DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

November 21, 2006

Number: **INFO 2006-0095**
Release Date: 12/29/2006

UIL: 3121.10-01

CONEX-149809-06

The Honorable Mel Martinez
United States Senator
SH-317
Washington, DC 20510

Attn:

Dear Senator Martinez:

This letter is in response to your fax dated October 24, 2006, sent to Assistant Secretary, Legislative Affairs, Department of the Treasury, on behalf of your constituent, contacted your office for help in resolving a dispute regarding the tax treatment and reporting of compensation it pays its .

Because completed a Form 8821, Tax Information Authorization, authorizing you and of your office to receive confidential tax information in connection with this tax matter, we are able to respond to the inquiry regarding the IRS rules about the tax treatment and reporting of compensation paid to .

According to your fax, we understand the following facts.
is a subject to regulation by the U.S. Department . (In their published guidance, these agencies refer to)
Currently, treats its as independent contractors and reports compensation paid to them on Forms 1099. However, according to a recently revised requires to treat as employees and to report compensation paid to them on Forms W-2.

has a private letter ruling from the Internal Revenue Service . relies on for permission to report compensation paid to on Forms 1099. is looking for additional guidance from both the IRS and in order to determine whether supersede the new guidance.

The application of the is within jurisdiction. Moreover, because of the confidentiality and disclosure requirements of section 6103 of the Internal Revenue Code, without the consent of a taxpayer we cannot disclose that taxpayer's identity or other tax return information to a third party. Thus, we cannot talk to about a specific taxpayer (such as), a taxpayer's letter ruling from us, or a taxpayer's specific facts. Therefore, we are not able to advise you as to whether must comply with the new .

If you would like to discuss your constituent's questions with a representative from , you can contact of the .

We can verify that the PLR issued to remains valid for federal tax purposes provided that the facts remain as set forth in the ruling.

We understand your constituent's concern regarding the proper tax treatment of its and its desire to pay the proper amount of employment taxes. Thus, we are providing additional information which explains the tax laws and also explains what tax consequences may follow if changes its federal tax reporting with respect to its . We hope the following is helpful to you and your constituent.

As explained below, the tax laws impose employment taxes on employers and employees. The tax laws provide relief from employment taxes for a business that did not treat a worker as an employee when certain criteria are met. If the business continues to meet the criteria, despite other changes in the working arrangement, the relief continues. If the business fails to meet the criteria for a tax period, the relief ends.

Definition of Employee and Imposition of Employment Taxes

The tax laws define an employee as any individual who, under the usual common law rules for determining the employer-employee relationship, has the status of employee. We determine whether a worker is an independent contractor or an employee under the common law rules by considering all of the facts and circumstances of each individual case. (Sections 3121(d), 3306(i), and 3401(c) of the Internal Revenue Code (the

Code), relating to the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and income tax withholding, respectively.) Guides for determining employment status are found in three substantially similar sections of the Employment Tax Regulations (the Regulations): sections 31.3121(d)-1, 31.3306(i)-1, and 31.3401(c)-1.

Generally, the relationship of employer and employee exists when the person for whom the worker performs the services has the right to control and direct not only as to the results of that person's work, but also as to the details and means by which he or she accomplishes the result. (Section 31.3121(d)-1(c)(2) of the Regulations.) *Publication 15-A, Employer's Supplemental Tax Guide*, found at www.irs.gov (http://www.irs.gov/pub/irs-pdf/p15a.pdf), explains this further. I am enclosing a copy for your convenience.

Generally, an employer must withhold, deposit, report, and pay employment taxes, including federal income tax withholding, FICA tax, and FUTA tax on wages it pays to employees.

Employment Tax Relief for Taxpayers Under Section 530 of the Revenue Act of 1978

If a business has a reasonable basis for not treating a worker as an employee, the law provides relief for that business from having to pay employment taxes with respect to that worker under section 530 of the Revenue Act of 1978. A reasonable basis for not treating a worker as an employee could be that the business:

- Reasonably relied on a court case about federal taxes or an IRS ruling issued to the business
- Underwent an IRS audit at a time when the business treated similar workers as other than employees and the IRS did not reclassify those workers as employees
- Treated the worker as other than an employee because of knowledge that a significant segment of the same industry treated similar workers as other than employees
- Relied on some other reasonable basis, such as the advice of an accountant who knew the facts about the business

In addition, the business must not have treated the worker, or any similar workers, as employees. Finally, the business must have filed all required federal tax returns (including information returns) for the worker for the period consistent with the worker not being an employee. For example, if the business treated the worker as an independent contractor, the business must have filed required Forms 1099 for the worker.

If a business meets the requirements of section 530, the business is relieved from having to pay employment taxes regardless of whether the worker or workers in question may be employees.

Revenue Procedure 85-18, 1985-1 C.B. 518, is a revenue procedure issued by the IRS to provide instructions for implementing the provisions of section 530 of the Revenue Act of 1978. I am enclosing a copy for your convenience.

