The Involuntary Conversion of Employees into Self-Employed: The Internal Revenue Service and Section 530

Marc Linder

© 1988 Marc Linder

The Involuntary Conversion of Employees into Self-Employed:
The Internal Revenue Service and Section 530

by Marc Linder

I. Introduction

A specter is haunting the United States—the specter of independent contracting. During the 1980s, increasing numbers of farmworkers as well as many other low-paid dependent workers have been deprived of various benefits and protections provided by federal and state law because their employers have denied the existence of an employment relationship. By classifying their employees as “independent contractors,” employers can shift the burden to workers to prove their employee status. Among the obligations—all of which presuppose the existence of an employment relationship—that employers are seeking to avoid are:

- employer’s social security tax;
- employer’s federal unemployment insurance tax;
- employer’s state unemployment insurance tax;
- workers compensation premiums;
- withholding of social security or income tax;
- collective bargaining;
- private pension benefits;
- safety and health inspections;
- prohibitions of race, sex and age discrimination; and
- sanctions for employment of “unauthorized aliens.”

The employees most affected by this practice are farmworkers, construction workers, nurses and allied health workers, janitors, carpet layers, casual and temporary retail employees, industrial homeworkers, forestry workers, truck and taxi drivers, and wholesale and door-to-door salespeople.

This article offers a narrative and analysis of the legislative history of the relatively little known (and uncodified) federal income tax provision, section 530, which has facilitated this wave of reclassifications. In order to illustrate the practical impact of section 530 on low-income workers, an example of how this purported conversion of employees into self-employed operates is set out first.

II. The Problem

Unable to locate jobs picking fruits and vegetables in the Midwest, a family of migrants from South Texas travels to West

1. The following footnotes cite the provision in the relevant acts in which the threshold employment-coverage definition is set forth.
Texas in June to try cotton hoeing. They have waited until school is out so that their five children can also work. This is crucial because the family will earn the bulk of its yearly income during the summer. When they arrive, they are assigned to various farmers. Although they are entitled to $3.35 per hour, $2.50 is the going rate all over West Texas for hoeing cotton.

At the height of the season, all seven members of the family work 10 to 11 (sometimes up to 14) hours a day, 7 days a week for 4 farmers. Even at $2.50 an hour, the family earns $1,200 a week, which to a family with cash income of only $5,000 a year is a large amount of money. With many other families—including illegal aliens—in the vicinity desperately needing work, this family is not in a position to complain that, by paying them 85 cents an hour under minimum wage, the farmers are underpaying them by $400-$500 a week.

In August, the family returns home so that the children can start school. The following January, the father receives from each of the farmers a Form 1099-MISC (Statement for Recipients of Miscellaneous Income) instead of the Form W-2 (Wage and Tax Statement) that he is normally given by employers. These forms impute to him the entire income that all seven workers earned. Nevertheless, the parents scrupulously report the entire sum, which is low enough to entitle them to an earned income credit,\(^\text{13}\) on their joint return.

Later the Internal Revenue Service sends the family Proposed Changes. Since they have been employees all their lives, the parents are accustomed to having their employers deduct FICA taxes. However, the IRS has informed them that they owe a 13.02 percent self-employment social security tax\(^\text{14}\) on their "non-employee compensation." With interest\(^\text{15}\) and an added late payment penalty,\(^\text{16}\) the IRS requests payment of almost $1,000, which the family does not have and legally does not owe. In addition, until the workers pay this FICA tax, the Social Security Administration (SSA) will not credit them for any coverage credits towards their old-age pensions or disability insurance payments.\(^\text{17}\)

Finally, when the parents apply for unemployment compensation benefits, the farmers contest coverage on the ground that no employment relationship existed. The workers now must bear the burden of proving that they were employees rather than self-employed.

When the family seeks assistance from its local legal services office, they learn that the same burden applies to the IRS matter. In certain regions,\(^\text{18}\) where the IRS offices have been alerted to the problem and acknowledge in principle that such workers are employees, an attorney\(^\text{19}\) can expedite resolution of the problem by helping the affected workers file an amended tax return (1040X) along with Form 4852 (Employee's Substitute Wage and Tax Statement).\(^\text{20}\) In other regions, where advocates have not yet discussed the issue with IRS officials, it is advisable to complete a form SS-8 (Information for Use in Determining Whether a Worker Is an Employee for Federal Employment Taxes and Income Tax Withholding)\(^\text{21}\) in order to induce the IRS to investigate the employers in question.\(^\text{22}\)

The reclassification of a worker from employee to self-employed is not ... based on any reorganization of production or introduction of new technology. The same worker can undergo this transformation from one day to the next.

