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

OFFICE OF
CHIEF COUNSEL

February 2, 2000

Number: **200023006**
Release Date: 6/9/2000
CC:EBEO:Br2
TL-N-3781-99

UILC: 3401.04-00; 3121.01-00; 3306.02-00

INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR , ASSISTANT DISTRICT COUNSEL

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

SUBJECT:

This Field Service Advice responds to your memorandum dated September 22, 1999. 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

The taxpayer =

ISSUES

1. Whether, in the year at issue, the taxpayer was the common law employer of the workers provided to its clients, taking into consideration the Danielson rule. See Commissioner v. Danielson, 378 F.2d 771, 775 (3d Cir. 1967) cert. denied, 389 U.S. 858 (1967).

2. If the taxpayer was not the common law employer of the workers, whether it was the employer under section 3401(d)(1) of the Internal Revenue Code with respect to compensation paid by the taxpayer to the workers.

3. If the taxpayer was the employer under section 3401(d)(1), whether it was the employer for purposes of determining a worker's wages under section 3121(a)(1) for purposes of the Federal Insurance Contributions Act ("FICA") and under section 3306(b)(1) for purposes of the Federal Unemployment Tax Act ("FUTA").

CONCLUSIONS

1. The Danielson rule is inapplicable under these circumstances. However, the taxpayer must establish that it was not a common law employer of the workers in order to establish its entitlement to a FICA or FUTA refund.

2. Because section 3401(d)(1) status does not apply to a common law employer, it would not apply to the taxpayer unless the taxpayer was not a common law employer.

3. If the taxpayer was not a common law employer, but merely the employer under section 3401(d)(1), then it was not the employer for purposes of determining a worker's wages under sections 3121(a)(1) and 3306(b)(1), and a single wage base applies to all wages attributable to employment with the client, whether paid by the taxpayer or by the client. However, certain additional legal and procedural issues must be considered in determining whether an employment tax overpayment exists for the years at issue.

FACTS

The taxpayer's business consists of furnishing employees to work in a client's business under a contract ("staffing contract") between the taxpayer and the client. The taxpayer treated the workers that it provided to clients as its (the taxpayer's) common law employees.

Different versions of the staffing contract were used during different years and in different states. Some versions of the contract referred only to the taxpayer as the employer of the workers and specified that the taxpayer reserved the right to direct and control the workers and to hire, fire and reassign them. Some versions provided also for the division of the rights and responsibilities of an employer between the taxpayer and the client. Some stated that each of the parties, i.e, the taxpayer and the client shall be deemed an employer.

When the taxpayer entered into a staffing contract with a new client, the taxpayer generally did not have a preexisting employment relationship with the workers whom it agreed to provide to the client. Generally the workers that the taxpayer provided to the client had previously been working for the client as the client's employees and had therefore been paid wages by the client earlier in the year. The taxpayer treated its relationship with the workers as a new employment relationship and applied new FICA and FUTA wage bases to the workers' pay. Taxpayer has now filed FICA and FUTA refund claims on the ground that, in applying the FICA or FUTA wage base to an employee's pay, it should have taken into account the wages previously paid to that employee by the client.

Attached to the taxpayer's various refund claims is an "Amended Memorandum in Support of Refund Claims" (hereinafter "memorandum"). In the

memorandum, the taxpayer represents that it is the "co-employer" and that it maintains a common law or joint employer status with respect to the employees. Specifically, the taxpayer describes its relationship with the employees as follows:

> [Taxpayer] maintains numerous indicia of common law employer status regarding the worksite employees, e.g., [Taxpayer] pays the employees, withholds and pays all payroll taxes, provides workers' compensation coverage, provides certain employee benefit programs, is involved in the hiring/firing process, hears and acts on complaints from the employees about working conditions and oversees workplace safety issues, etc. In addition to retaining a right to direct and control the employees, [Taxpayer] also exercises sufficient rights of control that it should be recognized as the co-employer of such individuals.

At the same time, the Taxpayer argues that, as a co-employer, it is a statutory employer under section 3401(d)(1). The taxpayer asserts that it has control over the payment of the employees' wages and that it pays wages and payroll taxes for the worksite employees without regard to payment from its clients. The taxpayer represents that clients did not advance funds to pay the workers, rather it paid the workers from its own funds, by checks drawn on its own accounts, and was reimbursed by its clients only after paying the employees. In some cases, clients defaulted on payments to the taxpayer, so it was never reimbursed for the payments to the workers. The taxpayer states that it was the employer under section 3401(d)(1) with respect to the compensation it paid to the workers. It argues, therefore, that the same FICA or FUTA wage base applies to the compensation paid by the client and by the taxpayer.

