

**Office of Chief Counsel  
Internal Revenue Service  
memorandum**

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to: Paul Marmolejo, Director  
Federal, State and Local Governments Division

from: Janine Cook   
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(Exempt Organizations/Employment Tax/Government Entities)

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subject: Federal Agencies and Employment Tax Relief under Section 530  
of the Revenue Act of 1978

This memorandum explains the law and history of employment tax and Section 530 of the Revenue Act of 1978 (Section 530) as they relate to federal agencies and the Internal Revenue Service's position regarding the application of employment tax relief under Section 530 to federal agencies.

**ISSUE**

Whether employment tax relief under Section 530 applies to federal agencies?

**CONCLUSION**

No. Employment tax relief under Section 530 does not apply to federal agencies.

**SUMMARY**

Section 530 does not expressly apply to federal agencies, and nothing in its legislative history indicates that Congress intended Section 530 to apply to federal agencies. At the time Section 530 was enacted in 1978, the consideration by Congress of application of Section 530 to federal agencies was not necessary because federal agencies were generally not subject to the Federal Insurance Contributions Act (FICA) tax, section 3402(d) mitigated the consequences of failure to withhold income tax, and the Service did not have a program for auditing federal agencies. Later amendments of Section 530 did not extend the application of Section 530 to federal agencies, including amendments made after Congress passed legislation in 1983 extending social security coverage to

new federal employees. The Service's consistent practice has been that Section 530 does not apply to federal agencies.

We also note that even if, for the sake of argument, Section 530 relief was applied to federal agencies, a federal agency could not satisfy the reasonable basis requirement of Section 530 if its position is in conflict with that of the Service. For employment tax and related purposes, the federal government is viewed as a single employer. Thus, a federal agency would not have a reasonable basis to take a position contrary to that of the Service, the federal government's agency with jurisdiction over the issue. Additionally, it is unlikely that a federal agency would satisfy the substantive consistency requirement of Section 530.

## **LAW**

This section of the memorandum will first set forth the employment tax responsibilities of federal agencies and then explain the provisions of Section 530.

### **I. Federal Employees--Income Tax Withholding and FICA Provisions<sup>1</sup>**

The income tax withholding and FICA tax provisions apply to federal agencies. Generally, for purposes of Collection of Income Tax at Source (income tax withholding) and the FICA, whether an individual is an employee is determined under the common law rules. The Service has the authority to determine whether an individual is an employee for income tax withholding and FICA tax purposes. See Rev. Rul. 75-343, in which the Service applied the common law test to determine that a worker who performed services for a federal agency as an examination monitor and counselor was an employee for income tax withholding and FICA purposes, even though his contract provided that he was not an employee.

Separately, the responsibilities of federal agencies with regard to federal employment taxes are acknowledged in the Treasury Financial Manual, Part 3, Chapter 4000 (March 2005), "Federal Income, Social Security, and Medicare Taxes." The Manual is the official publication for financial accounting and reporting of all receipts and disbursements of the federal government. It is issued by the Department of the Treasury, Financial Management Service, pursuant to the delegation in 31 U.S.C. §§ 3513(b) and (c). These provisions authorize the Secretary of the Treasury to develop and establish a coordinated financial reporting and accounting system for executive agencies, with the cooperation and approval of the Comptroller General.<sup>2</sup>

The Internal Revenue Manual also addresses these responsibilities. It refers to the Treasury Financial Manual and includes statements such as "Federal agencies are not exempt from the employment tax filing, paying and reporting requirements. Congress

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<sup>1</sup> For purposes of this memorandum, "employment tax" refers to income tax withholding under Internal Revenue Code section 3402 and FICA taxes under Code sections 3101 and 3111. FUTA tax does not apply to federal agencies. IRC § 3306(c)(6).

<sup>2</sup> See 31 U.S.C. §§ 3501 et seq.

did not provide any exceptions for Federal agencies"; "Federal agencies follow the same employment tax filing and reporting requirements that are required by private industry"; and "It is important to the image of the U.S. for Federal agencies to set a good example because private employers are expected to meet all requirements of filing and paying their employment taxes timely." IRM 5.1.7.6.2(1), (2) and (6) (10-9-2008).<sup>3</sup>

### **A. Income Tax Withholding**

For purposes of income tax withholding, section 3401(c) defines employee to include "an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing." Employment Tax Regulation § 31.3401(c)-1(a) explains that the term employee includes "every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee." It goes on to state: "The term includes officers and employees, whether elected or appointed, of the United States, a State, Territory, Puerto Rico, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing." Reg. § 31.3401(c)-1(b) sets forth the test for determining whether an individual is an employee under the usual common law rules, using text nearly identical to the text in the FICA tax regulations under section 3121.

