Private Letter Rulings

Private Letter Ruling 9406002, IRC Sec(s). 61

UIL No. 3121.01-00; 61.09-06; 3401.01-00

Headnote:

Section 61 -- Gross Income Defined

Reference(s): Code Sec. 61;

The Service has ruled in technical advice that the difference between the compensation paid to an employee who elects health insurance coverage and the greater amount that would have been paid to the employee if he or she had not elected coverage is includable in the employee's gross income.

A corporation provided its employees the option of electing group health insurance coverage from an unrelated insurance provider. Those employees electing health insurance coverage received less compensation than those employees declining health insurance. The difference between the compensation paid and the compensation that would have been paid had the employee not elected health insurance did not correspond to the actual cost of the health insurance. The corporation did not have a cafeteria plan as described in section 125.

In ruling that the difference between the compensation paid to an employee who elects coverage and the greater amount that would have been paid to the employee if he had not elected coverage is includable in the employee's gross income, the Service noted that anticipatory assignment of income does not shift the burden of taxation. Citing Rev. Rul. 74-32, 1974-1 C.B. 22, the Service stated that the corporation essentially contracts with its employees for services, whereby a portion of the remuneration otherwise payable to the employee will be paid to a third party (that is, the insurance company). Thus, to the extent that the employee could have otherwise received an amount that is paid to the insurance company, that amount is includable in the employee's gross income at the time it is paid over to the insurance company.

Full Text:

Chief, Appeals Office Taxpayer's Name: *** Taxpayer's Address: *** Years Involved: *** Date of Conference: ***

Issue

Under the facts presented, is the difference between the compensation paid to an employee who elects health insurance coverage and the greater amount that would have been paid to that employee if he or she had not elected health insurance coverage includible in the employee's gross income and considered wages for employment tax purposes.

Facts

The Taxpayer is engaged in the *** business. During the years under consideration, all employees were given the option of electing group term health insurance coverage from an unrelated health insurance provider. At the time employees were offered a job, the Taxpayer asked if they wanted health insurance coverage. Those employees electing health insurance coverage received less compensation than those employees declining health insurance coverage. The amount of compensation paid was determined before services were rendered by the employees. The difference between the compensation paid and the compensation that would have been paid had the employee not elected health insurance did not necessarily correspond to the actual cost of the health insurance selected. The Taxpayer, during the years under consideration, did not have a "cafeteria plan" as described in section 125 of the Internal Revenue Code.

Applicable LAW AND RATIONALE

Section 61(a) of the Code and the Income Tax Regulations under that section provide that, unless otherwise excluded by law, gross income means all income from whatever source derived, including compensation for services.

A gratuitous anticipatory assignment of income does not shift the burden of taxation and the donor is taxable when the income is received by the donee. See, Helvering v. Horst, 311 U.S. 112 (1940) and Lucas v. Earl, 218 U.S. 11 (1930)

In Commissioner v. P.G. Lake, Inc., 356 U.S. 260 (1958), the taxpayers assigned the right to a specified sum of money, payable out of a specified percentage of oil, or the proceeds received from the sale of such oil, if, as and when produced in return for cash. The Court concluded that, while the oil payments were interests in land, the consideration received for the oil payment rights was taxable as ordinary income because the lump-sum consideration was essentially a substitute for what would otherwise be received at a future time as ordinary income. The Court stated:

We have held that if one, entitled to receive at a future date interest on a bond or compensation for services, makes a grant of it by anticipatory assignment, he realizes taxable income as if he had collected the interest or received the salary and paid it over . . . As we stated in Helvering v. Horst, supra, 311 U.S. 117, 61 S. Ct. 147, "The taxpayer has equally enjoyed the fruits of his labor or investment and obtained the satisfaction of his desires whether he collects and uses the income to procure those satisfactions, or whether he disposes of his right to collect it as the means of procuring them." There, the taxpayer detached interest coupons from negotiable bonds

and presented them as a gift to his son. The interest when paid was held taxable to the father. Here, even more clearly than there, the taxpayer is converting future income into present income.

Rev. Rul. 74-32, 1974-1 C.B. 22, considers two fact patterns. Taxpayer A owns property which he contracts to sell at a gain. Taxpayer A stipulates in the sales contract that the amount of the selling price in excess of his basis is to be paid to a third-party. Taxpayer B, who reports his income on the cash receipts and disbursements method of accounting, contracts to perform services under an arrangement whereby the remuneration for his services will be paid to a third-party. In both fact patterns the contractual arrangement precedes the generation of income (i.e., the sale of the property and rendering of the services). Nevertheless, it is as if the entire proceeds of the sale or compensation for the services had been paid directly to the taxpayer and then paid over to the third- party. Citing Lucas v. Earl, the ruling concludes that in each situation, the payment is includible in the taxpayer's gross income at the time it is received by the third-party.

In the instant case, Taxpayer's prospective employees, like Taxpayer B in Rev. Rul. 74-32, contract to perform services under an arrangement whereby a portion of the remuneration otherwise payable for their services will be paid to a third-party (i.e., the insurance company) In our view, it is irrelevant in this situation that services have not been performed prior to entering into the contract. If a prospective employee contracts to have Taxpayer pay amounts to the insurance company where the employee has the option of receiving those amounts as wages, the employee is merely assigning future income (cash compensation) for consideration (accident and health insurance coverage) and thus, is treated as receiving the cash compensation for which the accident and health insurance coverage is a mere substitute. It is as if the entire compensation for services had been paid directly to the employee and then a portion paid over by the employee as his or her contribution to payment of the accident and health insurance premiums. Accordingly, just as in Rev. Rul. 74- 32, to the extent that the employee could have otherwise received an amount that is paid to the insurance company, it is includible in the employee's gross income at the time it is paid over to the insurance company.

Section 125(d) of the Code defines a "cafeteria plan" as a plan under which employees may choose among two or more benefits consisting of cash and qualified benefits (including accident and health coverage). Section 125(a) provides that, subject to certain nondiscrimination rules, no amount shall be included in the gross income of a participant in a cafeteria plan solely because the participant may choose among the benefits of the plan.

By enacting section 125 of the Code, Congress set forth a statutory scheme, complete with nondiscrimination requirements, under which employers could offer their employees or prospective employees a choice between cash and certain excludable employer-provided benefits such as accident and health insurance. To conclude, as Taxpayer does, that a type of choice specifically authorized by section 125 is not subject to that provision because it is part of the "negotiation" of the employment contract is, in our view, contrary to the statutory language and the intent of Congress in enacting section 125 of the Code.

The federal employment taxes are those imposed by the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages.

Because an employee who elects health insurance coverage has additional cash compensation those amounts are subject to income tax withholding. In addition, those amounts are subject to FICA and FUTA taxes. See, Rev. Rul. 65-208, 1965-2 C.B. 383.

Conclusion

The difference between the compensation paid to an employee who elects health insurance coverage and the greater amount that would have been paid to that employee if he or she had not elected health insurance coverage is includible in the employee's gross income and constitutes wages for employment tax purposes.

Except as specifically stated above, no opinion is expressed as to the application of any provision of the Code to the Taxpayer's health benefits program.

A copy of this technical advice memorandum is to be given to the Taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.