

Classification as "Independent Contractors" Scrutinized

The Fifth Circuit in *Bruecher Foundation Services, Inc.*, 105, AFTR2d 2020 (CA-5, 2010), held that workers used by the taxpayer in its business were the taxpayer's employees for employment tax purposes, and not independent contractors.

The taxpayer was a corporation wholly owned by its president. Its business consisted primarily of residential foundation repair and grading projects. In its tax filings, the taxpayers recognized two employees, its president and a secretary, and treated workers who performed manual labor involved in the foundation repair as independent contractors.

In 2002, the IRS audited the taxpayer and determined that the workers in question were actually employees and were improperly classified as independent contractors. It did not notify the taxpayer that it was conducting the audit and did not provide the taxpayer with notice of the worker classification safe harbor under section 530 of the Revenue Act of 1978 as required by law. The audit summary did apprise the taxpayer of the service's conclusion that the taxpayer was not entitled to the safe harbor because it failed to file Form 1099s for the workers at issue.

The IRS determined that the taxpayer had an obligation to have paid taxes on the workers' wages under the Federal Unemployment Tax Act (FUTA) and the Federal Insurance Contributions Act (FICA), and to have withheld and remitted specified amounts of the workers' anticipated federal income taxes. The Service calculated that the taxpayer owed \$7,524 in FUTA taxes and \$38,403 in FICA taxes and employee withholding for the 1999 and 2000 tax years. In 2005, it assessed the employment taxes, penalties, and interest against the taxpayer who argued that the workers were not employees. The IRS rejected the taxpayer's claim, issued a tax lien against the taxpayer, and executed a levy against the taxpayer's bank account. The taxpayer filed Form 1099s for each of the workers and then filed suit in district court, which concluded that the workers were the taxpayer's employees. The court denied the taxpayer's motion for summary judgment on the ground that it had complied with the section 530 safe harbor.

The taxpayer challenged the district court's decision on three grounds:

- (1) The court erred in concluding that it was not entitled to rely on the section 530 safe harbor.

(2) The government should have been assigned the burden of proof because the IRS had failed to comply with the advance notice procedures of section 530

(3) The court's conclusion that the workers were employees was incorrect.

The section 530 safe harbor provides employers with protection from employment tax assessments resulting from good-faith misclassification of employees as independent contractors, provided that employers meet certain requirements, including filing all required tax and information returns with the IRS. The government argued that the taxpayer could not avail itself of the safe harbor because it did not file its Form 1099 returns for the workers in dispute until two days before filing suit in district court-after the IRS had assessed the tax, denied the taxpayer's administrative claims, and begun collection enforcement. The taxpayer argued that statutory language imposed no time deadline by which to file the returns.

The Fifth Circuit agreed with the government; the taxpayer could not successfully raise the safe harbor because it filed the Form 1099s after the IRS assessed the taxes at the conclusion of the administrative process. The taxpayer conceded that it was not entitled to the protection of the safe harbor until it filed the Form 1099s. Because at the time the tax was assessed it had not done so, the appellate court said the assessment was correct when made, and the taxpayer could not complain in federal court of an "error" the IRS did not make.

The Fifth Circuit found that there was no basis for reversing the usual burden of proof as a remedy for the Service's failure to provide the section 530(e)(1) notice. The court said the resolution may have been different if the taxpayer asserted a violation of its due process right stemming from the lack of notice. That was not the case here; the taxpayer was apprised of the service's determination that the safe harbor did not apply at the conclusion of the audit, which allowed the taxpayer ample opportunity for administrative relief on those grounds.

Finally, the Fifth Circuit examined the factors set out by the Supreme Court in *Silk*, 35 AFTR 1174, 331 US 704, 91 L Ed 1757, 1947-2 CB 167 (1947), to determine whether a worker is an employee or independent contractor:

(1) Degree of control. The taxpayer retained a significant level of control over its workers' schedules and ability to perform foundation repair jobs, and where it did not exercise control, it retained the right to do so (supports employment).

(2) Opportunities for profit and loss. The workers could not profit or suffer a loss from their work with the taxpayer; the taxpayer paid the workers by the hour at the end of the week, even if the job was not completed (strongly supports employment).

(3) Investment in facilities. The taxpayer provided the workers all the tools and equipment necessary to perform their jobs (strongly supports employment).

(4) Permanency of relation. Although some workers' relationship with the taxpayer was not continuing, other workers did have a continuing relationship. The workers were free to terminate their relationship with the taxpayer at any time (neutral).

(5) Skill required. Some aspects of the taxpayer's work involved skill, but other tasks did not (including digging holes below foundations), and some workers had no relevant skills when they began work with the taxpayer (supports employment).

(6) Whether the workers were in business for themselves. When the workers worked for the taxpayer, they did not work for others (strongly supports employment).

Based on these factors, of which five out of six favored employment and the sixth was neutral) the Fifth Circuit agreed with the district court that the workers were the taxpayers' employees.

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