Income tax withholding is imposed on wages, defined in section 3401(a) as all remuneration for services performed by an employee for his employer, with certain listed exceptions. Thus, unless an exception applies, income tax withholding is required on remuneration to an employee for services to an employer. IRC § 3402.

If an employer fails to deduct and withhold income tax, relief may be provided under section 3402(d). If the worker has paid his income tax for the period, then the amount

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<sup>3</sup> See also IRM 5.19.15.1 (3-30-2010), "Federal Agency Delinquency (FAD) Overview," which provides in paragraph (4): "Federal agencies are not exempt from employment tax and reporting requirements." A 2007 report from the Treasury Inspector General for Tax Administration (TIGTA) notes that the Service has enhanced its efforts to address delinquent employment taxes owed by government entities. The report states:

For example, three different IRS functional offices (the TE/GE Division, the SB/SE Division, and the CFO) formed a working group to discuss ways to address Federal Government agency employment tax delinquencies. Additionally, in June 2005, the CFO issued letters to the CFOs of each Federal Government agency that owed employment taxes in an attempt to inform senior-level management of the taxes owed and resolve the delinquencies at the agency level. . . . It is critical to the image of the United States that Federal Government entities be held to the same standards as private employers.

*Efforts to Collect Delinquent Employment Taxes Owed by Government Entities Could Be Improved*, TIGTA 2007-10-166, at 3 (Aug. 27, 2007).

A follow-up TIGTA report repeated the emphasis on the responsibility of federal agencies to pay employment taxes. It focused in particular on the effectiveness of the Service's FAD program to collect delinquent taxes and secure delinquent tax returns from federal agencies. *A Concerted Effort Should Be Taken to Improve Federal Government Agency Tax Compliance*, TIGTA 2012-30-094 (cover memorandum) (Sept. 5, 2012).

that should have been withheld is not collected from the employer. The regulations provide that an employer will not be relieved of its liability for payment of the tax required to be withheld unless it can show that the tax has been paid. See Employment Tax Regulation § 31.3402(d)-1.<sup>4</sup>

## B. FICA

### 1. Section 3121 definitions – employee, wages, employment

For purposes of the FICA, section 3121(d) defines employee to include “any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.”<sup>5</sup> Employment Tax Regulation § 31.3121(d)-1(c) contains the familiar explanation of the test for determining whether an individual is an employee under the usual common law rules.

FICA tax is imposed on wages, defined in section 3121(a) as all remuneration for employment with certain enumerated exceptions. Thus, even if a worker is an employee for purposes of the FICA, if the worker does not receive wages or if the service is excepted from employment, then no FICA tax is owed. Employment is defined in section 3121(b), which provides certain exclusions, including 3121(b)(5) and (6) with respect to certain federal service. This memorandum does not address the situations to which those exceptions apply.<sup>6</sup>

Congress made federal agencies generally subject to the FICA through a series of enactments in the 1980s. Thus, as of January 1, 1983, federal employees are covered under the Medicare program and began to pay the Medicare portion of the FICA tax.<sup>7</sup> Federal employees hired on or after January 1, 1984 are also covered under social security.<sup>8</sup> Beginning in 1987, the Federal Employees' Retirement System replaced the Civil Service Retirement System for new employees.<sup>9</sup>

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<sup>4</sup> The Service has established a procedure for applying section 3402(d). Form 4669, *Statement of Payments Received*, is used by an employer to secure statements from employees that the income tax on the wages in question has been satisfied. Form 4670, *Request for Relief from Payment of Income Tax Withholding*, is used to summarize and transmit the Forms 4669 to the Service. See IRM 4.23.8.4 (6-7-2011).

<sup>5</sup> FICA employees also include corporate officers, statutory employees defined under section 3121(d)(3), and individuals covered under a section 218 agreement with the Social Security Administration, categories not relevant here.

<sup>6</sup> The FICA exception from “employment” in section 3121(b)(5) generally provides an exception for service performed in the employ of the United States or any instrumentality of the United States if the service would be excluded from the term “employment” if the provisions of section 3121(b)(5) and (6) as in effect in January 1983 had remained in effect, with certain requirements and limitations regarding the individuals to whom the provision applies (for example, for individuals in continuous service since 1983). The FICA exception from “employment” in section 3121(b)(6) provides limited exceptions from “employment” for service performed as an inmate or by certain federal employees (for example, certain students and emergency firefighters).

<sup>7</sup> See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324.

