the right to a deferral, or
- (2) The date on which the amount deferred is no longer subject to a substantial risk of forfeiture. [Section 3121(v)(2) of the Code].

This special rule generally accelerates the timing of FICA taxation to the time of deferral. Thus, FICA taxation will generally occur before the item of nonqualified deferred compensation is includable in income (when actually or constructively paid to the employee).

Nonqualified deferred compensation arrangements are either account balance plans or nonaccount balance plans. You constituent indicated he is receiving benefits under a nonaccount balance plan. A nonaccount balance plan does not credit deferred amounts to a particular participants’ individual account. [Employment Tax Regulation section 31.3121(v)(2)-1(c)(1)(i)].

There is a special rule for nonaccount balance plans. This rule permits an employer to delay including a deferral under the plan for FICA tax purposes until the amount deferred is considered “reasonably ascertainable.” It defines reasonably ascertainable as the first date on which the amount, form, and beginning date of the benefit are known, so that its present value can be computed [Regulations section 31.3121(v)(2)-1(e)(4)]. When the present value of a benefit becomes reasonably ascertainable, the present value amount is subject to FICA tax. Under some nonaccount balance plans, retirement benefits become reasonably ascertainable at the time of retirement.

The present value calculation does not consider the probability that an employer will not make payments because of the unfunded status of the plan. Nor does it consider the risk associated with any deemed or actual investment of the amounts deferred under the plan, or similar risks or contingencies. [Regulation section 31.3121(v)(2)-1(c)(2)(ii)].

According to your constituent, his employer paid FICA taxes on the present value of the nonqualified deferred compensation benefits in the year he began receiving distributions under the plan. As explained above, according to the Code and regulations, this is a proper method of withholding and paying FICA taxes on amounts deferred under a nonqualified deferred compensation plan that is a nonaccount balance plan.

Your constituent is also concerned that the employee share of FICA tax on the present value of his nonqualified deferred compensation benefit was included in his income. The liability for the employee share of FICA tax is on the employee. [Section 3102 of the Code]. The employer, through withholding, merely collects the tax liability of the employee. [Section 3102 of the Code]. Amounts withheld from the employee's wages for the employee share of FICA tax are treated as paid to the employee and repaid by the employee through withholding to satisfy the employee share of FICA tax. [Section 3123 of the Code]. Accordingly, the amount withheld by the employer as the employee share of FICA tax is properly included in the employee's income. [Regulation section 31.3401(a)-1(b)(5)].

This is different from the situation where the employer pays the employee share of FICA tax out of its own funds instead of withholding it from the employee's wages. In that situation, the employee must include in income both the amount that the employer should have withheld as the employee share of FICA tax and the additional amount paid by the employer out of its own funds.

The intent of Code section 3121(v)(2) is to impose FICA taxation on amounts deferred under a nonqualified deferred compensation arrangement when the amounts become vested in the employee (that is, not subject to a substantial risk of forfeiture). The fact that the employee later receives less than the amount originally deferred (or ultimately receives nothing at all) does not give a right to a refund of the FICA taxes paid on amounts deferred. See, *Balestra v. United States*, 803 F.3d 1363 (2015).

I hope this information is helpful. If you have any additional questions, please contact me or _____ of my office at _____.

Sincerely,

Lynne A. Camillo
Branch Chief, Employment Tax Branch 2
(TEGE Associate Chief Counsel)