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INTERNAL REVENUE SERVICE NATIONAL OFFICE
TECHNICAL ADVICE MEMORANDUM

UIL Numbers: 3121.01-00; 3121.04-01; 3306.02-00; 3306.05-00, 3401.04-01
Case Number: TAM-119980-97

District Director,

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's EIN:
Years Involved:
Date of Conference:

LEGEND

Operating Company =
Industry =

Employer Association =

Service Company =
Contract =
Special Compensation =

Project Contact =
Incidental Workers =
Form =
Worker Agreement =

ISSUES

1. Whether, in the years at issue, Taxpayer was the common law employer of workers performing services for Operating Companies in the Industry.

2. If Taxpayer was not the common law employer of the workers, whether Taxpayer was the employer under § 3401(d)(1) with respect to compensation paid by Taxpayer to the workers.

3. If Taxpayer was the employer under § 3401(d)(1) with respect to compensation paid to the workers, whether the Taxpayer was the employer for purposes of determining a worker's wages under §§ 3121(a)(1) and 3306(b)(1).

FACTS

In the years at issue, Operating Companies engaged in projects in the Industry. The practice in the Industry was for a worker to be hired for a single project and for the worker's services on a project to be of short duration. Thus, the worker generally performed services for multiple Operating Companies during a single year.

Workers in the Industry were generally covered by collective bargaining agreements ("CBAs") between the Employer Association and various unions. The CBAs governed many of the terms and conditions of the workers' employment, such as rates of pay, including overtime, work schedules, travel, and welfare and pension benefits.

Taxpayer was a member of the Employer Association. Taxpayer's role in the Industry was in part to facilitate compliance with the CBAs. As an employer member of the Employer Association, Taxpayer was a signatory to all CBAs in the portion of the Industry involved in this case. If the Operating Company was not a signatory to the CBA, Taxpayer was considered the primary employer. If the Operating Company was also a signatory to the CBA, Taxpayer was considered the secondary employer.[1]

Taxpayer was generally not involved in the planning stage of an Industry project. However, Taxpayer was often consulted by Operating Companies for estimated compensation costs to be used in proposed budgets for projects.

At the start of Taxpayer's involvement in a project, Taxpayer and an Operating Company entered into a standard Contract[2] relating to the workers hired for the project. The Contract referred to

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[1] One of the CBA documents attached to the technical advice request includes a sample agreement between the union and a Service Company. Because it is not clear whether Taxpayer was such a Service Company, our analysis of employer status does not consider the terms of that agreement. We note, however, that consideration of the terms of that agreement would not change our conclusion on employer status.

[2] Taxpayer used two versions of the Contract, depending on whether a project was a union or a nonunion project. The union version included various references to compliance with the CBAs and discussed the handling of Special Compensation provided under the CBAs. The union version also specified which party (Taxpayer or the Operating Company) was to be signatory to the CBAs applicable to the workers furnished under the Contract. Otherwise the two versions of the Contact did not contain material differences.

Taxpayer as "Employer" and provided for Taxpayer to furnish the Operating Company with the workers needed for the project.

Each project was assigned to a Project Contact, who was an employee of Taxpayer. The Project Contact handled primary communications between Taxpayer and the Operating Company on matters directly relating to payroll. Other Taxpayer employees communicated with the Operating Company on other matters such as employee benefits. The facts do not indicate that the Project Contact (or any other person on Taxpayer's behalf) was involved in the actual work on the project at the project site.

The Operating Company informed Taxpayer of the workers it had selected for the project, though Taxpayer sometimes selected Incidental Workers for a project in accordance with criteria specified by the Operating Company. In accordance with the Contract, Taxpayer provided the Operating Company with Forms for the workers engaged for a project. The Operating Company gave the Forms to the workers, who completed them and returned them to the Operating Company, which in turn returned them to Taxpayer. A completed Form provided necessary information about the worker, such as name, social security number, union status and citizenship. The Form also showed the worker's expected hours, rate of pay, and withholding allowance information. Taxpayer reviewed each Form to assure that employment of the worker on the project was permitted under the applicable CBAs and employment laws and advised the Operating Company of the requirements that applied to the worker. If employment of the worker was not permitted under a CBA or law, Taxpayer so advised the Operating Company and the worker was not employed.