The memorandum further states that, in the event that the Service determines that the taxpayer is the common law employer under the 20-factor test, the taxpayer reserves the right to argue that it is the "successor employer" with respect to the workers under section 3121(a)(1) and 3306(b)(1).

LAW

Employment taxes consist of taxes under the FICA, §§ 3101-3128, taxes under the FUTA, §§ 3301-3311, and income tax withholding under §§ 3401-3405.

For employment tax purposes, employee includes an individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. § 3121(d)(2); § 3306(i); § 31.3121(d)-1(c)(1); §§ 31.3306(i)-1(a); and 31.3401(c)-1.

The employment tax regulations describe an employer-employee relationship:

> Generally such relationship exists when the person for whom 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 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 has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer. Other factors characteristic of an employer . . . are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services.

Section 31.3121(d)-1(c)(2). See also, §§ 31.3306(i)(b)-1(b) and 31.3401(c)-1(b).

The analysis of whether an employment relationship exists typically arises in the context of determining whether an individual is an employee or an independent contractor. However, the determination of which of two potential employers is treated as the employer for employment tax purposes is made using the same standard. Bartels v. Birmingham, 332 U.S. 126 (1947); Professional & Executive Leasing, Inc. v. Commissioner, 89 T.C. 225, 232-233 (1987), aff'd, 862 F.2d 751 (9th Cir. 1988).

Courts and the Internal Revenue Service have looked at various factors in determining whether an employment relationship exists between workers and a particular entity. See, for example, “Independent Contractor or Employee?” Training 3320-102 (Rev. 10-96) TPDS 842381.

Under the common law doctrine of co-employment, a worker may have the status of an employee with respect to more than one employer provided that service to one does not involve abandonment of the other. Therefore, a worker may be employed by two employers simultaneously. See, for example, Rev. Rul. 66-162, 1966-1 C.B. 234.

Under § 3401(d), the term "employer" generally means the person for whom an individual performs any service, of whatever nature, as the employee of such person. Under § 3401(d)(1), however, if the person for whom the individual performs 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 such wages. See regulation § 31.3401(d)-1(f), which provides that the term "employer" means the person having legal control of the payment of the wages.

Under § 3401(d)(1), the employer is responsible for income tax withholding generally, but is not the employer for purposes of § 3401(a), which defines wages for purposes of income tax withholding. Section 3401(a) also provides various exceptions to the term "wages" that depend on the nature of the employer. As a result, the determination of whether remuneration is wages under § 3401(a) is made on the basis of the common law employer, even if another party is the employer under § 3401(d)(1).

Neither the FICA nor the FUTA provisions contain a definition of employer similar to the definition contained in § 3401(d)(1). However, Otte v. United States, 419 U.S. 43 (1974), 1975-1 C.B. 329, holds that a person who is an employer under § 3401(d)(1) is also an employer for purposes of FICA withholding under § 3102. Circuit courts have applied the Otte holding to conclude that the person having control of the payment of the wages is also the employer for purposes of § 3111, which imposes FICA excise tax on employers, and for purposes of § 3301, which imposes the FUTA tax on employers. See, for example, In re Armadillo Corp., 561 F.2d 1382 (10th Cir. 1977).

Otte dealt with the trustee in bankruptcy of a bankrupt employer and the tax liability attributable to wages paid by the trustee for services performed for the bankrupt employer. The trustee argued that the payments made by the trustee were not wages under § 3401(a). The Supreme Court rejected those arguments and noted that the payments were for services performed for the former employer. It stated that the fact that the services were performed for the bankrupt, rather than for the trustee, and the fact that payments were made after the employment relationship terminated, did not convert the remuneration into something other than wages. Otte also held that the payments were FICA wages, even though the employment relationship between the bankrupt and the employee no longer existed at the time of payment, and that the trustee was responsible for withholding the employee's share of FICA.

FICA taxes are composed of the OASDI taxes imposed under sections 3101(a) and 3111(a), also known as social security taxes, and the hospital insurance tax imposed by sections 3101(b) and 3111(b), also known as Medicare taxes.

