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Legend

= Board
= Agency
= District
= State
= City

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This is in response to a request for a ruling concerning whether amounts received by nurses with respect to services performed for the Board are subject to taxes under the Federal Insurance Contributions Act (FICA).

The Agency is a non-profit private duty nursing agency providing nursing care and services to a variety of clients. The Agency currently has a contract with the Board to provide several nurses to schools in the District. These nurses work a set schedule each day at various schools in the District throughout the school year and provide health services to the students attending these schools. The schools in the District are members of the State Retirement System.

Under the contract between the Agency and the Board, the Agency is solely responsible for the payment of wages to the nurses, the payment of all worker's compensation, unemployment compensation, Medicare, retirement or any other benefits which may accrue to the nurses. The Board has the right to designate from time to time the particular subject matter or projects for the Agency's services. As part of its services, the Agency monitors the work of the nurses and provides documentation relating to the nurses' services as requested by the Board supervisor.

The Board assists in monitoring the performance of the nurses, and provides and pays for all supplies used by the nurses in the provision of nursing services for the Board.

The Agency periodically submits invoices to the Board for the nurses' services, and the Board is required to pay such invoices within ten working days of receipt. The work schedule and supervision for the nurses performing services is the shared responsibility of their direct supervisor at the Agency and the Board's Director of Development, Student and Community Services.

FICA taxes are composed of the Old-Age, Survivors, and Disability Insurance (OASDI) taxes imposed under Internal Revenue Code ("Code") sections 3101(a) and 3111(a), also known as social security taxes, and the hospital insurance tax imposed by sections 3101(b) and 3111(b), also known as Medicare taxes. In general, all payments of remuneration by an employer for services performed by an employee are subject to FICA taxes, unless the payments are specifically excepted from the term "wages" or the services are specifically excepted from the term "employment."

In order to determine whether the remuneration paid to the nurses is subject to FICA taxes, it is first necessary to determine which of the two entities, the Agency or the Board, is the common law employer of the nurses.

Under the employment tax regulations, a common law employment relationship generally exists when the person for whom the services are performed has the right to control and direct the individual who performs the services not only as to the result to be accomplished by the worker but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but as to how it shall be done. It is not necessary that the employer actually direct or control the manner in which the services are performed, it is sufficient if he has the right to do so. See Employment Tax Regs. § 31.3121(d)-1(c)(2).

The analysis of whether an employment relationship exists typically arises in the context of determining whether an individual is an employee or an independent contractor. However, the determination of which of two potential employers is treated as the employer for employment tax purposes is made using the same standard. Bartels v. Birmingham, 332 U.S. 126 (1947); Professional & Executive Leasing, Inc. v. Commissioner, 89 T.C. 225, 232-233 (1987), aff'd, 862 F.2d 751 (9th Cir. 1988).

Section 4.01(52) of Revenue Procedure 2001-3, 2001-1 I.R.B. 111, states that the Service will not make determinations as to which of two entities under common law rules applicable in determining the employer-employee relationship is the employer, when one entity is treating the worker as an employee. Thus, we are unable to make a determination as to whether the Agency or the Board is the common law employer with respect to the nurses. However, the Agency and the Board have both represented that the nurses are employees of the Board under the common law rules insofar as the Board is the entity that has the right to control and direct the nurses not only as to the result to be accomplished by the work, but also as to the details and means by which

that result it accomplished. Accordingly, our analysis and conclusions are based on the assumption that the Board is the common law employer of the nurses.

Under Code § 3401(d), the term "employer" generally means the person for whom an individual performs any service, of whatever nature, as the employee of such person. Under Code § 3401(d)(1), however, if the person for whom the individual performs the services does not have control of the payment of the wages for such services, the term "employer" means the person having control of the payment of such wages. See Employment Tax Reg. § 31.3401(d)-1(f), which provides that the term "employer" means the person having legal control of the payment of the wages. Thus, a person other than the common law employer will be treated as an employer for employment tax purposes if: (1) the common law employer does not have control of the payment of the wages, and (2) the third party has control of the payment of the wages.

Under Code § 3401(d)(1), the person having control of the payment of wages is responsible for income tax withholding generally, even though that person is not the common law employer for purposes of Code § 3401(a), which defines wages for purposes of income tax withholding. Code section 3401(a) also provides various exceptions to the term "wages" that depend on the nature of the employer. As a result, the determination of whether remuneration is wages under Code § 3401(a) is made on the basis of the common law employer, even if another party is the employer under Code § 3401(d)(1).

The FICA provisions contain no definition of employer similar to the definition contained in Code § 3401(d)(1). However, Otte v. United States, 419 U.S. 43 (1974), holds that a person who is an employer under Code § 3401(d)(1) is also an employer for purposes of FICA withholding under Code § 3102. Circuit courts have applied the Otte holding to conclude that the person having control of the payment of the wages is also the employer for purposes of Code § 3111, which imposes FICA excise tax on employers. See e.g., In re Armadillo Corp., 561 F.2d 1382 (10th Cir. 1977).

Otte dealt with the trustee in bankruptcy of a bankrupt employer and the tax liability attributable to wages paid by the trustee for services performed for the bankrupt employer. The trustee argued that the payments made by the trustee were not wages under Code § 3401(a). The Supreme Court rejected those arguments and noted that the payments were for services performed for the former employer. It stated that the fact that the services were performed for the bankrupt, rather than for the trustee, and the fact that the payments were made after the employment relationship terminated, did not convert the remuneration into something other than wages. Otte also held that the payments were FICA wages, even though the employment relationship between the bankrupt and the employee no longer existed at the time of payment, and that the trustee was responsible for withholding the employee's share of FICA.

