DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF THE CHIEF COUNSEL

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Dear :

This letter responds to your request for information dated December 05, 2015, concerning the proper form for employers to use in reporting payments ("waiting time penalties") made under State of California Law by employers to a terminated or quitting employee if the employer fails to pay the employee's final wages within the required time period provided by State law.

You asked whether the payments should be reported on Form 1099-MISC, Miscellaneous Income, or Form W-2, Wage and Tax Statement. In an oral response to a telephone inquiry from your firm, we indicated that the correct form for reporting the penalty is Form 1099-MISC. After your office received our response, you transmitted a letter indicating the reasons that you think the waiting time penalty should be reported on Form W-2 rather than Form 1099-MISC. Your position is based on your interpretation of section 1.6041-2(a)(1) of the regulations. It is your view that the reference to other "compensation" in the regulations that is required to be reported on Form W-2 is not referring to just compensation for services, but to any payment made to the employee by the employer that is includible in the gross income of the employee and not specifically subject to reporting under another provision or form. If, contrary to your view, the penalty is required to be reported on Form 1099-MISC, you have also asked whether any penalties would apply if the employer reported the amounts on Form W-2 rather than Form 1099-MISC.

Section 203 of the California State Labor Code imposes the waiting time penalty if an employer willfully fails to pay, without abatement or reduction, in accordance with the due dates imposed by the State Labor Code governing the payment of wages, any wages of an employee who is discharged or who quits. Under section 203, if the waiting time penalty applies, "the wages of the employee shall continue as a penalty from the due date … [of the final pay] at the same rate until paid or until an action therefor is commenced; but the wages shall not continue for more than 30 days." An

employee who secretes or absents himself or herself to avoid payment, or who refuses to receive the payment when fully tendered, including any penalty then accrued under this section, is not entitled to any waiting time penalty for the time during which he or she so avoids payment.

The penalty under section 203 of the State Labor Code is based on the employee's daily rate of pay and is calculated by multiplying the daily wage (average wage on working days) by the number of days that the employee was not paid, up to a maximum of 30 days. Overtime wages are included in calculating the penalty only if overtime is regularly scheduled each week. Thus, occasional or infrequent overtime is not included in the calculation of the daily rate of pay for purposes of computing the penalty. The 30-day period is calendar days, and includes weekends and holidays and any other days that the employee would not normally work. Payment of the wages or the commencement of an "action" stops the penalty from accruing. Filing a complaint in court commences an action. An employee's filing a claim with the State Labor Office is not considered the commencement of an action, and does not stop the penalty from accruing. The State Labor Office website states that payment of the waiting time penalty is not wages and that no deductions are taken from the penalty payment.

There is no dispute that, under the broad definition of gross income for federal income tax purposes, the waiting time penalty is includible in the gross income of the former employee who receives the payment. The waiting time penalty, although includible in gross income, appears to be in the nature of a penalty for the behavior of the employer that would not be wages for purposes of federal employment taxes.[1] See Rev. Rul. 72-268, 1972-1 C.B. 313, which in part holds that liquidated damages paid under the Fair Labor Standards Act (FLSA) to an employee are not wages for federal employment tax purposes. The liquidated damages paid under the FLSA are similar to the waiting time penalty in that each is designed to punish employer conduct, and each is paid in addition to the wages the employer is obligated to pay to the employee.

Payments of rent, salaries, wages, compensation, or other fixed or determinable income are reportable under section 6041 of the Internal Revenue Code. Generally, such payments are reported on a Form 1099 per regulations §1.6041-1(a)(2). However, the regulations provide instances where other forms should be used for reporting, such as for payments to beneficiaries of a trust or estate (reportable on Form 1041) and payments of compensation from an employer to an employee (reportable on Form W-2). Section 1.6041-2(a)(1) specifies that wages, as defined in section 3401, and other "compensation" paid by an employer to an employee in the course of the employer's trade or business shall be reportable on Form W-2.

As noted, the payments of the waiting time penalty are not wages. The payments also do not constitute compensation for purposes of the reporting requirements under the

[1] A chief counsel advice, CCA 201522004, concluded that payments of the waiting time penalties are not wages for Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA), and federal income tax withholding purposes.

regulations. The Internal Revenue Service has consistently interpreted the undefined term “compensation” in section 1.6041-2 to include only payment for services, rather than to include all payments from an employer to an employee whatsoever. In this case, the payments are of a punitive nature, and do not compensate the employees for their services. As the Supreme Court of California stated in Pineda v. Bank of America, N.A., 241 P.3d 870, 878 (2010), the waiting time penalty “is not designed to compensate employees for work performed. Instead, it is intended to encourage employers to pay final wages on time, and to punish employers who fail to do so.”

Payments to employees that constitute fixed or determinable income, but do not compensate them for services, are reported on Form 1099-MISC. For example, liquidated damages, judgments, and settlements that are income but do not constitute compensation are reportable as Other Income in box 3 of Form 1099-MISC. See, for example, PMTA 2009-35, §VII.C-D, and the IRS Lawsuits, Awards, and Settlements Audit Techniques Guide, p. 26. The Instructions for Form 1099-MISC similarly state that punitive damages are reportable in box 3. Therefore, the payments are subject to reporting in box 3 of Form 1099-MISC, in the same manner as other non-compensatory liquidated damages, rather than on Form W-2.

You have also asked whether the IRS would impose penalties on a filer for reporting the payments at issue on Form W-2 rather than Form 1099-MISC. Penalties under sections 6721 and 6722 may be imposed with respect to failures to file and furnish the required information return, and to report the required information. Section 6724 provides for a waiver of such penalties if the filer can demonstrate that it had reasonable cause for the failures. Penalties may be waived if the filer demonstrates that there were significant mitigating factors, including but not limited to a history of compliance. The filer must also have acted in a responsible manner by, among other things, attempting to prevent reporting failures and promptly rectifying them. Therefore, whether the filer would be eligible for waiver under section 6724 depends on the facts and circumstances of the case.

For the reasons set forth above, the waiting time penalties are reportable in box 3 of Form 1099-MISC as Other income. They are not reportable on Form W-2 because they are neither wages nor other “compensation” paid to an employee, within the meaning of regulations §1.6041-1(a)(2).

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2016-1, §2.04, 2016-1 IRB 8 (Jan. 4, 2016). If you have any additional questions, please contact our office at .

Sincerely,

Lynne Camillo
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Office of the Associate Chief Counsel (Tax Exempt and Government Entities)