IRB 2021-24
June 14, 2021

ACTION ON DECISION

Subject: TriNet Group, Inc. v. United States of America, 979 F.3d 1311 (11th Cir. 2020)

Issue: Whether a professional employer organization was the statutory employer under section 3401(d)(1) of the Internal Revenue Code for purposes of claiming the section 45B income tax credit.

Discussion: Gevity was a professional employer organization (PEO) regulated and licensed under Florida law as an employee leasing company. As a PEO, Gevity provided various services to its clients including payroll processing, employment tax[1] services, and human resource services under individual professional services agreements (PSAs). Gevity's clients included restaurants and others in the food and beverage industry where tipping is customary.

Under the PSAs the clients were responsible for submitting information relating to the clients' employees' hours and pay for each pay period (including reported tips) on the first business day following the end of a pay period. Gevity would then generate an invoice for the wages, employer contributions to benefit plans, taxes, and fees due. The invoice was due immediately upon receipt. The PSAs specified that payment to Gevity must be made through wire transfer, Automated Clearing House (ACH) transfer, or other method acceptable to Gevity. The PSAs required Gevity's clients to promptly inform Gevity of any situation in which Gevity's invoice would not be paid on time, in which event Gevity had the right to remove from its payroll the employees for whom payment would not be made. Failure to make timely payments of the amounts shown on the invoice constituted a breach of the agreement by the client and gave rise to Gevity's right to immediately terminate the agreement.

Approximately seventy-five percent of clients paid using ACH transfer. In these transactions, Gevity initiated a debit from the client's account for the full payroll amount, including taxes and fees, two days before the pay date. Within one day of this debit, Gevity received a "provisional credit" for the payment in its account; however, the credit could be reversed at any time within five business days if the client had insufficient

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[1] References to "employment taxes" mean Federal Insurance Contributions Act (FICA) (consisting of both social security and Medicare taxes), Federal Unemployment Tax Act (FUTA), and Income Tax Withholding (ITW), although references to "withholding" only apply to FICA and ITW.

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funds or for certain other reasons, such as if the client placed a "stop payment" order on the transaction or if the client's account was frozen. Gevity did not receive notice when an ACH debit cleared. If an ACH debit did not clear, Gevity would learn of this fact from the clients (who were required to give notice if an invoice would not be paid on time) or from the bank within three to five business days following the provisional credit. Payments from clients made by company check similarly took three to five days to clear. On the other hand, funds paid through wire transfer or certified check became immediately available without a delay for the transaction to clear.

In addition to processing payroll, Gevity also remitted clients' employment taxes to the IRS and reported those amounts under its own employer identification number (EIN) on Forms 941, *Employer's Quarterly Federal Tax Return*, and 940, *Employer's Annual Federal Employment Tax Return*, that it filed. On its Form 1120, *U.S. Corporate Income Tax Return*, for the years at issue, Gevity claimed the section 45B credit for the employer social security and Medicare taxes on certain tips that it remitted to the IRS on behalf of some of its clients. The PSAs did not contain any provisions regarding whether Gevity or its clients were entitled to any tax credits, deductions, refunds, or other tax benefits—such as the section 45B credit. Trinet and the government agreed that Gevity was not the common law employer and that a section 3401(d)(1) statutory employer is entitled to take the section 45B credit.

The IRS determined that Gevity was not the section 3401(d)(1) statutory employer of the worksite employees because the client employers, not Gevity, had control of the payment of wages. During an examination of Gevity's corporate income tax return the IRS issued notices of deficiency, which Gevity paid in full. After the IRS denied claims for refund of these amounts, TriNet sued in federal district court as Gevity's successor, seeking a refund.

The district court in TriNet Group., Inc. v. United States, 359 F. Supp. 3d 1144 (M.D. Fla. 2018) held that Gevity was the statutory employer under section 3401(d), relying on its prior analysis in Paychex Business Solutions, LLC v. United States, 2017 WL 2692843 (M.D. Fla. June 22, 2017), that the PEO was a section 3401(d)(1) statutory employer because it had sole control over the bank accounts from which the wages were paid.[2] The IRS issued AOD- 2020-01 (March 16, 2020) to nonacquiesce in Paychex.