In extending statutory employer status to FICA, Otte did not explicitly address whether

FICA wages are determined with respect to the common law employer, rather than the § 3401(d)(1) employer. It thus inherently applied the § 3401(d)(1) definition of employer for FICA purposes in a manner analogous to its application for purposes of income tax withholding. Therefore, because § 3401(d)(1) employer status does not apply in determining wages for purposes of income tax withholding, it should not apply in determining wages for FICA or FUTA purposes under Code §§ 3121(a)(1) and 3306(b)(1), respectively.

Control of the payment of the wages means legal control of the funds used to pay the wages. See Century Indemnity Company v. Riddell, 317 F.2d 681, 686 (9th Cir. 1963); Employment Tax Regulations section 31.3401(d)-1(f). In three-party arrangements like the one in the instant case, if the section 3401(d)(1) employer is obligated to pay the common law employer's employees regardless of whether the common law employer advances funds to the § 3401(d)(1) employer or whether the common law employer subsequently reimburses it, the § 3401(d)(1) employer is in control of the payment of the wages. Conversely, if the § 3401(d)(1)'s payment of the common law employer's employees is contingent on, or proximately related to, the common law employer's transfer of funds to the § 3401(d)(1) employer, the common law employer is in control of the payment of the wages.

Although the Board is the common law employer of the nurses, the contract between the Board and the Agency provides that the Agency is responsible for the payment of the nurses' wages. You have represented that the Agency is obligated to pay wages to the nurses assigned to schools within the District regardless of whether the Board advances funds to the Agency or whether the Board subsequently reimburses it. Accordingly, the Agency has legal control of the payment of wages and is therefore responsible for withholding and paying employment taxes with respect to the nurses pursuant to § 3401(d)(1).

Section 3121(b)(7) of the Code generally excludes from "employment" services performed in the employ of any state, or any political subdivision thereof, or any wholly-owned instrumentality of any one or more of the foregoing. However, under Code section 3121(b)(7)(E), the exception from employment does not apply to services included under an agreement entered into pursuant to section 218 of the Social Security Act.

In the event that the services performed by the employees are not included under a section 218 agreement, Code § 3121(b)(7)(F) provides that the exception from employment shall not apply to services performed by an employee of a State, political subdivision or wholly owned instrumentality thereof by an individual who is not a member of the retirement system of such State, political subdivision or wholly owned instrumentality. See section 31.3121(b)(7)-2 of the Employment Tax Regulations.

If the employees are qualified participants in a retirement system of the employer within

the meaning of the regulations and, therefore, exempt under Code § 3121(b)(7)(F) from the taxes imposed under the FICA, they may nevertheless be subject to the Medicare portion of the FICA taxes. Under Code § 3121(u)(2)(C) of the Code, all State or local government employee hired after March 31, 1986 are subject to the Medicare portion of the FICA taxes regardless of membership in a retirement system provided by the employer.

The following six factors are considered in determining whether an organization is a wholly-owned instrumentality of a state: (1) whether the organization is used for a governmental purpose and performs a governmental function; (2) whether performance of its function is on behalf of one or more states or political subdivisions; (3) whether there are any private interests involved, or whether the states or political subdivisions involved have the powers and interests of an owner; (4) whether control and supervision of the organization are vested in public authority or authorities; (5) whether express or implied statutory or other authority is necessary for the creation and/or use of such an instrumentality, and whether such authority exists; and (6) the degree of financial autonomy and the source of its operating expenses. See Rev. Rul. 57-128, 1957-1 C.B. 311.

The Board consists of five members who are publicly elected City officials serving two year terms. The Board is responsible for establishing policy and monitoring activities of the District. The District is a public school district in State functioning under charter of the State Department of Education. The Board and the District are governed by State statute and the policies of the State Board of Education. The State provides most of the funding for the District, with the remaining funds consisting of revenue from local property taxes and a small percentage from federal sources.

Solely on the basis of the information submitted, we rule that the Board is a wholly-owned instrumentality of City, which is a political subdivision of State. Therefore, the services performed by the Board's employees who are qualified participants in a retirement system within the meaning of section 3121(b)(7)(F) are excluded from employment. Accordingly, the Board is not subject to the OASDI taxes under section 3111(a) with respect to wages paid to qualified participants in a retirement system. Similarly, such qualified participants are not subject to OASDI taxes under section 3101(a). Finally, the Agency, as the § 3401(d)(1) employer, is under no obligation to withhold and pay OASDI taxes with respect to wages paid to nurses who perform services for the Board.

No opinion is expressed as to the federal tax consequences of the transaction described above under any other provision of the Code. The above analysis is based on the assumption that the Taxpayer is not covered by a section 218 agreement. No opinion is expressed on whether the continuing-employment exception to the Medicare portion of the FICA tax provided by Code section 3121(u) applies to any employee of the Taxpayer. No opinion is expressed on whether the Taxpayer's retirement plan

constitutes a retirement system within the meaning of Code section 3121(b)(7)(F).

This ruling is directed only to the taxpayer which requested it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

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(Exempt Organizations/Employment
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