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subject: Tax Treatment of Employer-provided Tax Preparation Services as Part of Employer's International Tax Equalization Program

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

LEGEND

Taxpayer =
CPA Firm =

Year 1 =
Year 2 =

ISSUES

- (1) Are the tax preparation services that Taxpayer provides for the benefit of its employees working in foreign countries includable in the employees' gross income?
- (2) If the tax preparation services are includable in gross income, how does Taxpayer determine their value for purposes of imputing income to the employees?

- (3) Does the value of the tax preparation services constitute “wages” for Federal Insurance Contributions Act (FICA) tax purposes?
- (4) Does the value of the tax preparation services constitute “wages” for purposes of federal income tax withholding (FITW)?

CONCLUSIONS

- (1) The tax preparation services provided by Taxpayer for the benefit of its employees working in foreign countries are includable in the employees’ gross income.
- (2) The amount includable in the employees’ gross income is the fair market value of the tax preparation services.
- (3) The fair market value of the tax preparation services constitutes wages for FICA tax purposes.
- (4) The fair market value of the tax preparation services constitutes wages for purposes of FITW, unless Taxpayer had a reasonable belief that such value would be excludable from the employees’ gross income under § 911 or Taxpayer was required by the law of a foreign country to withhold income taxes on such value.

FACTS

Taxpayer is a large American company that employs thousands of United States citizens or residents in many countries around the world. Taxpayer’s employees frequently transfer from country to country. Taxpayer maintains a “tax equalization” policy in order to facilitate the transfers of its employees (“assignees”) to and from its international affiliates. Tax equalization is a process that is intended to result in assignees paying the same amount of income tax as the assignee would have paid if he or she had not been stationed away from the country of citizenship on an international assignment. Under the tax equalization process, Taxpayer calculates what is commonly referred to as a “hypothetical tax.” The hypothetical tax calculation made before the beginning of the tax year constitutes an approximation of what the assignee’s overall tax liability would be for the upcoming year if that assignee were to remain in the United States (“approximate hypothetical tax”). The assignee’s previously agreed upon remuneration for the upcoming year is reduced by an amount equal to this approximate hypothetical tax, and the assignee is not entitled to receive that portion of his or her prior remuneration. Taxpayer will then pay all taxes owed by the assignee on remuneration the assignee receives from Taxpayer, on behalf of the assignee, for both the country where the assignee is stationed as well as the assignee’s country of citizenship, without deducting such taxes from the assignee’s remuneration. Taxpayer’s payment of the assignee’s taxes on the assignee’s behalf results in additional remuneration to assignee. Taxpayer grosses up the additional remuneration that results from Taxpayer paying the assignee’s taxes so that the assignee is not out of pocket for any of the taxes paid on her or his remuneration from Taxpayer. Each

payment of tax on behalf of the employee creates additional income to the employee and these additional amounts are also subject to tax.

At the end of the year, Taxpayer and the assignee calculate the exact amount of taxes that the assignee would have owed had the assignee remained in the United States as the “actual hypothetical tax.” Upon making the new calculation, Taxpayer and the assignee adjust payments to make up the difference between the actual hypothetical tax and the approximate hypothetical tax computed before the beginning of the year. If the approximate hypothetical tax was too high, Taxpayer pays the assignee the difference between the actual hypothetical tax amount and the approximate hypothetical tax amount that reduced the previously agreed upon remuneration. If the approximate hypothetical tax is too low, however, the assignee is required to repay a portion of the assignee’s remuneration from Taxpayer. Thus, in order to adequately ascertain the amount payable/receivable by Taxpayer to/from an assignee, the actual hypothetical tax must be properly computed and compared to the approximate hypothetical tax. This process, of reconciling the approximate and actual hypothetical tax calculations is referred to as the “tax equalization settlement.”