III. Form 1099-MISC

The reclassification of a worker from employee to self-employed is not, as this example shows, based on any reorganization of production or introduction of new technology. The same worker can undergo this transformation from one day to the next. The crucial document that serves to facilitate this process is the IRS Form 1099-MISC. By filing this form reporting "non-employee compensation"\(^\text{23}\) with the IRS, an

---

13. Internal Revenue Code, 26 U.S.C. § 32. For tax year 1986 the cut-off point was $11,000. IRS, Instructions for preparing Form 1040 at 48 (1986). For 1987 the cut-off was raised to $15,432.

14. The self-employment social security tax is gradually being equalized to the combined employer and employee shares of the FICA tax during the 1980s. In 1990, both will amount to 15.3 percent.


18. The Austin, Texas regional office is an example of one of these offices.

19. This article is not intended as a tax guide for legal services lawyers.

20. Every child who earns income is entitled to his or her own statement of income from an employer. See 26 U.S.C. § 73. In those cases in which the employer treats the family as one income-earner, it is necessary to prorate the income on the 1040X. Thus only the parents' prorated shares of the income need be reported. One reason that this is important is that eligibility for the earned income credit is subject to an income ceiling. See supra note 13. Beginning with tax year 1987, children must file separately only if they earn in excess of $2,540.


22. In the normal course of events, the IRS often accepts the employee's offer of the employee's share of the FICA tax without pursuing the employer for the employer's share. It should also be observed that all workers are liable for the employee's share of the FICA tax (1987: 7.15 percent; 1988: 7.51 percent) on the income now claimed as wage income. 26 C.F.R. § 31.3102-1(c). Offer of payment of this tax should be tendered on the 1040X (to be inserted on line 11—Other Taxes). Since the employee nevertheless receives full social security credits, the remaining social security taxpayers in effect subsidize the noncontributing employers. Attorneys may also choose to complete the counterpart Form SSA-7160-F4 (Employment Relationship Questionnaire) for SSA. If, on the basis of the information furnished in this form, SSA determines that the worker is an employee, SSA will give credit for this income.

23. Non-employee compensation is one of 10 items appearing on Form 1099-MISC. Other non-employee compensation include rents, royalty payments, prizes and awards, and a share of proceeds from the sale of a catch to fishing crew members. For an explanation, see IRS, Instructions for Forms 1099, 1098, 5498, 1096, and W-2G at 10-11 (1987).
employer can create the legal basis for treating a worker as "self-employed."

Pursuant to the Internal Revenue Code (IRC), a business must file a Form 1099-MISC with the IRS and furnish a copy of the form to the payee if the employer pays $600 or more for services performed to a person who is not treated as an employee. How has it happened that this Statement for Recipients of Miscellaneous Income, which was once largely reserved for reporting payments of fees to attorneys, accountants, and similar independent contractors, has now become a standard income reporting form for the humblest hewers of wood and drawers of water?

IV. Legislative History of Section 530

In connection with the Tax Reform Act of 1976, the Senate Finance Committee strongly urged the IRS not to issue any retroactive revenue rulings concerning independent contractors until the committee staff had studied the issue of determining the status of independent contractors. Although the background to this controversy was not spelled out in 1976, when the Revenue Act of 1978 was enacted two years later, Congress explained that:

In the late 1960s, the Internal Revenue Service increased its enforcement of the employment tax laws. Previously, employment tax audits had been superficial or sporadic and only occasionally entailed examination of employment status issues. Many controversies developed between taxpayers and the Service about whether individuals treated as independent contractors should be reclassified as employees. If the IRS prevailed on a reclassification, the taxpayer became liable for employment taxes— withholding, social security, and unemployment—which neither had been withheld nor paid to the Treasury . . . .

