

The Classification of Technical Service Specialists For Employment Tax Purposes: Section 1706 and Beyond

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Abstract

Whether a worker is classified as an independent contractor or as an employee for payroll tax purposes has extensive implications for both the worker and the party for whom services are rendered. This article examines the significance of determining a worker's status and analyzes the factors involved in classifying those workers known as technical service specialists.

Introduction

The classification of a worker as an independent contractor or an employee is one of the most fundamental and far reaching of tax determinations. Such classification affects the character and timing of payroll tax payments, the deductibility of expenses incurred by the service provider, and the responsibilities of both the service provider and party for whom services are rendered. In addition, the classification of a worker for payroll tax purposes has both important tax and non-tax implications. As a result, whether a worker should be classified as an independent contractor or as an employee has been the focus of numerous Revenue Rulings, private letter rulings, technical advice memoranda and court decisions.

In recent years, clarifying worker status has been the subject of several legislative responses. Section 530 of the Revenue Act of 1978 established conditions preventing the Internal Revenue Service from reclassifying a worker's status from that of an independent contractor to that of an employee. The most recent legislative response to this issue is embodied in Section 1706 of the Tax Reform Act of 1986. In general, Section 1706 limits the applicability of Section 530 of the Revenue Act of 1978 by excluding from its province the class of worker known as a technical service specialist. Specifically, a technical service specialist is any worker who renders services as an engineer, designer, drafter, computer programmer, systems analyst, or any worker who renders like services.

In this article, the significance of determining a worker's employment tax classification status will be discussed. In addition, an analysis of how to determine

the employment tax status of technical service specialists will be provided.

Tax and Non-Tax Implications of Employee vs. Independent Contractor Status

Whether a worker is classified as an employee or as an independent contractor has extensive tax and non-tax implications. Where a worker is classified as an employee, amounts withheld from gross wages include his or her share of FICA taxes along with federal and state income taxes (1). In addition, an employer is required, on a regular basis, to pay these withheld amounts to the IRS and to pay in its matching share of FICA taxes. An employer is also required to make yearly FUTA payments on behalf of each employee (2). As a result, the classification of a worker as an employee poses a significant tax and administrative burden on the employer.

In contrast, a worker classified as an independent contractor is not subject to FICA or income tax withholding. As a self-employed individual, an independent contractor will generally be required to pay self-employment tax on net earnings and to make quarterly estimated federal income tax payments. In addition, under amendments made to the Social Security Act, self-employed persons will be subject to social security tax at the combined employer/employee tax rate (3).

Job-Related Expenses

Whether or not a worker is classified as an employee

will also affect the tax treatment of certain job related expenses. A worker classified as an employee will normally have deductible job related expenses that are reimbursed and/or unreimbursed in nature. In general, to claim employee business expenses that are unreimbursed or are reimbursed under a non-accountable plan, an employee must itemize such deductions on Schedule A of Form 1040 and must complete Form 2106 for unreimbursed travel, transportation, meals or entertainment expenses. Both unreimbursed and non-accountable plan employee business expenses fall within the "2% of AGI" category of itemized deductions (4). In addition, employee meals or entertainment expenses are generally first subject to an 80% limitation prior to their inclusion in the "2% of AGI" category of itemized deductions (5).

Where an employer fully reimburses its employee under an accountable plan and the employee makes an adequate accounting for all employee business expenses, because the reimbursements are not included in an employee's W-2 income, the employee will not claim such business expenses as an itemized deduction. However, where an employee has business expenses in excess of employer reimbursements, such excess, to the extent deductible, will be subject to the "2% of AGI" and/or 80% limitations (6).

In contrast, where a worker is classified as an independent contractor, job-related expenses, to the extent deductible, will be characterized as above-the-line (i.e. "for"-AGI) deductions. Such deductions are typically found on Schedule C, Profit or Loss From Business (Sole Proprietorship), on Federal income tax return Form 1040 (7).

