

Office of Chief Counsel
Internal Revenue Service
memorandum

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SEP 30 2003

date:

to: Tom Burger, Employment Tax (2404/IR)
Office of the Deputy Director - Compliance Policy

from: Will E. McLeod
Chief, CC:TEGE:EOEG:ET1



subject: **Information Reporting for Payments to Section 530 Workers**

This is in reply to your request that we review alternative recommendations for administratively changing information reporting requirements for payments made to Section 530 workers.

In addition, you also requested that we review a recommendation that a business be required to withhold the employee portion of Federal Insurance Contributions Act tax (employee FICA tax) on payments made to a Section 530 worker.

RECOMMENDATIONS:

[REDACTED]

[REDACTED]

CONCLUSIONS:

[REDACTED]

[REDACTED]

DP

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BACKGROUND

Section 530 of the Revenue Act of 1978, Pub. L. No. 95-600, 1978-3 (Vol. 1) C.B. 119 - 120, as amended, provides businesses with relief from federal employment tax obligations if certain requirements are met. Section 530(c)(1) defines "employment tax," for purposes of Section 530, as "any tax imposed by subtitle C of the Internal Revenue Code." Thus, Section 530 terminates the business's employment tax liability for employer and employee FICA taxes, Federal Unemployment Tax Act (FUTA) taxes, federal income tax withholding, and Railroad Retirement Tax Act (RRTA) taxes.

The Joint Committee on Taxation Staff in the General Explanation of the Revenue Act of 1978, 95th Cong., 301 (1979), indicated that Congress believed it was appropriate to provide "interim relief" for businesses who were involved in employment tax status controversies with the Internal Revenue Service (Service), and who potentially faced large assessments, as a result of the Service's proposed reclassifications of the workers, until Congress had adequate time to resolve the many complex issues in this area through legislation. Section 269(c) of the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 1982-2 C.B. 462, 536, however, extended Section 530 indefinitely. Section 530 is not part of the Internal Revenue Code; most publishers include it in the notes following § 3401.

Section 530(a) contains the core relief provisions of the statute. It provides relief from employment tax liability to eligible businesses who have failed to pay or withhold employment taxes on remuneration paid to workers because the businesses did not treat them as employees. Section 530(a)(1) terminates certain employment tax liability if:

- (1) for purposes of employment taxes, the business did not treat the worker as an employee for any period;
- (2) all required Federal tax returns were filed on a basis consistent with the business's treatment of the worker as not being an employee; and
- (3) the business had a reasonable basis for not treating the worker as an employee.

Section 530(e) was added by the Small Business Job Protection Act of 1996, Pub. L. No. 104 - 188, § 1122, 1996-3 C.B. 155, 166 - 168. Pursuant to Section 530(e), in an

employment status examination, the Service must first determine whether Section 530 relief applies before determining whether the worker is an employee.¹

Section 530(e) reversed the position taken by the Service in its draft Training Materials (Feb 1996). S. Rept. No. 104-281, 104th Cong., 2d Sess. 26 (1996). Lesson 3 of the draft Training Materials stated that it must first be determined whether the worker is an employee under § 3121(d) before Section 530 can become an issue. As finalized in October 1996, the Training Materials now indicate that the Service must first determine whether Section 530 relief applies. See IRS Training: Independent Contractor or Employee? (Training 3320-102, 10-96), p. 1-5. <http://www.irs.gov/pub/irs-utl/emporind.pdf>.

Section 530(e)(3) specifies that a worker does not have to be an employee of the business in order for relief to apply. See Marlar Inc. v. United States, 151 F.3d 962 (9th Cir. 1998) (providing Section 530 relief where dancers were treated as lessees of stage and dance facilities). Additionally, the business need not concede or agree to the determination that the workers are employees in order for Section 530 relief to apply. See IRS Training: Independent Contractor or Employee? (Training 3320-102, 10-96), p. 1-5.

If a business meets the requirements of Section 530 with respect to a group of workers, the Service will not determine the status of the workers (*i.e.*, whether the workers are independent contractors, employees, or some other status), as part of an employment tax examination. Thus, you cannot conclude that a worker is an employee based on the grant of Section 530 relief.

A Section 530 worker may want to file Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*.² A business or a worker may file Form SS-8 to request a determination of the status of a worker.

¹ Section 401(3) of Rev. Proc. 99-28, 1999-2 C.B. 109, 111 - 112, provides as follows:

Section 530(e)(3) is generally effective after December 31, 1996 and clarifies that the determination of whether a business is entitled to relief under § 530 is not dependent upon whether the relevant workers are first determined to be employees. As a result, IRS examiners will now consider the taxpayer's eligibility for relief under § 530 before initiating any examination of the relationship between a business and a worker.

² IRM 4.23.5 2 2(6) provides as follows:

If the business is entitled to such relief, the issue of worker classification will be discontinued. These workers will continue to receive Form 1099-MISC. However, the fact that the business is entitled to section 530 relief does not imply that the workers are employees. The workers may still request a determination of their individual status by filing a Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*.