Many taxpayers have complained that proposed reclassifications involve a change of position by the Internal Revenue Service in interpreting how the common law rules apply to their workers or industry. Some taxpayers have prior private letter rulings or technical advice memoranda from the Service in which the Service held that the workers were independent contractors. Other taxpayers have pointed to prior audits in which their treatment of workers as independent contractors was not challenged. Before the 1970s, however, most audits did not focus on employment tax status determinations; so most taxpayers relied on their own judgment, industry practice, or, in a few industries, published Revenue Rulings.

Numerous bills were submitted during 1978 to deal with these issues. The provisions ultimately adopted as section 530 of the 1978 Revenue Act were intended to "provide interim relief" to taxpayers potentially facing large assessments as a result of the aforementioned reclassifications until Congress had "adequate time to resolve the many complex issues . . . in order to formulate a proposal for a comprehensive solution."

As enacted, section 530 provided that, if for employment tax purposes the taxpayer did not treat an individual as an employee for any period before 1980 and filed all the required

25. Failure to provide an employee a Form 1099-MISC violates 26 U.S.C. § 6041A(e), and subjects the employer to penalty under 26 U.S.C. § 6722.
federal tax returns after 1978 on a basis consistent with such treatment, the individual would not be considered an employee "unless the taxpayer had no reasonable basis for not treating such individual as an employee." The statute defined such "reasonable basis" as "reasonable reliance on" judicial precedent, published rulings, technical advice or letter rulings; a past IRS audit of the taxpayer in which there was no assessment attributable to treatment of individuals in positions similar to that held by the individual in question; or a "long-standing recognized practice of a significant segment of the industry." Finally, Congress imposed a moratorium on the publication of regulations or revenue rulings "with respect to the employment status of any individual for purposes of the employment taxes.

It is important to keep in mind the limited significance of the original section 530. First, it was to expire at the end of the 1979 tax year, by which time Congress intended to enact permanent legislation. Second, granting employment tax relief to an employer did "not convert individuals from the status of employee to the status of independent contractor." However, it was also clear from the outset that certain legislators had already developed a far-reaching agenda. Representative Gephardt, for example, in H.R. 12176 (Clarification of Standards for Classification as Independent Contractors or Self-Employed Person), would have amended the statutory definition of "employee" for social security purposes by vastly expanding the dispositive criteria of non-employee status. Thus, such status would have been conferred on a worker (1) whose sole remuneration was commissions that were reported on Form 1099; (2) who had a written contract; (3) who did not have to work any specified hours; (4) who had his or her own principal place of business; or (5) who had the opportunity for profit or loss.

Although the bill did not become law, its introduction demonstrated that employers in some industries, apparently dissatisfied with real-world impact of the displacement of the economic reality of dependence test by the control test, sought much more capacious 'safe havens' than the reasonable bases for relief offered by section 530.

Since section 530 was due to expire at the end of the year, 1979 witnessed a renewed flurry of legislative activity designed to make relief permanent. Representative Gephardt introduced H.R. 3245 (Independent Contractor Tax Status Clarification Act of 1979), which would have amended the IRC to define as an employee any individual who:

(1) controls the aggregate hours actually worked and substantially controls all of his or her scheduling;
(2) does not have a principal place of business; or, if he or she has a principal place of business, the service recipient does not provide it; or, if the service recipient does provide the place of business, then the individual pays rent for it;
(3) has substantial investment in assets used in connection with performance of the service; or risks income fluctuation because remuneration is directly related to sales or other output rather than hours worked;
(4) performs pursuant to a written contract providing that he or she will not be treated as an employee for purposes of FICA, SSA, FUTA or withholding; and is provided with written notice of his or her self-employment tax obligations; and
(5) for whom service is performed files a Form 1099.

Significantly, H.R. 3245 contained a so-called no inference provision: if not all of the foregoing requirements were met, no inference would be created that the worker was an employee, and the usual rules of determination would apply. But it was these latter rules of determination that concerned Gephardt. He contended that although the common law test had provided certainty, beginning in the 1970s the IRS began to misapply them.