<sup>8</sup> See Social Security Amendments of 1983, Pub. L. No. 98-21, 97 Stat. 65; H.R. Rep. No. 98-47, at 407-408 (1983) (Conf. Rep.). Before it was amended by the Social Security Amendments of 1983, section

## 2. Section 3122 – Federal Service

Section 3122, titled “Federal Service,” provides special FICA tax rules for federal service. These rules state who has authority to determine whether service for the United States or an instrumentality is employment under section 3121(b) and whether remuneration for that service is wages under section 3121(a). Section 3122 does not refer to section 3121(d), which contains the definition of employee for FICA tax purposes.<sup>10</sup>

Prior to its amendment in 1988, section 3122 provided that the head of the federal agency or instrumentality having control of the service made these determinations. A 1988 amendment deleted this provision and reserved the authority to make these determinations to the Secretary of the Treasury. Section 3122, the amendment, and the Service’s view of these determinations are discussed below.

a. Section 3122: pre-1988 amendment. Prior to its amendment in 1988, section 3122 provided that the employing federal agency determined whether an individual’s service was employment for purposes of the FICA and the amount of pay that was wages:

In the case of the taxes imposed by this chapter with respect to service performed in the employ of the United States or in the employ of any instrumentality which is wholly owned by the United States . . . the determination whether an individual has performed service which constitutes employment as defined in section 3121(b), the determination of the amount of remuneration for such service which constitutes wages as defined in section 3121(a), and the return and payment of the taxes imposed by this chapter, shall be made by the head of the Federal agency or instrumentality having the control of such service, or by such agents as such head may designate. . . .

Under this provision, federal agency heads had the authority to determine whether an individual employee’s service was employment and whether his remuneration was wages for FICA tax purposes, but the Service retained the authority to determine whether an individual was an employee. This sometimes resulted in an individual’s remuneration being subject to income tax withholding and not subject to FICA tax.

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3121(b)(6) provided an exception from “employment” for service performed in the employ of the United States (or an instrumentality) if the service was covered by a retirement system established by a law of the United States. Thus, employees covered by the Civil Service Retirement System were not subject to FICA tax; under current law, they continue to be excepted from the social security portion of the FICA tax.

<sup>9</sup> See Federal Employees’ Retirement System Act of 1986, Pub. L. No. 99-335, 99 Stat. 514. As discussed further below, the legislative history to the Federal Employees’ Retirement System Act did not include any reference to section 530.

<sup>10</sup> There are no regulations under section 3122.

For example, in Rev. Rul. 75-343, the Service applied the common law test to determine that a worker who performed services for a federal agency as an examination monitor and counselor was an employee for income tax withholding and FICA purposes. The ruling noted that the worker's contract stated that he was not an employee of the agency and that the remuneration was not wages for federal employment tax purposes. The ruling stated: "In this regard, the agency has invoked the provisions of section 3122" of the FICA. Thus, even though the Service determined that the worker was an employee and his remuneration was subject to income tax withholding, the remuneration was not subject to FICA tax because the head of the federal agency determined that it was excepted. Rev. Rul. 75-343 added: "The pertinent portions of section 3122 relate only to whether the individual performed service constituting 'employment' or received remuneration constituting wages and do not preclude a finding under section 3121(d) of the Federal Insurance Contributions Act that the individual has the status of an employee."

This bifurcated determination process is also reflected in private letter rulings issued before the 1988 amendment to section 3122. PLR 7737039 was a ruling requested by a military retiree who returned to work as an "intermittent employee" of a federal agency and asked whether FICA tax should be withheld from his wages. The ruling explained that section 3121(b)(6)(A) excepted from the general definition of employment service performed by an individual in the employ of the United States or an instrumentality of the United States, if the service is covered by a retirement system established by a law of the United States. The worker stated that he was not covered by a retirement system. The Service noted that section 3122 provides that the determination of whether particular service constitutes employment for FICA purposes is to be made by the head of the federal agency having control of the service. The ruling stated that a determination made by the head of the agency is final for purposes of the FICA and that such determination cannot be disturbed by the Service. Therefore, citing Rev. Rul. 75-343, the ruling concluded that the determination whether the individual's remuneration was subject to the FICA tax was to be made by the head of the federal agency that employed him. See also PLR 5506292920A (ruling concerned a post office worker).<sup>11</sup>

b. Section 3122: post-1988 amendment. In 1988, section 3122 was amended. The amendment deleted the language "the determination whether an individual has performed service which constitutes employment as defined in section 3121(b)" and "which constitutes wages as defined in section 3121(a)" and added a sentence with the result that the relevant portion reads as follows (with deleted text shown italicized in brackets and added text underlined):

In the case of the taxes imposed by this chapter with respect to service performed in the employ of the United States or in the employ of any instrumentality which is wholly owned by the United States . . . [*the*

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<sup>11</sup> Over the years, the Service has issued many private letter rulings through the SS-8 program determining the status of individual workers. See Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*. While these rulings are not precedent, they illustrate the history of the Service's position on these matters.