Cost of Employee Benefits

In addition, the classification of worker's status as "employee" or "independent contractor" can have a profound impact upon the ultimate cost of employee benefits borne by an employer. Of the total compensation and benefits an employee receives from his or her employer, the employee benefits component has grown at a faster rate in recent years than that of wages.

While employer-provided benefits vary in nature and scope, employers typically provide their employees with paid vacations and holidays along with group-term life insurance. An employer may also provide its employees with health insurance coverage, benefits under so-called "cafeteria plans", and benefits provided by pension, profit-sharing, and other retirement plans.

Conversely, an independent contractor typically receives few, if any, benefits other than compensation for services rendered. For an independent contractor, the cost of providing certain benefits such as life and health insurance can be substantial.

The proper classification of a group of workers for employment tax purposes can ultimately affect the qualified status of an employer's pension or profit-sharing plan(8). In this situation, the reclassification of workers from independent contractor to employee status would carry far-reaching and unintended implications for the company itself and potentially for all of its employees participating in a qualified plan.

Penalty Provisions

An employer that incorrectly classifies an employee as an independent contractor can be held responsible for some or all of its employee's social security and federal income taxes which should have been withheld. The employer can also be held liable for its share of matching FICA and FUTA payments. Moreover, interest and penalties can be added to an employer's unpaid payroll tax liability (9). Because an employer that classifies a worker as an independent contractor will not have filed an employment tax return with respect to that worker, under I.R.C. Section 6501(c)(3), the employer may be subject to assessment at any time for such unpaid payroll taxes.

Determining Worker Status

In light of the important tax and non-tax implications of a worker's status, it is somewhat surprising that the Internal Revenue Code does not contain a comprehensive definition of the term "employee". Nevertheless, the Code provides some guidance on this issue in its federal income tax withholding, FICA tax and FUTA tax provisions.

According to Section 3401(c), for federal income tax withholding purposes, an employee includes an officer, employee, or elected official of the United States, a state or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing governmental bodies. In addition, an officer of a corporation fits within the statutory definition of an employee for income tax withholding purposes.

For FICA tax purposes, Section 3121(d) defines an employee as: (1) An officer of a corporation; (2) An agent or commissioned driver who delivers produce, meat or laundry; (3) A full-time life insurance salesman; (4) A person who works at home under the direction of a party that provides the materials and supplies for the work; (5) A travelling salesman; or (6) Any individual who, under the usual common law rules, has the status of an employee.

In addition, numerous sections of the Internal Revenue Code list types of workers who should be classified as employees for various purposes. As a result, certain

special classes of employment and special types of payments may be classified differently for income tax withholding, social security, and/or federal unemployment tax purposes. Federal employees who are members of the uniformed services, for example, are subject to income tax withholding and social security tax, even though their employer -- the federal government -- is not subject to FUTA tax.

Because the statutory definition of an employee under the Internal Revenue Code lacks precision, both the Treasury Regulations and the case law have given great weight to the common law rules in determining whether a worker should be considered an employee. Pursuant to these rules, an employer/employee relationship is said to exist when the party for whom the services are rendered has the right to control the worker, not only as to the result, but also as to the means by which to accomplish such result. As indicated by Regulation Section 31.3401(c)-1(b), it is the existence of the right to control rather than the actual exercise of control which is critical (10).

In addition, the Internal Revenue Service developed a twenty factor test to determine whether a worker is an independent contractor or an employee. Originally contained in Internal Revenue Manual 8463 and in other I.R.S. internal training materials, this twenty-factor test represents the Service's distillation of both the applicable regulations and case law focusing upon the "control" requirement.

During the late 1960's and early 1970's, the Internal Revenue Service systematically enforced the payroll tax laws in a more aggressive manner. Because the determination of whether a worker is an employee or an independent contractor under common law is fraught with uncertainty, many taxpayers complained that the law was being unfairly administered. These complaints found a sympathetic audience in Congress and resulted in the enactment of Section 530 of the Revenue Act of 1978.

