Office of Chief Counsel
Internal Revenue Service
Memorandum

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to: Jeremy Fetter
Area Counsel, Gulf Coast (Dallas)
(TEGEDC Division Counsel)

from: Michael Swim
Senior Technician Reviewer (Employment Tax Branch 1)
(EEE Associate Chief Counsel)

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subject: Section 218 workers and Section 530 relief

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Whether relief under Section 530 of the Revenue Act of 1978 ("Section 530") is available to state and local governments with respect to workers who perform services that are included under an agreement entered into pursuant to section 218 of the Social Security Act ("Section 218 agreement") for both federal income tax withholding and Federal Insurance Contributions Act (FICA) tax purposes.

CONCLUSION

Yes. The mere fact that the workers at issue are workers who perform services that are included under a Section 218 agreement (Section 218 workers) does not prohibit the application of Section 530 relief if the state or local government meets all the requirements of Section 530. Any state or local government meeting all Section 530 requirements will not have any federal income tax withholding or FICA tax obligations for the workers at issue.[1] Consistent with this advice, Field Service Advisory 2002 WL 1315737 ("2002 FSA") which holds that Section 530 relief for state or local governments is available for individuals covered under a Section 218 agreement for income tax

[1] Because state and local governments are not subject to Federal Unemployment Tax Act (FUTA) taxes under sections 3301-3311 of the Code, this Chief Counsel Advice does not address FUTA tax.

withholding purposes but not for FICA tax purposes, no longer represents the position of the government.

BACKGROUND

In conducting employment tax examinations, TEGEDC Division Counsel has informed our office that cases have arisen where state and local governments with Section 218 workers are requesting relief under Section 530. Consistent with the 2002 FSA, FSL/ET has asserted that the state and local government employers are not entitled to relief under Section 530 for FICA tax purposes. TEGEDC has asked our office to reconsider the legal position taken in the 2002 FSA.

Section 218 agreements are agreements executed and amended under the authority of Section 218 of the Social Security Act, 42 USC § 418, and are between a state and the Social Security Administration. The Social Security Administration has had jurisdiction over determining the scope and application of the Section 218 agreements and has jurisdiction over interpretations of these agreements. States and the Social Security Administration enter into Section 218 agreements through which they agree that workers in certain positions will be covered employees for FICA tax purposes, and consequently section 3121(d)(4) includes such individuals in the definition of "employee" for FICA purposes. Subsequently, during an IRS audit of an employer, the IRS requests a coverage determination from the Social Security Administration through which the Social Security Administration will perform a common law analysis solely for purposes of determining whether the specific workers at issue are employees of the taxpayer, and then interpret the Section 218 agreement as to whether they are covered employees.

LAW AND ANALYSIS

Section 530(a)(1) of the 1978 Act, as amended by the Tax Equity and Fiscal Responsibility Act of 1982, provides that "(A) if, for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and (B) in the case of periods after December 31, 1978, all Federal returns (including information returns) required to be filed by the taxpayer with respect to the 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 the individual as an employee."

For purposes of the reasonable basis requirement, Section 530(a)(2) provides that a taxpayer will be treated as having a reasonable basis if the treatment of the individual was in reasonable reliance on one of three safe harbors:

1. Judicial precedent or published rulings, whether or not relating to the particular industry or business in which the taxpayer is engaged, or technical advice, a

letter ruling, or a determination letter issued to the taxpayer under audit (Section 530(a)(2)(A));
2. A past IRS audit that resulted in no assessment of employment taxes attributable to the employment status reclassification of individuals holding positions substantially similar to the position held by the individual (Section 530(a)(2)(B)); or
3. A long-standing recognized practice of a significant segment of the industry in which the individual was engaged (Section 530(a)(2)(C)).

A taxpayer that fails to meet any of the three safe harbors may nevertheless still satisfy the reasonable basis requirement if the taxpayer can demonstrate by facts and circumstances that it had some other reasonable basis for treating the individual as a non-employee.

In order to be reasonable basis supporting the treatment, the taxpayer must demonstrate that it relied upon such basis for its treatment.

Section 530(c)(1) defines "employment tax," for purposes of Section 530, as "any tax imposed by subtitle C of the Internal Revenue Code," which includes FICA, FUTA, federal income tax withholding, and RRTA taxes.

Section 530(c)(2) defines "employment status" as "the status of the individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor."

However, when Section 530 was enacted, the only reference to employment status was in Section 530(b), which prohibits Treasury from issuing regulations and revenue rulings on "employment status." Section 530(a), the relief provision, does not use the term "employment status" or refer to the definition in Section 530(c)(2). It has been the IRS's longstanding position that Section 530 relief is available to statutory employees[2].

