Office of Chief Counsel
Internal Revenue Service
memorandum

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to:

Newark, NJ 07102
(Appeals, Area , Team)

From: Linda P. Azmon
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(Tax Exempt & Government Entities Division Counsel)

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subject:

This memorandum concerns information regarding the above taxpayer. This advice may not be used or cited as precedent in other cases. This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges, such as the attorney-client privilege. If disclosure becomes necessary, please contact this office for our views.

ISSUES

1. Whether is liable for the employment taxes proposed by the Examination Division for the taxable periods included in the and taxable years, as well as the taxable years ending December 31, and ?

2. Is entitled to relief treatment under Section 530 of the Revenue Act of 1978?

3. Whether the amount of proposed employment taxes should be calculated using the rates provided for in I.R.C. § 3509?[1]

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[1] All references to "section" are to the Internal Revenue Code of 1986, as amended, unless otherwise noted, except that references to "section 530" are to the Revenue Act of 1978. Section 530 has never been codified in Title 26 of the U.S. Code, but many publishers of the Internal Revenue Code include the

4. Whether would be entitled to an interest-free adjustment pursuant to I.R.C. § 6205?

5. Whether a Notice of Determination of Worker Classification should be issued to the in the event your office is unable to resolve the present dispute.

SUMMARY CONCLUSIONS

1. As the common law employer of the workers at issue, is liable for the employment taxes proposed by the Examination Division.

2. would not be entitled to relief treatment under section 530 of the Revenue Act of 1978 ("section 530"), as section 530 is not applicable to the present dispute.

3. The rates provided for in I.R.C. § 3509 are not applicable to the present dispute.

4. could be entitled to an interest-free adjustment of the FICA and ITW pursuant to I.R.C. § 6205 if they execute a Form 2504-WC, and tender payment to Service prior to the issuance of a Notice of Determination of Worker Classification.

5. Since the present case does not involve an issue regarding the proper employment status of workers, and since the Taxpayer has not alleged that it is entitled to relief treatment pursuant to section 530, the taxes may properly be assessed without the issuance of a Notice of Determination of Worker Classification.

[redacted]

[redacted]

FACTS

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text of section 530 in the notes following Code section 3401(a).

During the taxable quarters included in the taxable years ending December 31, through December 31, as well as the taxable years ending December 31, and December 31, ("taxable periods and years at issue"), ("the Taxpayer") operated a limousine transportation business. In conducting its operations, the Taxpayer employed workers to perform services in the accounting department, administrative department, marketing department and sales department. The Taxpayer also employed reservationists, fleet technicians, dispatchers, meeting and conference personnel, and chauffeurs.

The Taxpayer filed Forms 1120S (U.S. Income Tax Return for an S Corporation) for the taxable years ending December 31, and December 31 . On such Forms 1120S, the Taxpayer did not claim any deductions for officer compensation or salaries and wages. Instead, the Taxpayer claimed deductions for "Employee Leasing" for its entire workforce.

In October , the Taxpayer entered into a contract entitled "PEO SERVICES AGREEMENT" with . Subsequent to entering into this contract, in or about January became known as . On April 2, , the Taxpayer entered into another contractual agreement with . Although the administrative file contains only the contract entered into with , there is no dispute between the parties that the terms of the contracts remained substantially the same throughout October through December 31, and that each of these entities provided the same type of services to the Taxpayer based on substantially similar contractual language.

Article II of the October contract with describes the relationship between the Taxpayer and the PEO as follows:

> "Subject to the terms and conditions of this Agreement, shall retain the individuals who work at CLIENT'S location (the "Co-Employees"). is a "professional employer organization" and an "employer" under the Internal Revenue Code Section 3401(b). Nonetheless, the Parties shall share the responsibilities of being the employer of the Co-Employees as provided in this Agreement.
>
> Without limiting the generality of the foregoing and the Representations and Warranties and Covenants of CLIENT as set forth herein assigns and delegates to CLIENT, the responsibility for the day-to-day supervision and control of the Co-Employees does not and shall not have any liability, obligation or responsibility therefore whatsoever."[2]

[2] I.R.C. § 3401 contains a variety of definitions and does not appear to be applicable in the context

Although the contract refers to the workers as "Co-Employees", the Taxpayer does not appear to dispute that at all times during the taxable periods and years at issue, it was the common law employer of the "Co-Employees" and had the right to direct and control all aspects of the employment relationship between itself and the workers.