In connection with its tax equalization policy, Taxpayer engaged CPA Firm to assist with assignees’ tax matters. CPA Firm is a large, multinational accounting and consulting firm. Taxpayer’s tax equalization policy provides that the following services will be performed by CPA Firm with respect to tax-equalized assignees:

- (1) Preparation of foreign, United States, and state tax returns;
- (2) Computation and payment of the approximate and actual hypothetical tax and tax equalization settlements;
- (3) Respond to inquiries from taxing authorities, as related to the foreign assignment;
- (4) Global coordination of the assignment program; and
- (5) Provide advice and instructions to Taxpayer’s payroll department regarding how to report and tax appropriately.

For federal employment tax purposes, Taxpayer valued the United States and state tax return preparation services provided for the benefit of its assignees at \$ per year, and imputed this value as income and wages to its assignees. Taxpayer imputed no income or wages to its assignees in connection with the value of the employer-provided foreign tax return preparation services.

In valuing the United States and state tax return preparation services, Taxpayer relied, in part, on:

- (1) A survey conducted by the National Society of Accountants regarding the average tax preparation fees for an itemized Form 1040 with Schedule A and a state return; and

- (2) A Notice , published by the United States Treasury Department (“Treasury Department Notice”), which estimated the average time burden and average cost of preparing a Form 1040, 1040A, or 1040EZ return.

The National Society of Accountants survey and the Treasury Department Notice are described in greater detail below.

In valuing the United States and state tax preparation services at \$ per year for federal employment tax purposes, Taxpayer additionally reasoned, in part, that, but for the fact that Taxpayer sent the assignees on international assignment, the assignees would only have required and obtained “basic” domestic federal (Form 1040 and Schedule A) and state return preparation services. Moreover, Taxpayer determined that any additional benefit provided to the assignees in connection with Taxpayer’s tax equalization policy was primarily provided for Taxpayer’s benefit and, therefore, was properly excludable from the assignees’ wages.

In connection with Taxpayer’s examination for the and taxable years, the IRS requested (1) a complete list of all assignees who received tax preparation services, and (2) a copy of Taxpayer’s tax preparation services contract with CPA Firm, including fee structure, and all invoices related to CPA Firm’s services with respect to Taxpayer’s tax equalization policy. Taxpayer provided the IRS with a list of employees who received tax preparation services during the and taxable years, the CPA Firm fee schedule, as well as a spreadsheet itemizing the invoice amounts for each assignee.

The CPA Firm fee schedule indicated that \$ was actually paid by Taxpayer for the preparation of each assignee’s United States income tax returns (federal and one state). Of this total \$ charge, \$ was attributable to non-tax preparation (such as tax equalization and hypothetical tax calculations). Varying flat fees were also paid by Taxpayer to the CPA Firm for foreign returns depending on the country (e.g., \$ for , \$ for , \$ for , and \$ for). For , the average tax preparation fee for a foreign return was \$.

For , CPA Firm reduced its fee for preparation of the United States income tax returns (federal and one state) to \$ per assignee. Of this total \$ charge, \$ was attributable to non-tax preparation (such as tax equalization and hypothetical tax calculations). The average fee CPA Firm charged Taxpayer for a foreign return preparation for was \$, although the actual cost per foreign return, as explained above, depended on the country of assignment.

The IRS proposed substantial adjustments with respect to FITW and FICA taxes for Taxpayer’s and returns, based on the following assertions:

- (1) The fair market value of the tax preparation services provided by Taxpayer under its tax equalization policy is includable in the assignees' gross income for income tax purposes and constitutes wages for employment tax purposes.
- (2) The fair market value of the tax preparation services is the amount that an individual would have to pay for such services in an arm's length transaction, and the appropriate values of the tax preparation services as regards the assignees were at least equal to the amounts actually paid by Taxpayer to CPA Firm as reflected in the CPA Firm's invoices.
- (3) Taxpayer failed to reflect the proper value of the tax preparation services in the assignees' wages, which resulted in wage underreporting and employment tax underpayment.

No adjustments were proposed by the IRS under the Federal Unemployment Tax Act (FUTA) as the relevant wages (within the meaning of § 3306(b)) of all pertinent employees exceeded the FUTA wage base limitation of § 3306(b)(1).