Section 530 of the Revenue Act of 1978

Subject to certain exceptions, Section 530 of the Revenue Act of 1978 prohibits the Service from reclassifying any individual as an employee whom a taxpayer reasonably treated as an independent contractor until Congress enacts legislation on the classification of workers as independent contractors or employees. In addition, Section 530(b) prohibits the Service from issuing published rulings or regulations regarding the general moratorium on reclassification under Section 530(a), as long as Section 530 is in effect.

Another feature of Section 530 is that it prevents the reclassification of a worker from that of independent contractor to that of employee solely for employment tax purposes. As a result, the common law test of whether a

worker is an independent contractor or an employee continues to apply in determining whether a worker is an employee for purposes of inclusion in employee fringe benefit programs.

A taxpayer's classification will be considered reasonable for purposes of Act Section 530 if made in reasonable reliance upon the following: (1) past IRS audit practice with respect to the taxpayer; (2) published rulings or judicial precedent; (3) recognized practice in the taxpayer's industry; or (4) technical advice or a letter ruling given to the taxpayer.

In addition, for the moratorium of Act Section 530 to apply, all federal and information returns must be filed on a basis consistent with the taxpayer's treatment of the individual as an independent contractor.

As originally enacted, Section 530 placed a moratorium on the Service's reclassification of any individual as an employee prior to January 1, 1980 where the taxpayer had not treated the individual as an employee for any period after December 31, 1978. In addition, the "consistency" requirement applied to individuals holding similar positions on a taxpayer's federal tax returns after December 31, 1977. After two subsequent extensions, Section 530 was indefinitely extended by Section 269 of TEFRA until such time as Congress enacts legislation regarding the classification of workers as independent contractors or employees. As a result, although Act Section 530 is not codified in the Internal Revenue Code itself, it is a currently existing tax law.

A recent Fifth Circuit decision indicates the effectiveness of Section 530 as a shield against Service reclassification of a worker's employment tax status. In *Lambert's Nursery and Landscaping, Inc.* (11), a 1976 I.R.S. audit of the taxpayer's landscaping business resulted in no assessment being made relating to the taxpayer's treatment of its landscape workers as independent contractors. Four years later, the taxpayer expanded its business by providing janitorial services. When the I.R.S. audited the taxpayer's 1981-3 corporate tax returns it reclassified its janitorial workers as employees.

The Fifth Circuit held that where a taxpayer corporation has two businesses, the workers of which receive "substantially similar" treatment by the taxpayer with respect to "control, supervision, pay and demands", the taxpayer can use the "prior-audit" provision of Section 530 relating to workers in its first business to prevent reclassification of its workers' employment tax status in its second business. As a result, it is the terms of the relationship between taxpayer and worker, rather than the type of work performed that is of utmost importance in determining whether the "prior-audit" safe harbor applies to a given situation.

Section 1706 of the Tax Reform Act of 1986

Section 1706 of the Tax Reform Act of 1986 modified Act Section 530 by introducing subsection "d", a provision that specifically excludes certain employers of technical service specialists from availing themselves of the general Section 530 safe harbor provisions.

For Section 1706 to apply, the worker must be a technical services specialist. This class of worker includes those who provide services as engineers, designers, drafters, computer programmers, systems analysts, and those who are both similarly skilled and engaged in a similar line of work. However, the Service has held in a recent Letter Ruling that an auto body repair worker is not a technical service specialist for purposes of Act Section 1706 (12).

In addition, Section 1706 requires that the compensation must be received and services rendered by the technical service specialist after 1986 and that the technical service specialist must be one of the parties involved in a three-party arrangement. Typically, a technical service specialist will render services for the client of a technical services firm. In this arrangement, the technical services firm will enter into a contract to provide services to its client and the technical service specialist will act as the service provider.

Revenue Ruling 87-41

Where Section 1706 applies, a technical service specialist will be treated as an employee for employment tax purposes, if that is his or her status under common law. Because in most instances a technical services specialist will be subject to Section 1706, common law standards will apply. Given that the nature of the inquiry of whether a worker is an employee under common law is one of facts and circumstances, the Internal Revenue Service, in Revenue Ruling 87-41, lists 20 factors to be taken into account in determining whether a technical services specialist should be considered an employee of a technical services firm (13).

