DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF CHIEF COUNSEL

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MEMORANDUM FOR THOMAS BURGER
DIRECTOR, OETAC

Attn: Ida Volz

FROM: Jerry E. Holmes

SUBJECT: 45B Credit

This is in response to your question concerning which entity is entitled to the section 45B credit when a restaurant obtains its tipped employees from a leasing organization. According to our analysis, section 45B provides that the credit belongs to the employer. This is generally the employer under the common law, unless there is another entity that has control of the payment of the wages, i.e., a section 3401(d)(1) employer.[1]

Section 38 of the Internal Revenue Code (the Code) allows a general business credit against the tax imposed by chapter 1 of the Code for the taxable year. Section 38(b)(11) lists as a component of the credit the employer social security credit determined under section 45B.

Section 45B(a) provides that, for purposes of section 38, the employer social security credit determined under section 45B for the taxable year is an amount equal to the excess employer social security tax paid or incurred by the taxpayer during the taxable year.

Section 45B(b)(1), in relevant part, defines "excess employer social security tax" as any tax paid by an employer under section 3111 with respect to tips that are deemed under section 3121(q) to have been paid by the employer to an employee. Thus the taxpayer entitled to claim the section 45B credit is the employer on whom section 3111 imposes the employer portion of the Federal Insurance Contributions Act (FICA) tax.

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[1]An earlier memorandum from the Office of Chief Counsel assumed that the leasing organization was the common law employer. The identity of the common law employer is always a question of fact.

Although section 45B(a) provides that the amount of the employer social security credit is equal to the excess social security tax paid or incurred by the taxpayer, subsection (b) defines the "excess social security tax" as tax paid by an employer under section 3111. It is our opinion that the language of section 45B requires that the taxpayer entitled to the credit be the employer on whom section 3111 imposes the employer portion of the FICA tax.

How do we determine the identity of the employer? Generally for FICA tax purposes, the term "employee" is defined in section 3121(d), in relevant part, as any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. An employer has the right to direct and control the individual who performs the services. Section 31.3121(d)-1(c)(2), Employment Tax Regulations. Every person is an employer if he employs one or more employees. Section 31.3121(d)-2(a), Employment Tax Regulations.

The application of the common-law rule is of course a factual determination. While we think that the restaurant rather than the leasing agency is likely to be the employer, this may not always be so. There are no cases directly on point. Leasing agencies have on occasion been found to be the common-law employer of their workers. In re Critical Care Support Services, Inc. 138 B.R. 378 (Bkrtcy E.D.N.Y. 1992) (holding nurses common law employees of leasing agency), contra, Burnetta v. Commissioner, 68 T.C. 387 (1977) (leasing company not common law employer of doctors' office staff for ERISA purposes).

An important exception to the common-law employer rule is contained in section 3401(d)(1), which provides that the term "employer" means the person for whom an individual performs or performed any service as the employee of such person, except that, if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term "employer" means the person having control of the payment of the wages.

Section 31.3401(d)-1(f) of the regulations clarifies that section 3401(d)(1) applies if the person for whom the individual performs the services does not have legal control of the payment of wages. The regulation uses the example of the payment of retired pay by a trust. In other words, when a leasing organization merely acts as an agent of the employer, providing payroll and other services without legal responsibility for payment of the wages, the leasing organization is not the 3401(d)(1) employer.

The determination of whether an entity is a 3401(d)(1) employer is also a question of fact. No bright-line rule can be given. A number of cases have found that a leasing company is not the section 3401(d)(1) employer. In re Earthmovers, Inc. v. U.S., 199 B.R. 62 (Bkrtcy M.D. Fla 1996) (leasing company not the 3401(d)(1) employer of construction workers; court held that construction company and leasing company were "co-employers" because Florida law placed responsibility for paying employment

taxes on leasing company); U.S. v. Garami, 184 B.R. 834 (D.C. Fla. 1995) (leasing company not the 3401(d)(1) employer of cleaners; contractual agreement with leasing company did not relieve employer of FICA responsibility); In re Professional Security Services, Inc., 162 B.R. 901 (Bankr. M.D.Fla. 1993) (leasing company not the 3401(d)(1) employer of security guards; contractual agreement with leasing company did not relieve employer of FICA responsibility).

In summary, the section 45B credit should be claimed by the employer. This will be the common-law employer, unless the leasing company qualifies as the section 3401(d)(1) employer.

If we can be of further assistance, please contact Elizabeth Edwards of my office at 622-6040.