Section 530 does not change in any way the status, liabilities, and rights of the worker whose status is at issue. H.R. Rep. No. 95-1748, 95th Cong., 2d Sess. 7 (1978), 1978-3 (Vol. 1) C.B. 629, 635; Section 3.08 of Rev. Proc. 85-18, 1985-1 C.B. 518. A business entitled to relief under Section 530 may find, through a Form SS-8 determination, that the Section 530 workers were misclassified; that the Section 530 workers are employees.

Section 3101 imposes employee FICA tax on an employee. Section 3102 requires an employer to collect the tax imposed by § 3101, and also makes the tax a liability of the employer. Thus, both the employee and the employer are liable for the employee FICA tax, although the intent is that the employer will collect it from the employee and remit it to the Government. Regardless of whether it is the employer or the Government who collects it from the employee, the employee is fully liable for the employee FICA tax. See Rev. Rul. 86-111, 1986-2 C.B. 176 (involving a situation where the employer's liability was reduced under § 3509). See also Navarro v. United States, 1993 U.S. Dist. LEXIS 10270, 72 AFTR2d 93-5424 (W.D. Tex. 1993).

Section 31.3102-1(c) of the Employment Tax Regulations provides, in part, "[t]he employer is liable for the employee tax with respect to all wages paid by him to each of his employees whether or not it is collected from the employee." The section goes on, however, to state: "[u]ntil collected from him the employee also is liable for the employee tax with respect to all the wages received by him." Thus, the first passage establishes the employer's liability for the employee FICA tax, whether the employer withheld that amount or not. Section 530(a)(1), however, releases an employer from that liability. Moreover, even without the release of the employer, the employee remains fully liable for employee FICA tax arising from the receipt of wages since it was never withheld from the employee's wages. See Stewart v. United States, 1984 U.S. Dist. LEXIS 23091; 84-2 USTC ¶ 9962; 55 AFTR2d 84-506 (E.D. Wis. 1984) (involving a situation where the employer's liability was terminated under Section 530).

Rev. Proc. 85-18 provides instructions for the implementation of Section 530. Section 3.08 of Rev. Proc. 85-18 deals with the liability of employees for employee FICA tax in situations where businesses are entitled to relief under Section 530. It provides that, if a business's liability under § 3102 for employee FICA tax is terminated under Section 530(a)(1), the employee remains liable for that tax.

Section 530(a)(1) terminates the liability of the business for the employment taxes but has no effect on the workers. It does not convert a worker from the status of employee to the status of independent contractor. Misclassified employees are liable for employee FICA tax with respect to all wages received rather than for tax under the Self Employment Tax Contributions Act (SECA). Rev. Proc. 85-18, section 3.08; § 31.3102(c). If the business's liability for employee FICA tax was terminated under Section 530, the Service cannot require withholding of employee FICA tax by the business. Additionally, since you cannot conclude that a worker is an employee based on the grant of Section 530 relief, you cannot conclude whether a Section 530 worker is liable for employee FICA or SECA tax.

Under current procedures, a Section 530 worker, *who is an employee*, pays employee FICA tax with the Section 530 worker's Form 1040, U.S. Individual Income Tax Return. The computation of social security and Medicare taxes is shown on a modified Form 4137, Social Security and Medicare Tax on Unreported Tip Income, attached to Form 1040. The Section 530 worker deletes the word "Tip" and inserts the word "Wages" on both the top of Form 4137 and on Schedule U, U.S. Schedule of Unreported Tip Income, which is attached to the bottom of the Form 4137. Instructions to make pen and ink changes to Form 4137 and Schedule U can be found on the IRS web page and in Notice 989, *Commonly Asked Questions When IRS Determines Your Work Status is "Employee."*³ Schedule U is used to credit the employee's earnings records.

Currently, businesses are instructed to report payments to a Section 530 worker in Box 7, Nonemployee compensation, on Form 1099-MISC. See 2003 Instructions for Form 1099-MISC.⁴ Use of a box entitled "Nonemployee compensation" generally indicates that

³ Frequently Asked Questions 4.3 (<http://www.irs.gov/faqs/page/0,,id%3D15973,00.html>)

[Q.] The instructions for Form 1099-MISC, Box 7, say if you are not self-employed, call the IRS for information about how to report any social security and Medicare taxes. I need to know how do I report social security and Medicare taxes if I received income reported on a Form 1099-MISC, but was not self-employed?

[A.] You need to use Form 4137 (PDF), Social Security and Medicare Tax on Unreported Tip Income. Cross out the word "Tip" and insert the word "Wages" at the top of the form and also at the top of Schedule U, which is attached to the bottom of the form. Follow the instructions on Form 4137 to compute your share of your social security and Medicare taxes. Attach Form 4137 to your Form 1040. . . .

Instructions to Recipients for Box 7 (on the back of Copy B of Form 1099-MISC) provides as follows:

...