In making its adjustments with respect to FITW and FICA taxes, the IRS excluded from assignees' gross income and wages all costs attributable to Taxpayer's tax equalization calculations, and other costs not related to return preparation, from the valuation of the tax preparation services.¹ Thus, the IRS excluded all costs related to:

- Calculation of the hypothetical tax;
- Discussions with individuals about equalization issues, travel calendar, etc.;
- Tax payment coordination with Taxpayer for company balances due as part of the equalization arrangement; and
- Global coordination of the assignment program (meetings between Taxpayer and CPA Firm, status updates, reporting technology maintenance, etc.).

The IRS included in assignees' gross income and wages costs related to tax preparation, including:

- Preparation of basic domestic United States tax returns – 1040, 1040 NR, and first state return;
- Sourcing of compensation for Federal income tax purposes and the employee's foreign tax credit;
- Sourcing of compensation for nonresident and part-year resident state income tax purposes;

¹ The Service has previously concluded in FSA 200137039 that the value of services provided to the employer for the specific purpose of calculating the amount owing by, or due to, the employer to equalize the income tax costs of its employees working in other countries is excludable as a working condition fringe benefit under section 132(d).

- Preparation of Form 1116 (*Foreign Tax Credit*) and Form 255 (*Foreign Earned Income*);
- Optimization of foreign earned income exclusion or foreign tax credit position;
- Coordination with foreign tax return preparer to confirm globally consistent approach to residency positions, treaty articles, etc.; and
- Notification to employees of foreign bank account reporting (FBAR) obligations if they had overseas financial accounts related to foreign assignment.

LAW

Applicable Provisions of the Code and Regulations

Gross Income

Section 61(a)(1) provides that, unless otherwise excluded, gross income means all income from whatever source derived, including (but not limited to) compensation for services, including fees, commissions, fringe benefits, and similar items. Section 1.61-1(a) further states that gross income includes income realized in any form, whether in money, property, or services

Section 911(a) excludes from gross income, at the election of a qualified individual, the foreign earned income of such individual and the housing cost amount of such individual.

Section 911(d)(1) defines the term “qualified individual,” for purposes of § 911, as an individual whose tax home is in a foreign country and who is either:

- (A) a citizen of the United States who has been a bona fide resident of a foreign country for an uninterrupted period which includes an entire taxable year, or
- (B) a citizen or resident of the United States and who, during any period of 12 consecutive months, is present in a foreign country during at least 330 full days in such period.

Section 911(b)(1) defines the term “foreign earned income,” for purposes of § 911, as the amount received by such individual from sources within a foreign country or countries which constitute earned income attributable to services performed by such individual during the time periods described in § 911(d).

Section 911(d)(2)(A), as relevant here, defines the term “earned income,” for purposes of § 911, as wages, salaries, or professional fees, and other amounts received as compensation for personal services actually rendered.

Section 911(d)(3) defines the term “tax home,” for purposes of § 911, with respect to any individual, as such individual’s home for purposes of § 162(a)(2) (relating to traveling expenses while away from home). Section 911(d)(3) further adds that an individual shall not be treated as having a tax home in a foreign country for any period for which his abode is within the United States.

Section 911(b)(2)(A) provides that the foreign earned income of an individual that may be excluded under § 911(a) for any taxable year shall not exceed the amount of foreign earned income computed on a daily basis at an annual rate equal to the exclusion amount for the calendar year in which such taxable year begins. Section 911(b)(2)(D)(i) states that, in general, the exclusion amount for any taxable year is \$80,000. However, under § 911(b)(2)(D)(ii), for years after 2005, such \$80,000 amount is subject to cost-of-living adjustments. For _____ and _____, the exclusion amount under § 911(b)(2)(D) was \$ _____ and \$ _____, respectively.

Excludable Fringe Benefits

Section 132(d) provides an exclusion from gross income for any fringe benefit that qualifies as a “working condition fringe.” The term “working condition fringe” means any property or services provided to an employee of the employer to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under § 162 or § 167.

Section 1.132-5(a)(1)(iii) provides that an amount that would be deductible by the employee under a section other than § 162 or § 167, such as § 212, is not a working condition fringe.

