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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR Virginia E. Cochran
Deputy Area Counsel (Great Lakes / Gulf Coast, Dallas) CC:TEGE:GL/GC:DAL

FROM: Will E. McLeod
Assistant Branch Chief (Employment Tax 1),
Office of Assistant Chief Counsel CC:TEGE:EOEG:ET1

SUBJECT: Assistance regarding

This Field Service Advice responds to your faxed memorandum dated November 1, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

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LEGEND

Taxpayer = (parent entity)
Subsidiaries =

ISSUES

1. Whether section 530 applies on an entity by entity basis or on a consolidated basis for purposes of the substantive consistency test?
2. If section 530 applies on a consolidated basis, upon the tax-free combination of two consolidated groups, for purposes of the substantive consistency test, is a taxpayer required to maintain historically consistent classification practices based on those of the prior two consolidated groups or to adopt the classification practices of either the acquiring or acquired group?
3. How does utilization of a paying agent as provided by section 3504 for the remittance of employment taxes impact the answers to issues 1 and 2, if at all?

CONCLUSIONS

1. Section 530, for purposes of the substantive consistency test, is applied on an entity by entity basis, not on a consolidated basis.
2. Section 530 is not applied on a consolidated basis.
3. The utilization of a paying agent does not impact the application of section 530 and therefore does not impact our response to issues 1 and 2.

FACTS

The taxpayer is a large healthcare corporation that has been acquiring other healthcare-related entities as subsidiaries since its formation in **the** . The taxpayer formed a subsidiary corporation to serve as a paying agent. The corporation reports and pays over the employment taxes for the taxpayer's employees. The parent and subsidiaries file a consolidated income tax return.

According to the Revenue Agent, the taxpayer allows the workers of the newly acquired subsidiaries to choose their worker status. Workers who were employees of the newly acquired subsidiaries have the option to be employees or independent contractors of the parent corporation. The workers are primarily physicians and nurses.

LAW AND ANALYSIS

1. *Section 530 Applies on an Entity by Entity Basis*

Generally, section 530 of the Revenue Act of 1978 provides a taxpayer with relief from employment tax liability for a particular taxable period if the business can demonstrate that it meets the three statutory requirements of section 530(a)(1). For any period after December 31, 1978, the section 530 relief only applies if: (1) the taxpayer did not treat an individual as an employee for any period; (2) all federal returns (including information returns) required to be filed the by taxpayer with respect to the individual for the period are filed on a basis consistent with the taxpayer's treatment of the individual as not being an employee; and (3) the taxpayer has a reasonable basis for not treating the individual as an employee.

Section 530 provides relief to businesses that have potential liability for employment taxes. The statute uses the term "taxpayer" as the eligible entity entitled to relief. A "taxpayer" is defined as any person subject to any internal revenue tax. Employers are subject to employment taxes on wages paid to their employees. An "employer" is defined as every person that employs one or more employees. Treas. Reg. § 31.3121(d)-2(a). An employer may be among others an individual, partnership, trust, or corporation. Treas. Reg. § 31.3121(d)-2(b).

The taxpayer and each subsidiary of the taxpayer is organized as a corporation or some other legally recognized entity, and therefore, each entity is an employer as defined under the employment tax regulations. The taxpayer and each subsidiary are considered taxpayers and each entity is separately considered for section 530 relief.

This view is consistent with how the prior audit reasonable basis test is applied to a business. A business is treated as having reasonable basis if it relied on a prior audit. The prior audit safe haven is limited to past audits conducted on the business itself. Therefore, a business is not entitled to relief based upon a prior audit of any of its workers. Nor would a subsidiary corporation usually be entitled to relief based upon a prior audit of its separately filing parent corporation. Even if a consolidated return was filed in the year the parent was audited, the subsidiary would only be entitled to relief if the subsidiary was examined in connection with the parent.¹

¹Note that in World Mart, Inc. v. United States, 1993-1 USTC ¶50,304 (D. Ariz. Dec. 15, 1992), the court held that a prior audit of other corporations owned by the same individuals established a reasonable basis safe haven and that telemarketing corporations were entitled to relief from employment taxes with respect to handicapped probationary workers. While we did not recommend appeal, we believe

It appears that the option of allowing workers of the newly acquired subsidiaries to choose between being an employee or an independent contractor of the taxpayer could cause the taxpayer to fail the substantive consistency test, and the taxpayer would, therefore, not be entitled to section 530 relief. The section 530 provisions do not apply if the taxpayer treated the worker, or any worker holding a substantially similar position, as an employee any time after December 31, 1977.

2. If Section 530 Applies on a Consolidated Basis

Since section 530 is not applied on a consolidated basis, no discussion is required.

3. Use of a Paying Agent

Assuming the organization utilizes a paying agent,² section 530 is still applied on an entity by entity basis. Even though section 3504 authorizes a fiduciary or agent to perform the acts that employers are required to perform, the common law employers still remain subject to all provisions of law regarding employment tax liabilities. Thus, the taxpayer and each subsidiary, as the common law employers, each remain liable for employment taxes on an individual basis and are evaluated for section 530 relief on an individual basis.

If you have any questions or need further assistance, please call Kyle Orsini at (202) 622-6040.

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that the court erred in concluding that a prior audit of other corporations owned by the same individuals established a reasonable basis safe haven under section 530. The conclusion conflicts with the literal language of section 530, which provides that the safe haven applies to a past audit "of the taxpayer."

²In order to be recognized as an agent for purposes of employment tax obligations under section 3504, an entity seeking status as an agent is required under the employment tax regulations to apply for authorization from the district director or the service center with whom the agent will file returns in accordance with such authorization. Treas. Reg. § 31.3504-1(a). The procedures for obtaining authorization to be agent under section 3504 are contained in Rev. Proc. 70-6, 1970-1 C.B. 420.