Section 3.02 of Rev. Proc. 85-18, provides that for any period after December 31, 1978, the relief under section 530 will not apply, even if the taxpayer has met the "safe haven" rules (outlined above), if the appropriate Forms 1099 have not been timely filed with respect to the workers involved.

Section 3.03 of Rev. Proc. 85-18 provides that in determining whether a taxpayer did not "treat" an individual as an employee for any period within the meaning of section 530, the following guidelines should be followed:

> (A) The withholding of income tax or FICA tax from an individual's wages is "treatment" of the individual as an employee, whether or not the tax is paid over to the Government.
>
> (B) Except as otherwise provided in Rev. Proc. 85-18, the filing of an employment tax return (including Form 940 (Employer's Annual Federal Unemployment Tax Return), Form 941 (Employer's Quarterly Federal Tax Return), and Form W-2 (Wage and Tax Statement)) for a period with respect to an individual, whether or not tax was withheld from the individual, is "treatment" of the individual as an employee for that period.

Thus, if a business files a Form W-2 with respect to a worker for a tax period, the business has treated the worker as an employee and section 530 relief will not apply.

Other Federal Law – Department of

The U.S. Department of is authorized by legislation to approve to participate in programs and to regulate those . This authority is contained in the . Interpretation of these laws and promulgation of rules implementing the laws are under the jurisdiction of .

maintains a which

covers requirements and policies for approval and of for participation in the programs. The provides information to staff and participating on procedures for obtaining and retaining approval as a . The also provides basic information on program for monitoring the and performance of

On issued a revised , updating the prior version dated . The revised incorporates the provisions of , as well as all , regarding the approval requirements. The is available electronically at

provides: must meet the following general requirements to be approved for participation in the programs.

provides: An approved must employ trained personnel that are competent to perform their assigned responsibilities. . . . The must demonstrate the essential characteristics of the employer-employee relationship upon inquiry by the Department. . . . All compensation must be reported on Form W-2.

provides:
must be employees of the
must be employees of the ; its authorized agent; or, if the is a . Managers, may not be independent contractors or contract employees.

Although in the federal employment tax area, section 530 of the Revenue Act of 1978 provides relief for taxpayers that qualify from having to pay employment taxes or file Forms W-2 with respect to workers that may be employees, the rules do not explicitly address employers who qualify for relief under section 530. You would need to speak with at to determine what requires of an employer that qualifies for section 530 relief.

Constituent's IRS Private Letter Ruling

In IRS private letter ruling, we explained that a

significant percentage of activities and conduct is regulated by . The ruling says that asked for certain revisions in agreement to satisfy requirement that the functions be performed by persons classified as common law employees. In response to request for revisions to the agreement, revised the agreement to add provisions--

> (1) that will exercise control and responsible management supervision over the conduct and activity in -related activity, including regular and ongoing reviews of the performance.
> (2) that will pay the operating expenses incurred with respect to -related activity, including furniture, office rent, overhead charges, and office supplies.
> (3) that the will personally perform all customary functions with respect to -related activity and the agrees not to contract with a third party for any of these functions.

As explained above, if a taxpayer has the right to direct and control the results as well as the details and the means of accomplishing the results of a person's work, then the relationship of employer and employee exists. If is the employer of the , then it would ordinarily be required to withhold, deposit, report, and pay employment taxes on compensation it pays to them.

private letter ruling from the IRS that concludes that the use of the revised agreement with the will not be considered treatment of the as employees within the meaning of section 530 and therefore will continue to qualify for relief under section 530 with respect to these workers as long as—

> (1) continues to timely file all the required federal tax returns (including information returns) consistent with its treatment of as not being employees;
> (2) continues to treat individuals holding substantially similar positions as not being employees;
> (3) does not withhold income tax or FICA tax from a or pay the employer-s share of FICA tax or the FUTA tax on behalf of a ; and
> (4) does not file federal Forms W-2, 940, and 941 with respect to the .

The IRS private letter ruling addresses only federal tax issues within the jurisdiction of the IRS. It does not address compliance with the new guidance. The private letter ruling remains in effect provided that is continuing to operate consistent with the facts set forth in the ruling. A change in these facts will mean that the private letter ruling is not binding on the IRS, and may no longer qualify for relief under section 530.

If a business has relief under section 530 for a class of workers and subsequently files a Form W-2 with respect to a worker in that class, this is considered treatment of the worker as an employee, with the result that the business no longer qualifies for relief under section 530 for the class of workers. Once relief under section 530 for a class of workers terminates, the business will be responsible for employment taxes with respect to workers in that class.

I hope this information is helpful in responding to . If you have any questions, please contact me or at ( ) .

Sincerely,

Michael Swim
Senior Technician Reviewer
Office of Division Counsel/
Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosures (2):
Publication 15-A, Employer's Supplemental Tax Guide
Revenue Procedure 85-18, 1985-1 C.B. 518