[2] To the extent that the district court implied that the government could still pursue the common law employer for any unpaid employment tax liability involving a section 3401(d)(1) statutory employer, the Eleventh Circuit correctly rejected that view stating that "the statute places the duty to withhold and pay taxes on the person who controls the payment of wages. If the common-law employer does not have such control, the tax liability falls by law on the party with control..." TriNet at 1320.

The Eleventh Circuit in TriNet affirmed the district court's order that Gevity was the section 3401(d)(1) statutory employer and therefore entitled to claim the section 45B credit, because it, not its clients, had control of the payment of wages. In reaching this result, the Eleventh Circuit did not follow the bank account control interpretation of the district court.[3] Rather than saying that control of the bank account for making payments should always be determinative, the Eleventh Circuit created a new test for determining who has control of the payment of wages. Although the court agreed with other precedent and the government's position that a person cannot delegate the tax responsibility to another party as long as the person remains the 'employer', it noted that the parties' contract can certainly affect who has control of the payments, and hence the contractual arrangement must be taken into account in determining who is the employer under the statute. The Eleventh Circuit looked to both the language in the PSAs and how the relationship between the parties functioned, "most importantly the fact that Gevity *generally* issued wage payments before receiving cleared payment from its clients." (emphasis added).

The IRS disagrees with the Eleventh Circuit's new test as it ignores congressional intent, Treasury regulations, and longstanding precedent that section 3401(d)(1) should be narrowly construed.

Section 3401(d) defines the term "employer" for income tax withholding purposes as "the person for whom the individual performs or performed any service, of whatever nature, as the employee of such person, except that (1) if the person for whom the individual performs the services does not have control of the payment of the wages for such services, the term "employer" (except for purposes of determining "wages" under section 3401(a)) means the person having control of the payment of such wages."[4]

The conference report accompanying the enactment of the predecessor to section 3401(d)(1) explains that the exception in paragraph (d)(1) was enacted "to cover certain special cases, such as the . . . case of the person making payment of wages in

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[3] While the Eleventh Circuit correctly did not follow the bank account control interpretation of the district court, we disagree with its characterization of the holdings of Winstead v. United States, 109 F.3d 989 (4th Cir. 1997) and Consolidated Flooring v. United States, 38 Fed. Cl. 450 (1997), United States v. Total Employment Co., 305 B.R. 333 (M.D. Fla. 2004) to support a bank account control interpretation.

[4] FICA does not contain a definition of employer similar to the definition contained in section 3401(d)(1) relating to income tax withholding. However, in Otte v. United States, 419 U.S. 43 (1974), the Supreme Court held that a person who is an employer under section 3401(d)(1), relating to income tax withholding, is also an employer for purposes of withholding the employee's share of FICA under section 3102. The Otte decision has been extended to provide that the person having control of the payment of the wages is also an employer for purposes of section 3111, which imposes the FICA tax on employers, and section 3301 (Federal Unemployment Tax Act (FUTA) tax). See In re Armadillo Corp., 410 F. Supp. 407 (D. Colo. 1976), affd, 561 F.2d 1382 (10th Cir. 1977); In re The Laub Baking Co., 642 F.2d 196, 199 (6th Cir.1981).

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situations where the wage payments are not under the control of the person for whom the services. . . were performed." H.R. Rep. No. 78-510 at 31 (1943) (Conf. Rep.). Consistent with the legislative history, the IRS has narrowly construed what it means to be in control of the payment of wages under section 3401(d)(1). Treas. Reg. §31.3401(d)-1(h) explains that, "The special definitions of the term 'employer'…are designed solely to meet special or unusual situations. They are not intended as a departure from the basic purpose." Treasury regulations further clarify that the term control means legal control of the payment of wages. See Treas. Reg. § 31.3401(d)-1(f); Century Indemnity Co. v. Riddell, 317 F.2d 681, 686 (9th Cir. 1963) (stating "when the statute speaks of 'control' over the payment of wages, it means *legal control*. Further, we hold that legal control means legal *power* to control the actual payment of the wages rather than merely what actually may have been practiced by voluntary forbearance of the person actually having such legal power.").

It has been the longstanding position of the IRS that when the exception in section 3401(d)(1) applies, liability for employment taxes due on wages shifts from the common law employer to the person in control of the payment of those wages. This shift in sole liability coincides with the intended narrow construction of what it means to be in control of the payment of wages.