In addition to applicable CBAs, an Operating Company sometimes entered into a Worker Agreement with an individual worker for a project. The Worker Agreement specified the worker's union affiliation, pay rate, expense reimbursement arrangements, start date, and guaranteed hours.

The compensation rate for a worker was set by the CBAs or by agreement between the worker and the Operating Company, subject to any applicable employment laws, such as state or federal wage and hour laws.[3] The Contract provided for Taxpayer to compute and pay the compensation due to the workers. In accordance with the Contract, Taxpayer provided the Operating Company with blank time cards, which were used to report to Taxpayer each worker's actual days and hours worked. The Operating Company gave each worker a time card to be completed (generally weekly) and

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[3] The Contract provided that the Operating Company was responsible for compliance with applicable state and federal wage and hour laws.

returned to the Operating Company. The Operating Company approved the time cards and turned them in to Taxpayer.

Taxpayer reviewed the time cards to assure compliance with hour and schedule restrictions under any applicable CBAs and employment laws. Taxpayer then computed each worker's gross pay and applicable withholdings and prepared paychecks in the amount of net pay.[4] The paychecks were drawn on Taxpayer's own bank accounts and were paid from Taxpayer's own funds. The paychecks were then delivered to the Operating Company, along with the invoice described below, within a time specified in the Contract, and the Operating Company gave the paychecks to the workers. Besides withholding applicable employment taxes from the workers' pay, Taxpayer deposited the withheld amounts and employer taxes on the wages, filed state and federal employment tax returns and issued Forms W-2 to the workers. Taxpayer also made any contributions due to the various employee benefit funds established under the CBAs.

The Contract required the Operating Company to reimburse Taxpayer for the payroll costs incurred by Taxpayer. Payroll costs included gross wages, trust fund contributions, and the cost of benefits and other allowances and compensation that Taxpayer paid to the workers. Accordingly, Taxpayer also prepared an invoice for payroll costs and its related fee and delivered the invoice to the Operating Company with the paychecks. Reimbursement was required in accordance with the terms of the Contract and the invoice, which generally required reimbursement within 24 hours of the receipt of the invoice and paychecks.[5] However, in practice the Operating Company often took between 5 and 10 days, and sometimes longer, to reimburse Taxpayer. In some cases, an Operating Company did not reimburse Taxpayer, and Taxpayer suffered a loss on the Contract with that Operating Company.

The Contract provided that Taxpayer had the right to direct, control and supervise the workers supplied under the Contract, provided, however, that such direction, control and supervision was to be consistent with and subject to any instructions or requirements of the Operating Company.[6] The Contract further

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[4] Before preparing the paychecks, Taxpayer sometimes prepared a preliminary payroll summary at the request of the Operating Company. Paychecks were prepared after the summary was reviewed and approved by Taxpayer and the Operating Company.

[5] The paychecks were given to the workers before the Operating Company reimbursed Taxpayer for payroll costs.

[6] The union version of the contract provided that Taxpayer's direction, control and supervision was to be consistent also with the CBAs.

provided that, in the event of any disagreement, Operating Company's decision would be final and that day-to-day supervision and direction of the workers in the performance of their services for the benefit of the project would be the responsibility of the Operating Company.

As mentioned above, the Operating Company selected the workers for a project and informed Taxpayer of the workers it had selected. The contract specified that Taxpayer made no representations or gave any warranty as to the professional or technical experience, ability or qualifications of the workers furnished to the Operating Company under the Contact. The Contract also required the Operating Company to indemnify Taxpayer for any liability, loss, damage, or claim arising from the services performed by the workers for the Operating Company at the location described in the Contract. It also required the Operating Company to provide insurance (naming Taxpayer as an additional insured) for general public liability and auto liability during the period for which the workers were furnished to the Operating Company.

Subject to union limitations and restrictions, the Operating Company determined the type of work, number of hours worked, and work schedule. The Operating Company gave the workers detailed instructions about the work, including the order in which specific tasks by specific workers were to be done. The location of the work was also determined by the Operating Company. The Contract provided that the Operating Company was responsible for compliance with workplace health and safety requirements. The Operating Company provided the tools and equipment for the work.

