

INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

SEP 30, 2003

Number: **200421001**
Release Date: 5/21/04
Index (UIL) No.: 3121.10-03
CASE MIS No.: TAM-111306-03/CC:TEGE:EOEG:ET1

Director, EO Examinations, TE/GE

Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No:
Years Involved:
Date of Conference:

LEGEND:

Taxpayer =
Residents =
Workers =
State =
Year A =
Year B =
Year C =
Year D =
Year 1 =
Year 2 =
Year 3 =

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Year 4 =

ISSUES

1. Whether the Taxpayer is entitled to relief of employment tax liability under the provisions of Section 530 of the Revenue Act of 1978 because of a prior audit.
2. Whether the Taxpayer was required to file information returns for payments made to or for the benefit of Workers under section 6041 of the Internal Revenue Code (Code), if it is determined that the payments are income to the Workers.
3. Whether the payments made to or for the benefit of Workers were subject to backup withholding under section 3406 of the Code, if it is determined that the payments are income to the Workers.
4. Whether the Taxpayer is entitled to receive a Classification Settlement Program offer to resolve the workers classification issue.

CONCLUSION:

1. The Taxpayer is entitled to relief of employment tax liability under the provisions of Section 530 of the Revenue Act of 1978 because of a prior audit.
2. The Taxpayer was required to file information returns for payments made to or for the benefit of Workers under section 6041 of the Internal Revenue Code (Code), if it is determined that the payments are income to the Workers.
3. The payments made to or for the benefit of Workers were subject to backup withholding under section 3406 of the Code, if it is determined that the payments are income to the Workers.
4. Because the Taxpayer is entitled to relief of employment tax liability under the provisions of Section 530, the Taxpayer does not need to take advantage of the Classification Settlement Program.

FACTS:

The Taxpayer is a voluntary therapeutic residential community dedicated to the care and well being of people with developmental disabilities (Residents). The community also includes Workers, who care for Residents, and the Workers' children. The Residents, Workers and the Workers' children live together in extended family households and work together in a variety of craft shops and work areas. Crafts include candle making, stained glass, bookbinding, weaving and woodworking. Work

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on the land includes a dairy farm, vegetable gardens, and healing plant and seed gardens and processing. The community also has a bakery, gift shop, a café, culture and arts center, and medical therapy clinic.

There are short-term and permanent Workers, with children, living and working in the community. The Taxpayer also has full-time and part-time employees assisting Workers. The Workers have various credentials including credentials in education, social and physical sciences, and in arts and humanities. Residents and Workers share responsibilities for homemaking, training, administration, community outreach, and the cultural artistic, and spiritual life of the community. Each year, additional short-term Workers, many young adults from abroad, join the work of the community for time spans ranging from a few months to three years. The Taxpayer offers orientation and training courses to all short-term Workers and a three-year seminar in social therapy for qualified applicants.

Long-term Workers do not receive a salary. The Taxpayer has a community budget that pays for the Workers' basic expenses such as food, clothing, vacations, medical insurance, education and training. In addition, the Taxpayer makes payments to or on behalf of the Workers for "human concerns." Payments for "human concerns" include, sabbatical payments, severance or separation payments for former Workers, and payment for medical and dental bills for Workers and their children after separation.

The Taxpayer is licensed by the State to provide its services and receives revenue through charitable contributions, government funding and from the sale of products from its workshops, gift shop, and café. The Taxpayer is an exempt organization under section 501(c)(3).

On the Taxpayer's Form 990, Return of Organization Exempt from Income Tax, for Year 1 and Year 2, the Taxpayer reported certain payments referred to as "human concerns," vacation expenses, and tuition payments at private school for the children of the Workers. Also, Workers are provided free housing and receive monthly subsistence payments based upon the age of their children. The revenue agent treated these disbursements to be taxable compensation and expanded the audit to include employment taxes (Years 1 through 4).

In response to the employment tax audit, the Taxpayer advised the agent that it was not liable for employment taxes because it was entitled to relief under section 530 based on prior audits. Service records indicate that the Taxpayer was examined for Year A and the examination resulted in a no change letter. The Taxpayer was also examined for employment taxes for Years B through D. This examination also resulted in a no change letter. The Taxpayer asserts that it has consistently treated the Workers as volunteers and has never issued either Forms W-2 or Forms 1099 to the Workers. The

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Taxpayer has never obtained social security numbers from the Workers since they were volunteers.

LAW AND ANALYSIS:

Issue 1: Section 530

Generally, section 530 provides a taxpayer with relief from employment tax liability for a particular taxable period if the taxpayer 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 (substantive consistency requirement); (2) all federal returns (including information returns) required to be filed by the taxpayer with respect to the individual for the periods are filed on a basis consistent with the taxpayer's treatment of the individual as not being an employee (reporting consistency requirement); and (3) the taxpayer has a reasonable basis for not treating the individual as an employee.

Section 530 (a)(2) sets forth three safe havens which must be considered in determining whether a business has a reasonable basis for not treating an individual as an employee. The three safe havens are reasonable reliance on A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or letter ruling to the taxpayer; B) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged. However, a taxpayer who fails to meet any of the three safe havens is nevertheless entitled to relief if the taxpayer can demonstrate, in some other manner, a reasonable basis for not treating workers as an employee. The term "reasonable basis" should be construed literally in favor of the taxpayer. See Rev Proc. 85-18, 1985-1 C.B. 633.

