



LOSAPs, Lincoln and tax reporting

This bulletin summarizes the Lincoln Financial Group tax reporting policy for Length of Service Award Plans (LOSAPs) invested with us.

What federal tax form does Lincoln file to report LOSAP award distributions?

Lincoln reports distributions for LOSAPs invested at Lincoln on Form W-2: Wage and Tax Statement (Form W-2).

Why Form W-2?

Lincoln believes Form W-2 is the correct form to report LOSAP award distributions for the following reasons:

- The Internal Revenue Service (IRS) classifies volunteer firefighters as “employees”
- The instructions for Form W-2 specifically reference reporting “awards” paid to employees on Form W-2
- Other compensation, in addition to wages, is reportable on Form W-2
- The Internal Revenue Code (Code) provides that cash awards to employees in the course of their employment are taxable income
- Form 1099-R: Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc. (Form 1099-R) is limited to reporting distributions from profit-sharing or retirement plans, individual retirement arrangements (IRAs), annuities, pensions, insurance contracts, survivor income benefit plans, permanent and total disability payments under life insurance contracts, charitable gifts, annuities, and other distributions.
- There is a lack of current guidance from the IRS regarding tax reporting of LOSAP award distributions

Each of these points is explained in further detail below:

Volunteer firefighters and employee status

In 2014, the IRS addressed a number of issues regarding firefighters and their employing organizations, including the status of volunteer firefighters as employees. See www.irs.gov/Government-Entities/Federal,-State-&-Local-Governments/Issues-for-Firefighters.

The IRS website indicates, “Generally, tax laws apply to firefighters in the same manner as for other types of workers. It does not matter whether firefighters are termed ‘volunteers,’ are considered employees, or are identified by any other name, if the work they do is subject to the will and control of the payer, under the common-law rules, they are employees for Federal tax purposes.”

Therefore, Lincoln believes volunteer firefighters are employees to the extent the work they do is subject to the will and control of their employing organization.

Instructions for Form W-2

The instructions for Form W-2 state in part, “Box 1—Wages, tips, **other compensation** [emphasis added]. Show the total taxable wages, tips, and other compensation (before any payroll deductions) that you paid to your employee during the year....Include the following.

1. Total wages, bonuses (including signing bonuses), prizes, and **awards** [emphasis added] paid to employees during the year.”

These instructions specifically provide that awards paid to employees are reportable on Form W-2 and, as provided on the IRS website, a volunteer firefighter is generally considered an employee.

IRS Publication 15-B provides that if the recipient of a taxable fringe benefit is your employee, the benefit is subject to employment taxes and must be reported on Form W-2¹. However, Section 3121(a)(5)(I) of the Code excludes LOSAP awards from employment tax, which may be the root cause of questions concerning how to report taxes on LOSAP award distributions. (See the following sections for more details.)

Other compensation reportable on Form W-2

All governmental entities that employ workers are subject to Federal income and employment taxes on wages, except where the law provides specific exceptions. Section 3401 of the Code defines wages subject to income tax withholding. Section 3121 of the Code defines wages for Social Security and Medicare employment tax purposes.

In general, all compensation provided to an employee is included in taxable wages unless an exception is provided by law. An exception may apply for Federal Insurance Contributions Act (FICA) taxes, or Federal income tax withholding, or both.

Section 3121(a)(5)(I) of the Code provides that any payment made to, or on behalf of, an employee or his or her beneficiary under a LOSAP is not treated as “wages” for purposes of FICA taxes.

Some may interpret this treatment of a LOSAP award to mean the award is not reportable on Form W-2. However, many types of compensation reportable on Form W-2 are not treated as wages for FICA tax purposes. For example, contributions to a Social Security replacement plan, employer paid disability premiums, and third party sick pay made after six months of disability are reportable on Form W-2, but are not treated as wages for FICA tax purposes.

It is important to note that LOSAP award distributions are not excluded from the definition of wages for income tax withholding under Section 3401 of the Code. Thus, like other types of non-FICA compensation reportable on Form W-2, Lincoln believes LOSAP award distributions are reportable on Form W-2, even though such distributions are not treated as “wages” for purposes of FICA taxes.

Code section	LOSAP awards included or excluded
Section 3121 – Wages for Social Security and Medicare employment tax purposes	Excluded – See Code Section 3121(a)(5)(I)
Section 3401 – Wages for Federal income tax purposes	Included – See Code Section 3401(a)(1)-(23)

¹ IRS Publication 15-B (2014), Cat. No. 29744N

Cash awards as taxable income

LOSAPs pay compensation to volunteer firefighters in the form of (1) reimbursement for reasonable expenses incurred in the performance of duties or (2) reasonable benefits, including length of service awards and nominal fees for such services, customarily paid by eligible employers in connection with the performance of such services by volunteers.²

A LOSAP award is nearly always in the form of cash. The award may be subject to a substantial risk of forfeiture, but, once vested, the award is in the form of cash. Therefore, Lincoln believes a LOSAP cash award does not qualify for the fringe benefit exclusion.