Most of the training in the Industry was provided on an Industry-wide basis through a fund established by the Employer Association. Taxpayer made contributions to the fund based on the hours worked by the workers. As a result of the Industry-wide training, workers hired for a project tended to require little training. However, if a worker required training, the training was arranged and paid for by the Operating Company.[7]

The Operating Company determined how long a worker's services were needed. The Operating Company could discharge the worker if his work was unsatisfactory or his services were no longer needed. The Contract provided that the Operating Company would immediately notify Taxpayer of a worker's completion of assignment and layoff or termination date and provide Taxpayer with a time card needed for Taxpayer to prepare any final paycheck for the worker on a timely basis. In addition, the

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[7] Taxpayer licensed accounting software to Operating Companies and sometimes a portion of the licensing fee included Taxpayer's training of workers to use the program.

Contract gave Taxpayer the right to terminate the services of the workers provided to the Operating Company in the case of the Operating Company's breach of its obligations under the Contract or under an applicable CBA.

Taxpayer was responsible for providing to the unions any notices or reports required with respect to the workers' employment. When Taxpayer was the primary employer, it was responsible to the union for compliance with the CBAs. Even when the Taxpayer was acting as the secondary employer, it was sometimes contacted by the unions about grievances filed by workers.

As mentioned above, Taxpayer made contributions to various employee benefit funds that covered the workers. Taxpayer was responsible for any reports required and any questions that arose with respect to the contributions, and Taxpayer's books were subject to audit by the funds. Taxpayer also maintained separate health and disability plans in which workers could participate.

Taxpayer was treated as the employer ~~for~~ purposes of workers compensation and state unemployment compensation and certain other employment-related laws. For example, Taxpayer was named as the employer in complaints filed with the Equal Employment Opportunity Commission and defended itself against the claims at its own expense without reimbursement by an Operating Company.

Taxpayer states that it has taken responsibility for the workers' health, safety and welfare. For example, when some workers were stranded at an overseas worksite because of an Operating Company's insolvency, Taxpayer arranged and paid for their return to the United States. Additionally, when some workers were injured at an overseas worksite, Taxpayer arranged for their medical air evacuation and for a doctor to be sent overseas to provide medical services. The related expenses were paid by Taxpayer's workers compensation insurance carrier.

LAW AND ANALYSIS

Issue 1 - Whether, in the years at issue, Taxpayer was the common law employer of workers performing services for Operating Companies in the Industry.

Law

Employment taxes consist of social security and Medicare taxes under the Federal Insurance Contributions Act ("FICA"), §§ 3101-3128 of the Internal Revenue Code, taxes under the Federal Unemployment Tax Act ("FUTA"), §§ 3301-3311, and income tax withholding under §§ 3401-3405.

For employment tax purposes, employee includes an individual who, under the usual common law rules applicable in determining the

employer-employee relationship, has the status of an employee. § 3121(d)(2); § 3306(i); § 31.3121(d)-1(c)(1); §§ 31.3306(i)-1(a); and 31.3401(c)-1.

The employment tax regulations describe an employer-employee relationship:

> Generally such relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer . . . are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services.

Section 31.3121(d)-1(c)(2). See also, §§ 31.3306(i)(b)-1(b) and 31.3401(c)-1(b).

The analysis of whether an employment relationship exists typically arises in the context of determining whether an individual is an employee or an independent contractor. However, the determination of which of two potential employers is treated as the employer for employment tax purposes is made using the same standard. Bartels v. Birmingham, 332 U.S. 126 (1947); Professional & Executive Leasing, Inc. v. Commissioner, 89 T.C. 225, 232-233 (1987), aff'd, 862 F.2d 751 (9th Cir. 1988).

In re Critical Care Support Services, Inc., 138 B.R. 378 (E.D.N.Y. 1992), involved an agency that provided critical care nurses to hospitals. The agency screened the nurses for their qualifications, including licenses, skills and insurance. The agency determined whether to send a nurse to any hospital and also determined the hospitals, duties and shifts to which the nurse was assigned. The agency paid the nurses and billed the hospitals for the nursing services. If a hospital was dissatisfied with a nurse's performance, it notified the agency not to send the nurse again. The agency then decided whether to send the nurse on future assignments to other hospitals.

