IRS CHIEF COUNSEL ADVICE CONCLUDES PEO DOESN'T RELIEVE COMMON LAW EMPLOYER'S LIABILITY FOR EMPLOYMENT TAXES

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Practices & Industries

Employee Benefits

A recent IRS Chief Counsel Advice opinion ("CCA") addresses a common law employer's liability for unpaid employment taxes, including FICA, FUTA, and income tax withholding. The employer at issue leased employees from a professional employer organization ("PEO"). However, the employer had responsibility for the day-to-day supervision and control of the leased employees and was the common law employer of the leased employees.

The contract between the PEO and the employer provided that the PEO would be responsible for processing and paying wages from the PEO's own accounts to the leased employees, and that the PEO would be responsible for filing all employment tax returns. The contract also provided that the employer was required to pay the PEO, at least one business day in advance of the applicable payroll date, an amount equal to the compensation to be paid to the leased employees for the payroll date. In addition, the contract required the employer provide a security deposit or procure a letter of credit naming the PEO as beneficiary in an amount determined by the PEO. To the extent the employer failed to pay an invoice from the PEO when due, the PEO was entitled to terminate the contract immediately without notice.

The employer did not file any employment tax returns or pay any employment taxes for certain years, and the employer did not take any steps to confirm whether the PEO had filed any employment tax returns or paid any employment taxes for those years. In the course of an audit by the IRS, it was discovered that the PEO had not filed any employment tax returns or paid any employment taxes for the years at issue. During the audit, the employer asserted that, since it had paid the PEO in full, the employer should not be liable to the IRS for any unpaid employment taxes.

In general, the common law employer is responsible for paying any employment taxes. However, under Section 3401(d)(1) of the Internal Revenue Code, if the common law employer does not have control over the payment of wages, the person having control over the payment of wages is responsible for paying any employment taxes. The CCA concludes that, under the terms of the contract, the PEO did not have control over the payment of wages. In particular, the fact that (i) the employer was required to pay the PEO an amount equal to the compensation to be paid to the leased employees in advance of the applicable payroll date, (ii) the employer was required to provide a security deposit or letter of credit naming the PEO as beneficiary, and (iii) the PEO was entitled to terminate the contract at any time without notice if the employer failed to pay an invoice from the PEO when due, caused the IRS counsel to conclude that the PEO acted merely as a conduit for the employer making payroll.

The employer also argued to the IRS auditor that Section 530 of the Revenue Act of 1978 provided the employer with relief. Section 530 provides relief from employment taxes where (i) a taxpayer did not treat an individual as an employee for any period for purposes of employment taxes, (ii) the taxpayer must have filed all required Federal returns on a basis consistent with the taxpayer's treatment of the individual as not being an employee, and (iii) the taxpayer must have a reasonable basis for not treating the individual as an employee. Because the employer conceded that the leased employees were its common law employees, the CCA concludes that Section 530 does not provide the employer with any relief.

Employers who have entered into similar arrangements with a PEO should review the terms of their contracts with the PEO to determine whether the employer remains responsible for the payment of any employment taxes under the Internal Revenue Code. To the extent there is any question as to whether the PEO has control over the payment of wages, employers are encouraged to contact their attorney or other advisor. (CCA 201724025)