Section 1.132-5(a)(2)(i) provides that if the hypothetical payment for a property or service would be allowable as a deduction with respect to a trade or business of an employee other than the employee’s trade or business of being an employee of the employer, it cannot be taken into account for purposes of determining the amount, if any, of the working condition fringe.

Deductible Amounts

Section 162 provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 212(3) provides that, in the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in connection with the determination, collection, or refund of any tax.

Section 1.212-1(a)(1)(iii) provides that an ordinary and necessary expense paid or incurred by a taxpayer in connection with the determination, collection, or refund of any

tax may be deducted under § 212. Section 1.212-1(l) further states that expenses paid or incurred by an individual in connection with the determination, collection, or refund of any tax, whether the taxing authority be federal, state, or municipal, and whether the tax be income, estate, gift, property, or any other tax are deductible. The regulation adds that, thus, expenses paid or incurred by a taxpayer for tax counsel or expenses paid or incurred in connection with the preparation of his tax return or in connection with any proceedings involved in determining the extent of tax liability or in contesting his tax liability are deductible.

Courts have held that expenses paid or incurred by a taxpayer in connection with the determination, collection, or refund of a foreign tax are deductible under § 212(3) in the same manner as expenses paid or incurred in connection with the determination, collection, or refund of a domestic tax. See, e.g., Sharples v. United States, 533 F.2d 550 (1976) (in which the court stated, in allowing a § 212(3) deduction in connection with fighting a Venezuelan tax liability, that “the legislative history of subsection 212(3) illustrates the breadth that Congress intended for this statute”).

FICA Taxes

Sections 3101 (relating to the rate of tax on individuals), 3102(a) (relating to the requirement to deduct the amount of the FICA tax from wages), and 3111 (relating to the rate of tax on employers) collectively provide that every employer making payments of wages is required to withhold and pay FICA taxes.

Section 3121(a) provides that, for FICA tax purposes, the term “wages” means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, unless otherwise excepted.

Section 3121(a)(20) provides that, for FICA tax purposes, the term “wages” does not include any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe the employee will be able to exclude such benefit from income under § 132.

Section 3121(b) defines the term “employment,” in pertinent part, as including any service, of whatever nature, by an employee for the person employing him, irrespective of the citizenship or residence of either, within the United States; and service performed outside the United States by a United States citizen or resident as an employee of an American employer (as defined in § 3121(h)).

Section 3121(h) defines the term “American employer” as the United States or an instrumentality thereof; a United States resident; a partnership, two-thirds or more of the partners of which are United States residents; a trust, if all the trustees are United States residents; and a corporation organized under the laws of the United States or of any state.

The United States has established international social security agreements that coordinate the United States Social Security program with the comparable programs of other countries. These international social security agreements are generally referred to as “totalization agreements.” A totalization agreement may affect the United States FICA tax liability of a foreign national performing services in the United States, or of a United States citizen or resident performing services outside the United States as an employee of an American employer. See §§ 3101(c) and 3111(c).

FITW

Section 3402(a)(1) generally requires every employer making payment of wages to deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary.

Section 3401(a) generally defines the term “wages,” for purposes of § 3402, as all remuneration for services performed by an employee for his employer, including the cash value of all remuneration (including benefits) paid in any medium other than cash.

Section 3401(a)(19) provides that the term “wages” does not include any benefit provided to or on behalf of an employee if at the time such benefit is provided it is reasonable to believe the employee will be able to exclude such benefit from income under § 132.

Section 3401(a)(8)(A)(i) excludes from the term “wages” remuneration for services for an employer (other than the United States or any agency thereof) performed by a citizen of the United States if, at the time of the payment of such remuneration, it is reasonable to believe that such remuneration will be excluded from gross income under § 911.

Section 3401(a)(8)(A)(ii) excludes from the term “wages” remuneration for services for an employer (other than the United States or any agency thereof) performed in a foreign country or in a possession of the United States by a citizen of the United States if, at the time of the payment of such remuneration, the employer is required by the law of any foreign country or possession of the United States to withhold income tax upon such remuneration.