These twenty factors are based upon an examination of cases and rulings involving all types of workers. The degree of importance of each factor varies with the occupation of the service provider and the factual context in which the services are performed.

Of the twenty factors listed, sixteen are indicative of employee status, and four support a finding of independent contractor status.

Factors Supporting Employee Status

Instructions -- The party for whom the services are

rendered has the right to give the worker instructions concerning when, where and how services are to be performed;

Training -- The party for whom the services are performed trains the worker. Training may be provided in numerous ways, examples of which include requiring the worker to work with a more experienced worker, and requiring the worker's attendance at meetings;

Integration -- The worker's services are integrated with the operation of the enterprise for which the services are provided;

Personally Rendered Services -- Services must be rendered personally by the worker. The opposite of this situation occurs when the worker subcontracts out the responsibility to provide services to another worker;

Hiring, Supervising, and Paying Assistants -- The party for whom the services are to be rendered hires, supervises and pays the worker's assistants;

Continuing Relationship -- A continuing relationship exists between the worker and the party for whom the services are to be performed by the future rendering of services;

Set Hours of Work -- The party for whom the services are rendered imposes set work hours upon the worker;

Full-Time Work Requirement -- The party for whom the services are rendered requires a worker to work "full-time" as opposed to "part-time". This requirement restricts the worker's ability to obtain other gainful work;

Location of Where Services are Performed -- Work is to be performed on the premises of the party for whom the services are rendered. This is a particularly important factor if the work is performed on such premises but could be performed elsewhere;

Set Order or Sequence -- The party for whom the services are rendered establishes the order or sequence in which services are to be performed and the worker is not free to follow his own work pattern;

Reports -- The worker is required to submit regular oral or written reports to the party for which work is performed;

Method of Payment -- Payment is made at regular intervals (by the hour, week, or month, etc.), rather than in a lump sum, for services performed within such period.

Payment or Reimbursement of Certain Expenses -- The

worker is paid, given an allowance for, or reimbursed for work-related expenses (e.g. travel and transportation);

Furnishing of Materials or Tools -- The party for whom the services are rendered furnishes significant tools, materials, and/or other equipment to the worker;

Right to Discharge -- The party for whom the services are provided has the right to discharge the worker; and

Right to Terminate -- The worker has the right to terminate his work relationship without incurring liability;

Factors Indicative of Independent Contractor Status

Significant Investment -- The worker has a significant investment in facilities used in providing services, the investment in which is not typically held by an employee;

Profit or Loss -- The worker bears a significant risk of economic loss in rendering services;

Performance of Services For More Than One Party -- The worker performs more than de minimis services for multiple unrelated parties; and

Availability of Services to General Public -- The worker makes his services available to the general public on a regular and consistent basis.

In addition, Revenue Ruling 87-41 provides three illustrations focusing upon technical service specialists in particular in demonstrating the use of common-law tests to determine a worker's employment tax status.

Revenue Ruling 87-41: Situation One

In Situation One, a technical services firm supplies its client with a computer programmer for a temporary period. The technical services firm maintains a roster of workers who are available to provide technical services to prospective clients. The technical services firm neither trains the worker nor monitors his progress or time worked. The technical service firm determines the services that the workers are qualified to perform based upon information supplied by the workers.

The technical services firm has entered into a contract with its client. Under the contract, the firm is to provide its client with computer programmers possessing certain qualifications to work on a project expected to last less than one year. The firm provided several such workers to its client none of whom previously performed services for the firm or its client. The contract states that the worker is an independent contractor.

The worker performs a significant portion of his work

on the client's premises. The firm requires reports from the worker and reviews the worker's performance. The firm reserves the right both to terminate its contract where the worker's performance is unsatisfactory, and, after compensating him for partial work completed, to replace him with another worker.

