

**Employee v. Independent Contractor:
The IRS Is on the Worker-Classification Warpath –
Are You Ready for Battle?**

by

Hale E. Sheppard, Esq.
Chamberlain, Hrdlicka, White, Williams & Martin
191 Peachtree Street, N.E.
34th Floor
Atlanta, Georgia 30303

Phone: (404) 658-5441
E-mail: hale.sheppard@chamberlainlaw.com

BACKGROUND ON SPEAKER – HALE E. SHEPPARD

Hale E. Sheppard is a shareholder with Chamberlain Hrdlicka who primarily represents taxpayers (individuals and businesses) during federal and state tax audits, tax appeals, tax litigation, tax collection procedures, and criminal tax investigations.

Recent Cases and Rulings. Hale's recent reported cases and rulings include *Virginia Historic Tax Credit Fund v. Commissioner*, T.C. Memo 2009-295 (case of first impression regarding federal tax treatment of state tax credit partnerships), *Heartland Automotive Enterprises, Inc. v. United States*, 10 AFTR 2d 2009-2406 (M.D. Ga) (case concerning employment taxes and use of electronic federal tax payment system), *Tiger's Eye Trading, LLC v. Commissioner*, T.C. Memo 2009-121 (ruling on the validity of tax regulation and the ability to raise penalty defenses during TEFRA partnership proceedings), *Topping v. Commissioner*, T.C. Memo 2007-92 (significant hobby loss case in which the Tax Court ruled in favor of the taxpayer on all major issues), *Vines v. Commissioner*, 126 T.C. 279 (case of first impression involving the use of mark-to-market accounting by securities traders), and *IRS Private Letter Ruling 200751012* (granting taxpayer relief from back taxes, interest and penalties resulting from failure to properly report foreign retirement accounts).

Education. Hale holds five college degrees. At the University of Kansas, he earned a B.S., with distinction, M.A., with honors, and J.D. He later received an LL.M. degree in international law, with highest distinction, from the University of Chile. Finally, he obtained an LL.M. degree in tax from the University of Florida, where he was a graduate tax scholar. During his studies, Hale received several awards for academic excellence, including the prestigious Harry S. Truman Foundation Scholarship. Hale also served as a graduate editor of the Florida Tax Review and member of the Kansas Journal of Law & Public Policy.


Publications. Hale ranks among the most prolific tax writers in the country. He has published nearly 70 articles in some of the nation's top law reviews and tax journals, including Practical Tax Lawyer, Journal of Tax Practice and Procedure, Taxes Magazine, Journal of Passthrough Entities, Tax Management International Journal, Journal of Multi-State Tax & Incentives, Tax Notes International, Practical Tax Strategies, Monthly Digest of Tax Articles, Corporate Business Taxation, Journal of Taxation, International Tax Journal, The Tax Adviser, Houston Business and Tax Law Journal, and Journal of International Taxation.

Activities and Affiliations. Hale holds leadership positions in several professional and civic organizations, including: (i) Journal of Taxation, Editorial Board member and tax columnist, (ii) IRS-Practitioner Liaison Committee, state bar representative, (iii) Journal of Tax Practice & Procedure, Editorial Board member, (iv) Georgia Bar Tax Section, Executive Committee member, (v) Georgia Bar Journal, Editorial Board member, and (vi) GSU Low-Income Taxpayer Clinic, Advisory Committee member.

Contact Information. Hale can be reached by phone at (404) 658-5441 or by e-mail at hale.sheppard@chamberlainlaw.com


Employee vs. Independent Contractor: The IRS Is on the Worker Classification Warpath – Are You Ready for Battle?

Hale E. Sheppard, Esq.
Chamberlain, Hrdlicka, White, Williams & Martin
191 Peachtree Street, N.E. - 34th Floor
Atlanta, GA 30303
Phone: 404-658-5441
hale.sheppard@chamberlainlaw.com




Presentation Goals

- ▶ First – Why Are We Here Today?
- ▶ Second – Who Wants Which Classification and Why?
- ▶ Third – Why Is My Business under Audit?
- ▶ Fourth – What Are My Best Strategies for Winning?
- ▶ Fifth – Where Should this Battle Occur?
- ▶ Sixth – Can Businesses Recover Their Fees?



**First Goal:
Why Are We Here Today?**



Why Are We Here Today?