*determination whether an individual has performed service which constitutes employment as defined in section 3121(b)], the determination of the amount of remuneration for such service [which constitutes wages as defined in section 3121(a)], and the return and payment of the taxes imposed by this chapter, shall be made by the head of the Federal agency or instrumentality having the control of such service, or by such agents as such head may designate. . . . Nothing in this paragraph shall be construed to affect the Secretary's authority to determine under subsections (a) and (b) of section 3121 whether any such service constitutes employment, the periods of such employment, and whether remuneration paid for any such service constitutes wages. . . .*

Technical and Miscellaneous Revenue Act of 1988 (TAMRA), Pub. L. No. 100-647, § 8015(a)(2)(A) - (C), 102 Stat. 3342, 3790-3791.

These amendments yielded a statute that no longer provides that the head of the federal agency or instrumentality having control of the service determines whether service is employment and remuneration is wages. Instead, the statute provides that the authority to make these determinations is reserved to the Secretary of the Treasury. The statute and its legislative history assume that the workers in question are employees in the first place; they address whether the service constitutes covered employment and whether the remuneration constitutes wages.<sup>12</sup> Accordingly, after the effective date of the amendment (generally 1989), the Secretary of the Treasury

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<sup>12</sup> The relevant text of the legislative history to the 1988 amendment is as follows:

17. Clarification regarding social security coverage for certain civil servants

**Present Law**

(1) The Social Security Amendments of 1983 provided mandatory social security coverage for presidential appointees as well as the President, Members of Congress, Federal Judges, and certain executive level civil servants. However, section 205(p) of the Social Security Act provides that the Secretary of Health and Human Services (HHS) shall accept the determination of the head of a Federal agency as to whether a Federal employee has performed service, as to the periods of such service, and as to the amount of remuneration which constitutes wages. The Office of Personnel Management (OPM) has interpreted this section to mean that a Federal agency may determine whether or not an employee's service constitutes social security covered employment. Because the civil service statute permits career Senior Executive Service (SES) employees to retain their pay, rank, and retirement plan when they move to a presidential appointment, OPM has interpreted section 205(p) to mean that such individuals may avoid social security coverage despite the coverage provisions of the 1983 Social Security Amendments (while retaining coverage under the old Civil Service Retirement System).

(2) When an individual accepts a mandatorily covered Federal job and subsequently returns to his or her previous job or another noncovered Federal job, he or she loses social security coverage.

**House Bill**

(1) The House bill would clarify that the Secretaries of HHS and Treasury, not the head of any other Federal agency, have the authority to make the final determination as to whether an individual's services constitute social security covered employment, including those of presidential appointees.

(specifically, the Service) has authority to determine not only whether a worker is an employee, but also whether service is employment and whether remuneration is wages for FICA tax purposes.

After the amendment, private letter rulings issued to federal agencies discussed the effect of the changes. For example, PLR 9137012 analyzed whether test administrators for a federal agency were employees for purposes of the FICA under the common law as explained in the regulations and in Rev. Rul. 87-41. The ruling stated:

Section 3122, as amended, now provides, with regard to service commenced in any position on or after November 10, 1988, that the determination of whether remuneration constitutes wages and services constitutes employment, for FICA purposes, shall be made by the Secretary of the Treasury (as delegated to the Internal Revenue Service).

The ruling held that the workers were employees for FICA and income tax withholding purposes. See also PLR 9448013 (ruling held that Catholic religious education coordinator for children in kindergarten through twelfth grade performing services for branch of federal government was employee of the federal government for FICA tax and income tax withholding purposes under common law test). More recent private letter rulings apply the same analysis, without mentioning the section 3122 amendment, due to passage of time since the amendment. See, for example, PLR 200835025 (medical technologist for federal agency).

### **C. Other Related Provisions**

Other Code provisions, regulations, and rulings address the mechanics of employment taxes as they apply to federal agencies. They also demonstrate that, for employment tax and related purposes, the federal government is viewed as a single employer.

In general, an exception in the definition of FICA wages makes remuneration that exceeds the contribution and benefit base (\$113,700 for 2013) not subject to the social security portion of the FICA taxes. If an employer withholds more than the correct amount of FICA tax, it must make an adjustment as provided by regulation. The employer is required to return to the employee the amount that was overwithheld. This requirement could result in problems for the federal government, which is generally viewed as a single employer. Specifically, if two or more agencies employed the same employee in one year, they would have to check with each other to determine whether the employee received remuneration in excess of the contribution and benefit base. However, a special exception deems each head of a federal agency or instrumentality to be a separate employer for purposes of determining whether an employee has

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(2) In addition, the House bill would clarify that any civil servant who becomes covered by social security as a result of taking a mandatorily covered Federal job would retain social security coverage in any subsequent Federal job.

received wages equal to the FICA contribution and benefit base. Under this exception, a federal agency is not required to consider social security wages paid by another federal department, agency, or branch to the employee in determining the contribution and benefit base. See IRC §§ 3121(a)(1), 3122, 6413(a)(1) and (2), and 6413(c)(2)(A); Treas. Reg. § 31.6413(c)-1(a)(2).

