

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

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7436.01-00

date: November 13, 2017

to: Barbara Wulf  
Program Manager  
SB/SE Employment Tax Policy

from: Paul J. Carlino, Chief  
Employment Tax Branch 1  
(Tax Exempt & Government Entities)

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subject: Whether an Employment Tax Audit of a Foreign Corporation Involves Worker  
Classification

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

**ISSUE**

Whether, pursuant to an employment tax audit of a foreign corporation, the Service is required to issue a "Notice of Employment Tax Determination under IRC § 7436" (Letter 3523) when the foreign corporation asserts only that payments made to its employees are exempt from income tax withholding pursuant to the exclusion from the definition of wages under section 3401(a)(6) of the Internal Revenue Code.<sup>1</sup>

**CONCLUSION**

No. The Service is not required to issue a Letter 3523<sup>2</sup> when a taxpayer asserts only that payments made to its employees are excluded from the definition of wages for purposes of income tax withholding under section 3401(a)(6).<sup>3</sup>

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<sup>1</sup> All section references are to the Internal Revenue Code of 1986 unless otherwise noted.

<sup>2</sup> Letter 3523, formerly titled the "Notice of Determination of Worker Classification" has been renamed "Notice of Employment Tax Determination under IRC § 7436." For purposes of this memo, we refer to the notice issued to a taxpayer pursuant to section 7436 as "Letter 3523."

<sup>3</sup> Because the inquiry relates only to income tax withholding liabilities, we do not address Federal

## FACTS

The Service conducts an examination of a foreign corporation's Federal employment tax liabilities. The foreign corporation is organized outside of the United States in a country in which no tax treaty or totalization agreement is in effect with the United States.

The foreign corporation has a domestic subsidiary. The domestic subsidiary contracts with U.S. corporations (Clients) to provide a variety of computer and engineering services. The domestic subsidiary then contracts with the foreign corporation to provide the computer and engineering services to Clients in satisfaction of the terms of the contract between the domestic subsidiary and the Clients. Nonresident alien individuals (NRAs or employees) employed by the foreign corporation enter the United States on business visitor visas (B-1 visas) to perform the computer and engineering services within the United States for the Clients. The employees are citizens of countries in which no tax treaty or totalization agreement is in effect with the United States.

The contract between the foreign corporation and the domestic subsidiary provides that the domestic subsidiary will refer Clients to the foreign corporation in exchange for a commission-based fee. In turn, the foreign corporation will provide the actual computer and engineering services to the Clients using its own employees. The foreign corporation pays employees directly for services performed within the United States.

The Service proposes to assess Federal employment tax liabilities against the foreign corporation on the wages paid to the employees who perform services within the United States. The foreign corporation does not agree to the adjustment. It asserts that it is not liable for the proposed income tax withholding for the NRA employees who were present in the United States for 90 days or less during the tax year and whose compensation does not exceed \$3,000, because the employees are performing services for a foreign corporation not engaged in trade or business within the United States.<sup>4</sup>

Your request specifically asks whether the facts described involve a determination under section 7436 such that the Service should send foreign corporation a Letter 3523.

## LAW AND ANALYSIS

Section 3402(a)(1) provides, in part, that every employer making payment of "wages" is required to deduct and withhold upon those wages an income tax determined in accordance with the applicable tables or procedures prescribed by the Secretary.

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Insurance Contributions Act (FICA) taxes (under sections 3101-3128) or Federal Unemployment Tax Act (FUTA) taxes (under sections 3301-3311).

<sup>4</sup> The Service should consult with the Office of Chief Counsel, International, Branch 1, for consideration of whether a foreign corporation is "engaged in a trade or business within the United States."

Section 3403 provides the employer shall be liable for the payment of the tax required to be deducted and withheld under section 3402, whether or not it is collected from the employee by the employer. See Regulation § 31.3403-1.

Section 3401(a) defines “wages” as all remuneration for services performed by an employee for his employer.

Section 3401(a)(6) provides an exception from the definition of “wages” for remuneration paid for such services, performed by a nonresident alien individual, as may be designated by regulations prescribed by the Secretary. The implementing regulations provide detailed rules.

Regulation § 31.3401(a)(6)-1(a) provides that all remuneration paid for services performed by a nonresident alien individual, if such remuneration otherwise constitutes wages and if such remuneration is effectively connected with the conduct of a trade or business within the United States, is subject to withholding under section 3402 unless excepted from wages.