FICA taxes are imposed on “wages” as defined in section 3121(a). FUTA taxes are imposed on “wages” as defined in section 3306(b). Under section 3121(a)(1), for purposes of the OASDI portion of FICA, and under section and 3306(b)(1), for purposes of the FUTA, 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. Furthermore, if during a calendar year an employee 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 to the remuneration received during such calendar year from each employer. See §§ 31.3121(a)(1)-1(a)(3) and 31.3306(b)(1)-1(a)(3) of the regulations.

The legislative history of the Social Security Act of 1935 contains an example that demonstrates that a separate wage base applies to each employment relationship during the year. See H. R. Rep. No. 615, 74th Cong., 1st Sess. at 32 (1935), and S. Rep. No. 628, 74th Cong., 1st Sess. at 44-45 (1935). The Social Security Amendments of 1939 revised the Social Security Act to provide that only wages up to the OASDI base could be credited to an employee's earnings record for a year. The 1939 Amendments also enacted the predecessor of section 6413(c), under which an employee may claim a credit for excess OASDI taxes withheld because of employment with more than one employer. However, the lawmakers specifically decided to continue to apply separate wage bases to employers who pay wages to the same employee during the year. See S. Rep. No. 734, 76th Cong., 1st Sess. at 71-72 (1939) and H. R. Conf. Rep. No. 1461, 76th Cong., 1st Sess. at 13 (1939).

Sections 3121(a)(1) and 3306(b)(1) also provide that if an employer ("successor employer") during a calendar year acquires substantially all of the property used in a business of another employer ("predecessor"), or used in a separate unit of the predecessor's business, and immediately after the acquisition employs in the business an individual who immediately before the acquisition was employed in the business of the predecessor employer, then remuneration paid by the predecessor to the individual during the calendar year is considered paid by the successor employer for purposes of determining whether remuneration paid to the employees by the successor employer has reached the wage base.

Sections 31.3121(a)(1)-1(b)(3) and 31.3306(b)(1)-1(b)(3) of the regulations provide that the method of acquisition by an employer of the property of another employer is immaterial. The acquisition may occur by a purchase or any other transaction whereby substantially all the property used in a trade or business, or used in a separate unit of a trade or business, of one employer is acquired by another employer.

Under section 3302, a taxpayer may take credit against its FUTA liability for the amount of contributions paid by the taxpayer into a State unemployment fund. Section 3306(g) defines contributions as payments required by a State law to be made into an unemployment fund by any person on account of having individuals in his employ, to the extent that such payments are made by him without being deducted or deductible from the remuneration of individuals in his employ.

Section 6413(a) of the Internal Revenue Code provides that if more than the correct amount of employer or employee FICA tax is paid on any payment of

remuneration, proper adjustments, of both the tax and the amount to be deducted must be made, without interest, as prescribed by regulations. The regulations at § 31.6413(a)-1 provide that an adjustment of employee FICA tax is made by repaying or reimbursing the employees, in accordance with section 31.6413(a)-1(a)(2) and (b)(2), and by then claiming an appropriate credit on a return filed for either the period in which the error or overpayment is ascertained or for the succeeding period. An adjustment of employer tax is made by claiming a credit, in accordance with section 31.6402(a)-2, on the same return on which a corresponding credit of employee tax is claimed.

Section 6413(b) of the Code provides that if more than the correct amount of employer or employee FICA tax is paid on any remunerations, and the overpayment cannot be adjusted under section 6413(a), the amount of the overpayment must be refunded as prescribed by regulations. Section 31.6413(b)-1 of the Employment Tax Regulations refers to sections 31.6402(a)-1 and 2 for provisions relating to refunds of employer and employee FICA tax.

Section 31.6413(a)-1(b)(1)(i) of the regulations provides that when the employer ascertains that it has paid more than the correct amount of employee tax under section 3101 after the return reporting the payment has been filed, the employer "shall repay or reimburse the employee" if the error is ascertained within the applicable limitations period. However, the employer is exempted from the refund requirement if the overcollection and overpayment to the district director is "made the subject of a claim . . . for refund or credit, and the employer elects to secure the written consent of the employee to the allowance of the refund or credit under the procedure provided in [§ 31.6402(a)-2(a)(2)(i)]."