The test that the IRS applied (and still applies) for employment status determinations had long been considered economically realistic in contrast to the safe havens of H.R. 3245, which were manifestly designed to confer great discretion on employers to manipulate legal forms in order to avoid their statutory duties. Thus, the fourth and fifth requirements had absolutely nothing to do with the actual employer-employee
relationship and could be imposed by the former by fiat. The place of business requirement—especially its first prong—was obviously meaningless. The risk of income fluctuation requirement could be easily manipulated to encompass piece rates and other methods of remuneration. Only the control of hours requirement offered any challenge to the inventiveness of employers; yet here, too, it was possible to manipulate contractual forms to simulate worker control. The competing bills offered similar safe havens.

The hearings before the House Ways and Means Committee on H.R. 3245, which consist of over 700 pages of text, provided the most extensive congressional forum for discussion of the employer-employee relationship and independent contractors in decades—and perhaps ever. Yet, the positions were much narrower and more technical than they had been at the time of the last great debate of the issue 30 years earlier. Since certain industries had succeeded in framing the legislative debate in terms of overreaching by the IRS, the most interesting testimony came from or dealt with the IRS, which, thrown on the defensive, presented extensive investigatory material and its own set of proposals.

From that testimony, it appeared to emerge that the IRS, which administers the collection not only of federal income taxes but also the FICA and FUTA taxes, was not directly concerned with the scope and definition of the employer-employee relationship and, consequently, whether a worker was classified as an employee or independent contractor.

From the outset, the IRS, through its chief witness, made it clear that it wanted to get out of the business of status determination:

Now, how do we determine who is an employee and who is an independent contractor? . . . The present test for determining whether a worker is an independent contractor or an employee is the test of whether under the English common law he or she is an employee.

From that testimony, it appeared that the IRS, which administers the collection not only of federal income taxes but also the FICA and FUTA taxes, was not directly concerned with the scope and definition of the employer-employee relationship and, consequently, whether a worker was classified as an employee or independent contractor. Rather, the IRS had discovered that of the growing number of workers classified as independent contractors—and whose status was being contested by the IRS—the proportion not paying their federal income tax or self-employment social security tax was astronomical. In other words, the IRS concluded from these high non-compliance rates that the decision to characterize these workers as independent contractors was guided by the desire to avoid paying taxes. In many instances the IRS believed that the workers involved had an incentive to accept the employers' initiative because their immediate net compensation would be higher.

Thus, the interest of the IRS in employment status was distinctly derivative of and subsidiary to its task of protecting the Treasury and the integrity of the social security trust fund. The IRS's position was that, if it were possible to adopt certain changes eliminating the incentives to be classified as an independent contractor, it would be a matter of indifference to the IRS whether workers were called employees or independent contractors. This was the IRS's underlying logic for its compromise proposals to Congress.

From the beginning, the IRS, through its chief witness, made it clear that it wanted to get out of the business of status determination:
This test was developed centuries before the income tax to determine the rules of the doctrine that the master is liable for the tort of his servant.54

... There are 20 factors in the regulations that are in many cases extremely difficult to apply because various of the factors go in different directions.55

[T]here is no guidance as to what weight is to be given to particular factors, and we have a control test that, if one were starting anew, starting afresh, to design a test to determine whether a compensation payment paid by a payer to a worker should be subject to withholding or whether higher premiums should be paid on that compensation to finance an equal measure of social security benefits, I don't believe it would have been adopted as the way to separate the sheep from the goats, as you will.

With the incentives to classify workers as independent contractors... the pressures have been just too great for that test to work successfully. So we asked ourselves, how can we... reduce the pressure on the common law test?26

The answer was a two-part "recommendation... for a middle ground."57 The first part of the recommendation was the equalization of the SECA and combined FICA tax rates in order to reduce the incentive to classify employees as independent contractors.58 The IRS ultimately achieved this legislative goal.59


55. The 20 factors are not found in the regulations but in the Internal Revenue Manual at Exh. 4640-1 (Employer-Employee Relationship). The factors do constitute a kind of economic reality of dependence test. Of particular interest is the IRS's interpretation that the realization of profit or loss implies the use of capital. Provided that the "right to discharge" is itself viewed realistically and not in mere paper terms, it is indeed important that "the ever-present threat of dismissal... causes the worker to obey his [the employer's] instructions." Id.