The contract between the firm and the worker allows the worker to provide services for parties other than the firm's client. In reality, though, the worker devotes substantially all of his time working for the firm's client. The technical service firm keeps open the possibility of terminating the specialist's employment at any time, pays the specialist an hourly rate, and prohibits the specialist from working directly for its client. In addition, the firm's client is prohibited from hiring the services of the technical service specialist for three months following the termination of the individual's services for the client on the broker's behalf.

The Service applied the 20-factor common law test outlined in Revenue Ruling 87-41 and determined both that a legal relationship existed between the worker and the technical services firm and that the firm retained the right of control over the worker. As a result, the Service determined that the technical service specialist is an employee of the technical service firm.

Revenue Ruling 87-41: Situation Two

In Situation Two, a technical services firm supplies its client with technical services specialists. The client requested the services of a systems analyst. This arrangement does not prohibit the systems analyst, while working for the client, from providing services to parties other than the client. In fact, the specialist does perform substantial services for persons other than the firm's client during the period in which the specialist is working for the client. Moreover, after completion of the contract, both the client and the systems analyst are not precluded from further contracting with each other. For referring the specialist to the firm's client, the firm receives a fee that is fixed prior to the specialist's commencement of services and is unrelated to the number of hours and quality of work that he performs.

Neither the firm nor the client have priority over other parties in requiring the systems analyst's services. The analyst reports to the client, not the firm, and such reports are not made available to the firm. The client, not the firm, pays the worker for services rendered. The client pays the firm a flat fee for referring the worker to the client.

The services performed by the analyst do not require the client's direction or control as to hours, place of work, or work sequence or details. In addition, the client

can seek damages from the analyst, but not from the firm, where the analyst quits working prior to finishing the assigned task or performs his work in an unsatisfactory manner.

In applying the common law rules, the Service ruled that the systems analyst is not an employee of the technical services firm.

Revenue Ruling 87-41: Situation Three

In Situation Three, the client contacted the firm to provide the services of a drafter for a project expected to last less than one year. The firm recruits the draftsman, who is to perform substantially all of his services at the client's office using client-supplied materials. The client's employees supervise the worker. The worker regularly reports to the client.

The technical services firm pays the worker based upon the hours worked. However, the firm has no obligation to pay the worker if it does not receive payment from the client for services rendered by the worker. For recruiting the worker, the firm receives a predetermined flat fee that is fixed prior to the specialist working for the firm's client and is unrelated to the number of hours and quality of work he performs. The firm does not direct the worker; nor does it have any responsibility for the work performed or right to terminate the worker.

Instead, the firm's client has the right to terminate the worker without liability to the worker or to the firm. While the drafter is permitted to work for others while working for the client, he does not substantially do so.

Under these circumstances, the Service ruled that the draftsman will not be treated as an employee of the firm under the twenty factor common law test embodied in Revenue Ruling 87-41.

Planning Opportunities Involving the Use of Technical Service Specialists

As mentioned earlier, where certain conditions are met, Act Section 530 provides a moratorium on the reclassification of a worker from that of an independent contractor to that of an employee. However, under Section 1706, the general moratorium on reclassification does not apply where a technical service specialist receives compensation and renders services after 1986, and is involved in a three-party arrangement that typically involves the use of a technical services firm. Planning considerations involving the use of technical service specialists are as follows:

Use of Two-Party Arrangements

Because Act Section 1706 does not apply to two-party arrangements, one strategy to avoid its application is for the service user to hire the technical service specialist directly. In other words, by hiring the technical service specialist in a two-party arrangement, the party for whom the services are rendered can rely upon the general moratorium on reclassification under Act Section 530.

A party seeking the services of a technical service specialist can avoid the use of a technical services firm by placing advertisements in the "help wanted" section of a newspaper or trade magazine. In addition, a service user can develop its own network of contacts of specialists in the technical services field. However, in some situations, the use of technical service firms is unavoidable in matching users with providers of technical services.