Section 31.6402(a)-2(a)(2) of the regulations provides that every claim filed by an employer for refund or credit of employee tax must include a statement that the employer has repaid the tax to the employee or has secured the written consent of the employee to the allowance of the refund or credit. If the claim relates to employee tax collected in a year prior to the year in which the credit or refund is claimed, the employer must also submit a statement that it has obtained from the employee a written statement (a) that the employee has not claimed a refund or credit of the amount of the overcollection, or if so, such claim has been rejected, and (b) that the employee will not claim refund or credit of such amount. Thus, the employer must obtain the employee's consent and also must obtain a written statement.

In Atlantic Department Stores, Inc. v. United States, 557 F.2d 957 (2d Cir. 1977), the court considered whether the Service had to honor refund claims for overpaid employer FICA tax that were submitted by an employer who had taken no action to enable its employees to recover the corresponding overpayment of employee FICA tax. The court held that the legislative history of section 6413 of

the Code and the regulations under sections 6402(a) and 6413(a) established an obligation for the employer to first adjust the overpayment of employee tax with its employees and then claim a credit or refund from the Service. Atlantic Department Stores did not directly consider whether securing employee consents or attempting to secure employee consents to the allowance of refunds in accordance with section 31.6402(a)-2 of the regulations would fulfill this duty to first adjust overpaid employee FICA tax.

Revenue Ruling 81-310, 1981-2 C.B. 241, considered whether attempting to secure employee consents to the allowance of refunds in accordance with section 31.6402(a)-2(a)(2)(i) of the regulations would fulfill the employer's duty to first adjust overpaid employee FICA tax. The ruling holds that when the employer notifies its employees of the overpaid employee FICA tax, and requests their consents to its filing a refund claim on their behalf, it has made reasonable efforts to protect their interests. Thus, for purposes of the principle recognized in Atlantic Department Stores, the employer's request for employee consents should be treated as fulfilling its duty to "adjust" employee overcollection. Thus, even if the employer's reasonable effort to secure consents or statements is unsuccessful, the employer may claim a refund of the overpaid employer portion of the FICA tax.

Section 31.6051-1(c)(1) of the regulations provides that when wages as defined in section 3121(a) or tax under section 3101, are incorrectly reported on a W-2 submitted to an employee, a corrected statement must be issued to the employee marked "corrected by employer."

Under the rule established in Commissioner v. Danielson, 378 F.2d 771 (3rd Cir. 1967), cert. denied, 389 U.S. 858 (1967), (hereinafter the "Danielson rule"), if the terms of a contract are clear and unambiguous, the Commissioner may bind the parties firmly to those terms, unless proof is adduced which would be admissible, in an action between the parties to the agreement, to show unenforceability because of mistake, undue influence, fraud, or duress.

ANALYSIS

ISSUE 1

Under sections 3121(a)(1) and 3306(b)(1), separate FICA and FUTA wage bases generally apply to the compensation received by an employee from different employers during the year. Thus, if an employee moves from one common law employer during a calendar year to another common law employer, the second employer must generally apply the wage base without reference to the wages paid during the same year by the previous employer. As a starting point, therefore, if the taxpayer is the common law employer of the workers, it would appear to be subject to a separate wage base from the clients.

You have requested our views on whether the Danielson rule would apply in this case to preclude the taxpayer from arguing that it is not the common law employer. For the reasons set forth below, we do not think that the Danielson rule can be applied under these circumstances. We note initially that, although the taxpayer has represented in the memorandum attached to its claim for refund that it is the co-employer/common law employer with respect to the employees, the taxpayer's contract with the client companies does not state in clear and unambiguous terms that it is the common law employer. In the absence of clear and unambiguous contract terms, the Danielson rule has no application.

Moreover, while the Danielson rule is now construed to be applied broadly, there are limits to its use. The court in Danielson made it clear that there are circumstances in which taxpayers should not be subject to the Danielson rule. 378 F.2d at 778. For example, taxpayers may not by agreement designate one party as having the right to depreciate property when that party is not the legal owner. Similarly, we think taxpayers should not be permitted to designate one party to be an employer when that party fails to meet the federal criteria for status as an employer. In short, the parties may determine legal relationships between themselves, but federal law controls how such interests and rights so created shall be taxed. See e.g., Bartels v. Birmingham, 332 U.S. 126, 67 S. Ct. 1547 (1947), wherein the Supreme Court held that the total situation controls liability for employment taxes regardless of the fact that the taxpayer by agreement designated itself as the employer.