The agency argued that it was not the employer of the nurses because the agency did not actually control the nurses in their performance of services at hospitals; rather the nurses were

controlled by the hospital. The court observed that it is difficult to demonstrate the existence of a right to control without evidence of actual exercise of the right. The court noted, however, that the professional critical care nurses, who were carefully screened by the agency, did not have to be actually controlled in their every movement by the agency. The agency retained the right to control the nurses as reflected in its right to assign them to any hospitals (or none at all) or duties, specifying the time and place of the work. The agency also paid the nurses directly, regardless of whether receiving payment from the hospitals. The court held that the nurses were employees of the agency.

In Professional & Executive Leasing, Inc. v. Commissioner ("PEL"), supra, PEL furnished workers to client businesses and treated the workers as its employees. PEL covered the workers in pension, profit-sharing, and fringe benefit plans. PEL also issued paychecks to the workers, paid the related federal and state employment taxes, and provided workmen's compensation coverage. PEL received a fee for each worker provided to the client. By contract PEL had the right to terminate or reassign a worker. The workers generally had a preexisting employment and ownership relationship with the clients for whom they worked. PEL reviewed the workers' qualifications only for the proper professional licenses. The client businesses provided equipment, tools and office space for the workers. In appropriate cases, the client was required to provide malpractice insurance naming PEL as an insured.

Among the factors considered by the courts in PEL were the degree of control over the details of the work; investment in the work facilities; withholding of taxes, workmen's compensation and unemployment insurance funds; right to discharge; permanency of the relationship; and the relationship the parties think they are creating. Citing Bartels v. Birmingham, supra, the Tax Court noted that a contract purporting to create an employer-employee relationship will not control where the common law factors (as applied to the facts and circumstances) establish that the relationship does not exist.

The court found that an employment relationship did not exist between PEL and the workers because PEL exercised minimal, if any, control over the workers; rather, each client and the worker controlled the details of the work and the selection of assignments. PEL did not have a genuine right to terminate or reassign the workers. In addition, PEL had no investment in the work facilities; the clients provided office space, tools and equipment. Despite the contract terms giving PEL control over the workers and labeling the relationship between PEL and the workers as employment, the court found that PEL merely performed a payroll and bookkeeping function. The court held that the workers were not employees of PEL, but of the clients.

In Burnetta v. Commissioner, 68 T.C. 387 (1977), a company was formed to do the selection, hiring, training and instruction of workers who would then be contracted out to client businesses, such as Burnetta's. However, in actual practice, the clients did the screening and selection of workers. The client also had the right to discharge a worker and determined the workers' pay. The worker completed time sheets, which the client approved and submitted to the company. The company prepared the workers' paychecks, deducting applicable employment taxes, and mailed them to the clients to give to the workers. The company billed the client monthly and sometimes paid the workers before being paid by the client. The company received a fee based on a percentage of the workers' gross compensation.

The court held that the workers were employees of the clients, not of the company. The court found that the company essentially provided payroll and recordkeeping services for the clients. "In short, Staff simply relieved its business clients (including the petitioner corporations) of the burden of providing their payroll and recordkeeping functions and did not have the right to control its clients' employees in the manner normally associated with and contemplated by the typical common law employer-employee relationship." 68 T.C. at 391 and 399. It was the client, not the company, that interviewed and hired the workers, determined their salaries, and fired them if dissatisfied with their work. The court noted also that the right to control the workers as to the result to be accomplished by their work and the details and means by which the result was accomplished rested with the clients. The company never provided job-related instructions to the workers or had substantial contact with the workers during their employment.

