



June 15, 2006
Pennsylvania Personal Income Tax
No. PIT-06-008
Sick and Disability Pay

ISSUE

Are Taxpayer's sickness and accident benefits subject to Pennsylvania Personal Income Tax?

CONCLUSION

The sickness and accident benefits are subject to Pennsylvania Personal Income Tax.

FACTS

Taxpayer received sickness and accident benefits ("benefits") during tax year 2005 under the employee benefit plan ("Plan").

Under the Plan, benefits are paid if an employee becomes totally disabled because of sickness or accident. Benefits are paid on a weekly basis for a maximum of 104 weeks depending upon the employee's years of service.

The Plan provides for a schedule of weekly benefits based upon the employee's labor grade. The higher the labor grade, the higher the weekly benefit.

Benefits are payable beginning the first day of total disability when the disability is the result of an accident, or the earlier of: (1) the eighth day of total disability, or (2) the first day of hospitalization or outpatient surgery when disability is the result of sickness.

Benefits that are payable under the Plan are reduced by any weekly benefit the employee is entitled to receive under worker's compensation, occupational disease or other similar laws.

DISCUSSION

For Pennsylvania Personal Income Tax purposes, Article III of the Tax Reform Code of 1971 ("Code") provides that a resident taxpayer is subject to personal income tax on the privilege of receiving income from eight classes of income, one of which is "compensation". 72 P.S. §§ 7302 and 7303.

Compensation is defined as "[a]ll salaries, wages, commissions, bonuses and incentive payments whether based on profits or otherwise, fees, tips and similar remuneration received for services rendered whether directly or through an agent and whether in cash or in property. . . ." 72 P.S. § 7303(a)(1)(see also 72 P.S. § 7301(d)(definition of compensation)).

Because the employer provides sickness and accident benefits under the Plan in exchange for past and potentially future services, the benefits are taxable compensation absent a statutory exclusion from tax.

One exclusion provided for under the Code is the exclusion for “periodic payments for sickness and disability other than regular wages received during a period of sickness or disability.” 72 P.S. § 7301(d) .

Department regulations further define the exclusion. The regulations state that:

(c) Compensation does not mean or include any of the following:

(1) Periodic payments for periods of sickness or disability paid by or on behalf of an employer under a program or plan unless the payments are regular wages. Additionally, no amount of damages received (whether by suit or agreement and whether as lump sums or as periodic payments) if pain and suffering, emotional distress or other like noneconomic element was, or would have been, a significant evidentiary factor in determining the amount of the taxpayer’s damage.

61 Pa. Code § 101.6(c)(1).

Based upon the above, any periodic payment that qualifies as a payment of regular wages does not qualify for the exclusion. In relation to whether a payment constitutes a payment of regular wages, Department regulations provide that:

No payments made by third-party insurers for periods of sickness or disability would be considered payments of regular wages. [Further,] A program or plan where any of the following occur would not be considered payment of regular wages:

(i) The periodic payments have no direct relationship to the employee’s usual rate of compensation.

(ii) The periodic payments are computed with reference to the nature of the sickness or disability and without regard to the employee’s job classification.

(iii) Periodic payments would be reduced by payments arising under Workmen’s Compensation Acts, Occupational Disease Acts, Social Security Disability or similar legislation by any government.

(iv) The periodic payments exceed the employee’s usual compensation for the period.

61 Pa. Code § 101.6(c)(1).

In this case, because the Plan benefits are to be reduced by government sponsored disability programs, the benefits are not regular wages.

Nevertheless, even though the Plan benefits are not regular wages, the benefits are not necessarily excluded from tax. The benefits must still be periodic payments for a period of sickness or disability.

Neither the "Code" nor the Department's regulations define "periodic payments for periods of sickness or disability." Nevertheless, it is the Department's position that none of the following payments are for periods of sickness or disability:

- (1) Amounts received during a period of sickness or disability for services performed during another period or to which the employee would have been entitled regardless of whether he was sick or disabled,
- (2) Payments for unused sick leave, or
- (3) Payments paid in lieu of regular wages for a period during which an employee is absent from work on account of injury or sickness and computed with reference to:
 - (a) The period the employee is absent from work and
 - (b) The employee's regular rate of compensation and without regard to the nature of such injury or sickness.

For purposes of (3) above, payments are computed without regard to the nature of an injury or sickness if, under the plan, they can be made for injuries or sickness:

- (i) for which the employer, but for his agreement to indemnify his employees against loss arising from such contingencies, would otherwise have had no legal or moral duty whatsoever to make payment;
- (ii) which did not arise out of or in the course of, and were not incidental to, any employment relationship; and
- (iii) which are temporary, non-chronic, and of short duration with no long term or permanent impact^[1].

Payments are also computed without regard to the nature of an injury or sickness if unused benefits under the plan are payable upon termination of employment or other contingency.

In this case, the Plan benefits are (1) payable in weekly amounts based upon the period during which the employee is absent from work (up to a maximum of 104 weeks), (2) related to the employee's labor grade, and therefore, related to the employee's regular rate of compensation and (3) payable immediately upon the employee becoming totally disabled (or shortly thereafter). Therefore, the benefits are paid in lieu of regular wages as described in (3) above and are not "periodic payments for periods of sickness or disability." Consequently, the benefits are taxable compensation for Pennsylvania Personal Income Tax purposes.

^[1] It is the Department's policy to treat plans that have a waiting period of at least 30 consecutive days as conforming to this requirement.