Section 31.3401(a)(8)(A)-1(a)(1)(i) provides that the employer’s belief that § 911 applies need only be based upon evidence reasonably sufficient to induce such belief, even though the evidence is later determined by the Service or a court to be insufficient to support an exclusion under § 911. However, the reasonable belief must be based upon the application of § 911 and the regulations thereunder.

Section 31.3401(a)(8)(A)-1(b)(2) provides that remuneration is not exempt from withholding if the employer is not required by the law of a foreign country or of a possession of the United State to withhold income tax upon such remuneration. Mere agreements between the employer and the employee whereby the estimated income

tax of a foreign country or of a possession of the United States is withheld from the remuneration in anticipation of actual liability under the law of such country or possession will not suffice.

Other Applicable Guidance

In Rev. Rul. 73-13, 73-1 C.B. 42, the IRS ruled that the value of financial consulting services provided by a company to its overseas employees is includible in gross income under § 61 and constitutes wages for employment tax purposes.

In Rev. Rul. 92-29, 1992-1 C.B. 20, an individual taxpayer operating a consulting business as a sole proprietorship paid a tax return preparer \$500 to prepare his federal income tax return. Of the \$500, \$200 was properly allocable to preparing Schedule C (Profit or Loss from Business), and the remaining \$300 was properly allocable to preparing the remainder of the taxpayer's federal income tax return, including Form 1040, Schedule A (Itemized Deductions), and Schedule B (Interest and Dividend Income). Additionally, the taxpayer paid \$800 for services rendered in resolving asserted tax deficiencies relating to the business income of the taxpayer's sole proprietorship.

The IRS, in Rev. Rul. 92-29, concludes that in determining adjusted gross income under § 62(a)(1), the taxpayer may deduct expenses that relate to the taxpayer's business as a sole proprietor, including the \$200 expense for preparing Schedule C and the \$800 expense for resolving asserted tax deficiencies. The IRS also ruled that the taxpayer may deduct the remaining \$300 from adjusted gross income as an itemized deduction under § 212(3) in determining taxable income, subject to the 2 percent floor limitation under § 67.

Rev. Rul. 92-69, 1992-2 C.B. 51, analyzed whether employer-provided outplacement services constituted gross income for income tax purposes, or wages for purposes of FICA, FUTA, and FITW. In determining whether the value of employer-provided outplacement services was excludable from gross income as a working condition fringe in three different fact patterns, the IRS noted that § 1.132-5(a)(2)(i) requires that a hypothetical payment for the services must be allowable as a deduction with respect to the employee's specific trade or business of being an employee of the employer, rather than the employee's general trade or business of performing services as an employee. The Revenue Ruling states that this requirement is generally satisfied if, under all the facts and circumstances, the employer derives a substantial business benefit from the provision of the property or services that is distinct from the benefit that it would derive from the mere payment of additional compensation, and the employee's hypothetical payment for the property or services would otherwise be allowable as a deduction by the employee under § 162.

ANALYSIS

Working Condition Fringe Analysis

The enactment of § 132, as part of the Deficit Reduction Act of 1984, P.L. 98-369, effective January 1, 1985, resulted in the substitution of a statutory approach for the prior common law approach in determining whether employer-provided fringe benefits are excluded from gross income. The prior common law approach generally looked to whether the fringe benefit was compensatory or non-compensatory. Consequently, effective January 1, 1985, any fringe benefit is includable in the recipient's gross income unless the fringe benefit is excluded from gross income by a specific statutory provision.

