Part I

Section 3121.-- Definitions

26 CFR 31.3121(a)-1: Wages.
(Also: 3306, 3401, 31.3306(b)-1, 31.3401(a)-1)

Rev. Rul. 2004-109

ISSUE

Whether certain amounts an employer pays as bonuses for signing or ratifying a contract are wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source (Federal income tax withholding)?

FACTS

Situation 1. Baseball Club negotiates an employment contract with an individual player. It is the first contract between the Club and the player. The contract provides that the player receives a signing bonus if he reports for spring training at the time and place directed by the Club. The contract provides that the signing bonus is not contingent on the player's future performance of services.

Situation 2. An employer negotiates a collective bargaining agreement (CBA) with a union representing a group of its employees. The CBA will take effect on the “ratification date,” which is the date it is ratified by a majority of the union members covered by the agreement. The CBA provides that each employee covered by the terms of the agreement who is employed by the employer as of the ratification date receives a bonus. Each such employee is paid the same amount regardless of compensation, seniority, position and whether or not the employee voted for ratification. In addition, each eligible employee receives the payment even if the employee had not performed services for the employer before the ratification date. Finally, the CBA provides that the payment is not contingent on the employee’s future performance of services.

LAW

Sections 3101 and 3111 of the Internal Revenue Code (Code) impose FICA taxes on "wages," as that term is defined in section 3121(a), with respect to “employment,” as that term is defined in section 3121(b). FICA taxes consist of the Old-Age, Survivors and Disability Insurance tax (social security tax) and the Hospital Insurance tax (Medicare tax). These taxes are imposed on both the employer and employee. Sections 3101(a) and 3101(b) impose the employee portions of the social security tax and the Medicare tax, respectively. Sections 3111(a) and 3111(b) impose the employer portions of the social security tax and the Medicare tax, respectively.

The term "wages" is defined in section 3121(a) for FICA purposes as all remuneration for employment, with certain specific exceptions. Section 3121(b) defines the term "employment" as any service, of whatever nature, performed by an employee for the person employing him, with certain specific exceptions.

Section 31.3121(a)-1(b) of the Employment Tax Regulations provides that the term “wages” means all remuneration for employment unless specifically excepted under section 3121(a). Section 31.3121(a)-1(c) provides that the name by which the remuneration for employment is designated is immaterial. Salaries, fees, and bonuses are wages, if paid as compensation for employment. Section 31.3121(a)-1(d) provides that generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages. Section 31.3121(b)-3(b) defines employment as services performed by an employee for an employer, unless specifically excepted under section 3121(b).

The FUTA taxation provisions are similar to the FICA provisions, except that only the employer pays the tax imposed under FUTA. See sections 3301 and 3306(b) and the regulations thereunder. Although there are differences in the statutory exceptions to what constitutes wages and employment, the general definitions of the terms “wages” and “employment” for FUTA purposes are similar to the definitions for FICA purposes. See sections 3306(b) and 3306(c).

Section 3402(a), relating to Federal income tax withholding, generally requires every employer making a payment of wages to deduct and withhold upon those wages

a tax determined in accordance with prescribed tables or computational procedures. The term “wages” is defined in section 3401(a) for Federal income tax withholding purposes as all remuneration for services performed by an employee for his employer, with certain specific exceptions. Section 31.3401(a)-1(a)(2) provides that the name by which remuneration for services is designated is immaterial. Thus, salaries, fees and bonuses are wages if paid as compensation for services performed by the employee for his employer. Section 31.3401(a)-1(a)(3) provides that generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration is wages. Unlike the FICA and the FUTA, the Federal income tax withholding provisions do not include a definition of employment.

Revenue Ruling 58-145, 1958-1 C.B. 360, in answering four specific questions, holds that a bonus paid by a baseball club to an individual solely for signing the individual’s first contract and not in any way contingent on the performance of subsequent services is not remuneration for services and, therefore, is not wages for purposes of Federal income tax withholding under section 3402. The ruling further holds that a bonus paid to a baseball player that is contingent upon the performance of subsequent services is wages subject to Federal income tax withholding.

Revenue Ruling 69-424, 1969-2 C.B. 15, holds that amounts paid by a baseball club for educational expenses of a minor league baseball player attending college were not scholarships excluded from income under section 117 because the payments were “compensation for past, present or future employment services” within the meaning of section 1.117-4 of the Income Tax Regulations. The contract provided that the club was

not required to make the payments if the player failed to attend the college for two consecutive years without proper reason, did not report for spring training as directed by the club, or was placed on the voluntarily retired, disqualified or ineligible list. The ruling holds that the payments are wages for Federal income tax withholding and FICA purposes.

