ACKNOWLEDGED SIGNIFICANT ADVICE, MAY BE DISSEMINATED

Office of Chief Counsel
Internal Revenue Service
memorandum

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date: FEB 25 1998

to: James E> Keeton, Jr., District Counsel, Nashville
Attention: Nancy W. Hale, Senior Attorney

from: Mary E. Oppenheimer, Assistant Chief Counsel
(Employee Benefits and Exempt Organizations)

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subject: Significant Service Center Advice - Worker Classification of Off-Duty Law Enforcement Officers

This is in response to your memorandum dated November 24, 1997, in which you requested significant advice on behalf of the Memphis Service Center. You requested significant advice regarding the worker classification of off-duty police officers. This advice is "significant advice" because it will guide administrative procedures in a significant number of cases and is material to the tax administration function of all the Service Centers.

Disclosure Statement

Unless specifically marked "Acknowledged Significant Advice, May Be Disseminated" above, this memorandum is not to be circulated or disseminated except as provided in CCDM (35)2(13)3:(4)(d) and (35)2(13)4:(1)(e). This document may contain confidential information subject to the attorney-client and deliberative process privileges. Therefore, this document shall not be disclosed beyond the office or individual(s) who originated the question discussed herein and are working the matter with the requisite "need to know." In no event shall it be disclosed to taxpayers or their representatives.

ISSUE

Whether police officers performing police-type services while off-duty should be presumed to be employees for federal employment tax purposes with respect to the income earned while off-duty.[1]

CONCLUSION

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[1]This memorandum collectively refers to the following as employment taxes: (1) The taxes imposed on employees and employers by the Federal Insurance Contributions Act, sections 3101 and 3111 of the Internal Revenue Code; (2) The tax imposed on employers by the Federal Unemployment Tax Act, section 3301 of the Code; and (3) The requirement for collection of income tax at source on wages, section 3402 of the Code.

Whether an off-duty police officer is an employee or independent contractor must be determined based upon the facts and circumstances. There is no basis in law for presumptively treating off-duty law enforcement officers in the State of Louisiana as employees with respect to the income earned while off-duty. Accordingly, the Memphis Service Center should not extend its treatment of Louisiana law enforcement officers to law enforcement officers in other states. Indeed, it should stop treating Louisiana law enforcement officers as per se employees with respect to income earned while off-duty.

FACTS

The Memphis Service Center (the "Service Center") presumes Louisiana law enforcement officers working off-duty assignments in the State of Louisiana to be employees. In circumstances where an officer receives a Form 1099 and reports the off-duty income on Schedule C, the Service Center, through its Correspondence Examination Section, proposes an adjustment to assess the employee share of FICA and a corresponding adjustment to reduce self-employment tax. In addition, the expenses incurred in connection with earning the income are treated as employee business expenses (deductible on Schedule A) and not Schedule C expenses.

The Service Center treats law enforcement officers working outside the State of Louisiana in a manner consistent with the particular information return issued to them; that is, with respect to off-duty activities, an officer is treated as an independent contractor if he received a Form 1099, and, likewise, an officer is treated as an employee if he received a Form W-2. The Service Center has requested advice on whether it should extend its treatment of Louisiana law enforcement officers to law enforcement officers in other states. In other words, it is asking if it should presume that all income earned by off-duty police officers while performing police-type services is wages.

DISCUSSION

Section 3121(d)(2) of the Internal Revenue Code provides that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.

The question of whether an individual is an employee under the common law rules or an independent contractor is one of fact to be determined upon consideration of the facts and the application of the law and regulations in a particular case. Guides for determining the existence of that status are found in three substantially similar sections of the Employment Tax Regulations; namely, sections 31.3121(d)-1, 31.3306(i)-1 and 31.3401(c)-1 relating to the Federal Insurance Contributions Act

(FICA), the Federal Unemployment Tax Act (FUTA), and federal income tax withholding, respectively.

Section 31.3121(d)-1(c)(2) of the regulations provides that, generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but as to how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he or she has the right to do so.

In determining whether an individual is an employee under the common law rules, twenty factors have been identified as indicating whether sufficient control is present to establish an employer-employee relationship. The twenty factors have been developed based upon an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending upon the occupation and the factual context in which the services are performed. See Rev. Rul. 87-41, 1987-1 C.B. 296.