In Rev. Rul. 58-599, the Service considered whether a member of the armed forces on the retired list for physical disability is “absent from work” for purposes of the exclusion provided in former section 105(d) when he performs services in another department, agency or branch of the United States government. Under the section 105(d) regulations relevant to the ruling, an employee is not absent from work when he performs any services for his employer at his usual place or places of employment or substantial services for his employer at a place other than the usual place of employment. The ruling concluded, in effect, that the United States government is considered one employer and that the individual is considered not absent from work from his employer when he performs services as an employee of the United States, whether such services are performed in the same department or in another department, agency, or branch of the United States government.

Rev. Rul. 58-599 explained that, while the power of appointment with respect to officers and employees in the government of the United States (other than that specifically reserved to the President by the Constitution) is vested by the Congress in the President, in the courts of law, or in the heads of the departments and independent establishments, the relationship of employer and employee is between the United States and the individual so appointed. The ruling cites a 1944 Comptroller General opinion, 24 Comp. Gen. 104 (1944), as authority for its position. The Comptroller General opinion relies on answers provided by the Commissioner of Internal Revenue in discussing the amount of income tax withholding for which the United States as an employer is liable in various situations, including where an employee works for more than one federal agency. The revenue ruling also cites section 31.3401(d)-1(d) of the Employment Tax Regulations. That section provides in relevant part, “The term ‘employer’ embraces . . . governments of the United States, the States, Territories, Puerto Rico, and the District of Columbia, including their agencies, instrumentalities, and political subdivisions.”<sup>13</sup>

The Tax Court applied the same reasoning in *Black v. Commissioner*, T.C. Memo. 1981-474, in which it held that a retired Marine Corps master gunnery sergeant was not absent from work for purposes of section 105(d) when he performed services as a

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<sup>13</sup> Similarly, Revenue Ruling 77-15 held that a federal employee who retired on disability was not absent from work for purposes of section 105(d) when he performed services as an employee of the U.S. Postal Service because he was performing substantial services for his employer, the United States government. The ruling explained that the Postal Reorganization Act, Pub. L. No. 91-375, 84 Stat. 719 (1970), created the United States Postal Service as an independent establishment of the executive branch of the government of the United States, to be operated as a service to the people by the government of the United States. Thus, it explained, an officer or employee of the United States Postal Service is an employee of the government of the United States.

civilian employee of the Marine Corps. In so holding, the Tax Court declined to draw a distinction for purposes of the sick pay provision at issue between the United States government as employer when an employee is in the military service and the United States government as employer when the employee is in the federal civil service. While recognizing differences in conditions for military personnel and civilian employees of the United States, the Tax Court stated that there is nonetheless an employer-employee relationship between the United States and its military personnel and between the United States and its federal civilian employees. This meant that because the employee performed substantial services for his employer, the United States, he was not absent from work. Thus, the income exclusion did not apply.

## **II. Section 530 of the Revenue Act of 1978**

### **A. Generally**

Section 530 generally provides a taxpayer relief from federal employment tax liability with respect to any individual for any period, regardless of the legal relationship between the taxpayer and the individual, if the taxpayer meets each of three requirements with respect to that individual:

- (1) The taxpayer (or predecessor) did not treat the individual or any individual holding a substantially similar position as an employee for any period beginning after December 31, 1977 ("substantive consistency requirement," Sections 530(a)(1)(A) and 530(a)(3));
- (2) For periods after December 31, 1978, the taxpayer filed all federal tax returns (including information returns) required to be filed with respect to that individual for that period on a basis consistent with the taxpayer's treatment of that individual as not being an employee ("reporting consistency requirement," Section 530(a)(1)(B)); and
- (3) The taxpayer had a reasonable basis for not treating the individual as an employee ("reasonable basis requirement," Section 530(a)(1)).

For purposes of the reasonable basis requirement, Section 530(a)(2) provides that a taxpayer is treated as having a reasonable basis if the treatment of the individual was in reasonable reliance on one of three safe harbors:

- (A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer (Section 530(a)(2)(A));
- (B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the

individuals holding positions substantially similar to the position held by this individual (Section 530(a)(2)(B));<sup>14</sup> or

(C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged (Section 530(a)(2)(C)).

A taxpayer that fails to meet any of the three safe harbors may nevertheless be entitled to relief if the taxpayer can demonstrate, in some other manner, a reasonable basis for not treating the individual as an employee. Rev. Proc. 85-18, sec. 3.01.<sup>15</sup>

The determination of whether an individual holds a position substantially similar to a position held by another individual must include consideration of the relationship between the taxpayer and such individuals. Section 530(e)(6).