In fact, however, the taxpayer does not appear to argue that it is not the common law employer. The taxpayer argues in its claim for refund that it should be recognized as the co-employer of the workers. It appears to believe that, as a co-employer, it would be subject to a single FICA and FUTA wage base with the client. Thus, it could take wages paid by the client earlier in the year into account in applying the wage base.

The concept of a "co-employer" is not recognized in Subtitle C of the Internal Revenue Code. However, even assuming the taxpayer has "co-employer" status, the taxpayer would not be entitled to a refund of FICA or FUTA taxes, as a new wage base applies even if the taxpayer is a co-employer under the common law. The statutory scheme and legislative history make it clear that a separate wage base applies to each employer, even though an employee's wage credit for benefit purposes is limited to the wage base. The only statutory exceptions are for successor employers (discussed below) or common paymasters (not applicable here).[1] Thus, if the taxpayer was the common law employer or co-employer of the

[1] The common paymaster provisions of sections 3121(s) and 3306(p) of the Code provide for certain related companies to use a single wage base for Federal

workers, it is subject to separate FICA and FUTA wage bases from the client. The taxpayer's restarting of the wage base with respect to workers that it provides to a client under a new staffing contract would not result in an overpayment of FICA or FUTA taxes.

As noted earlier, in its refund claim the taxpayer has indicated that it reserves an argument for single wage base treatment on the alternative grounds that it is the successor employer. Successor employer status would require that the taxpayer have acquired substantially all of the property used in the business of the predecessor (in this case, the client) or used in a separate unit of the predecessor's business. There is no indication in the material provided with the taxpayer's refund claims, including copies of the contracts with its clients, that the taxpayer acquired any assets from its client.

We recognize that, under very limited circumstances, actual ownership of the assets by the successor employer is not necessary. Nonetheless, the successor employer must have some legal interest in the assets, such as a lease. Mere continued use of the assets by workers who have changed employers is not sufficient to establish successor employer status. Thus, the taxpayer cannot be considered a successor employer of the clients, and the wages paid by the clients to their respective employees who later became employees of the taxpayer cannot be considered as having been paid to such employees by the taxpayer for purposes of the FICA and FUTA wage limitations under the successor employer provisions.

In summary, if the taxpayer was the common law employer (or co-employer) of the workers, it was subject to separate FICA and FUTA wage bases from the client and cannot take wages paid by a client into account in applying the wage bases. Therefore, in order to establish a FICA or FUTA overpayment, the taxpayer must prove that it was not the common employer (or co-employer) of the workers.

The material submitted by the taxpayer in connection with its refund claims does not establish that it was not the common law employer of the workers. To the contrary, the taxpayer asserted common law employer status. The taxpayer has therefore not established its entitlement to a refund.

ISSUE 2

Insurance Contributions Act (FICA) and FUTA purposes for individuals employed by both companies. These provisions apply only where two or more related companies employ the same person and where only one of the companies pays the person. In such cases, the company that pays the employee is referred to as the common paymaster.

The taxpayer's claim for refund contains conflicting arguments on the issue of statutory employer status. For example, the taxpayer represents that it is the common law employer or "co-employer" with respect to the workers, but also represents that it is the statutory employer under section 3401(d)(1). The taxpayer appears to believe that, in the case of co-employers, the co-employer that has control of the payment of the wages to the employee is treated as a statutory employer under section 3401(d)(1).

A plain reading of section 3401(d) reveals that statutory employer status under section 3401(d)(1) does not apply to a common law employer. Under the opening language of section 3401(d), the term 'employer' means any person for whom an individual performs or performed any service, of whatever nature, as the employee of such person. Only if the common law employer does not have control of the payment of the wages, does another person, the person who has control of the payment of the wages, become the employer under section 3401(d)(1).

A co-employer would be considered a common law employer under section 3401(d). Therefore, if the taxpayer is the co-employer of the workers and the taxpayer has legal control over the payment of wages, then the taxpayer would not be considered the statutory employer under section 3401(d)(1). Contrary to the taxpayer's apparent argument, a co-employer under the common law who has control of the wages paid to employees is not a statutory employer under section 3401(d)(1) with respect to the same employees and the same wages. Only if the taxpayer proves that it is not the common law employer (or co-employer) of the workers could it be the statutory employer under section 3401(d)(1).