The value of the tax preparation services provided by Taxpayer was a direct and personal benefit to the assignees. Therefore, such value is includable in income unless excluded by a specific statutory provision, such as § 132(d) which excludes working condition fringes. In order for a benefit to be excludable as a working condition fringe, the expense incurred in providing the benefit must be an expense that the employee could deduct under section 162 if the employee had paid for the benefit herself or himself. The tax preparation services in this case are not deductible by the employee under section 162 because they are different from the business expenses of preparing a Schedule C (Profit or Loss From Business), or resolving asserted tax deficiencies relating to a taxpayer's sole proprietorship described in Rev. Rul. 92-29. Like the expenses associated with preparing a federal income tax return, including Form 1040, Schedule A (Itemized Deductions) and Schedule B (Interest and Dividend Income) in Rev. Rul. 92-29, the tax preparation services provided by Taxpayer to the assignees are personal expenses of the assignees that would only be deductible by the assignees, if at all, under § 212(3).

As stated in Rev. Rul. 92-69, in order for a fringe benefit to be excludable under § 132(d), as a working condition fringe, the employer must derive a substantial business benefit from the provision of the property or services that is distinct from the benefit that it would derive from the mere payment of additional compensation, and the employee's hypothetical payment for the property or services would otherwise be allowable as a deduction by the employee under § 162. As provided in § 1.132-5(a)(1)(iii), an amount that would be deductible by the employee under a section other than § 162, such as § 212, is not a working condition fringe.

The value of tax preparation services provided in this case cannot be deductible under § 162 because § 212(3) explicitly provides that all the ordinary and necessary expenses paid or incurred during the taxable year in connection with the determination, collection, or refund of any tax are deductible under that section (and thus not under § 162). See Sharples, supra, at 555-556; Rev. Rul. 92-29. Unlike the outplacement services described in Rev. Rul. 92-69, the value of the employer-provided tax preparation services in this case cannot possibly qualify as a working condition fringe benefit under § 132(d) because the cost of such services are not allowable as a deduction by the

employees under § 162. See § 1.132-5(a)(1)(iii).² Consequently, the value of employer-provided tax preparation services in the present case cannot be excluded from the assignees' gross income under § 132(d) as a working condition fringe benefit.³

Similarly, as regards the foreign tax preparation services, since the assignees received the same or similar personal benefit from having their foreign tax returns prepared as they did from having their domestic returns prepared, and were personally obligated to file complete and accurate tax returns, there is no valid basis for excluding the value of the foreign tax preparation services from gross income while including the value of the domestic tax preparation services. Expenses paid or incurred by a taxpayer in connection with the determination, collection, or refund of a foreign tax are deductible under § 212(3) in the same manner as expenses paid or incurred in connection with the determination, collection, or refund of a domestic tax. See Sharples v. United States, 533 F.2d 550 (1976). Like the employer-provided financial consulting services described in Rev. Rul. 73-13, the receipt of the Taxpayer-provided tax preparation services (both for the domestic and foreign returns) conferred a direct and personal benefit on the assignees, and the value received must be included in the assignees' gross income under § 61.

In summary, the assignees in this case were obligated to file tax returns (both domestic and foreign), and the tax preparation services provided to them by Taxpayer had a direct bearing on their ability to fulfill this personal obligation. An employer paying a personal expense of an employee results in taxable income to the employee. See Old Trust Company v. Commissioner, 279 U.S. 716 (1929). Accordingly, based on the foregoing, the value of the tax preparation services is includable in the assignees' income.

The IRS correctly did not assert that the costs attributable to Taxpayer's equalization computations were includable in the assignees' income and wages. These expenses are correctly viewed as expenses of the employer and, unlike tax return preparation costs, are not personal expenses of the assignee.

The Value of the Tax Preparation Services

Section 1.61-21(b)(1) provides that an assignee must include in gross income the amount by which the fair market value of the fringe benefit exceeds the sum of –

² It has been the Service's long-standing position that the fair market value of tax preparation services provided by an employer to its employees in connection with the employer's tax equalization policy is includable in the employees' gross income for income tax purposes and constitutes wages for employment tax purposes. See TAM 8547003; NSAR 10795; and FSA 200137039.

³ We note also that it would not have been reasonable for the Taxpayer to believe that the tax preparation services it provided to the assignees in this case were excludable as de minimis fringe benefits within the meaning of section 132(e) because the value of the tax preparation services is not "so small as to make accounting for it unreasonable or administratively impracticable."

