DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR DISTRICT COUNSEL, DISTRICT

Attn:

FROM: Assistant Chief Counsel
(Employee Benefits and Exempt Organizations)
CC:EBEO

SUBJECT:

This Field Service Advice responds to your memorandum dated November 20, 1998. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be cited as precedent.

LEGEND:
Taxpayer =
Tax Periods =
Tax Year =

ISSUE:

Whether the Taxpayer is liable for the section 6656 failure to deposit penalty for the Tax Periods.

CONCLUSION:

Insofar as it appears that the Taxpayer is not the employer, the Taxpayer cannot be liable for the section 6656 penalty.[1]

[1] Your request and our response consider only the application of the section 6656 penalty for failure to make timely deposits of taxes attributable to the wages paid to the employees leased to the Taxpayer's clients. We note that it may be necessary to determine the appropriate time for depositing taxes attributable to wages paid to any other employees of whom the Taxpayer is the employer.

FACTS:

This memorandum responds to your request for our views regarding whether Taxpayer is liable for the section 6656 failure to deposit penalty for the Tax Periods. For the reasons set forth below, we do not believe that Taxpayer is liable for the penalty.

The relevant facts are that Taxpayer is in the employee leasing business. It specializes in supplying small to medium sized employers with "co-employment" administrative and human resource personnel and services. Taxpayer provides its clients with comprehensive human resources, insurance, and other related financial services. All clients must purchase Taxpayer's payroll processing service. However, each client is free to choose the services it wishes to buy, thereby creating a customized package of services for each client.

Taxpayer is not directly engaged in the business of hiring, firing, directing or supervising the employees leased to its clients ("leased employees"). Rather, all of this is done by Taxpayer's clients. Each client designates payroll frequency and submits funds to Taxpayer to enable Taxpayer to make the required payrolls. Taxpayer makes and withholds the mandatory tax and benefit deductions and remits same to the appropriate taxing authority and service provider. Thereafter, Taxpayer remits net paychecks to the leased employees. Taxpayer uses its own EIN when applying Federal and State taxes and Taxpayer maintains all benefit programs in its name. Taxpayer has advised the Service that it does not offer any qualified or nonqualified retirement benefits to any employees.

Taxpayer files one employment tax return each quarter that reports all wages it pays on behalf of all its clients. In this regard, Taxpayer combines the wages it pays for all its clients, and reports them on the same return under its own EIN.

For Tax Year, Taxpayer was classified as a semi-weekly depositor. However, Taxpayer's clients were classified as monthly depositors. Because Taxpayer failed to make payroll tax deposits on a semi-weekly basis, the examiner assessed penalties under I.R.C. § 6656 for failure to timely deposit taxes for the Tax Periods. Taxpayer claims that it is not the "employer," and thus, cannot be assessed the failure to deposit penalty.

LAW AND ANALYSIS:

Section 6656 provides that if any person is required by the Code or regulations to deposit any tax in a government depositary that is authorized under I.R.C. § 6302(c) to receive the deposit, and fails to deposit the tax within the time

prescribed therefor, a penalty shall be imposed on such person unless the failure is shown to be due to reasonable cause and not due to willful neglect. Treas. Reg. § 31.6302-1(a) and (c) provides that employers are required to withhold income tax and FICA taxes from wages paid to their employees and also are liable for their portion of FICA taxes. Thus, a Taxpayer has to be an employer to be liable for the failure to deposit timely employment taxes. It follows therefrom that it is necessary to address the issue of whether Taxpayer is the employer in this matter before a determination can be made as to whether Taxpayer is liable for the § 6656 penalty in this case.

The materials you submitted suggest that Taxpayer is not the employer. Pursuant to section 3401(d), the term "employer" means the person for whom an individual performs any service, of whatever nature, as the employee of such person. A common law employment relationship generally 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 worker 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. It is not necessary that the employer actually direct or control the manner in which the services are performed, it is sufficient if he has the right to do so. In the instant case, the Taxpayer argues that under existing precedent it is not the common law employer because it simply acts as an administrative agent hired for the purpose of facilitating preparation of payroll and Forms 941, and obtaining employee benefits at a discounted cost to the client by taking advantage of economies of scale.

Pursuant to section 3401(d)(1), however, if the person or entity for whom the workers perform the services as employees 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 such wages. Thus, a person other than the common law employer will be treated as an employer for employment tax purposes if: (1) the common law employer does not have control of the payment of the wages, and (2) the third party has control of the payment of the wages.

You have indicated that you do not believe I.R.C. § 3401(d)(1) applies in this case because the client companies designate payroll frequency and submit funds to the Taxpayer to enable Taxpayer to make the required payrolls. In re Earthmovers, Inc., 199 B.R. 62 (Bankr. M.D. Fla. 1996); In re Professional Security Services, Inc., 162 B.R. 901 (Bankr. M.D. Fla. 1992). Assuming this is correct, we agree with your analysis that § 3401(d)(1) does not apply in this case.

Insofar as it appears that the Taxpayer is not the employer of the leased employees, we conclude that the Taxpayer is not liable for the § 6656 penalty. This is because the Taxpayer's clients and not the Taxpayer were required to make timely tax deposits.

You have also requested advice regarding the issue of whether to seek enforcement of two administrative summonses. The summonses that were served were Collection Information Statements (Forms 6637), and requested the production of documents regarding the assets and liabilities of the taxpayers. The summonses were served in order to obtain information on possible responsible officers. Since the assessments have already been made, the statute of limitations under I.R.C. § 6501 is protected. Under section 6502, the statute of limitations for collection of the liabilities will expire 10 years after the assessments were made. Since the statute of limitation for collection will not expire any time soon, it is entirely within the discretion of the district as to whether to seek enforcement of the summonses at this time.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

[redacted]

We also have concerns that a court would view unfavorably any attempt by the Service to impose the § 6656 penalty if Taxpayer were to establish that had employees wages been reported by their actual employer, the tax deposits would have been considered timely and no § 6656 penalty would have been assessed. Therefore, we believe the Service should [redacted] Service should also advise Taxpayer to discontinue reporting and depositing under its own EIN the employment tax liabilities of its clients.

In short, we do not recommend assertion of the § 6656 penalty in this matter if you conclude that Taxpayer is not the employer. Rather, we recommend that the Service [redacted]

[redacted]. Please let us know if you wish to pursue that argument and we will consult with the Procedural Branch of Field Service regarding the feasibility and propriety of such an argument in this matter. There also is the possibility that State law covers the agreement between Taxpayer and its clients, and would make Taxpayer liable for any liability of the employers that arose in this matter. We advise that you coordinate with General Litigation if you decide to pursue that theory.

We have coordinated with the Income Tax and Accounting Division, the Income Tax and Accounting Branch in Field Service and the General Litigation Division regarding this matter. If you have any further questions, please call (202) 622-6040.

MARY E. OPPENHEIMER

By: _____
PATRICIA M. McDERMOTT
Senior Technician Reviewer
Branch Two, CC:EBEO:2