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OFFICE OF
CHIEF COUNSEL

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CC:TEGE:EOEG:ET1:STackney
COR-132273-01

[redacted]

Dear [redacted]:

This letter follows up the telephonic conversation that you had with Stephen Tackney of this office on July 9, 2001, regarding your May 18, 2001 correspondence. You have asked for information regarding the application of the Federal Insurance Contributions Act (FICA) tax upon a firm's termination of the use of a professional employer organization (PEO) to administer the firm's payroll, benefits and human resource functions. Specifically, you question whether upon a termination in the middle of the calendar year, and a worker's corresponding movement from the PEO's payroll to the firm's payroll, the firm may include the PEO's payments to that worker earlier in that calendar year in the worker's FICA wage base.

Based on the conversation that you had with Mr. Tackney, I am enclosing a copy of the Chief Counsel Advice 200017041, 2000 IRS CCA LEXIS 20 (March 3, 2000), which discusses the application of the FICA wage base upon the movement of a worker from a firm's payroll to a PEO's payroll. The same issues discussed in the advice arise in the movement of the worker from the PEO's payroll back to the firm's payroll, so the advice addresses the issues you have raised.

Apart from the procedure for issuing a formal opinion, as described in Revenue Procedure 2001-1, 2001-1 I.R.B. 1, the Internal Revenue Service is not able to provide binding legal advice applicable to particular taxpayers. Furthermore, because the relationships between the worker, the firm and the PEO may differ materially in separate cases, any ruling or other opinion will depend on the facts of the relevant case and should not be relied upon as to other taxpayers. We are able, however, to provide general information, including the enclosed Chief Counsel Advice which provides extensive analysis of the issues raised in your correspondence.

The FICA Wage Base

The FICA tax is composed of the Old Age, Survivors and Disability Insurance (OASDI) taxes imposed under section 3101(a) and 3111(a), also commonly known as social security taxes, and the hospital insurance tax imposed by sections 3101(b) and 3111(b), also known as Medicare taxes.

The FICA tax is imposed on wages as defined in section 3121(a) of the Code. Under section 3121(a)(1), for purposes of the OASDI portion of FICA, the term wages does not include that part of the remuneration paid by an employer to an employee within any calendar year which exceeds the applicable annual wage base. Under section 31.3121(a)(1)-1(a)(3) of the Employment Tax Regulations, for an employee who receives remuneration from more than one employer, the annual wage base does not apply to the aggregate remuneration received from all of such employers, but instead applies separately to the remuneration received during such calendar year from each employer.

Under section 6413(c) of the Code, the employee may claim a credit for excess OASDI taxes withheld because of employment with more than one employer. However, as the legislative history makes clear, this credit applies only to employees, and not to employers. *See* S. Rep. No. 734, 76th Cong., 1st Sess. at 71-72 (1939) and H.R. Conf. Rep. No. 1261, 76th Cong. 1st Sess. at 13 (1939).

Application of the FICA Wage Base to PEO's

The calculation of the FICA wage base generally is based upon the common law employer. Therefore, whether the firm must use a new and separate FICA wage base when the worker returns to the firm's payroll from the PEO's payroll generally will depend upon whether the PEO was the worker's common law employer during the period the PEO paid the worker's wages. Although the contract between the PEO and the firm typically designates the PEO as the common law employer for purposes of the FICA tax, the parties' contractual designation is not determinative. Rather, the identification of the common law employer or employers requires an analysis of the particular facts of a given case.

Employment With Related Employers

In your correspondence, you have also questioned how the FICA wage based should be applied in the case of workers who move from one employer to a related employer (e.g., a parent or subsidiary corporation). If the worker moves from providing services to one common law employer to providing services to another common law employer, the second employer generally must apply a new and separate wage base in calculating the FICA tax, even if the employers are related. In certain situations, however, the use of a single wage base for all of an employee's earnings from related entities may be warranted. For example, if the employee engages in concurrent

employment with more than one related entity, the related entities may qualify for and elect to use a common paymaster under section 3121(s) of the Code, resulting in a single wage base for the employee. Thus there is no single rule applicable to all workers receiving payments from related firms. Rather, the identification of the common law employers, as well as the application of the common paymaster and other rules, requires an analysis of the particular facts of a given case. Also please note that a PEO generally will not be considered a related entity to the client firm, because there will be no shared ownership.

We hope this information has been helpful in responding to your concerns. If you have any questions or require additional information, please contact Stephen Tackney (IRS ID # 50-18084) at (202) 622-6040.

Sincerely,

Michael A. Swim
Chief, Employment Tax Branch 1
Office of Associate Chief Counsel
(Tax Exempt and Government Entities)

Enclosure