



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

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MEMORANDUM FOR: Director, Examination Appeals  
Director, Specialized Examination Programs & Referrals

FROM: Anita M. Hill /s/ *Anita M. Hill*  
Director, Case and Operations Support

SUBJECT: Employment Tax Procedures for IRC 7436 Wage Issues

**Purpose:** This memorandum issues guidance to Appeals employees regarding a change in procedures for identifying and closing employment tax cases involving determinations subject to review by the United States Tax Court pursuant to Internal Revenue Code (IRC) 7436. Appeals employees will follow this guidance for analyzing and closing employment tax cases until all applicable Internal Revenue Manual (IRM) sections are updated. Please ensure that this information is distributed to all affected employees within your organization.

**Background/Source(s) of Authority:** Historically, employment tax issues fell into two categories: (1) wage issues and (2) worker classification issues.

The United States Tax Court in SECC Corporation v. Commissioner, 142 T.C. 225 (2014) and American Airlines, Inc. v. Commissioner, 144 T.C. 24 (2015), created a new category of employment tax cases subject to Tax Court review. This new category of cases (called "Wage Issues subject to IRC 7436") involve unagreed employment tax adjustments in which a taxpayer has issued both Forms W-2 and Forms 1099 to the worker for the same taxable periods, makes an argument regarding worker classification with respect to the payment being adjusted, or argues that it is entitled to Section 530 relief.

**Procedural Change:** Appeals will consider Wage Issues subject to IRC 7436 as being subject to Tax Court review and will continue to distinguish IRC 7436 issues (both worker classification issues and Wage issues subject to IRC 7436) reviewable by the United States Tax Court from non-IRC 7436 issues (wage issues) for determining the appropriate closing documents. If a taxpayer raises either a worker classification (including the issuance of both Forms W-2 and Forms 1099 to

the worker for the same taxable period) or Section 530 argument, Appeals will consider the case as an IRC 7436 issue subject to Tax Court review.

IRC 7436 issues subject to Tax Court review include:

1. Worker classification issues: Whether the Service determines that an individual(s) who was treated as a non-employee should be reclassified as an employee;
2. Section 530 issues: Whether the taxpayer is entitled to Section 530 relief; and
3. Wage issues subject to IRC 7436: Whether a taxpayer raises either a worker classification or Section 530 argument with respect to a wage issue. (See Exhibits 1, 2 and 3.)

The Service has revised [Letter 3523](#), the Form 2504 series, and settlement computation documents (Form 4666, Form 4667, and Form 4668) and is in the process of revising [Publication 3953](#) to reflect the Service's current position that certain wage issues are reviewable by the Tax Court. Appeals will close unagreed Wage Issues subject to IRC 7436 cases by issuing Letter 3523 by certified or registered mail.

For agreed IRC 7436 issues, Appeals will secure agreement Form 2504-T for settlements not based on mutual concessions. See [IRM 8.6.4.1.1](#), *Mutual Concession Settlements*. For settlements based on mutual concessions, Appeals will continue to secure agreement Form 2504-AD and select the paragraph containing the following language: "I am waiving the restrictions on assessment provided in section 7436(d) and 6213(a) the Internal Revenue Code of 1986."

Appeals will prepare separate settlement computation documents for IRC 7436 issues and non-IRC 7436 issues if both are present in an employment tax liability case. See [IRM 8.7.16.7](#), *Settlement Computations on Employment Tax Cases*, and related subsections for information on the following settlement computation documents:

- [Form 4666](#) - Summary of Employment Tax Examination
- [Form 4667](#) - Examination Changes – Federal Unemployment Tax, and
- [Form 4668](#) - Employment Tax Examination Changes Report

For unagreed IRC 7436 issues, Appeals will issue Letter 3523 via certified or registered mail to allow the taxpayer the opportunity to petition the Tax Court for review of the Service's determination.

For employment tax liability forms and letters, see Exhibits 2 and 3. Failure to follow these procedures could result in the taxpayer having an unrestricted timeframe to petition the Tax Court for a pre-assessed liability and could result in erroneous assessments and statute of limitation problems.

