FOR BOARD INFORMATION
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L-98-26

TO : The Board

FROM : Steven A. Bartholow
Deputy General Counsel

SUBJECT : Section 530 of the Internal Revenue Service Act of 1978

This is in response to the memorandum dated November 6, 1998, from Management Member Kever, wherein he requested an analysis of what is commonly known as section 530 relief.

Beginning in the late 1960's and early 1970's concern for the state of the social security trust funds and a perceived low compliance by many independent contractors in paying the self-employment tax caused the Internal Revenue Service (IRS) to increase the number of employment tax audits. The result of this policing was that in many industries workers who had been traditionally treated as independent contractors were reclassified as employees. Employers argued that the IRS was not consistent in its reclassification and, therefor, within the same industry one employer would have to treat individuals as employees, and thus bear the employer portion of the social security tax, while a competitor could treat substantially similar individuals as independent contractors.

Congress stepped into the picture in 1976 when it asked the IRS to halt the audits until the matter could be studied further. Congress asked the Comptroller General to make a study of the problem and in 1977 the Comptroller recommended to Congress that safe-harbor legislation would be appropriate.[1]

[1]See Report of the Comptroller General to the Joint Committee on Taxation, CG D-77-88, November 21, 1997.

In response to the comptroller General's recommendation, the 95th Congress enacted section 530 of the Revenue Act of 1978. This section , as amended through the years, provides an employer with relief from Federal employment taxes with respect to workers who have been reclassified as employees. Section 530 relieves the employer from paying and withholding any employment taxes (including withholding on income tax) with respect to these employees not only for the period covered by the audit, but for future periods as well.

Specifically, section 530 provides in part:[2]

> TAX LIABILITY.---
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> (1) IN GENERAL.---If---
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> (A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and
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> (B) in the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee, then, for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

Thus, if an employer has consistently treated an employee as an independent contractor and had a reasonable basis for doing so, section 530 applies. Paragraph 2 of section 530 provides 3 nonexclusive ways in which an employer may establish a "reasonable basis": 1. there is judicial or IRS precedent supporting the employer's position; 2. a past IRS audit did not

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[2]See section 530 of Public Law 96-600, 92 Stat. 2885 (1978) as amended by Public law 96-167, 93 Stat. 1278 (1979); Public Law 96-541, 95 Stat. 3204 (1980); Public law 97-248, 96 Stat. 552 (1982); and Public Law 104-188, 110 Stat. 1766 (1996).

question the employer's treatment; or 3. long-standing industry practice supports the employer's treatment.

Furthermore, paragraph 3 of section 530 provides that the relief provided by paragraph 1 shall not apply for any period after December 31, 1978, if the employer treated an individual in a substantially similar position to the employee for whom section 530 relief is sought as an employee and not an independent contractor.

Section 530 on its face applies to any tax imposed by subtitle C of the Internal Revenue Code, which includes, among other employment tax provisions, the Railroad Retirement Tax Act (RRTA). We have confirmed with the Internal Revenue Service that it has applied section 530 relief to certain nurses whom the Board has found to be covered employees under section 1(b) and 1(d) of the Railroad Retirement Act (RRA) and a similar provision in the Railroad Unemployment Insurance Act (RUIA). This will result in inconsistent treatment of these employees by the employer under the RRTA and the RRA and RUIA. This is because section 530 is an administrative relief provision and is only applied when the IRS has determined that the workers in question are employees. Thus, a worker who is the subject of section 530 relief will generally meet the definition of employee under the Acts.[3] There is nothing in section 530 which would relieve the employer of its reporting requirements under the RRA and RUIA. Accordingly, based on the Board's ruling, the service and compensation of the nurses in question is covered under the RRA and RUIA, and the employer is responsible for reporting such service and compensation and for payments of RUIA contributions thereon.

[3]Section 1 (b) of the RRA provides that an individual who performs service for a covered employer for compensation is a covered employee. Section 1 (d) provides that an individual is in the service of an employer when he or she is subject to the direction of the employer with respect to the manner of rendition of service or, performs professional or technical services for the employer and is integrated into the staff and operations of the employer, or performs on the property used in the employer's operations personal services the rendition of which is integrated into the employer's operations.

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