Revenue Ruling 71-532, 1971-2 C.B. 356, holds that Rev. Rul. 69-424 is to be applied without retroactive effect with respect to wages paid prior to January 1, 1970. The ruling makes clear that the amount paid for certain educational expenses under the employment contract described in Rev. Rul. 69-424 is distinguishable from the bonus paid solely as consideration for signing a contract described in Rev. Rul. 58-145, but nonetheless limits the retroactive effect of Rev. Rul. 69-424.

Rev. Rul. 74-108, 1974-1 C.B. 248, analyzes whether a sign-on fee paid by a domestic corporation that operates a professional soccer club to a non-resident alien player as an inducement not to negotiate with any other team is treated as income from sources within or without the United States. Rev. Rul. 74-108 cites Rev. Rul. 58-145 as authority for the conclusion that the sign-on fee is not compensation for labor or personal services and that, therefore, source is not determined under the rules in section 861(a)(3) or 862(a)(3). Instead, Rev. Rul. 74-108 characterized the sign-on fee as a payment for a covenant not to compete both within and without the United States, with the result that the sign-on fee was attributable to sources both within and without the United States.

ANALYSIS

The Code and regulations provide that amounts an employer pays an employee as remuneration for employment are wages, unless a specific exception applies. Sections 3121(a), 3306(b), and 3401(a) and sections 31.3121(a)-1(b), 31.3306(b)-1(b), and 31.3401(a)-1(a)(1) of the regulations. The regulations also provide that the name by which the remuneration is designated is immaterial. Salaries, fees, and bonuses, for example, are all wages, if paid as compensation for employment. Sections 31.3121(a)-1(c), 31.3306(b)-1(c), and 31.3401(a)-1(a)(2).

The Code and the regulations also provide that any service of whatever nature performed by an employee for the person employing him is employment, unless a specific exemption applies. Sections 3121(b) and 3306(c) and sections 31.3121(b)-3(b) and 31.3306(c)-2(b).

Employment encompasses the establishment, maintenance, furtherance, alteration, or cancellation of the employer-employee relationship or any of the terms and conditions thereof. If the employee provides clear, separate, and adequate consideration for the employer's payment that is not dependent upon the employer-employee relationship and its component terms and conditions, the payment is not wages for purposes of FICA, FUTA, or Federal income tax withholding.

Under the facts presented in Situation 1, the individual receives the signing bonus in connection with establishing the employer-employee relationship. The individual does not provide clear, separate, and adequate consideration for the payment that is not dependent upon the employer-employee relationship and its component terms and conditions. Thus, the signing bonus is part of the compensation the Baseball Club pays

as remuneration for employment, making it wages regardless of the fact that the contract provides that the bonus is not contingent on the performance of future services.

Under the facts presented in Situation 2, the employees receive the ratification bonus payments as part of a bargain that establishes the terms and conditions of the employment relationship with all of the employees covered by the CBA. The employees do not provide clear, separate, and adequate consideration for the employer's payments that is not dependent upon the employer-employee relationship and its component terms and conditions. The payments are part of the compensation the employer pays as remuneration for employment. Thus, the ratification bonuses are wages regardless of the fact that they are uniform in amount, do not vary based on seniority or position or any other factor, and are not explicitly contingent on the performance of services.

Revenue Ruling 58-145 considered whether Federal income tax withholding applied to a bonus paid to a baseball player at the time a first contract was signed with a baseball club. It erred in its analysis by failing to apply the Code and regulations appropriately to the question of whether the bonus was wages in each of the four questions presented. Specifically, it failed to apply the correct definition of wages and to consider whether the bonus was paid in connection with establishing the employer-employee relationship. Accordingly, Rev. Rul. 58-145 is revoked. In addition, Rev. Rul. Rev. Rul. 74-108 is revoked as its conclusion relies upon Rev. Rul. 58-145**.**

HOLDING

Amounts an employer pays as bonuses for signing or ratifying a contract in connection with the establishment of the employer-employee relationship are wages for purposes of FICA, FUTA, and Federal income tax withholding. Accordingly, the payments in Situations 1 and 2 are wages for purposes of FICA, FUTA, and Federal income tax withholding.

EFFECT ON OTHER RULINGS

Rev. Rul. 58-145 and Rev. Rul. 74-108 are revoked. Rev. Rul. 69-424 and Rev. Rul. 71-532 are obsoleted in view of the amendment of section 117 by section 123(a) of the Tax Reform Act of 1986, 1986-3 (Vol.1) C.B. 1, 29. See section 117(c) and Notice 87-31, 1987-1 C.B. 475.

APPLICATION

Under the authority of section 7805(b), the Service will not apply the position adopted in this ruling to any signing bonus, sign-on fee, or similar amount paid to an employee in connection with the employee's initial employment with the employer pursuant to a sign-on agreement or other contract entered into before January 12, 2005, provided the amount is paid under facts and circumstances that are substantially the same as in Rev. Rul. 58-145 or Rev. Rul. 74-108.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Marie Cashman and Stephen Suetterlein of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt &

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