While the Eleventh Circuit recognized that there is a shift in sole liability from the common law employer to the person in control of the payment of wages when the exception in section 3401(d)(1) applies, the court ignored relevant legislative history evidencing Congressional intent that section 3401(d)(1) is "designed solely to meet unusual situations and not intended as a departure from the basic purpose to centralize responsibility for withholding, returning, and paying the tax and furnishing receipts." Conf. Rep. at 31.[5] By disregarding this intent and creating a new test heavily focused on the parties' contractual language, the court significantly broadened the scope of the exception in section 3401(d)(1), largely circumventing the principle that an employer may not simply delegate or contract away its taxing responsibilities. See Earthmovers, Inc. v. U.S., 199 B.R. 62, 68 (Bankr M.D. Fla 1996); United States v. Garami, 184 B.R. at 838. The court should have considered the "legal control" standard in Treas. Reg. § 31.3401(d)-1(f) in addition to the legislative history indicating a narrow construction to determine if the requisite level of control had shifted from the common law employer to the PEO. The court should not have disregarded § 31.3401(d)-1(h), which provides that the basic purpose is to centralize in the employer the responsibility for withholding, returning, and paying the tax, and for furnishing the statements. If Congress intended to create a new test it would have done do so legislatively as, for example, in enacting Treas. Reg. 31.3504-2, which provides specific rules to follow for the designation of a payor to perform acts of an employer. Also, see § 31.3401(d)-1(f).

[5] See also Sen. Rep. No. 78-221 at 19-20 (1943).

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We further disagree with the Eleventh Circuit's analysis and conclusion under its new test because it did not accurately depict the relationship between Gevity and its clients. The Eleventh Circuit relied heavily on Gevity's use of the ACH debit payment method as support for its view that Gevity had taken on financial risk, and therefore was in control of the payment of wages. We disagree with this analysis and conclusion.

First, the IRS disagrees with the Eleventh Circuit's view that the inherent lag of one day in the ACH system creates sufficient financial risk for Gevity to be a section 3401(d)(1) statutory employer. Focusing on the ACH system in isolation ignores the economic reality of the arrangements between Gevity and its clients. The clients determined the employees' wages and hours, and they were required to provide Gevity with funds to pay the wages and related employment taxes. The whole point of the arrangement was that the clients were the source of the funds from which wages are paid. The clients, not Gevity, were responsible for compensating employees for their work. While wage and tax payments were actual costs for the clients, they were mere flow-through transactions for Gevity.[6]

Additionally, approximately 75% of Gevity's clients used ACH transfer. The remaining clients paid invoices through wire transfer or certified check. The Eleventh Circuit stated that these remaining funds "became immediately available without delay for the transaction to clear." There was no financial risk to Gevity concerning 25% of the payments, yet the court still concluded Gevity was a section 3401(d)(1) statutory employer with respect to all payments. Whether an entity has legal control of the payment of wages is determined by considering the facts and circumstances related to each payment of wages. Even applying the standard set forth by the Eleventh Circuit, Gevity should not be a section 3401(d)(1) statutory employer with respect to the payments sent by wire transfer or certified check because there was no financial risk and no control by Gevity with respect to those payments.

The IRS will continue to take the position that an entity is not in control of the payment of wages if the payment of wages is contingent upon, or proximately related to, the entity having received funds from the common law employer.

Recommendation: Nonacquiescence

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[6] Although not discussed by the court, Gevity did not include wage and tax payments that it received from its clients as revenues on its financial statements filed with the SEC because SEC accounting rules indicate that flow-through amounts cannot be treated as revenue. Gevity's SEC filings, thus, show that it served as a conduit for the wage payments of its client companies, and they are further evidence that Gevity did not have control of the payment of such wages.

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The court's new test for determining who has control of the payment of wages for purposes of section 3401(d)(1) expands the scope of section 3401(d)(1) beyond it's intended narrow purpose. The IRS' position is that an entity is not in legal control of the payment of wages within the meaning of section 3401(d)(1) and the regulations thereunder if the payment of wages is contingent upon, or proximately related to, the entity having first received funds from the common law employer, including by virtue of having a security deposit to cover any arrears in transfers of amounts. Although we disagree with the decision of the court, we recognize the precedential effect of the decision to cases appealable to the Eleventh Circuit, and therefore will follow it within that circuit only with respect to cases that have the same facts as this case. We will continue to assert our position in cases having different facts in the Eleventh Circuit, and in all cases in other circuits.

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