ISSUE 3

In connection with its argument that it is the statutory employer under section 3401(d)(1), the taxpayer argues also that the wages that it pays to an employee as the statutory employer are subject to the same FICA or FUTA wage base as the wages paid by a client to the employee in the same year.

In extending statutory employer status to FICA, Otte did not explicitly address whether FICA wages are determined with respect to the common law employer, rather than the § 3401(d)(1) employer. It did, however, characterize the payments by the trustee as FICA wages, based on the relationship between the workers and the common law employer. It thus inherently applied the § 3401(d)(1) definition of employer for FICA purposes in a manner analogous to its application for purposes of income tax withholding. Therefore, because § 3401(d)(1) employer status does not apply in determining wages for purposes of income tax withholding, it should not apply in determining wages for FICA or FUTA purposes under §§ 3121(a)(1) and 3306(b)(1), respectively.

As a result, the determination of whether remuneration is wages under section 3401(a) is made on the basis of the common law employer, even if another party is the employer under section 3401(d)(1). Thus, if the client companies are the common law employers of the workers and the taxpayer is merely the statutory employer under section 3401(d)(1), a single wage base applies to all wages attributable to employment with the client, whether paid by the taxpayer or by the client.

Assuming that the taxpayer establishes that it is not the common law employer of the workers,[2] this does not necessarily mean, however, that it is entitled to a refund. Certain other legal and procedural questions must be considered as discussed below.

Amount of FUTA Credit

Even if the taxpayer establishes that it was not the common law employer of the workers, but merely the statutory employer under section 3401(d)(1), so that FUTA wages paid to workers by clients during the year may be taken into account in applying the wage base, this does not necessarily mean that an overpayment of FUTA exists. The fact that the taxpayer was not the common law employer could affect its right to take credit for contributions to a State unemployment fund in determining its FUTA liability for the years at issue. It may be necessary to determine whether the taxpayer underpaid its FUTA taxes with respect to other workers to whom it paid wages during those years.

Under section 3306(g), contributions (for which a taxpayer may take credit under section 3302) include only payments required by a State law to be made by a person on account of having individuals in his employ. We believe that State unemployment laws generally require contributions to be made by the common law employer. Thus, even if the taxpayer made contributions to the State fund, the taxpayer is not entitled to the credit unless the taxpayer, rather than the common law employer, is liable for contributions under State law.

In addition, an employer's State unemployment contribution rate is generally based on the employer's experience for the prior year. Therefore, the amount of

---

[2] Note that, if the taxpayer establishes that it is not the common law employer, it does not also have to prove that it is the statutory employer under section 3401(d)(1) in order to be entitled to use the same wage base as the client. If the taxpayer is not a common law employer, a single wage base applies regardless of whether the taxpayer is the statutory employer under section 3401(d)(1) or pays the employees merely as the agent of the client.

State contributions paid by the taxpayer would not be the same amount required to be paid by its clients because the rate varies based on prior year's experience.

The issue must be developed whether the taxpayer is the person required to make State unemployment contributions. Development will require an analysis of the applicable State law. Although State law is likely to impose contribution requirements on the common law employer, some States have special statutory definitions of "employer" that vary from the common law standard. For example, some States have laws that treat a staffing firm as the employer. It is appropriate therefore to consult the law of the State where the employees work to determine whether the taxpayer is entitled to take credit for State unemployment contributions.

Documentation of Wages Paid by Client

You have indicated that the taxpayer calculated the asserted overpayment on the basis of an estimate of the wages paid to the workers by the clients earlier in the year. However, a mere estimate of FICA and FUTA by the taxpayer is not sufficient to establish that an overpayment exists. In order to prove its right to a refund, the taxpayer should provide documentation of the amount of the FICA and FUTA wages paid to each employee by a particular client. For example, the taxpayer could obtain statements from the clients showing the amount of wages paid to the individual employees during the years at issue. Copies of the W-2 Forms issued by the clients to the employees for the years at issue would show the amount of FICA wages, but not FUTA wages. Nor would a Form 940 or 941 filed by the client show the amount of wages attributable to individual employees.