Because of the difficulty in applying the twenty-factor test and because business trends have changed over the years, the Service has recently begun using a new approach with respect to worker classification. Rather than listing items of evidence under the twenty factors, the approach now is to group the items of evidence into the following three main categories: behavioral control, financial control, and the relationship of the parties. See the training materials on employee versus independent contractor status, "Independent Contractor or Employee?" Training 3320-102 (Rev. 10-96) TPDS 84238I.

In Kaiser v. Commissioner, T.C. Memo. 1996-526, the court addressed whether income earned by a police officer while off-duty was income from self-employment within the meaning of section 1402 of the Code. The petitioner asserted that the income earned while off-duty was wages and therefore not subject to self-employment tax. The petitioner, while off-duty, provided security, traffic control, and other police-type services for private companies. The police department (the "Department") which employed the petitioner had certain policies and procedures in place with respect to the off-duty activities of its officers. These included requiring the officers to abide by a code of conduct at all times and also mandated that any outside employment be approved in advance by the Department.

The petitioner argued that under common-law principles, the level of control exerted by the Department over the services he provided to the companies rendered him an employee of the Department with respect to such services. In rejecting the petitioner's argument, the court reasoned that the control vested in the Department with respect to off-duty employment relates solely to the on-duty employer-employee relationship. In addition, it found the broad control over off-duty activities to be qualitatively different from the direct, operational control found in a common-law employer-employee relationship. Therefore, the court concluded that the Department was not the petitioner's employer with respect to the income earned while off-duty.[2]

Revenue Ruling 56-154, 1956-1 C.B. 477, involved a regular member of a police department who, while off-duty, was engaged and paid by a merchant to regulate lines of customers outside the merchant's business establishment so that entrances of nearby business establishments would not be blocked. The police officer had taken an oath to uphold the laws twenty-four hours per day and be subject to call at all times. The merchant designated the time the police officer was to be on duty, instructed him as to what was to be done, determined and paid his wages, and had the authority to terminate his services at any time. The Service concluded that the merchant had the right to direct and control the police officer and was therefore the employer for federal employment tax purposes.

Revenue Ruling 74-162, 1974-1 C.B. 297, involved off-duty police officers who volunteered for assignments to direct traffic at a bank auto-drive-in facility. The bank and the police department (the "Department") had an arrangement under which two off-duty policemen reported to the bank each day. The assignments were made and scheduled by members of the Department. The bank had no voice in selecting the policemen assigned to the work and did not negotiate with the individual policemen or give them instructions as to the manner of performing the services. While performing the services, the policemen were subject to all of the departmental rules of a police officer on regular duty and were subject to recall by their supervisors at any time. The bank paid the city and the city in turn paid the officers for their off-duty services. Based upon these facts, the Service concluded that the officers were under the direction and control of the Department and were therefore employees of the city.

Revenue Ruling 70-530, 1970-2 C.B. 220, involved an individual who performed patrol services for merchants. The individual entered into a separate agreement with each merchant

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[2]The court did not address whether the recipients of the off-duty services were common-law employers.

who engaged his services, specifying the services to be rendered and the remuneration to be paid. The merchants did not act as a group in supervising the individual and each agreed that they would not require duties of the individual that could not be carried out in conjunction with his duties to the other merchants. No instructions were given as to the manner in which the services were to be performed. Based upon these facts, the Service held that the individual was not an employee of the merchants for employment tax purposes.

The authorities discussed above illustrate that the determination of whether off-duty police officers are employees or independent contractors depends upon the facts and circumstances in each case. It is not appropriate to make presumptions about the employment tax status of a particular class of workers. As the authorities reveal, it is possible for an off-duty officer to be an employee of a police department for which he is employed on a full-time basis or an employee of the recipient of the off-duty services, or an officer may be properly classified as an independent contractor. Therefore, it is inappropriate to routinely accept or challenge the worker classification implicit in the document (Form 1099 or W-2) received by off-duty police officers in Louisiana or elsewhere.

The attorney assigned to this matter is John Richards. Mr. Richards can be reached at (202) 622-6040.

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