In Packard v. Commissioner, 63 T.C. 621 (1975), the employment of the employees of a dental practice was transferred to a separate corporation owned by the dentist-partners of the practice. After the transfer, the employees continued to be supervised by the general manager who was in turn supervised by the dentists, now as officers of the corporation. The Service argued that the transferred employees remained the common law employees of the partnership for purposes of qualified plan participation because the partners continued to have supervisory powers over the employees after the transfer. However, the court honored the structure of the arrangement and accepted the fact that the employees were supervised by the dentists as corporate officers. In addition, it noted that the corporation paid the salaries, the employment taxes, liability insurance, workmen's compensation, and unemployment insurance. The court held that the corporation assumed all the obligations of the employer and had the right to control the services, so the corporation, not the partnership, was the employer.

Rev. Rul. 74-45, 1974-1 C.B. 289, dealt with an organization that provided day care services for children. The organization arranged a meeting between a parent and a prospective sitter to determine where and when the services would be performed. The sitters reported their hours to the organization and were paid by the organization. The organization obtained evaluations of the sitters from the parents and replaced sitters as needed. The organization enforced state training requirements for the sitters, sometimes providing the training needed. The organization could discharge a sitter who did not comply with state requirements. Rev. Rul. 74-45 acknowledged that certain factors in the case indicated a lack of direction and control exercised by the organization over the baby sitters. However, it concluded that, since the sitters were trained, they did not require constant supervision and the organization retained the right to supervise them. The organization had the right to determine not only what the sitters did, but how it would be done. The sitters were thus employees of the organization.

Rev. Rul. 56-502, 1956-2 C.B. 688, involved individuals engaged by an agency to perform domestic services for its clients. Rev. Rul. 56-502 stated that the agency is the employer of the individuals where the facts show that (1) the agency is engaged in the business of furnishing such services and so holds itself out to the general public; (2) the agency furnishes the employment of the individuals and fixes their remuneration; (3) the clients for whom the services are performed look to the agency for duly qualified and trained individuals; (4) the services are necessary to the conduct of the agency's business and promote or advance its business interests; and (5) the total business income of the agency is derived through a percentage of the remuneration received by the individuals for the performance of their services.[8]

Analysis

Many factors in this case demonstrate the Operating Companies' direction and control over the workers. The Operating Companies hired the workers,[9] determined their compensation, and provided

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[8] Rev. Rul. 56-502 stated that the above rule is applicable whether the agency pays the individuals directly or they are paid directly by the clients. Rev. Rul. 56-502 was modified by Rev. Rul. 80-365, 1980-2 C.B. 300, to provide that the rule contained in Rev. Rul. 56-502 applies to babysitting services only if the agency pays the sitters directly, in accordance with § 3506(a), effective after 1974.

[9] Although Taxpayer sometimes hired Incidental Workers meeting criteria specified by the Operating Company, that fact is not sufficient to prevent the analysis and conclusion applicable

any training needed. The Operating Companies decided the location, the number of hours, the time of commencement and termination, and the type of work to be done. The Operating Companies handled the day-to-day supervision and direction of the workers. The Operating companies provided the equipment and materials used in a project and were responsible for worksite health and safety. The Operating Companies were responsible for any liability resulting from the services of the workers. The Operating Companies generally determined when employment of the workers ended. The Operating Companies had the right to discharge a worker if the worker's services were not satisfactory.

Taxpayer bore certain responsibilities in connection with the workers. Taxpayer was responsible for providing the workers' pay and benefits. Under the Contract, the Operating Companies were obligated to reimburse Taxpayer for the cost of the pay and benefits. However, Taxpayer's responsibility to the workers was independent of any reimbursement by the Operating Companies, and Taxpayer provided their pay and benefits even when not reimbursed by an Operating Company. Taxpayer also monitored compliance with the CBAs and employment laws. In that regard, Taxpayer could prevent a worker from being employed, could affect a worker's hours and pay, could remove the worker from a project in the case of breach by the Operating Company, and was named in worker grievances. In addition, Taxpayer was considered the employer for purposes of certain employment laws.

