Office of Chief Counsel
Internal Revenue Service

memorandum

CC:SER:KYT:LOU:TL-N-2198-99
FWKrieg

date: APR 30 1999

to: Director, Cincinnati Service Center
Examination Branch Self-Employment Tax Coordinator
Dee Helton

from: Frederick W. Krieg, Senior Attorney

subject: **Self-Employment Tax**
[redacted]

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This responds to your March 29, 1999, request for an advisory opinion. You requested that we "clarify the effect of a ruling" by one of our attorneys "as it would apply to other employees of the same employer."

Issues

(1). Was taxpayer an employee of the [redacted] (school board) or [redacted] during the [redacted] school year or was she an independent contractor and thereby liable for self-employment tax?

(2). Was part of taxpayer's compensation exempt from self-employment tax under I.R.C. § 1402(a)(1) because part was paid for use (rent) of the school bus ($[redacted] per mile)?

Conclusions

(1). Taxpayer was an independent contractor, not an employee of the school board or [redacted] and therefore she is liable for self-employment tax.

(2). No part of taxpayer's compensation is exempt from self-employment tax. The "rent" paid by the contractor was not exempt under I.R.C. § 1402(a)(1) as rental income.

Facts

The "ruling" to which you refer is a Tax Court case styled [redacted]. The attorney who handled that matter is no longer with our office. The case was a small tax case (i.e., "S" case) which was settled. An "S" case is handled less formally than a regular Tax Court Case and a court opinion can not be appealed. Because this case was settled and because it was an "S" case, it does not have any precedential value. That is, even if the case had been tried and decided by the Tax Court it would not have precedential value because of its "S" status.

In reference to the [redacted] settlement, you stated that our attorney's letter to the taxpayer's representative, [redacted], advised him to "move" school bus rental income and expenses of the operation of a school bus from Schedule C to Schedule E (rentals). Such treatment made that part of the overall income of owning and operating a school bus free from the self-employment tax. We have not found any situations where this has been done in other school bus transportation businesses. We agree that [redacted] operated the business as an independent contractor and not as an employee of either the school board or [redacted]. [redacted] was [redacted]'s and other drivers/owners' agent. She and others were "members" of [redacted].

In the present case [redacted] entered into a contract with the school board or [redacted] for the [redacted] school year. She was an owner-operator of a school bus. The contract provided $[redacted] per hour for school bus driving by [redacted] and $[redacted] per mile for miles driven over the assigned route. Allegedly, the mileage dollars were for "rent". The issues are employee v. independent contractor, and if it is determined [redacted] was an independent contractor, then an issue arises of allocating income between

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[1] [redacted] is the representative for your present taxpayer, [redacted], as well as for [redacted] and [redacted].

Schedule C self-employment income (and expenses) and Schedule E rental income (and expenses).

Discussion

Several areas are discussed below. They are (1) the settlement of [redacted] supra, (2) the facts and analysis of the present case involving [redacted] and (3) our suggestion concerning your preparing a request for technical advice.

The first area sets forth the basic facts of the [redacted] and [redacted] Tax Court case and its settlement.

[redacted] owned and operated a school bus for the transport of students. She was paid non-employee compensation pursuant to contract with [redacted]. Apparently, the issue was not whether [redacted] was an employee of the school board (she was not) or [redacted] (she was not), and not whether she received self-employment income (she did), but whether she could allocate rental receipts and expenses to Schedule E as non self-employment income not subject to self-employment tax. Apparently the normal issue of employee v. independent contractor was not an issue at all, as it was in revenue rulings, a private letter ruling, and cases mentioned in your request.

Based on its facts, in the [redacted] case it was agreed that [redacted]% of total receipts were considered as Schedule E rental income of the bus and [redacted]% were considered as Schedule C income for [redacted]'s hours of driving. Expenses were allocated according to whether they were expended for the production of rental income (mileage, maintenance, gas, etc.) or for the production of earned income from the actual driving.

Apparently, at the time of settlement, the Government attorney suggested that the taxpayers should obtain a private letter ruling for subsequent years. We do not know whether they did so.

The second area involves the facts, analysis, and our conclusions with regard to the present [redacted] case.

[redacted] entered into a contract with the [redacted] or Contract Services for the [redacted] school year. She was an owner-operator of a school bus. The contract provided $[redacted] per hour for school bus driving by [redacted], and $[redacted] per mile for miles driven over the assigned route. Allegedly, the mileage dollars were for "rent". Apparently, the issues are employee v. independent contractor, and if it is

determined [redacted] was an independent contractor, then an issue arises of allocating income between Schedule C self-employment income (and expenses) and Schedule E rental income (and expenses).

We have read the various cases, revenue rulings, and one private letter ruling with regard to determining whether a school bus driver is an employee or an independent contractor. In the [redacted] and [redacted] situations described above, we think there is little, if any, doubt that the owner/operator-drivers were independent contractors and not employees of either the school board or [redacted]. The [redacted] case was settled under that theory. Your [redacted] case should also be resolved using the conclusion that she was an independent contractor and not an employee. See the attached Rev. Rul. 72-175, 1972-1 C.B. 316 and Rev. Rul. 69-362, 1969-1 C.B. 254.

See also the attached PLR 9034003 (May 9, 1990) on the specific facts therein which were that a private corporation owned the buses used to transport the school district's students, where the corporation hired, supervised and paid workers who drove the buses, and where the workers were held to be employees of the private corporation, not independent contractors. That is, the drivers were not independent, they were employees who the employer had a right to control and direct and who performed the services exactly as directed. This letter ruling is completely in accord with the theory of independent contractor v. employee analysis above.

Another area involves the issue of whether consideration should be given to [redacted]'s and her representative's contention that the rental income and expense of the business should be considered Schedule E rental income not subject to self-employment tax.

Thus, should you treat [redacted] as [redacted] was treated by allowing [redacted] to use a percentage split between rental income (Schedule E) and bus driving income.

We think [redacted] was an independent contractor and not an employee. Further her rental income was merely a part of her overall business operation of transporting school children for money. Her business did not involve real property rent which can be an exception to the self-employment tax under I.R.C. § 1402(a). The rental income did not fall into the rental income from real property exception of I.R.C. § 1402(a)(1) and Treas Reg. § 1.1402(a)-4(a). See Johnson v. Commissioner, 60 T.C. 829 (1973), Stevenson v. Commissioner, 57 T.C.M. (CCH) 1032 (1989), and Gill v. Commissioner, 70 T.C.M. (CCH) 120 (1995), copies of which are

attached. Thus, all the income, including the "rental income", is [redacted]'s self-employment income.

The third area is our suggestion that you seek technical advice concerning (a) whether the "rent" of $[redacted] per mile should be considered rental income exempt from self-employment tax (Schedule E) or (b) whether it is a part of Schedule C self-employment income subject to self-employment tax. For procedures in this regard, see Rev. Proc. 99-2, I.R.B. 1999-1 (Jan 4, 1999), at Sections 1 through 10, pages 73 through 86, a copy of which pages are attached.

We are closing our file in this matter. However, if you have any further questions, please call me at 502-582-6577.

FREDERICK W. KRIEG
Senior Attorney

Attachments

cc: Regional Office, Southeast Region, Attn: Assistant Regional Counsel (Tax Litigation)
cc: National Office, Attn: Assistant Chief Counsel (Field Service)

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