Section 530(e)(3) provides that nothing in Section 530 shall be construed to provide that the relief of Section 530(a) only applies where the individual involved is otherwise an employee of the taxpayer. This provision applies to periods after December 31, 1996. Congress intended to make clear that there does not first have to be a determination that a worker is an employee under the common law standards before application of Section 530. See H.R. Rep. No. 104-737, at 202 (1996) (Conf. Rep.). The Service has interpreted this provision to mean that the Section 530 issue must be examined first and, if Section 530 relief applies, the Service does not examine whether the individuals are employees.<sup>16</sup>

A taxpayer is entitled to relief from employment taxes if it meets the requirements of Section 530. If a taxpayer does not meet the requirements of Section 530 with respect to the individuals at issue, the inquiry turns to whether the individuals are employees of the taxpayer under the common law. See IRC § 3121(d)(2); Employment Tax Regulations §§ 31.3121(d)-1 and 31.3401(c)-1.

## B. Legislative History

There is a substantial amount of legislative history surrounding the enactment and amendment of Section 530. We reviewed all of the legislative history of Section 530 and its amendments, including:

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<sup>14</sup> With respect to the prior audit safe harbor, a taxpayer may not rely on an audit commenced after December 31, 1996, unless that audit included an examination for employment tax purposes of whether the individual involved (or any individual holding a position substantially similar to the position held by the individual involved) should be treated as an employee of the taxpayer. Section 530(e)(2)(A).

<sup>15</sup> Congress intended "reasonable basis" to be construed liberally in favor of the taxpayer. Tax Reform Act of 1978, H.R. Rep. No. 95-1748, at 5; Revenue Procedure 85-18, sec. 3.01; *Smoky Mountain Secrets, Inc. v. United States*, 910 F. Supp. 1316, 1323 (E.D. Tenn. 1995); *Veterinary Surgical Consultants, P.C. v. Commissioner*, 117 T.C. 141, 147 (2001), *aff'd. sub nom.*, *Yeagle Drywall Co. v. Commissioner*, 54 Fed. Appx. 100 (3d Cir. 2002).

<sup>16</sup> See Training Materials, "Independent Contractor or Employee?", Department of the Treasury, Internal Revenue Service, Training 3320-102 (Rev. 10-96), TPDS 84238I, at p. 1-1; IRM 4.23.5.2(3) (8-31-2012); IRM 4.23.5.2.1(1) (11-3-2009); and IRM 4.23.5.2.2(5) (8-31-2012).

- Revenue Act of 1978, Pub. L. No. 95-600, § 530, 92 Stat. 2763, 2885-2886;
- Act of Dec. 29, 1979, Pub. L. No. 96-167, § 9(d), 93 Stat. 1275, 1278-1279, extending the “interim relief” through 1980;
- Tax Treatment Extension Act of 1980, Pub. L. No. 96-541, § 1, 94 Stat. 3204, extending provisions relating to employment status for employment taxes to July 1, 1982;
- Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 269, 96 Stat. 324, 551-554, extending provisions relating to employment status for employment taxes indefinitely; also adding IRC § 3508, regarding treatment of real estate agents and direct sellers, and § 3509, “simplified procedure for determining amount of employment taxes”;
- Tax Reform Act of 1986, Pub. L. No. 99-514, § 1706, 100 Stat. 2085, 2781, adding Section 530(d), regarding treatment of certain technical personnel in three-party arrangements;
- Small Business Job Protection Act of 1996, Pub. L. No. 104-188, § 1122(a), 110 Stat. 1755, 1766-1768, adding Section 530(e), regarding (1) notice requirement at beginning of audit, (2) additional rules regarding reasonable basis safe harbors, (3) determination regarding employee not required, (4) burden of proof, (5) preservation of prior period safe harbor, and (6) consideration of relationship in determining whether position is substantially similar; and
- Pension Protection Act of 2006, Pub. L. No. 109-280, § 864(a), 120 Stat. 780, 1024, adding Section 530(f) regarding treatment of test room supervisors and proctors.

A thorough review of the legislative history reveals no indication that Congress intended the employment tax relief to apply to federal agencies, or even any suggestion that it might. The legislative history states that Section 530 was directed at employment tax status controversies between the Service and taxpayers:

The bill provides an interim solution for controversies between the Internal Revenue Service and taxpayers involving whether certain individuals are employees under interpretations of the common law . . . .

The bill provides relief from employment tax liability to certain taxpayers involved in employment tax status controversies with the Internal Revenue Service as a result of the Service's proposed reclassification of workers, whom taxpayers have considered as having independent contractor status or some other status (e.g., customer), as employees.

H.R. Rep. No. 95-1748, at 4 (1978).