The relationships in this case are very like those in PEL and Burnetta. Various factors show that the Operating Company, like the clients in those cases, possessed and exercised direction and control over the workers and was the employer of the workers. In contrast, like PEL and the company in Burnetta, Taxpayer's administrative responsibilities in connection with the workers were limited in comparison to the authority of the Operating Companies and cannot by themselves establish a common law employment relationship. Although Taxpayer provided the workers' pay and benefits, its services were much like those of a payroll agent and it routinely received reimbursement from the Operating Companies. In addition, responsibility for compliance with the CBAs and employment laws is not the same as the right to hire or discharge a worker or to determine the worker's pay and schedule. Moreover, because special definitions of employer often apply for purposes of particular employment laws, treatment as the employer under such laws is not sufficient for common law employer status. The facts in this case do not establish that Taxpayer was the common law employer of the workers.

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to the workers generally from applying to the Incidental Workers.

As Taxpayer points out, employer status turns on the right to direct and control, not on actual direction and control. Taxpayer argues that, under the Contract, it merely delegated a portion of its right to direct and control to the Operating Company, but that it retained the right to direct and control the employees and thus was the employer. However, contract provisions are only one factor considered in determining whether an employment relationship exists. In addition, even under the Contract provisions, Taxpayer's purported right to direct and control was subordinate to the Operating Company's right.

Taxpayer analogizes its situation to the revenue rulings discussed above in which agencies were found to be employers even though they did not directly supervise the workers' services. However, in those rulings, the employers' right to direct and control the workers was demonstrated by actions such as assigning the workers to clients, fixing their remuneration, training them, and the ability to discharge them. See also, Critical Care. Taxpayer did not have the right to, and in fact did not, screen the workers for their qualifications, place them with Operating Companies, set their compensation, or determine for how long they would be employed. The facts in this case do not show that Taxpayer ever possessed sufficient right to direct and control the workers to support a finding that it retained the right to direct and control them and was thus their employer. Rather, the Operating Companies possessed the right to direct and control the workers and exercised that right.

Taxpayer argues that, even though the workers were hired by the Operating Company, Packard supports the conclusion that workers hired by one entity, i.e., the dental practice, can become employees of a second entity, i.e., the separate corporation, to which they are transferred. However, the court in Packard accepted the fact that, after the transfer, the employees were under the direction and control of the corporation as exercised by the dentists in their capacity as officers of the corporation. The facts in the present case are quite different. In this case, Taxpayer had no representative at the worksite even arguably exercising direction and control of the workers on behalf of Taxpayer.

Taxpayer argues that the provision of employee benefits is the overriding criterion for determining employer status and that taxpayer is therefore the employer. However, as PEL clearly proves, merely providing benefits is not enough to establish an employment relationship.

Issue 2 - If Taxpayer was not the common law employer of the workers, whether Taxpayer was the employer under § 3401(d)(1) with respect to compensation paid by Taxpayer to the workers.

Law

Under § 3401(d), the term "employer" generally means the person for whom an individual performs any service, of whatever nature, as the employee of such person. Under § 3401(d)(1), however, if the person for whom the individual performs the services does not have control of the payment of the wages for such services, the term "employer" means the person having control of the payment of such wages. See regulation § 31.3401(d)-1(f), which provides that the term "employer" means the person having legal control of the payment of the wages.

Neither the FICA nor the FUTA provisions contain a definition of employer similar to the definition contained in § 3401(d)(1). However, Otte v. United States, 419 U.S. 43 (1974), 1975-1 C.B. 329, holds that a person who is an employer under § 3401(d)(1) is also an employer for purposes of FICA withholding under § 3102. Circuit courts have applied the Otte holding to conclude that the person having control of the payment of the wages is also the employer for purposes of § 3111, which imposes FICA excise tax on employers, and for purposes of § 3301, which imposes the FUTA tax on employers. See, for example, In re Armadillo Corp., 561 F.2d 1382 (10th Cir. 1977).

In Consolidated Flooring Services, 38 Fed. Cl. 450, 97-2 U.S. Tax Cas. (CCH) ¶50,680 (1997), the taxpayer, CFS, sold flooring and installation to customers. The installation was actually done by installers with whom CFS contracted. The installers hired their own helpers. As a result of a reclassification by California, CFS started to apply federal income tax withholding to its payments to the installers and to pay the helpers directly in the amounts that the installers told it to pay. The court found that the installers were independent contractors. It found that CFS had even less control over the helpers than it had over the installers, so that, like the installers, the helpers were not employees of CFS. The court found, though, that CFS controlled the account from which the helpers were paid and therefore did control the payment of wages to the helpers, even though the installers determined the wages to be paid.