In order to satisfy the reporting consistency requirement, a business must timely file all required Forms 1099 with respect to workers for the period, on a basis consistent with the business' s treatment of the worker as not being an employee. In Training 3320-102 (Rev. 10-96), Independent Contractor or Employee?, at page 1-6, we state "If a business is not "required to file," relief will not be denied on the basis that the return was not filed." An example is provided where a business is not required to filed information returns because the \$600 threshold has not been met.

The Taxpayer asserts that it did not file Forms 1099 because it treated the Workers as volunteers. In prior audits it was not required to file Forms 1099 for payments made to Workers treated as volunteers. Since the taxpayer was not required to file Forms 1099 for volunteers, the Taxpayer has satisfied the reporting consistency requirement.

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In order to satisfy the substantive consistency requirement, the Taxpayer must demonstrate that it has not treated any individual holding a similar position as an employee. Based on the factual information presented by the Taxpayer, the Taxpayer has demonstrated that it has consistently treated Workers, and other individuals performing substantially the same function as Workers, as volunteers. Thus, Taxpayer has satisfied the substantive consistency requirement.

In order to satisfy the "reasonable basis test," the Taxpayer must have reasonably relied on judicial precedent, a past audit, industry practice or some other reasonable basis for its treatment of the individuals. Here, the Taxpayer relied on several prior audits which specifically included an audit of employment taxes. Thus, the Taxpayer has satisfied the reasonable basis test. Consequently, the Taxpayer is entitled to relief under Section 530.

Issue 2: Information Returns

Section 6041 of the Code requires all persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income, of \$600 or more in any taxable year, to render a true and accurate return in such form and manner and to such extent as may be prescribed by the regulations.

Section 1.6041-1(b) provides that the term "all persons engaged in a trade or business," as used in section 6041(a), includes not only those so engaged for gain or profit, but also organizations the activities of which are not for the purpose of gain or profit. Thus, the term includes the organizations referred to in sections 401(a), 501(c), 501(d) and 521.

Section 1.6041-1(c) provides that income is fixed when it is paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually or at regular intervals. The term "gain, profits and income," as used in section 1.6041 of the regulations, means gross income. A payer is not required to make a return under section 6041(a) for payments that are not includible in the recipient's income.

The Taxpayer is exempt from federal income taxation pursuant to section 501(c)(3) of the Code. Section 1.6041-1(b) provides that the term all persons engaged in a trade or business includes organizations the activities of which are not for the purpose of gain or profit. In particular, section 1.6041-1(b) provides that the term includes the organizations referred to in section 501(c). The Taxpayer provides for the care and well being of adults with developmental disabilities. Therefore, even though the Taxpayer is exempt from federal income taxation pursuant to section 501(c)(3), the Taxpayer is

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engaged in a trade or business for purposes of section 6041. The Taxpayer asserts that it not subject to withholding taxes on the "taxable fringe benefits" as proposed by the agent since the individuals performing services are volunteers. In support of this position, the Taxpayer relies on St. Joseph Farms of Indiana Bros. of Congregation of Holy Cross, Southwest Province, Inc. v. Commissioner, 85 T.C. 9 (1985). In St. Joseph Farms, the Tax Court discussed the term "trade or business" as defined under section 513. The term "trade or business" is defined for purposes of section 6041 in section 1.6041-1(b) of the Income Tax Regulations. Therefore, the definition provided in St. Joseph Farms is irrelevant for purposes of our analysis.

The Taxpayer was created to provide for the care and well being of adults with developmental disabilities. Workers care for the Residents and in return the Taxpayer provides for the Workers' basic expenses such as food, clothing, vacations, medical insurance, education and training. Therefore, the payments made by the Taxpayer are made in the course of its trade or business.

Whether the payments are reportable under section 6041, depends on whether the payments are income to the Workers. If the payments are income, the Taxpayer is required to file information returns for payments made to or for the benefit of the Workers to the extent that the payments exceed \$600.

Issue 3: Backup Withholding

Section 3406(a)(1) provides that in the case of any reportable payment, if (A) the payee fails to furnish his TIN to the payer in the manner required, (B) the Secretary notifies the payer that the TIN furnished by the payee is incorrect, (C) there has been a notified payee underreporting described in subsection (c), or (D) there has been a payee certification failure described in subsection (d), then the payer will deduct and withhold from such payment a tax equal to 31 percent of such payment.

Section 3406(b)(1) provides that the term "reportable payment" means (A) any reportable interest or dividend payment, and (B) any other reportable payment.

Section 3406(b)(3) provides that the term "other reportable payment" means any payment of a kind, and to a payee, required to be shown on a return required under section 6041 (relating to certain information at source).

Section 31.3406(d)-1(d) of the Employment Tax Regulations provides that for accounts, contracts, or relationships subject to information reporting under section 6041, the payee must furnish the payee's TIN to the payer.

Section 31.3406(e)-1(b)(1)(i) provides that a payer is required to withhold under section 3406(a)(1)(A) on any reportable payment at the time the payer pays the reportable

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payment to the payee if the payer has not received the payee's TIN in the manner required in section 31.3406(d)-1.

If the payments constitute income, the payments will be reportable under section 6041. Since the Taxpayer did not obtain social security numbers from the Workers, the payments would also be subject to withholding under section 3406. Pursuant to section 31.3406(a)-4(a)(1), the Taxpayer would be required to withhold at the time it made the payments to the Workers.

Issue 4: Classification Settlement Program

Because the Taxpayer is entitled to relief of employment tax liability under the provisions of Section 530, the Taxpayer does not need to take advantage of the Classification Settlement Program.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.