- › Old issue, new focus by IRS
- › 6,000 employment tax audits over 3 years
- › "Random" audit letters started in 2010
- › Each reclassification affects *many* workers
- › Foregone conclusion: lots of misclassifications
- › States signed data-sharing agreement on QETP

 Chamberlain Haddock
ATTORNEYS AT LAW


Why Are We Here Today?

- › Get best possible overall result for clients
- › Avoid malpractice claims

 Chamberlain Haddock
ATTORNEYS AT LAW

Second Goal:

Who Wants Which Classification and Why?

 Chamberlain Haddock
ATTORNEYS AT LAW

Divergent Interests Breed Conflict

- Service recipients / businesses – IC
- IRS – employee



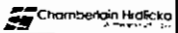
Reasons Businesses Want IC Status Tax Reasons

- Avoid FITW
- Avoid payment of one-half FICA
- Avoid payment of all FUTA
- Reduce compliance – Forms 940 and 941
- Avoid trust fund exposure – Section 6672



Reasons Service Recipients Want IC Status Non-Tax Reasons

- Reduce overall labor costs, stay competitive
 - no holiday, sick, vacation pay
 - no health or life insurance
 - no child care
 - no retirement plans
 - etc.



**Reasons Service Recipients Want IC Status
Non-Tax Reasons**

- Inapplicability of many employee-protection laws
 - Fair Labor Standards Act
 - Social Security Act
 - National Labor Relations Act
 - Title VII of Civil Rights Act
 - Equal Pay Act
 - Age Discrimination in Employment Act
 - Family and Medical Leave Act
 - Americans with Disabilities Act

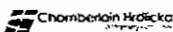


Reasons IRS Wants Employee Status

- Reduce non-compliance by workers
 - Form 1099 issued: 77% reported income
 - No Form 1099 issued: 29% reported
 - Form W-2: 99% reported income
 - Inflated Schedule C business expenses



**Third Goal:
Why Is My Business under Audit?**



Common Triggers of Classification Audits

- Audit program by IRS
- Informants
- Worker files Form SS-8 (Determin. of Worker Status)
- Worker files Form 4852 reporting pay as wages
- Mismatch - worker puts income on Line 7 Form 1040
- State employment or labor audit

 Chamberlain Hrdlicka
ATTORNEYS AT LAW

Fourth Goal: What Are My Best Strategies for Fighting the IRS?

 Chamberlain Hrdlicka
ATTORNEYS AT LAW

Main Arguments/Strategies

- Section 530 applies, so classification is irrelevant
- Business is entitled to offer under CSP
- Worker is not a common-law employee
- Work is not a statutory employee either
- Even if worker is employee, Section 3509 applies

 Chamberlain Hrdlicka
ATTORNEYS AT LAW

Main Arguments/Strategies

- Section 530 applies, so classification is irrelevant
- Business is entitled to offer under CSP
- Worker is not a common-law employee
- Work is not a statutory employee either
- Even if worker is employee, Section 3509 applies

 Chamberlain Hrdlicka
ATTORNEYS AT LAW


Section 530 – The Ultimate Salvation

- Worker's (true) classification is irrelevant
- No *retroactive* taxes, penalties, or interest
- No *prospective* treatment as employee

 Chamberlain Hrdlicka
ATTORNEYS AT LAW

Section 530 – Rationale in 1978

"The [Senate Finance] Committee believes that it is appropriate to provide *interim relief* for taxpayers who are involved in employment tax status controversies with the [IRS], and who potentially face large assessments, as a result of the [IRS's] proposed reclassifications of workers, until the Congress has adequate time to resolve the many complex issues involved in this area."

 Chamberlain Hrdlicka
ATTORNEYS AT LAW

Section 530 – No Centralized Guidance

- Off-Code provision
- Regulations and revenue rulings prohibited
- Legislative history – 4 major laws
- Series of Revenue Procedures (outdated)
- IRS Training Manual (1996) (outdated)
- Internal Revenue Manual (precedent?)
- Case law



Section 530 – What Did Congress Intend?