This stance is supported by IRS Publication 15-B, which provides that cash awards for length of service or safety achievements do not qualify for the “fringe benefit exclusion” from the recipient’s pay. Specifically, the publication states, “This [fringe benefit] exclusion applies to the value of any tangible personal property you give to an employee as an award for either length of service or safety achievement. The exclusion does not apply to awards of cash [emphasis added], cash equivalents, gift certificates, or other intangible property such as vacations, meals, lodging, tickets to theater or sporting events, stocks, bonds, and other securities.”

In addition, Section 274(j)(3) of the Code provides in part that a length of service or safety achievement award is an item of tangible personal property awarded to the recipient “under conditions and circumstances that do not create a significant likelihood of the payment of disguised compensation.”

Thus, Lincoln believes distribution of a LOSAP award is taxable income to the volunteer for Federal income tax purposes.³

Form 1099-R

Some LOSAP sponsors and investment providers report LOSAP award distributions on Form 1099-R.

Form 1099-R is used to report distributions from pensions, annuities, retirement or profit sharing plans, IRAs, and insurance contracts for each person to whom the employer has made a designated distribution or who is treated as having made a distribution of \$10 or more from profit sharing or retirement plans, IRAs, annuities, pensions, insurance contracts, survivor income benefit plans, permanent and total disability payments under life insurance contracts, or charitable gift annuities.

A LOSAP is a plan that pays a length of service award of \$6,000 or less per year to bona fide volunteers of firefighting and prevention services, emergency medical services and ambulance services.⁴

A LOSAP is not a pension, annuity, retirement or profit sharing plan, IRA, or insurance contract. Rather, a LOSAP provides compensation for reimbursement of expenses or length of service awards and nominal compensation to employees from their employers. Such awards enjoy tax deferral and are not taxed to the volunteer until the year they are paid or made available without substantial limitation, as required under Section 451 of the Code.⁵

² Section 457(e)(11)(B)(i) of the Code

³ See [irs.gov/Government-Entities/Federal,-State-&-Local-Governments/Issues-for-Firefighters](https://www.irs.gov/Government-Entities/Federal,-State-&-Local-Governments/Issues-for-Firefighters)

⁴ Section 457(e)(11)(B)(ii) of the Code

⁵ Rev. Rul. 2003-47

Because LOSAP benefits become immediately taxable (without regard to whether a participant has taken an actual distribution) upon expiration of a substantial limitation, a LOSAP can be analogized to an executive compensation plan subject to Section 409A of the Code or a top hat deferred compensation plan of a tax exempt entity subject to Section 457(b) of the Code. For those types of plans, the instructions for Form 1099-R state, “report distributions to employee plan participants from Section 409A nonqualified deferred compensation plans (including nongovernmental Section 457(b) plans) on Form W-2, not Form 1099-R.”

Because we believe a LOSAP award distribution should be reported similarly to a distribution from a 409A or a 457(b) top hat plan, Lincoln reports LOSAP award distributions on Form W-2, not Form 1099-R.

Statutory and/or regulatory guidance applicable to LOSAPs

Currently issued statutory and regulatory guidance regarding LOSAPs is limited to the following:

- **LOSAP rules** – Section 457(e)(11)(A)(ii) of the Code provides general rules for LOSAPs
- **LOSAP awards not treated as wages** – Section 3121(a)(5)(l) of the Code provides that any payment made to, or on behalf of, an employee or his or her beneficiary under a LOSAP is not treated as wages for purposes of FICA taxes
- **LOSAP example** – Revenue Ruling 2003-47 provides an example to eligible employers of a type of length-of-service award program that would qualify as a valid LOSAP plan described in Section 457(e)(11)(A)(ii) of the Code
- **Private letter ruling (PLR) regarding a plan’s status as a LOSAP** – In PLR 200918007, a length-of-service award plan sponsor sought and received a PLR regarding its plan’s status as a valid LOSAP plan, as described in Section 457(e)(11)(A)(ii) of the Code.

Tax reporting of LOSAP award distributions is not addressed in any current IRS guidance regarding LOSAPs. This absence of IRS guidance has resulted in different reporting practices by LOSAP sponsors and investment providers.

Conclusion

Until the IRS issues definitive guidance regarding tax reporting of LOSAP award distributions, the LOSAP sponsor or investment provider must interpret existing guidance to determine how LOSAP award distributions should be reported for tax purposes.

Based on our interpretation of existing IRS guidance regarding LOSAP award distributions and general tax reporting principles discussed in this bulletin, Lincoln has concluded that LOSAP award distributions should be reported on Form W-2.

This material was prepared to support the promotion and marketing of retirement products. Lincoln Financial Group[®] affiliates, their distributors, and their respective employees, representatives, and/or insurance agents do not provide tax, accounting, or legal advice. Any tax statements contained herein were not intended or written to be used, and cannot be used for the purpose of avoiding U.S. federal, state or local tax penalties. Please consult your own independent advisor as to any tax, accounting or legal statements made herein.

Affiliates of Lincoln National Corporation include, but are not limited to, The Lincoln National Life Insurance Company, Lincoln Life & Annuity Company of New York, Lincoln Retirement Services Company, LLC and Lincoln Financial Group Trust Company, Inc (herein separately and collectively referred to as “Lincoln”).

Lincoln Financial Group is the marketing name for Lincoln National Corporation and its affiliates. Affiliates are separately responsible for their own financial and contractual obligations.