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Key:

[redacted]

This is in response to your letter to [redacted], dated August 31, 2000, concerning the applicability of section 530 of the Revenue Act of 1978 (section 530) to State's treatment of its election workers. This is intended to be a general information letter, which calls attention to recognized principles of law.

You write that State has always treated its election workers as independent contractors, who are paid through State's vendor system. When information reporting is required with respect to election workers, the election workers are issued Forms 1099. You ask whether State would be entitled to section 530 treatment of its election workers under the safe harbor for long-standing recognized practice of a significant segment of the industry in which the employer was engaged. Section 530(a)(2)(C).

Rev. Rul. 2000-6, 2000-1 C.B. 512, dealing with information reporting requirements with respect to election workers, states that information reporting with respect to election workers is required in any case in which FICA tax applies, regardless of the amount of the payment. Internal Revenue Code (Code) section 6051(a). In any case in which an election worker is not subject to FICA tax, information reporting applies if the worker earns $600 or more in a calendar year. The proper form for information reporting is Form W-2. Code section 6041(a) and section 1.6041-2, Income Tax Regulations.

When an employer is audited by the IRS, section 530 can relieve the employer of employment taxes and penalties for misclassifying workers as independent contractors. Section 530 also entitles an employer to continue to treat the workers as independent contractors, provided that the employer continues to meet the requirements of reporting consistency and substantive consistency.

Section 530 provides, in part, that if, for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, then the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for treating the individual as an independent contractor. This treatment applies only if both the following consistency rules are satisfied: (1) all federal tax returns (including information returns) required to be filed are filed on a basis consistent with the taxpayer's treatment of the individual as not being an employee ("reporting consistency rule") and (2) the taxpayer (or any predecessor) has not treated any individual holding a substantially similar position as an employee for employment tax purposes. Following a longstanding, recognized practice of a significant segment of the industry is considered a reasonable basis for not treating a worker as an employee. Section 530(a)(2)(C).

Section 530 was enacted in 1978 to provide relief to employers involved in employment tax controversies with the IRS as a result of disputes concerning worker classification. When Congress enacted section 530, state and local governments and their employees were not subject to FICA taxes. "Employment" for FICA purposes was defined to exclude service performed in the employ of a state or a political subdivision thereof. Section 3121(b)(7).

Social security contributions made by a state or local government before 1987 were not taxes under Subtitle C of the Code, but were paid pursuant to agreements under section 218 of the Social Security Act (section 218 agreements). The states were primarily liable for payment of the taxes to the Treasury under regulations prescribed by the Social Security Administration (SSA). SSA was responsible for interpreting section 218 agreements to determine whether employees were included within a coverage group. In our view, section 530 had no application under these facts.

There have been two significant changes in the statutory scheme since 1978 which have caused us to reevaluate our conclusion on the application of section 530.

First, wages paid by state and local government employers pursuant to a 218 agreement became subject to FICA taxes, effective for remuneration paid after December 31, 1986. Section 9002(b) of the Budget Reconciliation Act of 1986, Pub. L. No. 99-509, adding section 3121(b)(7)(E) to the Code. This section provides that "employment" includes "service included under an agreement entered into pursuant to section 218 of the Social Security Act."

Second, FICA tax was imposed on the wages of state and local government employees who are not members of a retirement system. Section 3121(b)(7)(F), added to the Code by section 11332(b) of the Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508. This provision is effective for remuneration paid after July 1, 1991.

The adoption of these two provisions has had an effect on the application of section 530. Section 530, by its terms, did not apply to controversies between SSA and the states concerning the coverage of state and local government employees under section 218 agreements. As we understand it, section 530 still has no application to workers who have coverage under a 218 agreement.

Now, however, state and local government workers are subject to FICA tax outside the scope of 218 agreements. State and local governments are involved in controversies with the IRS involving the reclassification of independent contractors as employees. Consequently, we think that state and local government employers whose employees have FICA coverage under section 3121(b)(7)(F) are eligible for section 530 treatment. We think this is so even though Congress did not contemplate section 530 treatment for state and local government employers in 1978. The statutory scheme has subsequently been modified so that state and local government employers have a similar status vis-a-vis the IRS as private employers. They pay FICA taxes, they are involved in controversies concerning worker classification, and they also potentially qualify for section 530 treatment.

Section 530 was drafted with businesses in mind. In the business community, there is great concern about industry practice because treatment of workers as independent contractors confers a competitive advantage. Congress recognized this problem when it provided that longstanding, recognized practice in the industry in which the employer is a part is a reasonable basis for treating a worker as an independent contractor. There is no authority on the issue of how to define the relevant industry for a sovereign state.

We add that the IRS is primarily interested in employee treatment for federal income and employment tax purposes. See Rev. Proc. 85-18, 1985-1 C.B. 518, defining “treatment as an employee” as meaning withholding of income and FICA taxes, filing of employment tax returns, such as Forms 940 and 941, and information reporting on Form W-2. The IRS may not give consideration to treatment for state purposes, including from what fund the employees are paid or how the state accounts for the expenses of the workers.

I hope this information has been of assistance to you. If you have any further questions, please call Elizabeth Edwards [redacted] of this office at (202) 622-6040.

Sincerely,

Jerry E. Holmes
Chief, Employment Tax Branch 2
Office of the Assistant Chief Counsel
(Exempt Organizations/Employment Tax/
Governmental Entities)