**Effective Date/Effect on Other Documents:** This guidance is effective as of the date of this memorandum and will be incorporated into IRM 8.7.16, *Appeals Employment Tax Procedures*, within two years from the date of this memorandum.

**Contact:** Appeals employees should follow existing procedures to elevate questions through their management chain and follow established procedures on [How to Contact an Analyst](#).

Attachments:

- Exhibit 1 - IRC 7436 Decision Tree
- Exhibit 2 - Agreement Forms
- Exhibit 3 - Employment Tax Closing Letters

cc: [www.irs.gov](http://www.irs.gov)

**Exhibit 1 - IRC 7436 Decision Tree:**

Step	Action	Notes
1)	Identify whether issue is a worker classification issue or wage issue	<p>The issue is a worker classification issue if:</p> <ul style="list-style-type: none"> <li>• The worker received compensation reported only on Form 1099-MISC</li> <li>• The worker was paid, but received no information return, and the taxpayer did not withhold employment taxes</li> <li>• The worker received both Form W-2 and Form 1099-MISC, but they were for two distinct periods of time, or two separate and distinct services performed</li> </ul> <p>unless it is clear the payments were for services performed as an employee in a prior year.</p> <p>The issue is a wage issue if the worker was already treated as an employee, but received additional compensation that was not included as wages, such as:</p> <ul style="list-style-type: none"> <li>• Payments under non-accountable plans</li> <li>• Payments in property, such as stock</li> <li>• Payments of non-qualified deferred compensation</li> <li>• Severance payments</li> <li>• Fringe benefits</li> </ul> <p>What is considered a worker classification issue or a wage issue has not changed, but now some wage issues could fall under the Tax Court's jurisdiction</p>
2)	Identify whether the issue is an IRC 7436 issue	<p>An issue will fall under IRC 7436 if:</p> <ul style="list-style-type: none"> <li>• It is a worker classification issue</li> <li>• It is a wage issue where <b>either</b> <ol style="list-style-type: none"> <li>1. The payment was reported on Form 1099-MISC</li> <li>2. The taxpayer raises the argument that the worker was not an employee <b>OR</b></li> <li>3. The taxpayer raises the argument that Section 530 should apply.</li> </ol> </li> <li>• The taxpayer raises Section 530</li> </ul>
3)	Identify the appropriate agreement form for settlement	Refer to Exhibit 2 below
4)	Identify the letter to send	Refer to Exhibit 3 below

**Exhibit 2 - Agreement Forms:**

<b>If</b>	<b>Then</b>
Employment tax adjustments for 7436 issues	<ul style="list-style-type: none"> <li>• Prepare Form 2504-AD. Click on “Show Selectable Paragraph Pages” and select option 1 for settlement based on mutual concessions; or</li> <li>• Prepare Form 2504-T for settlement not based on mutual concessions</li> </ul>
Employment tax exam adjustments for non-7436 issues when worker classification issues were not examined	<ul style="list-style-type: none"> <li>• Prepare Form 2504-AD. Click on “Show Selectable Paragraph Pages” and select option 2 for settlement based on mutual concessions; or</li> <li>• Prepare Form 2504-S for settlement not based on mutual concessions</li> </ul>
Employment tax adjustments for non-7436 issues when worker classification issues were also examined (whether adjusted or not)	<ul style="list-style-type: none"> <li>• Prepare Form 2504-AD. Click on “Show Selectable Paragraph Pages” and select Option 3 for settlement based on mutual concessions; or</li> <li>• Prepare Form 2504 for settlement not based on mutual concessions</li> </ul>

**Exhibit 3 - Employment Tax Closing Letters:**

<b>Letter #</b>	<b>Purpose</b>
4450	Appeals Transmittal letter for securing agreement
4452	Closing letter for agreed case
3523	Include unagreed 7436 issues reviewable by Tax Court
4451	Include unagreed non-7436 issues for immediate assessment