Regulation § 31.3401(a)(6)-1(b) provides that remuneration paid to a nonresident alien individual for services performed outside the United States is excepted from wages and is not subject to withholding.

Regulation § 31.3401(a)(6)-1(f) provides that remuneration paid for services performed within the United States by a nonresident alien individual after December 31, 2000, is excepted from wages and is not subject to withholding if such remuneration is, or will be, exempt from income tax by reason of a provision of the Code or an income tax treaty to which the United States is a party.

Section 864(b) provides that the term “trade or business within the United States” includes the performance of personal services within the United States, but does not include the performance of personal services for a foreign corporation not engaged in a trade or business within the United States by a nonresident alien individual temporarily present in the United States for a period or periods not exceeding 90 days during the taxable year and whose compensation for such services does not exceed \$3,000. See also Regulation § 1.864-2(a) and (b).

Section 3401(d) defines “employer” for purposes of income tax withholding as the person for whom an individual performed any service, of whatever nature, as the employee of such person, with certain specific exceptions.

Section 7436 provides that:

SEC. 7436(a). Creation of Remedy.--If, in connection with an audit of any person, there is an actual controversy involving a determination by the Secretary as part of an examination that--

(1) one or more individuals performing services for such person are employees of such person for purposes of subtitle C, or

(2) such person is not entitled to the treatment under subsection (a) of section 530 of the Revenue Act of 1978 with respect to such an individual,

upon the filing of an appropriate pleading, the Tax Court may determine whether such a determination by the Secretary is correct and the proper amount of employment tax under such determination. Any such redetermination by the Tax Court shall have the force and effect of a decision of the Tax Court and shall be reviewable as such.

When an employer pays wages to its employees but fails to subject those wages to the withholding required by section 3402(a), the Service may assess income tax withholding against the employer under section 6201. However, if the audit involves a worker classification determination or a determination of whether taxpayer is entitled to relief under Section 530 of the Revenue Act of 1978, the Service will provide formal notice of such determination to the employer with any related employment tax adjustment using Letter 3523.

The Tax Court has previously held that its jurisdiction over a determination related to matters specified in section 7436(a) can arise even though the determination is not made in a formal notice. See, SECC Corp. v. Commissioner, 142 T.C. 225, 231 (2014). In this case, however, the Service did not make any determination, in a formal notice or otherwise, related to the matters set forth in section 7436(a).

In American Airlines, Inc. v. Commissioner, 144 T.C. 24 (2015), the Service did not make a determination regarding worker classification. However, the Court held that it still had jurisdiction over the case because there was a dispute over whether the taxpayer was entitled to Section 530 relief, and the Service made an informal determination regarding such relief. In the present case, the foreign corporation neither raised such issue nor did the Service make a determination, informal or otherwise, regarding such issue.

In the facts described, there is no dispute that the NRAs performing computer and engineering services on behalf of the foreign corporation are employees, that the services were performed within the United States, and that such NRAs received compensation from the foreign corporation for those services. Rather, the foreign corporation is asserting that it is not liable for income tax withholding because it was not engaged in a trade or business within the United States. This argument is not based on a position that the NRAs are not employees. Thus, there is no actual controversy over the worker classification of the NRAs. Rather, the foreign corporation's disagreement is premised on the position that the NRAs are employees, but that because the employees worked for a foreign corporation while temporarily in the United States and were compensated less than a threshold amount the foreign corporation did not have a trade or business within the United States. Essentially, the foreign corporation is arguing that the exception from the definition of "wages" in section 3401(a)(6) is applicable.

Since the NRAs must be employees of the foreign corporation in order for it to invoke the exception from the definition of “wages” in 3401(a)(6), the Service is not making a worker classification determination when it proposes income tax withholding liabilities on the basis that the exception to the definition of “wages” in section 3401(a)(6) does not apply. Accordingly, since no controversy exists regarding whether the NRAs are employees or non-employees, the audit does not involve worker classification.

Because the Service did not make any determination under section 7436(a)(1) or (2), it is not required to issue Letter 3523. As such, in the event the foreign corporation is not willing to agree to the proposed Federal employment tax adjustments, the Service should assess the taxes under section 6201.

#### CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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Please call (202) 317-6798 if you have further questions.