Prohibited Use of Closely-Held Corporations to Circumvent the Provisions of Act Section 1706

For purposes of Act Section 1706, the Committee Reports to the Tax Reform Act of 1986 prohibit a technical service specialist from organizing a controlled corporation and then claiming to provide services as an employee of that corporation rather than as an employee of the technical services firm.

For closely-held corporations formed prior to the enactment of Act Section 1706, it is unclear whether this prohibition would apply. Although closely held corporations in existence prior to the effective date of Act Section 1706 are not specifically "grandfathered-in", the legislative history can logically be interpreted to yield this result. Specifically, the formation of a closely-held corporation prior to the enactment of Act Section 1706 does not constitute an abuse in need of a cure; it is only the post-enactment formation of a closely-held corporation that can constitute such an abuse.

Determining Whether the Worker Is a Technical Service Specialist

For several reasons, it makes sense to examine whether those workers hired as independent contractors and through the use of a three-party arrangement are in fact technical services specialists. Section 1706 lists examples of technical service specialists which include engineers, designers, drafters, computer programmers, systems analysts, and other similarly skilled personnel.

While most of the workers hired through the use of a technical services firm are technical services specialists,

the fact that a worker is hired through such a firm does not make him a technical service specialist *per se*. For example, where a technical service firm provides its client with the services of a worker knowledgeable in the use of a word processing program such as WORDSTAR, it would appear unlikely that such a worker would be treated as a technical services specialist, notwithstanding the fact that anyone who performs work on a personal computer is arguably a "computer programmer".

Another reason for scrutinizing whether the worker is in fact a technical service specialist is that the consequences of misclassification can be severe. For example, assume that a firm qualifies for Act Section 530 relief with respect to a certain category of workers, none of whom are technical service specialists. Assume also that a worker within this category is incorrectly classified as a technical service specialist, and, after applying the 20-factor common law tests, is treated as an employee of the party for whom services are rendered. Under these facts, the "consistency" requirement of Section 530 would be violated. As a result, Section 530 relief would be unavailable for the entire category of workers so affected.

Structuring a Three-Party Arrangement Under the Guidance of Situations 1-3 of Revenue Ruling 87-41

Where Section 1706 applies, a technical service specialist will be treated as an employee if that is his status under the common law. For planning purposes, Situations 1-3 give some guidance in determining whether the worker is an employee of the technical services firm.

Situation One

In Situation One, the technical service specialist is treated as an employee of the technical services firm, under the applicable common law rules. This fact pattern indicates the typical situation involving the use of technical service specialists through three-party arrangements.

A recent Letter Ruling contains a fact pattern substantially similar to that in Situation One of Revenue Ruling 87-41. In PLR 8946073, a technical services firm engaged the services of a human factors engineer to provide services to the firm's client. To its clients, the firm represents that the worker was its employee; pays the worker on an hourly basis; provides for paid holidays and vacations; and has priority over the worker's time. The firm also carries workmen's compensation insurance on the worker, deducts FICA and Federal income taxes from his wages and reports his income on Form W-2.

The worker is to provide personal services on the premises of the firm's client. While not required to follow a routine or schedule established by the firm, the worker must make weekly reports to the firm. The worker bears no risk of loss and can terminate his

services with the firm without either party incurring any liability. Although not restricted from providing his services to other firms, the worker spends substantially all of his working time providing services for the firm or for its client.

The client provides the worker with equipment and supplies. Upon the request of the client, the worker's services can be terminated at any time. Based upon these facts, the Service ruled that PLR 8946073 and Illustration One of Revenue Ruling 87-41 represents substantially similar fact patterns.

As a result, for planning purposes, the party for whom the services are rendered should require the technical services firm to treat the worker as its employee where the fact pattern of the three-party arrangement is substantially similar to that contained in Situation One or in PLR 8946073.

Situations Two and Three of Revenue Ruling 87-41

Situation Two presents a fact pattern in which the technical services firm basically acts as an employment agency in placing the worker with its client. The fact pattern in Situation Three shares characteristics of both Situation One and Situation Two.