57. Id. at 10-11.

58. Id. at 10.

59. The Social Security Amendments of 1983 provided for the phased equalization of the rates. Pub. L. No. 98-21, 97 Stat. 65, 89, Title 1, § 124(a) (Apr. 20, 1983). The stated purpose was to end the subsidy to the self-employed and to increase revenues for the social security trust fund. See, e.g., Rep. No. 23, 98th Cong., 1st Sess. 31-33 (1983); H. Rep. No. 25, 98th Cong., 1st Sess. 32-33 (1983); H. Conf. Rep. No. 23, 98th Cong., 1st Sess. 125-26 (1983). These other grounds may have helped to overcome the objection that increasing the SECA tax rate would only increase the incentive to classify employees as independent contractors. Additional ranking measures were included in the Economic Recovery Tax Act of 1981 and the Tax Reform Act of 1986 to require those filing Forms 1099 to furnish them to the payees, and to increase the penalties for not filing and not furnishing Forms 1099. These provisions are now codified as 26 U.S.C. §§ 6041(A)(e), 6721, 6722. The IRS requested these measures during the 1979 hearings. See Independent Contractor Hearings, supra note 44, at 17-18.

The second part of the recommendation involved setting up "a more logical test":

We don't want to get into questions of pensions of [sic] fair labor standard rates, or any of the questions that don't have anything to do with rate of taxation. The logical test in determining whether withholding is appropriate is whether the amount paid to the worker in gross is pretty close to his net take...50

With respect to the technical tax collection issue to which the IRS has narrowed the question of employment status, its solution probably was expedient. Given its operating assumption that the SECA and FICA taxes would be equalized (and that economically the incidence of employment taxes ultimately falls on the employee), it was only logical for the IRS to "like to get away from the term employees under an ideal test... [and instead refer to] persons subject to withholding."62 In a sense, then, the IRS was slowly moving in the direction of the most comprehensive social security systems (namely, those in Scandinavia), which generally detach entitlements from employee status. The only problem that the IRS did not address was how it would approach employment status for

60. Independent Contractor Hearings, supra, note 47, at 10. Cf. id. at 45.
61. Id. at 18.
62. Id. at 10.
63. In Denmark, for example, the self-employed have been included in the unemployment insurance funds system since 1976. See Lov om arbejdssøskredforsikring [Law on Employment Service and Unemployment Compensation], § 30, as amended by Law No. 311 (June 10, 1976).
purposes of FUTA so that no qualified worker would be deprived of unemployment benefits.64

One proposal tendered by the IRS would in essence have imposed a flat 10 percent withholding tax on all Form 1099-MISC payees (except those providing services to more than 5 payors annually). The new IRS test submitted as the alternative to flat-rate withholding65 would have required graduated withholding on all workers not paid on a wage or salary basis unless gross payments would not approximate net income and the worker provided services to multiple payors. The following test would have functioned as a surrogate for the gross-net deviation: (1) separate place of business (other than home); (2) substantial investment in assets; (3) employment of own employees who provide a substantial proportion of the services; or (4) substantial continuing expenses.66 Had these factors been formulated cumulatively rather than disjointly, they might have provided the basis for an economic reality of dependence test with regard to workers with skill and/or capital.67

Although the testimony of the Social Security Administration was generally consistent with that of the IRS,68 there was inserted into the record, at Representative Gephardt's request,69 an earlier, critical report of the IRS by the General Accounting Office (GAO).70 The GAO's chief concern was that the IRS had "interpreted the common law definition of an employee in such a way that persons operating separate businesses are often considered the employees of another business because one can exercise a certain amount of control over the other."71 In derogation of 150 years of common law jurisprudence, which has held that a "separate business" does not exist per se, but only in relation to its micro-economic integration into other businesses,72 the GAO recommended that: "Where separate business entities exist, some degree of control to protect the image of the manufacturer, supplier, or prime contractor should be allowed without necessarily creating an employer/employee relationship under the common law."73 It then offered this "clear-cut test" to amend section 3121 of the IRC "to exclude separate business entities from the common law definition of employee . . . where they:" (1) have a separate set of books and records reflecting income and expenses; (2) have the risk of loss and opportunity for profit; (3) have a principal place of business other than one provided by the persons provided services; and (4) hold themselves out as self-employed or generally make their services available to the public. If a "business entity"74 met only three of the criteria, the "common law criteria" would apply; if "the independent contractor" met fewer than three, he would be considered an employee.75

