

Department
of the
Treasury

Internal
Revenue
Service

Office of
Chief Counsel

Notice

N(35)000-141

December 2, 1996

Litigation Strategy for Certain
Insurance Agents Claiming Independent
Subject: Contactors Status **Cancellation Date:** March 2, 1997

The purpose of this Notice is to assist District Counsel attorneys in the management of cases in which individual insurance agents of Allstate Insurance Company, American Family Mutual Insurance Co., the Auto Club Insurance Association, and other companies, who were treated as common law employees by the companies engaging their services, claim independent contractor status. This Notice is not intended to affect similar worker classification cases for which a trial has occurred, but for which a decision has not yet been entered.

These taxpayers claim independent contractor status for purposes of deducting business expenses based upon Butts v. Commissioner, T.C. Memo 1993-478, aff'd per curiam, 49 F.3d 713 (11th Cir. 1995). See also Smithwick v. Commissioner, T.C. Memo 1993-582, aff'd per curiam, 49 F.3d 713 (11th Cir. 1995) and Ware v. United States, 850 F. Supp. 602, aff'd, 67 F. 3d 574 (6th Cir. 1995). In these cases District Counsel attorneys should no longer challenge the taxpayer's claim of independent contractor status.

While conceding the classification issue, District Counsel attorneys should ensure that the taxpayer is treated as an independent contractor for all purposes under the Internal Revenue Code. Thus, in addition to the amount of wages, tips, and compensation reported by the employer in box 1 of the Form W-2, District Counsel should assert additional "income items" to calculate the taxpayer's net earnings from self-employment. Potential additional income items include, but are not limited to, the following benefits that are not excludable from the income of an independent contractor: (1) elective contributions under an I.R.C. § 401(k) cash or deferred arrangement; (2) elective contributions to an I.R.C. § 125 cafeteria plan; and (3) employer-provided contributions (premiums) for dental, health, or life insurance policies, or, if the company's medical plans are self-insured, the benefits under such plans.

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Box 13 of the Form W-2 issued to the taxpayer should include, among other items, the amount of the elective contributions to the section 401(k) cash or deferred arrangement. Other information concerning the income items may be obtained from the taxpayer or the company that engaged the services.

Further, the taxpayer will owe Self Employment Contributions Act (SECA) taxes on net earnings from self-employment even if Form W-2 indicates that the taxpayer paid the maximum employee FICA tax for the year. As an independent contractor, the taxpayer may request a refund for the employee FICA tax paid under I.R.C. § 3101 or receive a credit for such amount under I.R.C. § 6521 if a refund is barred by the statute of limitations. However, the taxpayer cannot claim a credit against SECA liability for the amount of the employer FICA paid under I.R.C. § 3111.

The income items and SECA tax liability should be raised by Exam or Appeals in the Statutory Notice of Deficiency. However, if they are not in the Statutory Notice of Deficiency, then District Counsel attorneys should (1) include the income items and SECA tax liability in the answer as an affirmative allegation; (2) amend answers already filed to reflect the concession of the classification issues and to raise the additional income items and SECA tax liability; or (3) in an S-case, follow the district counsel office procedure for raising affirmative allegations under Tax Court Rule 175(b) and CCDM (35)160.

Further guidance may be issued at a later date concerning the treatment of accrued benefits, other than elective contributions, under the company's qualified plans. Pending such guidance, the value of such accrued benefits should not be treated as includible in the taxpayer's gross income.

It is requested that District Counsel attorneys notify Mr. David N. Pardys of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations) at (202) 622-6040 of any case concerning an individual, other than one working in the insurance industry, who was treated as a common law employee but claims independent contractor status based upon Butts, Smithwick, or Ware.

/s/

Sarah Hall Ingram
Associate Chief Counsel
(Employee Benefits and Exempt Organizations)