- Revenue Act of 1978
- TEFRA of 1982
- Tax Reform Act of 1986
- Small Business Job Protection Act of 1996



Section 530 – Outdated IRS Guidance

- Rev. Proc. 78-35 (superseded)
- Rev. Proc. 80-35 (superseded)
- Rev. Proc. 81-43 (superseded)
- Rev. Proc. 85-18
 - Issued before Tax Reform Act of 1986
 - Issued before SBJPA of 1996



Section 530 – Eligibility Requirements

- First - workers treated as ICs
- Second - Reporting Consistency
- Third - Substantive Consistency
- Fourth - Reasonable Basis for IC treatment



Section 530 – Cobbling Together Answers

- First Component – workers treated as ICs
 - Treated for *federal* employment tax purposes



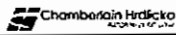
Section 530 – Cobbling Together Answers

- Second Component - Reporting Consistency
 - Filed timely annual Forms 1099
 - Small failure is not fatal
 - If below \$600, no need to file Forms 1099



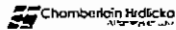
Section 530 – Cobbling Together Answers

- Third Component - Substantive Consistency
 - Treated all other workers in "substantially similar positions" as ICs
 - Battle with IRS over job descriptions/duties



Section 530 – Cobbling Together Answers

- Fourth Component – Reasonable basis
- Four Safe Harbors – Reasonably relied on:
 - Administrative or court precedent
 - Prior IRS audit
 - Longstanding practice, of significant segment, of applicable industry
 - Other reasonable basis



Section 530 – Cobbling Together Answers

- Safe Harbor 1 – Reliance on precedent
 - Precedent must exist at time of classification
 - IRS will check if facts are "sufficiently similar"
 - Reliance on one case or ruling may suffice
 - State court decisions do not count
 - Rulings by non-IRS agencies do not count



Section 530 – Cobbling Together Answers

- Safe Harbor 2 – Reliance on prior IRS audit
 - Audit workers in substantially similar positions
 - The IRS must have conducted the audit
 - Must have been an employment tax audit
 - Must have been an "audit"
 - No – inquiry from Service Center
 - No – Form SS-8 determination letter



Section 530 – Cobbling Together Answers

- Safe Harbor 3 – Three subparts
 - longstanding recognized practice
 - of a significant segment
 - of the applicable industry



Section 530 – Cobbling Together Answers

- Safe Harbor 3(1) - Longstanding practice
 - Courts: requires 10-year duration
 - Congress: "New industries can take advantage of Section 530"
 - Must be aware of practice at time of initial IC treatment; Awareness after audit is too late



Section 530 – Cobbling Together Answers

- Safe Harbor 3(2) – Significant segment
 - IRS Manual: requires > 25% or more
 - Courts: Does not require > 25% or more
 - Congress: Designed as a relief provision; percentage can be lower



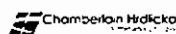
Section 530 – Cobbling Together Answers

- Safe Harbor 3(3) – Applicable industry
 - Businesses compete for same customers, and
 - Provide same or similar product or service
 - Determined by geographic area (state, city, cnty)



Section 530 – Cobbling Together Answers

- Safe Harbor 4 – Other Reasonable Basis
 - Reliance on CPA or attorney
 - Advice offered at time of classification



Section 530 – Other Important Points

- Internal Revenue Manual (I.R.M. 4.23.5)
 - Possible Section 530 relief is “first step”
 - RA “must explore” Section 530, even if TP fails to raise it
 - If Section 530 applies, issue discontinued
 - RA can’t weigh hazards of litigation; AO can



Section 530 – Other Important Points SBJP Act of 1996

- If business makes prima facie case of reasonable basis for IC treatment, and
- Business fully cooperates with reasonable requests by RA, then
- Burden of proof switches to IRS
- See Section 530(e)(4) and T.C. Rule 142(a)




Section 530 – Other Important Points

- Be brave businessperson!!!
- Stay the course to get Section 530 relief!!!
- If business wants to change to employee status, must do so via CSP (see following slides)



Refresher - Main Arguments/Strategies

- Section 530 applies, so classification is irrelevant
- Business is entitled to offer under CSP
- Worker is not a common-law employee
- Work is not a statutory employee either
- Even if workers is employee, Section 3509 applies

 Chamberlain Haddock
ATTORNEYS AT LAW

Classification Settlement Program

- Introduced in 1996 (IR-96-7)
- Originally a two-year trial basis
- Extended indefinitely in Notice 98-21
- Declining CSP does not affect std. rights
- Can be raised at Exam or Appeal

 Chamberlain Haddock
ATTORNEYS AT LAW

IRM 4.23.6: "Graduated settlement offers"

- *Good* CSP Offer
 - Met Reporting Consistency, but
 - "Clearly failed" Substantive Consistency, or
 - "Clearly failed" Safe Harbors
 - Then offer is the following:
 - TP pays 100% employment tax for year under audit (calculated under Section 3509), and
 - TP must treat as employees going forward!!!