The IRS, the Treasury Department, the Department of Labor, and the Department of Justice were all critical of the GAO test criteria.76 They shared the fear that the criteria were so easily manipulable that many employees would be incorrectly classified as independent contractors. Although virtually all of the industry groups that testified excoriated the IRS77 and supported H.R. 3245, neither H.R. 3245 nor any competing bill was enacted in 1979. Consequently, Congress extended the life of section 530 by one year.78 A year later, it was extended for an additional 18 months.79 In 1981, more bills of a similar nature were introduced, but, again, none was passed.80 With time running out on section 530, renewed efforts were undertaken to enact permanent legislation in 1982. Representative Gephardt introduced his bill again as did Senator Dole.81 The Subcommittee on Oversight of the IRS of the Senate Finance Committee held a hearing on Senator Dole's bill,82 which provided a familiar three-part safe harbor test. Under this test, the individual would be an independent contractor if he or she (1) had control of his or her hours, (2) received no principal place of business rent-free from the service recipient, and (3) had 74. Use of this term prejudices the issue since only natural persons can be employees for social security purposes.
75. Id. at 98-99.
76. Id. at 129-50, 182-200.
77. Much of this testimony was replete with pretentious phrases about the sanctity of the independence of direct sellers who earned $15 dollars a week so that they could "put a good meal on the table." Id. at 441, 448-9, 461 (statements and testimony of James Preston, Executive Vice Pres., Avon Products, and Robert Nathan, consulting economist on behalf of the Direct Selling Ass'n). The representative of the Associated General Contractors of America, Gilbert Turner, asserted that the IRS's "apparent goal of eventual elimination of the small, independent, free enterprise entrepreneurs, to be replaced by more placid, more regimented and less productive employees" was "an insidious infringement on our cherished freedoms . . . ." Id. at 475. In so arguing, he agreed with the GAO, which included among the benefits accruing to employers from classifying workers as self-employed, the services of "more aggressive workers." Id. at 118. The GAO did not indicate whether this enhanced aggressiveness was connected to the unlawful deprivation of a large number of statutory entitlements.
80. E.g., H.R. 4531, 4971; S. 8.
81. H.R. 5729 and S. 2369. In addition, other legislation was introduced. For instance, Sen. Danforth offered S. 2213, and Rep. Guarini H.R. 5867. The latter contained a six-factor safe harbor test and provided for 10 percent withholding on independent contractors. Representative Gephardt also offered H.R. 6311.
82. See generally Staff of Joint Committee on Tax, Background on Classification of Employees and Independent Contractors for Tax Purposes and Description of S. 2369, 97th Cong., 2d Sess. (1982).
substantial investment and earnings based on his or her sales or output. Although the IRS presented a modified version of its previous withholding proposal, and despite the support of the usual group of industry representatives, none of the comprehensive bills received a majority vote. However, apparently perceiving that a definitive solution was not forthcoming in the near future, Congress extended the provisions of section 530 indefinitely.

Equally—and perhaps even more importantly—the first categories of statutory non-employees were created. As a result of years of lobbying by two industries, the Tax Equity and Fiscal Responsibility Act inserted into the IRC section 3508, which declared qualified real estate agents and direct sellers not to be employees for purposes of employment taxes. The safe-haven criteria were considerably more relaxed than those of any of the previously discussed bills. The three-part test for both occupations included provisions that: the services be performed pursuant to a written contract reciting that the person will not be treated as an employee for federal tax purposes; and substantially all of the remuneration be directly related to sales or other output rather than to the hours worked. In addition, real estate agents were required to be licensed, while direct sellers were required to sell (or solicit for sale)

83. Its three-part test included: (1) a principal place of business (meeting the requirements of IRC section 260A); (2) substantial assets; or (3) incurrence of unincumbered expenses such as payroll, goods, etc. Independent Contractor Tax Provisions: Hearing on S. 2369 Before the Subcommit. on Oversight of the Internal Revenue Service of the Senate Comm. on Finance, 97th Cong., 2d Sess. 104 (1982) (statement of John Chapoton) [hereinafter cited as Independent Contractor Tax Proposals].