- (i) The amount, if any, paid for the benefit by or on behalf of the recipient, and
- (ii) The amount, if any, specifically excluded from gross income by some other section of the Code.

Section 1.61-21(b)(2) provides that, in general, fair market value is determined on the basis of all the facts and circumstances. The regulation goes on to state that the fair market value of a fringe benefit is the amount that an individual would have to pay for the particular fringe benefit in an arm's length transaction. The regulation further states that an employee's subjective perception of the value of a fringe benefit is not relevant to the determination of the fringe benefit's fair market value, nor is the cost incurred by the employer determinative of the fair market value.

In computing the value of the United States income tax preparation services it provided to assignees, Taxpayer relies, in part, on the average tax preparation fee for a return according to a survey conducted by the National Society of Accountants. According to that survey, the average tax preparation fees for an itemized Form 1040 with Schedule A and a state return in was \$. Additionally, Taxpayer cites the Treasury Department Notice, which states that, using the best forward-looking estimates available for income tax returns for tax year , the estimated average time burden for all taxpayers filing a Form 1040, 1040A, or 1040EZ is hours, with an average cost of \$ per return. The Notice explains that this average includes all associated forms and schedules, across all preparation methods and taxpayer activities. In a further breakdown of its estimates, the Notice adds that the average burden for taxpayers filing Form 1040 is about hours and \$; the average burden for taxpayers filing Form 1040A is about hours and \$; and the average for Form 1040EZ filers is about hours and \$. Taxpayer concludes that its valuation of the United States tax return preparation services, \$, exceeds the value estimated by both the National Society of Accounts and the Treasury Department Notice.

In contrast, the fee schedule of the CPA Firm utilized by Taxpayer indicates that \$ was actually paid by Taxpayer for the preparation of each assignee's United States income tax returns (federal and one state), \$ of which was attributable to non-tax preparation (such as tax equalization and hypothetical tax calculations). Varying fees were paid by Taxpayer to the CPA Firm for foreign returns depending on the country (e.g., \$ for , \$ for , \$ for , and \$ for). For , the average tax preparation fee for a foreign return was \$.

For , CPA Firm reduced its fee for preparation of the U S income tax returns (federal and one state) to \$ per assignee, \$ of which was attributable to non-tax preparation (such as tax equalization and hypothetical tax calculations). The average fee for a foreign return preparation for was \$, although the actual cost per foreign return, as explained above, depended on the country of assignment.

Neither the average tax preparation fee for an itemized Form 1040 with Schedule A and a state return according to the survey conducted by the National Society of Accountants, nor the Treasury Department Notice estimating the average time burden and cost for all taxpayers filing a Form 1040, 1040A, or 1040EZ, represent an adequate measure for determining the fair market value of the tax preparation services the assignees in this case received. These assignees received sophisticated tax return preparation services from a large, multinational accounting and consulting firm with respect to both domestic and foreign tax returns. The fair market value of those services is the amount that the same or a similar large, multinational accounting and consulting firm would charge an individual employee for the same services in an arm's length transaction.

As noted above, the regulations specifically provide that neither the employee's subjective perception of the value of a fringe benefit nor the employer's cost in providing the benefit are determinative of its fair market value. Instead, the fair market value is the amount that an individual would have to pay for the particular fringe benefit in an arm's-length transaction. Unfortunately, data regarding arm's length transactions between individual employees similar to the assignees and large, multinational accounting and consulting firms similar to the CPA Firm for the same type of tax return preparation services is not generally available. Large, multinational accounting and consulting firms like the one utilized by Taxpayer in this case, which provide premier international tax consulting services, do not typically have individual employees like the assignees in this case as tax return preparation clients. Instead, large companies, like Taxpayer, enter into contracts with multinational accounting and consulting firms, like CPA Firm, to provide tax preparation services for numerous employees stationed in various countries throughout the world.

In most cases, the employer's cost in providing fringe benefits will be lower than the amount an employee would have to pay for a particular benefit in an arm's-length transaction because the employer will have the benefit of discounts typically associated with bulk purchasing and economies of scale. That may be particularly true in this case in light of the fact that the tax preparation services were provided to numerous assignees of Taxpayer stationed in many different countries.