Paragraph III of the contract sets forth the duties and rights of which basically were to: 1) "administer CLIENT payroll, designated benefits, and personnel policies and procedures related to the Co-Employees"; 2) provide "Human Resource Administration and Payroll Administration"; 3) furnish and keep workers' compensation insurance covering the "Co-Employees" in force; 4) and process and pay "Co-Employee" wages from its own accounts based on the hours reported by the Taxpayer.

In terms of funding for payroll and benefit administration, paragraph VI.A. of the contract requires that the Taxpayer pay "at least one (1) business day before each payroll date, an amount equal to all wages, salaries and any all other charges or payments to be to or with respect to the Co-Employees on the next payroll date." Thus, this contractual provision requires the Taxpayer to remit all salary and wages to for use in payment of the wages and salaries of the employees prior to actual payment of such wages and salaries by to the common law employees of the Taxpayer.

To ensure that would not be responsible for payment of wages to the Taxpayer's common law employees, paragraph VI.E. of the contract requires that the Taxpayer provide a security deposit or procure a letter of credit beneficiary in the amount as determined by to cover wages, salaries, contributions, premiums and any and all other charges or payment to be paid to or with respect to the Co-Employees on any given payroll date.

Additionally, paragraph VII of the contract provides that could terminate the contract immediately without notice upon the occurrence of the Taxpayer's failure to pay any invoice in full in the amount and at the time specified when due or any breach or default of the contract by the Taxpayer. Upon termination of the contract for any reason whatsoever, the contract provides that the Taxpayer is "responsible for payment of all wages, salaries and employment related taxes."

Although the Taxpayer entered into contractual agreements with the aforementioned entities, during the taxable periods and years at issue, employment tax returns (Forms 940 and Forms 941) as well as information returns (Forms W-2) were

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contained in the agreement. I.R.C. § 3401(b) provides: "For purposes of this chapter, the term "payroll period" means a period for which a payment of wages is ordinarily made to the employee by his employer, and the term "miscellaneous payroll period" means a payroll period other than a daily, weekly, biweekly, semimonthly, monthly, quarterly, semiannual or annual payroll period."

apparently filed by reporting the wages and salaries of the Taxpayer's common law employees during the taxable periods and years at issue. The Taxpayer did not file any Forms 940, Forms 941 or issue or file Forms W-2 with respect to any employees for any taxable periods and years at issue. Although the Taxpayer took no steps to verify the filing and payment of employment taxes, the Taxpayer states that "it paid the amount in question in full to all three PEOs and asserts that it is not liable for any unpaid tax that was failed to be remitted to the Service by the PEOs". The Examination Division has taken the position that, as the common law employer, the Taxpayer remains liable for the payment of the taxes at issue, and that Section 530 of the Revenue Act of 1978 is not applicable to the present dispute.

LAW AND ANALYSIS

Issue 1 – Whether . is liable for the employment taxes proposed by the Examination Division?

The applicable Federal employment taxes at issue consist of taxes under the Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA) and Federal income tax withholding (ITW). For any of these Federal employment taxes to apply, an employer-employee relationship must exist.

The existence of an employer-employee relationship generally is determined using the common law control test. See: §§ 31.3121(d)-1(c)(1); 31.3306(i)-1(a); and 31.3401(c)-1(a) of the Employment Tax Regulations. Specifically, the employment tax regulations describe an employer-employee relationship:

> Generally such relationship exists when the person for whom 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 work 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 how it shall be done. In this connection, 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. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer . . . are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services.

Treas. Reg. §§ 31.3121(d)-1(c)(2), 31.3306(i)-1(b) and 31.3401(c)-1(b).

In the present case, there is no dispute that the Taxpayer was at all times the common law employer of workers at issue. The Taxpayer alleges, however, that it paid