FICA Refund Procedures

Under Atlantic Department Stores, an employer is not entitled to a refund of overpaid employer FICA tax unless the employer takes steps to enable its employees to recover the corresponding overpayment of employee FICA tax. Generally the employer should refund the overpaid FICA tax to the employees or obtain their consent to obtaining a refund. Under Rev. Rul. 81-310, the employer should at a minimum notify its employees of the overpaid employee FICA tax and request their consents to filing a refund claim on their behalf.

The taxpayer's FICA refund claims gives no indication that it has made efforts to contact the employees about the asserted FICA overpayment. Even if an overpayment of employer FICA exists, the taxpayer's ability to obtain a refund is

subject to the procedures required under Atlantic Department Stores and Rev. Rul. 81-310.[3]

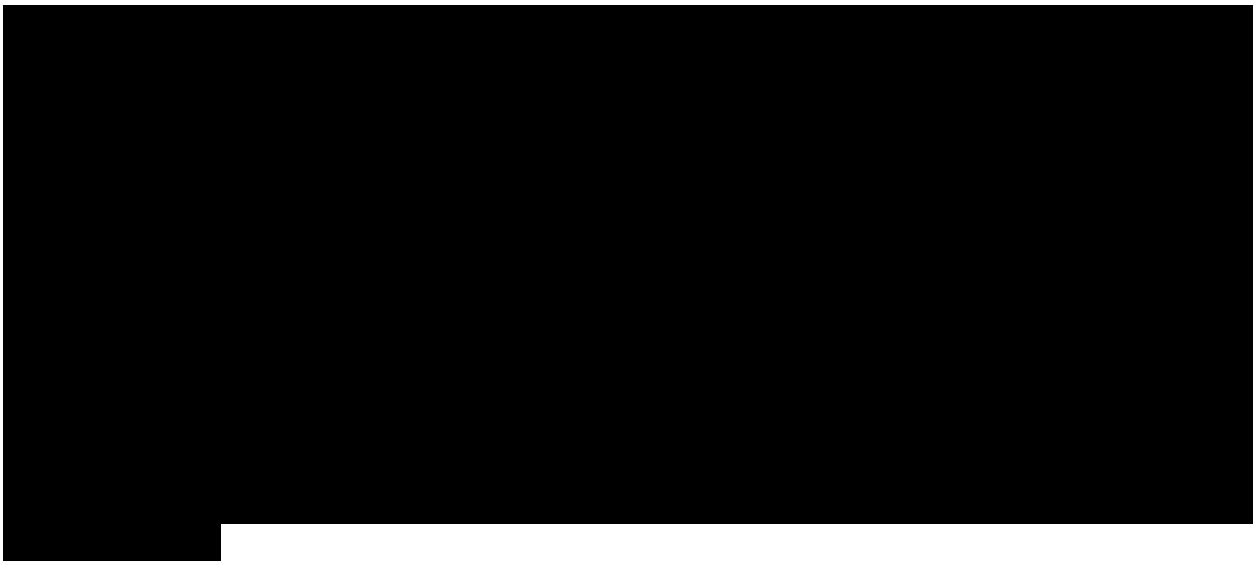
In addition, the taxpayer should issue corrected Forms W-2 to employees to reflect the correct amount of FICA wages.

Additional Wage Amounts

In determining whether an employment tax overpayment exists, it is appropriate also to ascertain whether additional wages result from the fact that the taxpayer is not the common law employer of the workers. For example, the taxpayer's refund claims indicate that the taxpayer covers the workers in a section 401(k) plan. Depending on how the plan is structured, section 402(e)(3) might not apply to amounts that the workers elect to have contributed to the plan. If section 402(e)(3) does not apply, the elective contributions would not qualify for the wage exclusion under section 3401(a)(12), and the taxpayer could be liable for additional income tax withholding for the years at issue.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

[3] If the taxpayer and the client issued Forms W-2 to the employee showing total wages in excess of the FICA wage base and therefore excess withholding of employee FICA tax, the employee might have already claimed a refund or credit under section 6413(c). Obviously, in that case, no adjustment or refund should be made with respect to the employee FICA tax.



Please call if you have any further questions.

Mary Oppenheimer
Assistant Chief Counsel
Employee Benefits and Exempt Organizations
By: PATRICIA M. MCDERMOTT
Senior Technician Reviewer
CC:EBEO:Br2