We note that, although the employer's cost is not, by itself, determinative of a benefit's fair market value, the facts and circumstances of this case indicate that it is reasonable to use the amounts Taxpayer paid for the tax preparation services provided to the assignees (i.e., the employer's actual cost) as the best indicator of fair market value of such services. First, it is not possible to determine what each assignee would have paid if he or she engaged CPA Firm individually for the same services because CPA Firm does not typically offer the same type of services to individuals like the assignees in this case. Second, there is no survey data available to be used in determining the average amounts charged for similar services by similar premier international tax consulting firms. Finally, there is no reason to believe Taxpayer and CPA Firm did not engage in an arm's length transaction in arriving at a fair cost for the services. In this case, there

was an arm's length transaction resulting in the precise amount charged for particular services for specific individuals by a distinct service provider. Thus, the CPA Firm's charges paid by Taxpayer, in this case, is the most accurate information available to determine the fair market value of the tax preparation services provided to the assignees. If other credible information were available to establish that the fair market value of the tax preparation services is either higher or lower than the charges to Taxpayer, then the Service would be required to take such information into account. However, in the absence of any other information, using the amounts actually paid by Taxpayer to CPA Firm for the employer-provided tax preparation services under the facts and circumstances of this case serves as a reasonable basis for determining the fair market value of such services under § 1.61-21(b)(2).

FICA Tax Analysis

For the reasons stated earlier, the value of the tax return preparation services provided in-kind by Taxpayer to the assignees is not excludable as a working condition fringe under § 132(d). Consequently, it was not reasonable for Taxpayer to believe at the time the fringe benefit was provided that the employee receiving the benefit would be able to exclude the benefit from gross income under section 132. Accordingly, the value of the tax preparation services is not excepted from FICA taxes under § 3121(a)(20). However, depending on the country of assignment and the length of the foreign assignment, a totalization agreement between the United States and that country may apply to determine the social security taxation of such employer-provided tax return preparation services benefits.

FITW Analysis

The value of the tax preparation services provided by Taxpayer to the assignees was remuneration paid to the assignees in a medium other than cash. Therefore, pursuant to § 3401(a), the value of the tax preparation services constitutes wages subject to FITW, unless otherwise excepted. Moreover, for the reasons stated previously, it would not have been reasonable for Taxpayer to believe, based on applicable law, that the assignees were entitled to exclude the value of the tax preparation services from income under § 132. Therefore, the value of the tax preparation services is not excepted from income tax withholding under § 3401(a)(19).

Pursuant to § 3402(a)(8)(A)(i), the value of the tax return preparation services may be excludable from wages for income tax withholding purposes if the Taxpayer had a reasonable belief, at the time the services were provided, that the value of the services would be excludable from the assignee's gross income under § 911, provided the value of the fringe benefit combined with all other remuneration paid to the employee for the services performed was below the threshold. Provided the Taxpayer's belief that § 911 applies is based upon the application of § 911 and the regulations thereunder, Taxpayer's belief need only be based upon evidence reasonably sufficient to induce such belief, even though the evidence is later determined by the Service or a court to be

insufficient to support an exclusion under § 911. See § 31.3401(a)(8)(A)-1(a)(1)(i). It is Taxpayer's responsibility, in this case, to provide documentation to support exclusion of wages from FITW under § 3402(a)(8)(A)(i).

Furthermore, Taxpayer in this case had assignees stationed in many different countries throughout the world. Whether Taxpayer was required by the laws of any foreign country to withhold income taxes on the value of the tax return preparation services it provided to assignees depends upon the laws of each of the foreign countries in which its assignees were stationed. If any of the laws of the foreign countries in which assignees were stationed required Taxpayer to withhold income tax upon remuneration paid to Taxpayer's assignees, then § 3401(a)(8)(A)(ii) would apply to except the value of the tax return preparation services provided to the assignees stationed in those foreign countries from income tax withholding.

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Please call (202) 317-4774 if you have any further questions.