

Treatment of Certain Payments Received as Temporary Assistance for Needy Families (TANF)

Notice 99-3

SECTION 1. PURPOSE

This notice addresses the federal income and employment tax consequences of payments received by individuals with respect to certain work activities performed in state programs under part A of title IV of the Social Security Act, as amended by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), Pub. L. No. 104-193, 110 Stat. 2105 (August 22, 1996) (TANF payments). The notice sets forth certain conditions under which TANF payments are not income, earned income, or wages for federal income and employment tax purposes. The Treasury Department and the Internal Revenue Service intend to issue regulations that will address the federal income and employment tax consequences of TANF payments. It is generally expected that the regulations will be consistent with this notice and, therefore, will be effective retroactively, to this extent, to December 17, 1998.

SECTION 2. SCOPE

This notice addresses only the treatment of TANF payments under certain income and employment tax provisions of the Internal Revenue Code. Because this notice is based on the “general welfare doctrine” (see section 4.01, below), which is unique to the determination of federal tax liability, this notice does not determine the treatment or effect of TANF payments (or determine whether an employment relationship exists) under any other provision of law, including the Fair Labor Standards Act and other federal and state employment laws. For purposes of the analysis set forth herein, however, it is assumed that the recipient of the TANF payments is a common law employee. This notice does not reach a determination as to whether the recipient of TANF payments is a common law employee or is self-employed.

SECTION 3. BACKGROUND

Congress reformed the welfare system

through the enactment of PRWORA, which replaced Aid to Families with Dependent Children (AFDC) with Temporary Assistance for Needy Families (TANF). AFDC required individuals to perform some work activities in order to continue to receive public assistance. TANF provides states with more flexibility than they had under AFDC to determine basic eligibility rules and benefit amounts. TANF also requires that specified percentages of individual recipients engage in work activities and imposes penalties on the states for non-compliance with that requirement.

For purposes of TANF, the term “work activities” is defined under § 407(d) of the Social Security Act, 42 U.S.C. § 607(d), as:

- (1) unsubsidized employment;
- (2) subsidized private sector employment;
- (3) subsidized public sector employment;
- (4) work experience (including work associated with the refurbishing of publicly assisted housing) if sufficient private sector employment is not available;
- (5) on-the-job training;
- (6) job search and job readiness assistance;
- (7) community service programs;
- (8) vocational educational training (not to exceed 12 months with respect to any individual);
- (9) job skills training directly related to employment;
- (10) education directly related to employment, in the case of a recipient who has not received a high school diploma or a certificate of high school equivalency;
- (11) satisfactory attendance at secondary school or in a course of study leading to a certificate of general equivalence, in the case of a recipient who has not completed secondary school or received such a certificate; and
- (12) the provision of child care services to an individual who is participating in a community service program.

SECTION 4. TREATMENT OF TANF PAYMENTS

.01 General Analysis.

The federal income and employment tax consequences of TANF payments generally are determined under the following analysis.

Payments by a governmental unit to an individual under a legislatively provided social benefit program for the promotion of the general welfare that are not basically for services rendered are not includible in the individual’s gross income and are not wages for employment tax purposes, even if the individual is required to perform certain activities to remain eligible for the payments. See Rev. Rul. 71-425, 1971-2 C.B. 76; Rev. Rul. 75-246, 1975-1 C.B. 24. Similarly, these payments are not earned income for Earned Income Credit (EIC) purposes. If, however, taking into account all the facts and circumstances, payments by a governmental unit are basically compensation for services rendered, even though some training is provided, then the payments are includible in the individual’s gross income and are generally wages for employment tax purposes. Rev. Rul. 75-246, 1975-1 C.B. 24. Similarly, such payments generally are earned income for EIC purposes.

In addition, § 32(c)(2)(B)(v) of the Internal Revenue Code (as added by § 1085(c) of the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 111 Stat. 788 (August 5, 1997), and effective for taxable years beginning after December 31, 1997) provides that earned income for EIC purposes does not include amounts received for “service performed in work activities as defined in paragraph (4) or (7) of section 407(d) of the Social Security Act to which the taxpayer is assigned under any State program under part A of title IV of such Act, but only to the extent such amount is subsidized under such State program.”

.02 Application of General Analysis to Certain TANF Payments.

Due to the flexibility TANF affords states to determine basic eligibility rules and benefit amounts, a TANF payment may be made both for the promotion of the general welfare and as compensation for services. In these cases, it is extremely difficult to characterize the basic purpose of the payments. It is also not practically feasible to determine the relative proportion of the payment each purpose represents.

In many of these cases, TANF payments are received in lieu of (and generally in amounts no greater than) payments the individual formerly received or would

have received under AFDC based upon the individual's personal and family subsistence requirements. In these cases, the primary measure of the amount received is the personal or family need of the individual recipient rather than the value of any services performed.

These cases typically share, and can be identified by, common characteristics. In cases where the following three conditions are satisfied, TANF payments will be treated as made for the promotion of the general welfare and therefore will not be includible in an individual's gross income; will not be earned income for EIC purposes; and will not be wages for employment tax purposes:

- (1) The only payments received by the individual with respect to the work activity are received directly from the state or local welfare agency (for this purpose, an entity with which a state or local welfare agency contracts to administer the state TANF program on behalf of the state will be treated as the state or local welfare agency);
- (2) The determination of the individual's eligibility to receive any payment is based on need and the only payments received by the individual with respect to the work activity are funded entirely under a TANF program (including any payments with respect to qualified state expenditures (as defined in § 409(a)(7)-(B)(i)(I) of the Social Security Act) and the Food Stamp Act of 1977; and
- (3) The size of the individual's payment is determined by the applicable welfare law, and the number of hours the individual may engage in the work activity is limited by the size of the individual's payment (as determined by applicable welfare law) divided by the higher of the federal or state minimum wage.

The federal income and employment tax treatment of TANF payments that do not satisfy each of these three conditions is determined under the general analysis described in section 4.01, above.

REQUEST FOR COMMENTS

The Treasury Department and the Service invite comments on this notice and on the future regulations. In particular, comments are requested on the three con-

ditions set forth in section 4.02 of this notice. Written comments should be submitted by February 15, 1999. An original and eight copies of written comments should be sent to:

Internal Revenue Service
Attn: CC:DOM:CORP:R
Room 5228 (IT&A:Br2)
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044.

or hand delivered between the hours of 8 a.m. and 5 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:DOM:CORP:R
(Notice 99-3)
Room 5228 (IT&A:Br2)
1111 Constitution Avenue, NW
Washington, D.C.

Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to:

http://www.irs.ustreas.gov/prod/tax_regs/comments.html (the IRS internet site). All comments will be available for public inspection and copying in their entirety.

FURTHER INFORMATION

For further information, contact Mr. Edwin B. Cleverdon at (202) 622-4920 regarding the income tax issues in this notice and Ms. Jean Casey at (202) 622-6060 regarding the EIC and employment tax issues in this notice (not toll-free calls).