If you believe you are an employee, report this amount on line 7 of Form 1040 and call the IRS for information on how to report any social security and Medicare taxes.

⁴ 2003 Instructions for Form 1099-MISC

pages MISC-2 and MISC-3

TIP

Section 530 of the Revenue Act of 1978 as extended by section 269(c) of P.L. 97-248, deals with the employment tax status of independent contractors and employees. To qualify for relief under section 530, employers must file Form 1099-MISC. Additional requirements for relief are discussed in Rev. Proc. 85-18, 1985-1 C.B. 518. Also, see Notice 87-19, 1987-1 C.B. 455, for special rules that may apply to certain skilled workers, such as engineers, designers, drafters, computer programmers, and systems analysts.

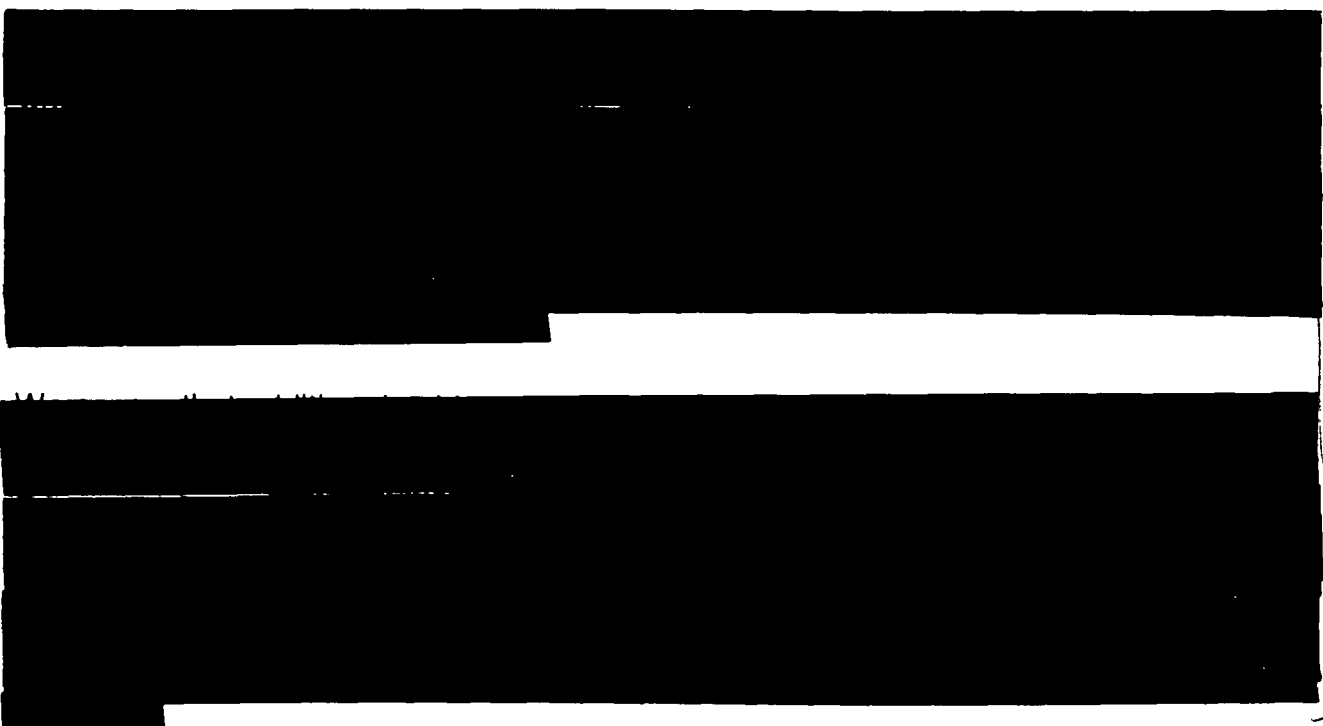
page MISC-4

Box 7. Nonemployee Compensation. Self-employment tax.

Generally, amounts reportable in box 7 are subject to self-employment tax. However, corporations are not subject to self-employment tax. If payments to individuals are not subject to this tax and are not reportable

the worker is an independent contractor. Because the Form 1099-MISC indicates that nonemployee compensation has been paid, the Section 530 worker, who is an employee, may erroneously report income and expenses as a self-employed person on Form 1040 and pay SECA tax. Additionally, in some cases, the Section 530 worker, who is an employee, may be burdened by receiving collection notices from the Service for unpaid SECA tax based on the amount shown in Box 7, as Nonemployee compensation.

SUMMARY



We hope this information is useful to you. If you have any further questions, please call (202) 622-6040.

elsewhere on Form 1099-MISC, report the payments in box 3. However, report section 530 (of the Revenue Act of 1978) worker payments in box 7.

page MISC-5

Examples. The following are some examples of payments to be reported in box 7:

- Payments to section 530 (of the Revenue Act of 1978) workers. See the TIP on page MISC-2.