



OFFICE OF  
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224  
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR DISTRICT COUNSEL, KENTUCKY-TENNESSEE DISTRICT,  
NASHVILLE  
Attn: Vicki Miller

FROM: Chief, Branch 6 CC:EBEO:BR6  
Office of the Associate Chief Counsel (Employee Benefits  
and Exempt Organizations)

SUBJECT:  
This Field Service Advice responds to your memorandum dated November 26,  
1999. Field Service Advice is not binding on Examination or Appeals and is not a  
final case determination. This document is not to be cited as precedent.

LEGEND

X=  
ISSUE

Whether developmentally disabled individuals in the sheltered employment  
program of X are employees for federal employment tax purposes.

CONCLUSION

Developmentally disabled individuals in the sheltered employment program of X are  
employees for federal employment tax to the extent their activities most closely  
resemble those of the second class of individuals described in Rev. Rul. 65-165.

FACTS

X is a non-profit organization which is exempt from taxation under Internal  
Revenue Code section 501(c)(3). X maintains sheltered employment and  
supported living programs. The subject of this FSA is the sheltered employment  
program.

X provides training, job placement and on-site employment for individuals (clients) who are developmentally disabled. X asserts that its goal is to provide a therapeutic program for developmentally disabled clients to become self-sufficient by improving social skills and self help. Disabled individuals are initially evaluated for current and future employment potential and clients adjustment needs. Evaluation methods include observation, works samples, psychological evaluations, community skills profiles and inhouse assessment document profile. The vocational evaluation program lasts approximately six weeks. Thereafter, clients are placed in a work program most suited to their skills. The clients of X sheltered employment program are paid on a piece-rate basis and do not receive vacation, raises, bonuses or employee benefits. X admits that 50% of the developmentally disabled individuals remain in the sheltered employment program for an indefinite period of time.

#### LAW AND ANALYSIS

We see no material distinction between the activities of the clients in X's sheltered employment program and the activities of the individuals held to be employees in Technical Advice Memorandum 9801003. Therefore, the position as described in Rev. Rul. 65-165 is applicable to X.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

In your incoming memorandum, you suggest that the appropriate solution to these cases is to develop a "functionality" standard to determine the level at which a client would be deemed to be an employee. We are aware of various alternative approaches such as this. However, these approaches are not consistent with the position of the Service as announced in Rev. Rul. 65-165



Please call Lisa Tavares at 202-622-6090 if you have any questions.

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HARRY BEKER