 Chamberlain Haddock
ATTORNEYS AT LAW

IRM 4.23.6: "Graduated settlement offers"

➤ *Better* CSP Offer

- Met Reporting Consistency, and
- "Colorable argument" that met Substantive Consistency and a Safe Harbor
- Then offer is the following:
- TP pays 25% employment tax for year under audit (calculated under Section 3509), and
- TP must treat as employees going forward!!!



IRM 4.23.6: "Graduated settlement offers"

➤ *Best* CSP Offer

- TP meets Reporting Consistency, Substantive Consistency, and Safe Harbor
- Section 530 relief applies



Refresher - Main Arguments/Strategies

- Section 530 applies, so classification is irrelevant
- Business is entitled to offer under CSP
- Worker is not a common-law employee
- Work is not a statutory employee either
- Even if workers is employee, Section 3509 applies



Common-Law Employee Factors

- Rev. Rul. 87-41: 20 Factors
 - Provides instruction to workers
 - Provides training
 - Integrates worker's job into business
 - Requires that services be rendered personally
 - Hires, supervises, and pays assistants
 - Requires that works only for business
 - Sets hours of work

 Chamberlain Hrdlicka
ATTORNEYS AT LAW


Common-Law Employee Factors

- Rev. Rul. 87-41: 20 Factors (cont.)
 - Requires full-time work
 - Requires work done on premises
 - Sets order or sequence of work
 - Requires oral or written reports
 - Pays worker by hour, week, month (not by job)
 - Pays worker's business expenses
 - Furnishes tools to do work

 Chamberlain Hrdlicka
ATTORNEYS AT LAW

Refresher - Main Arguments/Strategies

- Section 530 applies, so classification is irrelevant
- Business is entitled to offer under CSP
- Worker is not a common-law employee
- Work is not a statutory employee either
- Even if workers is employee, Section 3509 applies

 Chamberlain Hrdlicka
ATTORNEYS AT LAW

Statutory Employees

- Five general categories
 - Corporate officers
 - Certain agent/commission drivers
 - Full-time life insurance salespersons
 - Home workers
 - Traveling salespersons
- Section 3121(d) and Treas. Reg. § 31.3121(d)-1(d)

 Chamberlain Haddock
ATTORNEYS AT LAW

Refresher - Main Arguments/Strategies

- Section 530 applies, so classification is irrelevant
- Business is entitled to offer under CSP
- Worker is not a common-law employee
- Work is not a statutory employee either
- Even if worker is employee, Section 3509 applies

 Chamberlain Haddock
ATTORNEYS AT LAW

Two Rationales for Section 3509

- Rationale One: Punishment for misclassification
- Rationale Two: Revenue recovery – estimated taxes lost because of non-compliant workers

 Chamberlain Haddock
ATTORNEYS AT LAW

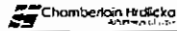
Section 3509 - Three Potential Outcomes

- > Misclassification and filed Forms 1099
- > Outcome: Employer must pay:
 - o 1.5% of worker's taxable wages for lack of FITW
 - o Employer's unpaid share of FICA
 - o 20% of employee's share of FICA
 - o All FUTA



Section 3509 - Three Potential Outcomes

- > Misclassification and Forms 1099 not filed
- > Outcome: Employer must pay:
 - o 3% (up from 1.5%) of worker's taxable wages for lack of FITW
 - o Employer's unpaid share of FICA
 - o 40% (up from 20%) of employee's share of FICA
 - o All FUTA




Section 3509 - Three Potential Outcomes

- > Intentional misclassification
- > Outcome: Employer must pay:
 - o Amount of FITW that should have been withheld
 - o Employer's unpaid share of FICA
 - o 100% (up from 40%) of employee's share of FICA
 - o All FUTA
 - o Note: potential refunds/reductions - 3402 and 6521

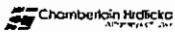


Fifth Goal:
Where Should this Battle Occur?