In Winstead v. U.S., 109 F. 2d 989, 97-1 U.S. Tax Cas. (CCH) ¶50,322 (4th Cir. 1997), Winstead owned land that was farmed by sharecroppers, who were accountable for their hired help. However, the sharecroppers could not pay the hired help until after the crops were sold. Therefore, Winstead paid the help from his checking account, over which the sharecroppers had no authority, then deducted what he paid from the sharecroppers' share of the crop proceeds. Winstead was held to have control of

the payment of wages to the hired help and thus to be the employer under § 3401(d)(1).[10]

Analysis

Precedents such as Winstead and Consolidated Flooring consider the situation where a third party pays the employees with its own funds, without having received funds from the common law employer in advance, and then is reimbursed by the common law employer or offsets funds owed to the common law employer by the amount of the wages. Those precedents hold that the third party is in control of the payment of wages and thus is the employer under § 3401(d)(1).

The facts in this case are very similar. Although an Operating Company provided information used to determine the workers' compensation, it did not advance funds to pay the workers. Rather, Taxpayer paid the workers from its own funds, by checks drawn on its accounts, and was reimbursed by the Operating Company, if at all, only some time later. Taxpayer was thus the employer under § 3401(d)(1) with respect to the compensation it paid to the workers.

Issue 3 - If Taxpayer was the § 3401(d)(1) employer with respect to compensation paid to the workers, whether Taxpayer was the employer for purposes of determining a worker's wages under §§ 3121(a)(1) and 3306(b)(1).

Law

Under § 3401(d)(1), the § 3401(d)(1) employer is the employer for income tax withholding generally, but is not the employer for

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[10] Various revenue rulings have also found a person to be the employer under § 3401(d)(1) when it paid another's employees without receiving advance funds from the employer. See Rev. Rul. 73-253, 1973-1 C.B. 414 (racing association paying track stewards, who were employees of State board, had control of the payment of wages and was employer under § 3401(d)(1)); Rev. Rul. 69-316, 1969-1 C.B. 263 (parent corporation that paid employees of subsidiary, then billed subsidiary for amount of wages, had control of the payment of wages and was employer under § 3401(d)(1)); Rev. Rul. 57-145, 1957-1 C.B. 332 (architectural firm that from its own funds paid clerks, who were employees of client, and was reimbursed by client, had control of the payment of wages and was the employer under § 3401(d)(1)); Rev. Rul. 54-471, 1954-2 C.B. 348 (ad agency that paid demonstrators, who were employees of State commission, then received repayment plus fee from commission, had control of the payment of wages and was employer under § 3401(d)(1)).

purposes of § 3401(a), which defines wages for purposes of income tax withholding. Section 3401(a) also provides various exceptions to the term "wages" that depend on the nature of the employer. As a result, the determination of whether remuneration is wages under § 3401(a) is made on the basis of the common law employer, even if another party is the employer under § 3401(d)(1).

Under §§ 3121(a)(1) and 3306(b)(1), for FICA and FUTA purposes, respectively, the term "wages" does not include that part of the remuneration paid by an employer to an employee within any calendar year which exceeds the applicable annual wage base. Furthermore, if during a calendar year an employee receives remuneration from more than one employer, the annual wage base does not apply to the aggregate remuneration received from all of such employers, but instead applies to the remuneration received during such calendar year from each employer. See §§ 31.3121(a)(1)-1(a)(3) and 31.3306(b)(1)-1(a)(3) of the regulations.

Sections 3121(a) and 3306(b) contain other exceptions from FICA and FUTA wages. Sections 3121(b) and 3306(c) contain exceptions from employment for FICA and FUTA purposes. Like the wage exceptions under § 3401(a), some of the wage exceptions under §§ 3121(a) and 3306(c) and exceptions from employment under §§ 3121(b) and 3306(c) depend on the nature of the employer.