Since Section 530 was first enacted, the IRS has considered on multiple occasions whether relief under Section 530 is limited to disputes regarding common law employees. In 1978, the IRS issued Rev. Proc. 78-35, 1978-2 C.B. 536, to provide instructions for implementing the provisions of Section 530. In this publication, the IRS was clear that Section 530 was only available with respect to common law employees.

[redacted]

[2] Note that the Tax Court has previously held that Section 530 is not applicable in cases involving statutory workers, such as corporate officers. *See Joseph M. Grey Public Accountant, P.C. v. Commissioner,* 119 T.C. at 132-134. However, the IRS continues to take the position, both in guidance and litigation, that Section 530 applies more broadly than the court has interpreted and is available to statutory employees.

[redacted]

Announcement 79-44, 1979-12 I.R.B. 25, revisited the original 1978 revenue procedure and extended relief to taxpayers involved in controversies concerning the employment tax status of other workers by omitting references to "common-law employees." The 1978 revenue procedure was further corrected upon publication in the Cumulative Bulletin to include that, for the purposes of Section 530(a), the term employee means employees under sections 3121(d), 3306(i), and 3401(c) of the Code. This broad definition has appeared in all subsequent revenue procedures and other guidance which provides instructions concerning the implementation and application of Section 530.

The IRS has had other occasions to reconsider this issue in connection with litigation as it relates to whether Section 530 relief is available in cases involving corporate officers. Concerning statutory employees listed in section 3121(d)(1), the IRS has continued to interpret the relief provision in Section 530 broadly, limiting the more narrow reference to common law status in Section 530(b) to only that provision which prohibits guidance.

The IRS's current position is that relief under Section 530 is available to disputes involving the proper classification of § 3121(d)(1) corporate officers and other statutory employees under § 3121(d)(4) when the service recipient meets the statutory requirements of Section 530. This position is supported by the language of Section 530(a)(1) which begins with the language, "If, for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period…" This language notably does not limit the definition of employee, and the reference to employment taxes leads the reader to conclude that the provision applies with respect to all individuals not treated as employees, including statutory employees. Consistent with this interpretation, Section 530 relief should also be available to taxpayers who meet all of the requirements of Section 530 with regard to workers covered under Section 218 agreements because they are also statutory employees under § 3121(d)(4).

Originally, the Office of Chief Counsel's understanding was that the agreements between the Social Security Administration and the states regarding a category of workers equated to employee determinations with respect to all individual workers holding that position and this understanding may have influenced the position taken in the 2002 FSA that Section 530 relief was not available for FICA tax purposes with respect to such workers. The 2002 FSA distinguishes § 3121(d)(4) employees from employees covered under §§ 3121(d)(1), (2), and (3) by stating that classifications of the latter are made under rules provided in the Internal Revenue Code and the regulations thereunder, and the classifications of the former are made specifically with reference to Section 218 of the Social Security Act. It goes on to state that if an

individual is covered under a Section 218 agreement, then, by definition, the individual is an employee for FICA tax purposes. The FSA reasons that because the determination of whether an individual is covered under a Section 218 agreement is made by the Social Security Administration under Section 210(j), then Section 530 relief for FICA taxes is inappropriate since coverage under the Section 218 agreement is dispositive of the individual's FICA tax status. First, this is not a correct reading of Section 530 and this interpretation has led to an incorrect analysis of whether Section 218 workers can qualify for Section 530 relief with respect to FICA taxes. Second, this interpretation conflicts with the IRS's longstanding broad reading that Section 530 applies to statutory employees. Lastly, entering into a Section 218 agreement does not include a determination by the Social Security Administration regarding which workers are common law employees.

The IRS broad interpretation is consistent with Congressional intent for implementing Section 530. Congress made it clear that Section 530 was intended as a broad relief provision, both in the original text of Section 530 and legislative history, and in every subsequent round of consideration. Moreover, Congress has had repeated opportunities to make a change to the IRS's public interpretation of the applicability of section 530(a) with regard to corporate officers, a statutory employee. Section 530(a) has not been amended since the date of enactment. In 1986, when Congress added Section 530(d) to limit relief for certain taxpayers, it could have clarified that the relief under Section 530(a) was not available to taxpayers with regard to corporate officers, but it did not do so. In the Small Business Protection Act of 1996, Congress made several clarifications and modifications to Section 530 without adding a limitation regarding applicability with respect to corporate officers.

For these reasons, Section 530 relief is available for state and local government entities with respect to categories of workers covered under Section 218 agreements for both income tax withholding and FICA tax purposes, if the requirements are otherwise met. Accordingly, the 2002 FSA is revoked.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call Nina Roca or Michael Swim at (202) 317-6798 if you have any further questions.