Three Main Battlegrounds

- Exam – regular or CSP
- Appeals – regular or Early Referral Program
- Litigation - Tax Court or District Court



Three Main Battlegrounds - Appeals

- Appeal Office – Early Referral Program
- Sources
 - IR-96-7 introduced as one-year trial
 - Announcement 96-13 explained
 - Announcement 97-52 extended
 - Section 7123(a) – codified
 - Rev. Proc. 99-28 – further explained
 - IRM § 4.23.16



Three Main Battlegrounds - Appeals

- Early Referral Program – Rev. Proc. 99-28
 - TP makes request in writing to group manager
 - IRS Notice issued w/n 30 days
 - TP responds w/n 30 days
 - Must be a fully developed, unagreed issue
 - 30-day letter must not be issued yet



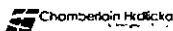
Three Main Battlegrounds - Appeals

- Early Referral Program – Rev. Proc. 99-28
- Appropriate issues for early referral
 - Whether worker is an employee or IC
 - Whether Section 530 relief applies
 - Whether a Section 3509 reduction applies



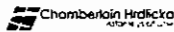
Three Main Battlegrounds - Appeals

- Early Referral Program – Rev. Proc. 99-28
- Should businesses take this route?
 - Good - expedites issues
 - Good – if employment tax matter is sole issue
 - Good – TP can go to Tax Court if bad result
 - Bad – in multi-issue case, no “horse trading”



Three Main Battlegrounds – Tax Court

- Section 7436
- Enacted in 1997, expanded in 2000
- Issues that Tax Court will address
 - Are workers employees or ICs?
 - Does Section 530 apply?
 - How much employment tax, penalties, and interest does business owe?



Three Main Battlegrounds – Tax Court

- IRS issues “Notice of Determination of Worker Classification”
- Business (not workers) file Petition w/n 90 days
- No assessment during trial and/or appeal
- Burden of proof-- possibly switched to IRS
- IRS guidance: Notice 2002-5



Sixth Goal:

Can Businesses Recover Their Fees?



Recouping Fees – Section 7430

- The "prevailing party" can recover
- Reasonable administrative *and* litigation costs
- To "prevail," TP must win case, and
- IRS's position must not be "substantially justified"
 - No reasonable basis in fact and law
 - TP presented all relevant information



Recouping Fees – Section 7430

- Fee recovery in worker-classification cases
 - *Images in Motion of El Paso, Inc. v. Commissioner*, T.C. Memo 2006-19
 - *Vendor Surveillance Corp. v. United States*, 76 AFTR 2d 95-8081



Exhibit 1
Section 530

Text of Section 530, Including Amendments

I. SECTION 530. CONTROVERSIES INVOLVING WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF THE EMPLOYMENT TAXES.

(a) TERMINATION OF CERTAIN EMPLOYMENT TAX LIABILITY. --

(1) In General. -- If --

- (A) for purposes of employment taxes, the taxpayer did not treat an individual as an employee for any period, and**
- (B) in the case of periods after December 31, 1978, all Federal tax returns (including information returns) required to be filed by the taxpayer with respect to such individual for such period are filed on a basis consistent with the taxpayer's treatment of such individual as not being an employee,**

then, for purposes of applying such taxes for such period with respect to the taxpayer, the individual shall be deemed not to be an employee unless the taxpayer had no reasonable basis for not treating such individual as an employee.

(2) STATUTORY STANDARDS PROVIDING ONE METHOD OF SATISFYING THE REQUIREMENTS OF PARAGRAPH (1). -- For purposes of paragraph (1), a taxpayer shall in any case be treated as having a reasonable basis for not treating an individual as an employee for a period if the taxpayer's treatment of such individual for such period was in reasonable reliance on any of the following:

- (A) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;**
- (B) a past IRS audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or**
- (C) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.**

(3) **CONSISTENCY REQUIRED IN THE CASE OF PRIOR TAX TREATMENT.** -- Paragraph (1) shall not apply with respect to the treatment of any individual for employment tax purposes for any period ending after December 31, 1978, if the taxpayer (or a predecessor) has treated any individual holding a substantially similar position as an employee for purposes of the employment taxes for any period beginning after December 31, 1977.

(4) **REFUND OR CREDIT OF OVERPAYMENT.** -- If refund or credit of any overpayment of an employment tax resulting from the application of paragraph (1) is not barred on the date of the enactment of the Act by any law or rule of law, the period for filing a claim for refund or credit of such overpayment (to the extent attributable to the application of paragraph (1)) shall not expire before the date 1 year after the date of the enactment of this Act.