84. Id. at 288 (testimony of Jay van Andel, Chairman of Amway Corp.).

85. The Senate Finance Committee recommended passage of what was in essence H.R. 3245 of 1979. S. REP. No. 494, 97th Cong., 2d Sess. 358-68 (1982). But the safe harbor test provisions were deleted in conference. H. CONG. REP. No. 760, 97th Cong., 2d Sess. 651 (1982). For revenue-related reasons, the Reagan Administration has apparently not been willing automatically to validate the independent contractor status of various occupational groups or to ignore long-standing compliance problems. Melissa Brown, Treasury Urges Changes in Independent Contractor Bill, 15 TAX NOTES 429 (1982).


87. These categories were created despite the GAO warning that such statutory exclusions would constitute "discriminatory treatment in favor of a few industries." Independent Contractor Hearings, supra note 44, at 124.

88. Whether the success of these two industries in securing statutory conversion of their employees into non-employees represents future trends has been cast in doubt by an amendment to section 530 proposed by Sen. Moynihan as an amendment to the Tax Reform Act of 1986. Amendment No. 2152 to H.R. 3838, 132 CONG. REC. S8088-89 (June 20, 1986). It was introduced in the context of a discussion of foreign tax credits, to which it had no obvious relationship. It exempts from the safe harbor provisions of section 530 engineers, designers, drafters, computer programmers, systems analysts, or other similarly skilled workers retained by technical service firms to provide services to clients. Pub. L. No. 99-514, 100 Stat. 2085, 2781, § 1706(a) (Oct. 22, 1986). See also H. CONG. REP. No. 841, 99th Cong., 2d Sess. II-834-35 (1986). The tax lawyer lobby was quick to emphasize that the purpose of the provision was to subject technical workers to the common law test—not to make them statutory employees. ABA Tax Section Members Comment on Section 1706 of 1986 Tax Act, 34 TAX NOTES 910 (1987).

consumer products on a buy-sell or commission basis outside of stores.

Despite its success in equalizing the SECA and FICA tax rates as well as in creating stricter reporting and filing provisions for payors of Form 1099-MISC recipients, the IRS has indicated that its enforcement efforts have been severely hampered by the restrictions imposed by section 530. If, however, the IRS ultimately succeeds in achieving Form 1099-MISC withholding (at a high rate of tax compliance), it may lose any further interest in the issue of employment status. Unless those businesses and industries—that is, timber, trucking and taxi—that have not yet managed to secure statutory non-employee status for their employees were to perceive that the whole purpose of the independent contracting regime was being undermined by withholding, it is conceivable that the controversy would subside.

If the controversy did subside, the low-paid and unorganized workers who have been dispossessed of the statutory entitlements that they so desperately need, will—given the best perfidious attention that the union movement has devoted to this issue—be sorely pressed to raise the question on their own. Alternatively, the integrity of the social security trust fund will continue to be eroded by the payment of benefits to employees who have paid their share of the FICA tax but whose employers have been relieved of their employment tax obligation by virtue of the operation of section 530.

V. Conclusion

Despite its success in equalizing the SECA and FICA tax rates as well as in creating stricter reporting and filing provisions for payors of Form 1099-MISC recipients, the IRS has indicated that its enforcement efforts have been severely hampered by the restrictions imposed by section 530. If, however, the IRS ultimately succeeds in achieving Form 1099-MISC withholding (at a high rate of tax compliance), it may lose any further interest in the issue of employment status. Unless those businesses and industries—that is, timber, trucking and taxi—that have not yet managed to secure statutory non-employee status for their employees were to perceive that the whole purpose of the independent contracting regime was being undermined by withholding, it is conceivable that the controversy would subside.

If the controversy did subside, the low-paid and unorganized workers who have been dispossessed of the statutory entitlements that they so desperately need, will—given the best perfidious attention that the union movement has devoted to this issue—be sorely pressed to raise the question on their own. Alternatively, the integrity of the social security trust fund will continue to be eroded by the payment of benefits to employees who have paid their share of the FICA tax but whose employers have been relieved of their employment tax obligation by virtue of the operation of section 530.

90. Thus, the IRS has already achieved this goal with regard to interest income reported on Form 1099-INT. See 26 U.S.C. §§ 3408(a)(1)(C), (2); 26 U.S.C. § 6049.