The legislative history speaks in terms of “employer” and “taxpayer” and includes references to “business” and “businessman.” The legislative history contains many

pages of testimony on behalf of small business owners: filling station operators, direct sellers, fishermen, loggers, pulp cutters, skidders, beauticians, barbers, insurance and real estate salespeople, independent truckers, taxicab drivers, and home improvement workers, including plumbers, sheet metal workers, and brick masons. These references and testimony illustrate the setting in which Congress acted in 1978.<sup>17</sup>

### C. Other Historical Background

In 1978, when Section 530 was enacted, the Service did not have a program for conducting federal agency employment tax audits. In 2000, when the Tax Exempt and Government Entities (TE/GE) operating division was created as part of a Service-wide reorganization, it included a new Government Entities function, which housed the office of Federal, State and Local Governments (FSLG). IR-99-93, 1999 WL 1034745 (Nov. 15, 1999). In 2005, the federal agency tax compliance group was created as a part of FSLG and began federal agency audits in that year. IRM 4.90.1.3.4(2) (11-30-2005, subsequently revised); FSLG Newsletter (Jan. 2006) at 2-3, 9.

Further, in 1978, federal agencies were required to withhold income tax from employees, but service performed by individuals covered by the Civil Service Retirement System was not subject to FICA tax. See IRC § 3121(b)(5)(A), referring to former § 3121(b)(6)(A). Also, until it was amended in 1988, section 3122 provided that the employing federal agency determined whether an individual's service was employment for purposes of the FICA and the amount of pay that was wages. Section 530 was amended three times (1979, 1980, and 1982) before the FICA tax was extended to federal agencies in 1984. Thus, until 1988, any employment tax controversy between a federal agency and the Service would have been limited to the issue of income tax withholding. Consequences for failure to withhold income tax are

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<sup>17</sup> See, for example, two references in the legislative history to Section 530.

First, the statement of Senator Dole on introducing S. 3007, an early version of Section 530 aimed at disregarding certain changes in the Service's treatment of certain individuals:

S. 3007. A bill to disregard, for purpose of certain taxes imposed by the Internal Revenue Code of 1954 with respect to employees, certain changes since 1975 in the treatment of individuals as employers; to the Committee on Finance. . . . Mr. President, the Internal Revenue Service frequently determines that persons have been misclassified as self-employed and should, instead, be considered employees. Such determination by the Internal Revenue Service are [sic] generally retroactive. This determination can be devastating upon a small or large businessman.

124 Cong. Rec. 11790 (1978).

Second, the Staff of the Joint Committee on Taxation discussed refund litigation as an unsatisfactory method of resolving employment tax disputes because of costs and time, the possibility that the Service might still levy during litigation, and "the fact that the litigation itself creates a contingent liability which ordinarily must be noted for financial statement purposes." Staff of J. Comm. on Taxation, 96<sup>th</sup> Cong., Issues in the Classification of Individuals as Employees or Independent Contractors 9 (Comm. Print 1979). The report stated further: "Without clearly established rules for the classification of workers as employees or independent contractors, various businesses may be placed in an economically disadvantageous position vis-a-vis other similar operations." *Id.* at 21.

often mitigated in large part by application of section 3402(d), which provides relief from income tax withholding to the extent the employee paid the income tax.<sup>18</sup>

#### **D. Case Law Interpreting Section 530**

As of the date of this memorandum, courts have considered Section 530 in some 200 reported cases, none of which discusses the application of relief under Section 530 to federal, state, or local government employers.

#### **E. IRS Materials on Section 530 in Connection with FSLG**

The Service has provided some limited informal guidance on Section 530 in connection with FSLG taxpayers. Private letter rulings regarding worker classification issued to federal agencies from 1982 through 1986 mentioned the existence of Section 530, referring to Rev. Proc. 81-43, but expressed no opinion regarding the applicability of Section 530.<sup>19</sup> After 1986, worker classification rulings did not contain the Section 530 language. In the early 1990s, the IRS Office of Chief Counsel issued two memoranda ultimately concluding that Section 530 relief may be available to state and local governments (but not addressing the federal government). See TAM 9105007; FSA 2002 WL 1315737. Subsequently, the Service has issued Publication 963, *Federal-State Reference Guide* (11-2012), which discusses Section 530 in connection with FSLG taxpayers but does not address whether it can apply to federal government agency employers.

Internal Revenue Manual section 4.90 provides guidance to FSLG revenue agents conducting audits of federal, state, and local governments. The IRM recognizes federal agencies, state agencies, local governments, and quasi-governmental entities as four distinct customer market segments. IRM 4.90.1.1, 4.90.1.3.4 (9-1-2008). While IRM 4.90 contains references to Section 530 (see IRM 4.90.8, 4.90.9, 4.90.11, and 4.90.13 (9-1-2008)), it provides no clear statement about the application of Section 530 to federal or other governmental entities. In practice, however, the Service has not applied the Section 530 relief provision to federal agencies.

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<sup>18</sup> Section 3402(d) was added to the Code in 1943 as section 1622(d). As explained above, regulations under section 3402(d), added in 1957, provide that the employer will not be relieved of liability for payment of the tax required to be withheld unless it can show that the tax has been paid.