(b) **PROHIBITION AGAINST REGULATIONS AND RULINGS ON EMPLOYMENT STATUS.** -- No regulation or Revenue Ruling shall be published on or after the date of the enactment of this Act and before the effective date of any law hereafter enacted clarifying the employment status of individuals for purposes of the employment tax by the Department of the Treasury (including the IRS) with respect to the employment status of any individual for purposes of the employment taxes.

(c) **DEFINITIONS.** -- For purposes of this section --

(1) **EMPLOYMENT TAX.** -- the term "employment tax" means any tax imposed by subtitle C of the IRC of 1954.

(2) **EMPLOYMENT STATUS.** -- The term "employment status" means the status of an individual, under the usual common law rules applicable in determining the employer-employee relationship, as an employee or as an independent contractor (or other individual who is not an employee).

(d) **EXCEPTION.** -- This section shall not apply in the case of an individual who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work.

Small Business Job Protection Act

SEC. 1122. SPECIAL RULES RELATING TO DETERMINATION WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF EMPLOYMENT TAXES.

(a) In General.--section 530 of the Revenue Act of 1978 is amended by adding at the end the following new subsection:

"(e) Special Rules for Application of section.--

"(1) Notice of availability of section.--An officer or employee of the Internal Revenue Service shall, before or at the commencement of any audit inquiry relating to the employment status of one or more individuals who perform services for the taxpayer, provide the taxpayer with a written notice of the provisions of this section.

"(2) Rules relating to statutory standards.--For purposes of subsection (a)(2)--

"(A) a taxpayer may not rely on an audit commenced after December 31, 1996, for purposes of subparagraph (B) thereof unless such audit included an examination for employment tax purposes of whether the individual involved (or any individual holding a position substantially similar to the position held by the individual involved) should be treated as an employee of the taxpayer,

"(B) in no event shall the significant segment requirement of subparagraph (C) thereof be construed to require a reasonable showing of the practice of more than 25 percent of the industry (determined by not taking into account the taxpayer), and

"(C) in applying the long-standing recognized practice requirement of subparagraph (C) thereof--

"(i) such requirement shall not be construed as requiring the practice to have continued for more than 10 years, and

"(ii) a practice shall not fail to be treated as long-standing merely because such practice began after 1978.

"(3) Availability of safe harbors.--Nothing in this section shall be construed to provide that subsection (a) only applies where the individual involved is otherwise an employee of the taxpayer.

"(4) Burden of proof.--

"(A) In general.--If--

"(i) a taxpayer establishes a prima facie case that it was reasonable not to treat an individual as an employee for purposes of this section, and

"(ii) the taxpayer has fully cooperated with reasonable requests from the Secretary of the Treasury or his delegate,

then the burden of proof with respect to such treatment shall be on the Secretary.

"(B) Exception for other reasonable basis.--In the case of any issue involving whether the taxpayer had a reasonable basis not to treat an individual as an employee for purposes of this section, subparagraph (A) shall only apply for purposes of determining whether the taxpayer meets the requirements of subparagraph (A), (B), or (C) of subsection (a)(2).

"(5) Preservation of prior period safe harbor.--If--

"(A) an individual would (but for the treatment referred to in subparagraph (B)) be deemed not to be an employee of the taxpayer under subsection (a) for any prior period, and

"(B) such individual is treated by the taxpayer as an employee for employment tax purposes for any subsequent period,

then, for purposes of applying such taxes for such prior period with respect to the taxpayer, the individual shall be deemed not to be an employee.

"(6) Substantially similar position.--For purposes of this section, the determination as to whether an individual holds a position substantially similar to a position held by another individual shall include consideration of the relationship between the taxpayer and such individuals."

October 30, 1996

Exhibit 1-2
Page 3 of 3

(b) Effective Dates.--

(1) **In general.--**The amendment made by this section shall apply to periods after December 31, 1996.

(2) **Notice by Internal Revenue Service.--**section 530(e)(1) of the Revenue Act of 1978 (as added by subsection (a)) shall apply to audits which commence after December 31, 1996.

(3) Burden of proof.--

(A) **In general.--**section 530(e)(4) of the Revenue Act of 1978 (as added by subsection (a)) shall apply to disputes involving periods after December 31, 1996.

(B) **No inference.--**Nothing in the amendments made by this section shall be construed to infer the proper treatment of the burden of proof with respect to disputes involving periods before January 1, 1997.