92. Since a worker's status as an employee is not affected by the granting of employment tax relief to his or her employer, he or she remains liable for the employee's share of the FICA tax if the employer has not collected it from him or her. "Accordingly, section 530 has no substantive effect on SSA determinations involving employer-employee relationships." SOCIAL SECURITY ADMINISTRATION, PROGRAM OPERATIONS MANUAL SYSTEM § RS 02101.020 (Jan. 1987).
It is a growing trend among agricultural employers to treat migrant and seasonal farmworkers as independent contractors in order to avoid the reach of numerous federal and state statutes designed to protect farmworkers. A farmworker's receipt of IRS Form 1099-MISC from his or her employer rather than Form W-2 is evidence that the farmworker has been treated as a self-employed independent contractor. As such, the employer did not withhold any income or social security (FICA) tax from the farmworker's wages. To ensure that the farmworker will receive wage credits for social security earnings records purposes and not be cited for a tax deficiency, assuming the farmworker did not pay the FICA tax for a self-employed person, the farmworker must pay the IRS the employee's share of the FICA tax.

Wage credits for social security purposes affect the farmworker's eligibility for social security benefits and the amount of benefits.

In almost all cases, farmworkers are not independent contractors. Generally, the employment relationship issue is decided on a right to direct and control the method and manner in which the work is done by the person for whom the services are performed. (See 26 C.F.R. § 31.3306(i)-1(b); Marvel v. United States, 719 E2d 1507 (10th Cir. 1983)). An independent contractor is one who is hired to perform services for another according to his own method and manner, free from direction and control of the employer in all matters relating to the performance of the work, except as to the result or the product of the work.

Farmworkers who are not independent contractors should file Form 4852 with their tax return to ensure proper crediting of their earnings records along with a statement as to why they believe their employer incorrectly used Form 1099. This statement should describe the nature of the taxpayer's work for the employer in the context of the employment relationship test used for FICA tax purposes.

Form 4852 acts as a substitute W-2 Form and allows the reporting of wages for persons who have not received a W-2 or have received an incorrect W-2. The form asks for an explanation of how the reported wages were determined. If the wages reported on Form 4852 were taken from Form 1099, that should be stated. Form 4852 can also be used in cases in which the employer pays the wages paid to all family members in the W-2 of a single family member. In these cases, the wages should be prorated among family members and reported individually to the IRS using Form 4852 for each family filing a tax return.

In cases in which the farmworker incorrectly received a 1099, the farmworker/taxpayer should file a tax return using Form 1040. The farmworker/taxpayer should indicate his or her share of the FICA tax on the line of the tax form used to report social security tax on tip income. On the 1987 Form 1040 this was line 51. The employee's share of the FICA tax in 1987 was 7.15 percent of his or her gross wages and will be 7.51 percent in 1988. (Neither Forms 1040A nor 1040EZ provide a means for the taxpayer to pay the FICA tax.)

If the farmworker's share of the FICA tax is not paid, the IRS has the authority to seek a tax deficiency against the farmworker for failing to pay the FICA tax. The IRS also has the authority to seek the entire FICA tax (both employer's and employee's share) from the employer or take no action against either the employer or the farmworker. The consequences of not paying the employee's share of the FICA tax should be carefully discussed with the client. However, nonpayment of the FICA tax will not affect an individual's social security earnings record. The Social Security Administration only considers the amount of wages paid in covered employment, not whether the FICA tax was paid, in developing earnings records.

In addition to reporting the social security tax on the line of the Form 1040 used to report social security tax on tip income, the printed statement on that line needs to be modified. The line should be changed to read "Social Security tax on income not reported by employer." Eliminate any reference to Form 4137 on this line.

Because of the farmworkers' low incomes, they may owe no additional taxes for the year and/or will receive the earned income tax credit. Their share of the FICA tax due IRS will be deducted from their refund.

Even though IRS claims that this earnings information will be reported to SSA for wage credit purposes, farmworkers should periodically check the accuracy of their social security wage records by filing SSA-Form 7050-F3, Request for Social Security Earnings Information. There is a charge for this information depending upon the number of years covered in the earnings information request.

Cynthia G. Schneider
Staff Attorney
Migrant Legal Action Program