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Legend

Taxpayer =

State =

Statute =

This is in reply to your letter dated March 22, 2005, in which you requested rulings on behalf of Taxpayer concerning the Federal income tax treatment under section 104(a)(1) of the Internal Revenue Code (the Code) of disability benefits made to certain collectively bargained employees.

The Statute is the State's Workers' Compensation Law. Section 103 of the Statute provides:

Every employer and employee subject to the Workers' Compensation Law shall, respectively, pay and accept compensation for personal injury or death by accident arising out of and in the course of employment without regard to fault as a cause of the injury or death . . .

Section 114 of the Statute further provides:

(a) No contract, agreement, written or implied, or rule, regulation or other device, shall in any manner operate to relieve any employer, in

whole or in part, of any obligation created by this chapter except as herein provided.

(b) However, any employer may set off from temporary total, temporary partial, and permanent partial and permanent total disability benefits any payment made to an employee under an employer funded disability plan for the same injury; provided that the disability plan permits such an offset. Such an offset from a disability plan may not result in an employee receiving less than the employee would otherwise receive under the Workers' Compensation Law. In the event that a collective bargaining agreement is in effect, this provision shall be subject to the agreement of both parties.

The Taxpayer entered into a collective bargaining agreement (Agreement) with a group of its specialized employees ("employees") to provide the coverage for workers' compensation benefits required by the Statute. The Agreement provides that if an employee sustains a workers' compensable injury or illness, his occupational illness/injury payments shall be offset against his workers' compensation benefits. In addition to amounts provided pursuant to the Statute, the employees are also eligible for a set number of hours of occupational injury/illness leave for each occupational injury or illness. The Agreement also provides that if employees receive workers' compensation payments and sick leave pay at the same time, the employees may not receive more than 100 percent of their minimum pay due to worker's compensation payments.

Section 61(a) of the Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived, including compensation for services.

Section 104(a)(1) of the Code provides that gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations provides that section 104(a)(1) of the Code excludes from gross income amounts received by an employee under a workmen's compensation act, or a statute in the nature of workmen's compensation act that provides compensation to employees for personal injuries or sickness incurred in the course of employment. In Dyer v. Commissioner, 71 T.C. 560 (1979), acq. in result, 1987-2 C.B. 1, the court stated that, "[W]e conclude that whether a payment is in the nature of workmen's compensation depends upon whether the payment is made because of injuries sustained in the line of duty, not upon the amount paid. See also, Rev. Rul. 72-136, 1972-1 C.B. 35; Rev. Rul. 68-10, 1968-1 C.B. 50. Amounts excludable from gross income under section 104(a)(1) of the Code are not wages subject to income tax withholding under section 3402 of the Code.

Section 3121(a)(2)(A) of the Code excludes from the definition of “wages” for purposes of the Federal Insurance Contributions Act (“FICA”), any payment made to or on behalf of an employee on account of sickness or accident disability, if received under a workers’ compensation law. Section 3306(b)(2)(A) contains a similar exception for Federal Unemployment Tax Act (“FUTA”).

Based on the representations made and authorities cited above, we conclude that pursuant to the Statute, all amounts received under the Agreement by employees who sustain a workers’ compensable injury or illness are excludable from gross income under section 104(a)(1) of the Code and are not subject to income tax withholding.

We further conclude that because such payments are received under a workers’ compensation act, they are also excluded from FICA and FUTA pursuant to sections 3121(a)(2)(A) and 3306(b)(2)(A) of the Code, respectively.

This ruling is directed only to the Taxpayer on whose behalf it was requested. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Harry Beker, Chief
Health and Welfare Branch
Office of Division Counsel/Associate Chief
Counsel
(Tax Exempt & Government Entities)