

City of Cambridge

MASSACHUSETTS

Agenda #2

Transfer of \$20,000 in the appropriations
of Employee Benefits

In City Council October 27 1975

| | YEA | NAY | ABSENT | PRESENT |
|----------------|-----|-----|--------|---------|
| Mrs. Ackermann | ✓ | | | |
| Mr. Clinton | ✓ | | | |
| Mr. Danehy | ✓ | | | |
| Mr. Duehay | | | ✓ | |
| Mrs. Graham | ✓ | | | |
| Mr. Russell | ✓ | | | |
| Mr. Vellucci | ✓ | | | |
| Mr. Wylie | ✓ | | | |
| Mayor Sullivan | ✓ | | | |
| | 8 | 0 | 1 | |

INTRODUCED BY CITY MANAGER JAMES L. SULLIVAN

AN ORDER CONCERNING AN APPROPRIATION FOR THE FISCAL YEAR BEGINING JULY 1, 1975

ORDERED: That the following transfer be made in the General Fund of the City of Cambridge:

| FROM | AMOUNT | TO | AMOUNT |
|---|--------|---|--------|
| employee benefits other ordinary maintenance | 20 000 | employee benefits salaries and wages | 20 000 |

REASON(S)

The above transfer in the General Fund is necessitated by a recent opinion of the Internal Revenue Service that "sick leave buy-back" payments must be included in an employee's statement of income.

In City Council October 27, 1975
Adopted by yea and nay Vote
Yeas 8 Nays 0 Absent 1
Paul E. Leahy
City Clerk



CITY OF CAMBRIDGE
MASSACHUSETTS
BUDGET AND PERSONNEL DEPARTMENT
876-6800

TO: James L. Sullivan, City Manager DATE: October 23, 1975
FROM: Don Hawkes *DP Hawkes*
RE: SICK LEAVE BUY BACK

I am enclosing a letter from the Internal Revenue Service relative to the legal status of sick leave buy back payments to retiring employees. The IRS states that any such money must be included on the employees W2 statement. In order to facilitate this I hereby request a transfer from the following:

| | |
|---|-----------|
| FROM: Employee Benefits (other ordinary maintenance) | \$20,000. |
| TO: Employee Benefits (salaries and wages) | 20,000. |

Department of the Treasury

Regional Counsel

Internal Revenue Service

North-Atlantic Region

Date: OCT 14 1975 | In reply refer to: CC:BOS-GL 741-75
TPDougherty, Jr.



▷ City of Cambridge (Law Dept.)
City Hall
Cambridge, Massachusetts 02139

Attn: Edward A. Cunningham, Esquire
Special Counsel

In re: OPINION: Withholding and Employment Taxes,
Requirement to pay

Gentlemen:

This refers to your letter of October 1, 1975 in which inquiry was made into whether the amount of accumulated sick leave "bought back" by the City upon an employee's retirement or termination of service should be reflected on the employee's W-2 form and be subject to withholding tax.

Based upon a conversation of October 8, 1975 between a representative of this office and your Attorney Edward Cunningham, we understand that the City's buy-back of accumulated sick leave is based upon a lump sum payment to the employee for unused sick days accrued during the course of his employment. Accordingly, payment is made to the employee at the rate of \$10.00 for each unused day of sick leave and this, in effect, compensates the departing employee for days of active service which the City was obligated to pay for even if the employee had been absent due to illness. As we understand it, the buy-back program is merely an incentive for on-the-job attendance and is not a reimbursement to employees of amounts contributed to a sick pay fund of any sort.

Based on the aforesaid facts, it is our view that the City has a duty to withhold a portion of the amount paid to the departing employee for accumulated sick days to satisfy the income tax attributable to such amount. As you know, Int. Rev. Code of 1954 (hereinafter Code) § 3401, et seq imposes a duty upon employers to withhold income tax from employees' wages. In the instant case the City is an "employer" of the beneficiaries of the buy-back plan even if the money is actually paid thereto after the termination of the employee's service. Code § 3401(d), Treas. Reg. § 31.3401(d)-1(b). Further, it would appear that amounts paid to departing employees under the buy-back plan are "wages" within the contemplation of Code § 3401(a). For purposes of income tax withholding, the term "wages" is broadly defined as "... all remuneration for services performed by an employee for his employer unless specifically excepted under section 3401(a) or excepted under section 3402(e)." Treas. Reg. § 31.3401(a)-1(a)(1).