The Service ruled in both Situation Two and Situation Three that under the applicable common law the worker is not an employee of the technical services firm. Where the fact pattern is substantially similar to that in Situations Two and Three, it would appear that the firm's client, upon satisfying the conditions of Act Section 530(a), can rely upon the general moratorium of Section 530 to prevent the reclassification of its worker from that of an independent contractor to that of an employee for federal income tax withholding purposes.

Where the party for whom the services are rendered cannot satisfy the general requirements of Section 530(a), it is unclear whether the workers in Situations Two and Three would be treated as an independent contractor or as an employee. The fact that, under common law, the worker in Situations Two and Three is not an employee of a technical services firm does not preclude him from being treated as an employee of the party for whom the services are rendered. Basically, the determination of whether a worker is an employee or independent contractor depends upon the calculus of a given set of facts, and the relationship between the worker and technical services firm exhibits a different fact pattern than that exhibited between the worker and the firm's client.

Given these caveats, using the fact pattern in Situation Two, a good argument can be made that the systems analyst would not be treated as an employee of the party for whom services are rendered under the common law

tests contained in Revenue Ruling 87-41. The skill level of a systems analyst and the nature of the duties performed is not unlike that of other professions such as law or accounting.

In Situation Three, however, the party for whom services are rendered not only has the right of control over the worker, but in fact exercises control. As a result, where Section 530(a) is inapplicable, under common law the worker in Situation Three would apparently be treated as an employee of the party for whom services are rendered.

Conclusion

As a practical matter, companies often require the talents of technical service specialists provided by technical service firms. In enacting Act Section 1706, Congress has stripped the protection of the general moratorium on employment tax reclassification from most of the technical service specialists previously qualifying for Section 530 relief.

Under current law, it is of critical importance for the party for whom services are rendered to separate those technical service specialists covered under Act Section 1706 from those not so covered. In most cases where Act Section 1706 applies, the technical service specialist will be treated as an employee of the technical services firm.

However, a technical service specialist covered under Act Section 1706 can be treated as an independent contractor for employment tax purposes if that is his status under applicable case law. Given the Services aggressive posture in recent years regarding employment tax issues, whether a technical service specialist is an independent contractor or an employee under applicable case law may prove to be an extensively litigated issue in the future.

Endnotes

- 1 I.R.C. Section 3402.
- 2 See I.R.C. Section 3301 and 3306(a).
- 3 Note that Section 164(f) somewhat mitigates the effect of self-employment taxes by providing for a possible deduction of one-half of self-employment taxes paid.
- 4 Employee business expenses are deductible under Section 162. See Section 67 regarding itemized deductions subject to the 2% rule. See also Temp. Reg. 1.62-2T.
- 5 I.R.C. Section 274(n).
- 6 See Temp. Reg. 1.61-1T and 1.61-2T.
- 7 I.R.C. Section 62(a)(1).
- 8 See the rules concerning qualified retirement plans (I.R.C. Sections 401-416) which contain tests concerning discrimination, participation,

and vesting based upon an examination of employees.

- 9 I.R.C. Section 3403.
- 10 The common law standard is essentially incorporated in Reg. 31.3401(c)-1.
- 11 *Lambert's Nursery and Landscaping, Inc. v. U.S.*, 65 AFTR2d 90-573 (1990).
- 12 PLR 8843003.
- 13 Rev. Rul. 87-41, 1987-1 CB 296.

References

- 1 *Internal Revenue Code*, Sections 62, 67, 162, 164, 274, 401- 416, 3301, 3306, 3402 & 3403.
- 2 *Lambert's Nursery and Landscaping, Inc. v. U.S.*, 65 AFTR2d 90-573 (1990).
- 3 Private Letter Ruling 8843003 (1988).
- 4 Treasury Reg. 31.3401(c)-1.
- 5 Revenue Ruling 87-41, 1987-1 CB 296.
- 6 Temp. Reg. 1.61- 1T & 1.61- 2T.