<sup>19</sup> See PLR 8208208 (consultant for federal agency was an employee for federal employment tax purposes), PLR 8227077 (reconsideration of PLR 8208208 without modification), PLR 8227083 (consultant for federal agency was an employee for federal employment tax purposes), and PLR 8619013 (nutrition advisor for a federal agency was an employee for federal employment tax purposes). The relevant text in these rulings read: "We wish to bring to your attention that section 530 of the Revenue Act of 1978, which was extended by Pub. L. No. 96-541, 96th Cong., 2nd Sess. 1981-6 I.R.B. 12, provides relief from employment taxes on payments to certain workers. The enclosed copy of Rev. Proc. 81-43, 1981-39 I.R.B. 11 sets forth the criteria to be used in determining whether a taxpayer will be granted relief under section 530. No opinion is expressed with regard to the applicability of section 530 to this case."

### III. Analysis

The express terms of Section 530 do not state that it applies to federal agencies. Furthermore, the legislative history of Section 530 reveals no indication that Congress intended the employment tax relief to apply to federal agencies, nor any suggestion that it might. Rather, the legislative history of Section 530 shows that it was meant to relieve businesses, not the government, of the burden of employment taxes where the business had a reasonable basis for treating individuals as other than employees and met the other requirements. In fact, at the time Section 530 was enacted in 1978, application of Section 530 to federal agencies was not necessary. At that time, federal agencies were not likely to be involved in an employment tax status controversy with the Service. Relief from income tax withholding was available under section 3402(d) to the extent the employee paid the income tax. Section 3122 gave agency heads authority to decide whether services were employment for FICA purposes. Thus, relief under Section 530 was not needed. Audits of federal agencies were not taking place at that time. Later amendments of Section 530 did not extend the application of Section 530 to federal agencies.

In addition, other employment tax legislation did not expressly extend Section 530 to federal agencies. When Congress made federal agencies subject to the social security portion of the FICA beginning in 1984, it made no mention of possible relief from liability under Section 530 in either the statutory language or the legislative history. In 1988, Congress amended section 3122 to take away agencies' authority to determine whether service for the United States or an instrumentality is employment under section 3121(b) and whether remuneration for that service is wages under section 3121(a). The amendment reserved that authority to the Secretary of the Treasury.<sup>20</sup> Again, Congress did not mention Section 530 relief for federal agencies in either the statutory language or the legislative history. The specific instruction in section 3122 that the Secretary of the Treasury determines the application of FICA tax further supports the position that Section 530 lacks any role to give relief from that tax based on a federal agency's determination to the contrary.

We also note that even if, for the sake of argument, Section 530 was applied to federal agencies, a federal agency could not satisfy the provisions of Section 530. As discussed above, a number of employment tax provisions and other guidance indicate that, for employment tax and related purposes, the federal government is viewed as a single employer. Specifically, this view is illustrated by the special exception that Congress had to make for ease of administration, deeming each head of a federal agency or instrumentality to be a separate employer for a certain purpose. In addition, Rev. Rul. 58-599, in applying the provisions of former section 105(d) to determine taxability of disability income, provides that the United States government is one

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<sup>20</sup> As discussed above, the Service has always taken the position that it has authority to determine whether an individual is an employee for purposes of FICA and income tax withholding under sections 3121(d) and 3402(c). Even before Congress extended FICA tax to federal agencies, the Service was making determinations regarding employee status for income tax withholding purposes; this determination was not left to federal agencies.

employer, stating "the relationship of employer and employee is between the United States and the individual." Section 31.3401(d)-1(d) of the Employment Tax Regulations also provides in relevant part, "The term 'employer' embraces . . . governments of the United States, the States, Territories, Puerto Rico, and the District of Columbia, including their agencies, instrumentalities, and political subdivisions." See also Rev. Rul. 77-15; *Black*, T.C. Memo. 1981-474 (United States government is one employer).

As part of the federal government as one employer, a federal agency cannot satisfy the requirement of Section 530(a)(1)--that a taxpayer must have had a reasonable basis for not treating the individual workers as employees (the reasonable basis requirement). The Service is the federal agency with jurisdiction over federal tax issues, including specifically determining employee status for employment tax purposes. A federal agency would have no reasonable basis for purposes of the requirement of Section 530(a)(1) to take a position contrary to that of the Service.

Further, it is unlikely that a federal agency could ever satisfy the requirement of Section 530(a)(3)--that the taxpayer (i.e., the federal government for this purpose) must not have treated any individual worker holding a substantially similar position as an employee for employment tax purposes for any period beginning after December 31, 1977 (the substantive consistency requirement).

For the reasons described in this memorandum, we conclude that Section 530 does not apply to provide employment tax relief to federal agencies.

If you have any questions, please contact Rebecca Wilson at (202) 622-0047.

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