Based upon our understanding of the facts, none of the pertinent exceptions applies herein. The amount the City pays for unused sick days constitutes compensation for services performed by the employee during the course of his employment. Accordingly, these amounts are taxable to the employee and are not susceptible of classification as excludable sick pay under Code § 105(d). In view of the fact that the City is the "employer" and the amounts paid under the buy-back program are "wages", such payments are subject to the withholding of income tax under Code § 3402 and the regulations promulgated thereunder. See, Rev. Rul. 65-276, 1965-2 C.B. 386, Rev. Rul. 72-572, 1972-2 C.B. 535.

Since the City's policy of buying back unused sick days applies to employees generally and encompasses any separation from service, such payments also have Federal Insurance Contributions Act (Code §§ 3101, et seq, and 3111, et seq) and Federal Unemployment Tax Act (Code § 3301, et seq) consequences. However, under the applicable provisions of the Code, F.I.C.A. taxes would be withheld from buy-back payments and Old Age and Survivors Disability Insurance and F.U.T.A. contributions made only where the payments are made for a reason other than the employee's retirement. In this regard, we note

that the definition of "wages" for purposes of these other employment taxes is narrower than that prescribed by the income tax withholding provisions. Code §§ 3121(a)(2)(A), 3121(a)(3), 3306(b)(2)(A), 3306(b)(3). Compare with, Treas. Reg. § 31.3401(b)(1)(i).

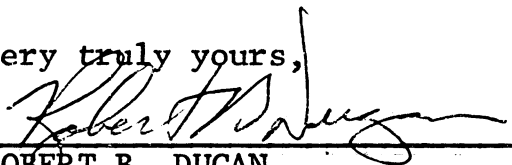
Under Treas. Reg. § 31.3121(a)(3)-1 (relating to F.I.C.A. taxes) and Treas. Reg. § 31.3306(b)(3)-1 (relating to F.U.T.A. taxes), the term "wages" does not include amounts paid by an employer to an employee on account of the employee's retirement, even if the payment is not made under a formal pension plan or system. Under these provisions, where the employee's retirement from service triggers the buy-back of unused sick leave, the amount paid by the City would not be "wages" subject to the taxes imposed under the F.I.C.A. and F.U.T.A. provisions. Rev. Rul. 65-276, supra.

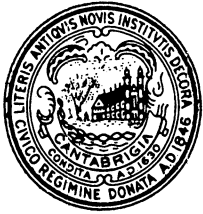
In summary, it is our view that amounts paid to departing employees under the City's buy-back plan are subject to income tax withholding irrespective of the reason for the employee's separation and are additionally subject to F.I.C.A. and F.U.T.A. taxes if the employee's separation is due to any reason other than retirement.

The foregoing represents the opinion of this office based on the facts presented in your letter of October 1, 1975 and oral advice from Attorney Edward Cunningham. If a formal ruling is desired, it is recommended that you seek a "determination letter" from the District Director of Internal Revenue, Boston, Massachusetts pursuant to Treas. Reg. § 601.201.

We trust the foregoing will be of help to you. If you have any questions regarding the views expressed herein kindly feel free to contact this office.

Very truly yours,


ROBERT B. DUGAN
Assistant Regional Counsel



CITY OF CAMBRIDGE

CAMBRIDGE, MASSACHUSETTS 02139
Tel. 876-6800

EXECUTIVE DEPARTMENT
JAMES L. SULLIVAN
City Manager

October 27, 1975


To the Honorable, the City Council:

I transmit herewith a communication from Donald P. Hawkes, Director of Budget-Personnel, relative to the legal status of sick leave buy back and requesting the following transfer in the appropriations for Employee Benefits:

| | | |
|-------|----------------------------|-------------|
| FROM: | Other Ordinary Maintenance | \$20,000.00 |
| TO: | Salaries and Wages | \$20,000.00 |

Also enclosed please find order providing for same.

Very truly yours,


James L. Sullivan
City Manager

JLS/mbf
Encs.

Transfer in the appropriations of Employee
Benefits in the sum of \$20,000

In City Council,
Oct. 27, 1975

10/27/75
Order
Adopted
P-0-1