Section 3306(a)(1) defines "employer" for FUTA purposes generally as any person who (A) during any calendar quarter in the calendar year or the preceding calendar year paid wages of $1,500 or more, or (B) on each of some 20 days during the calendar year or during the preceding calendar year, each day being in a different calendar week, employed at least one individual in employment for some portion of the day. Thus, a person who employs employees becomes an "employer" for FUTA purposes only if meeting the wages threshold under § 3306(a)(1)(A) or the days of employment threshold under § 3306(a)(1)(B).

Until 1970, § 3306(a)(1) defined "employer" only with reference to days of employment. In that year, the wages threshold was added as an alternative definition by § 101 of the Employment Security Amendments of 1970, Pub. L. No. 91-373. The legislative history of Pub. L. No. 91-373 explains that, under prior law, the FUTA definition of "employer" excludes employers that do not have individuals in their employ in each of 20 different calendar weeks and that the proposal would broaden the definition of "employer" to include all employers paying wages of a minimum amount. The alternative test is linked to the size of the employer's payroll. H.R. Rep. No. 91-612, 91st Cong., 1st Sess. 8-9 (1969).

Otte, supra, dealt with the trustee in bankruptcy of a bankrupt employer and the tax liability attributable to wages paid by the trustee for services performed for the bankrupt employer. The trustee argued that the payments made by the trustee were not wages under § 3401(a). Otte rejected those arguments and noted that the payments were for services performed for the former employer. It stated that the fact that the services were performed for the bankrupt, rather than for the trustee, and the fact that payments were made after the employment relationship terminated, did not convert the remuneration into something other than wages. Otte also held that the payments were FICA wages, even though the employment relationship between the bankrupt and the employee no longer existed at the time of payment, and that the trustee was responsible for withholding the employee's share of FICA.

Analysis

Otte did not explicitly address whether FICA wages are determined with respect to the common law employer, rather than the § 3401(d)(1) employer. It did, however, characterize the payments by the trustee as FICA wages, based on the relationship between the workers and the common law employer. It thus inherently applied the § 3401(d)(1) definition of employer for FICA purposes in a manner analogous to its application for purposes of income tax withholding. Therefore, because § 3401(d)(1) employer status does not apply in determining wages for purposes of income tax withholding, it should not apply in determining wages for FICA or FUTA purposes. As a result, Taxpayer is not the employer for purposes of determining a worker's wages under §§ 3121(a)(1) and 3306(b)(1).

An Operating Company, as the common law employer, is the employer for purposes of determining a worker's wages under §§ 3121(a)(1) and 3306(b)(1). Moreover, because each Operating Company is a separate common law employer, a separate wage base applies to the compensation paid to a worker with respect to the services performed for each Operating Company, regardless of the fact that Taxpayer is the § 3401(d)(1) employer with respect to all those wages.

We note that substituting the § 3401(d)(1) employer as the common law employer for purposes of determining wages, and presumably for determining employment, would cause a fundamental change in the wage and employment exclusions. For example, the existence of a for-profit § 3401(d)(1) employer would eliminate the exclusion from wages under § 3121(a)(16) for remuneration of less than $100 paid by a § 501(a) organization during the year. There is no indication that Otte and its progeny intended so fundamental a change.

Taxpayer argues that it was the employer of the workers for FUTA purposes under § 3306(a)(1)(A) because it paid the workers' wages. However, the legislative history of § 3306(a)(1)(A) indicates that § 3306(a)(1)(A) was intended merely to extend FUTA liability to any employer with a payroll of a certain amount. There is no indication that it was intended to substitute a third party handling payroll for the common law employer for purposes of determining FUTA liability. In addition, as described above, such a substitution would cause a fundamental change in the FUTA wage and employment exclusions. The legislative history gives no indication that so fundamental a change was intended.

CONCLUSIONS

1. Taxpayer was not the common law employer of the workers performing services for the Operating Companies. Rather, the Operating Companies were the employers.

2. Taxpayer was the employer under § 3401(d)(1) with respect to compensation paid by Taxpayer to the workers.

3. Taxpayer was not the employer for purposes of determining a worker's wages under §§ 3121(a)(1) and 3306(b)(1). Rather, a separate wage base under §§ 3121(a)(1) or 3306(b)(1) applied to the compensation paid to a worker for the services performed for each Operating Company.