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NATIONAL OFFICE
TECHNICAL ADVICE MEMORANDUM

Uniform Issue List Nos.: 3121.04-01, 3306.05-00, 3401.04-02

ISSUES

(1) Whether instructors for a statewide community college are employees or independent contractors for federal employment tax purposes.

(2) If the instructors are employees, whether the College is entitled to relief from liability for the federal employment taxes under section 530 of the Revenue Act of 1978.

FACTS

The College is a nonprofit community college with ***** locations in the State. It was established in *****. Its purpose is to make a college education available to everyone in the State by bringing college to the community and offering a class schedule that allows a student to pursue a two-year Associate Degree while working. Unlike most college students, the College's students create their own degree program based on classes the College regularly offers (Core Classes) and on whatever experimental classes (non-Core Classes) the College is offering at the time.

The College is one of five institutions affiliated as the State college system. A chancellor and board of trustees govern the affiliation. The other schools differ from the College in that they have campuses, full-time faculties, and separate departments for various academic disciplines. Three of the four offer courses of study leading to a four-year bachelor's degree. Credit for the College's courses can be transferred and applied toward a degree at an affiliated school. Instructors at the other schools are covered by an agreement between the State and the Secretary of Health and Human Services under section 218 of the Social Security Act. The College's exclusively part-time faculty is not included in the agreement.

During the College's early years, most instructors came to the College asking to teach a class. The College's agreement with instructors at that time was that if the instructor could find enough students to take the class, the College would offer college credit, accept tuition payments from students and pay the instructor a lump sum for teaching the class. The College's contact and interaction with instructors was negligible, so much so that by 1979 the Association, the accrediting body for area schools and colleges, was threatening to revoke the College's accreditation. Accordingly, at the Association's direction, the College increased its contact with course instructors.

Currently, 500 to 700 instructors teach College courses each semester. Most of them have regular full-time jobs elsewhere and teach only one course for the College during the semester. The turnover rate each semester is approximately 35 percent.

Core Classes are generally offered at least once each academic year in numerous College locations. Some are offered each semester. Non-Core Classes are designed around an instructor's desire to teach a certain subject.

The College does not prescribe course content, but it does require that instructors for Core Classes meet basic course objectives. This requirement is a result of the Association's 1979 threatened accreditation revocation. Non-Core Class instructors devise their own course objectives but submit them to the College for review. The College and the instructor negotiate the class schedule and location. These negotiations are governed by availability of class facilities and accreditation requirements regarding the number of hours that a course must meet in order for students to receive college credit.

The College leases office space in ***** locations in the State. Some classes are held in those locations, but most are held at local community buildings such as schools, libraries and state or municipal offices. The College makes the necessary arrangements for booking class sites and pays a nominal rent for many sites.

The College provides computer labs at ***** locations for use by the instructors and the students. The College also allows instructors to use its copying machines to reproduce necessary course materials and may purchase other equipment for classroom use. Instructors select course textbooks and prepare course materials, except that where an instructor replaces another instructor who had planned to teach a particular course, the new instructor will be required to use books selected by the replaced instructor. Most textbooks are ordered by the College. Students may purchase them through arrangements with their local College office.

The College and the instructor enter into an Agreement for Professional Services which provides that the instructor will

"discharge the various responsibilities of a College teacher including: a. meet with a college representative for course planning; b. conduct designated class meetings; c. submit required attendance records; d. submit final evaluations, for all students on the official class list, within two weeks after the final class meeting; e. comply with all College rules, regulations and directives; and f. perform such other responsibilities and services as may be appropriate to the responsible completion of the foregoing duties."

The College Catalog instructs both faculty and students with respect to grading and academic standards, expected academic honesty and student behavior, registration procedures, withdrawal procedures, conditions under which classes will be cancelled, the availability of independent study programs and field experience programs, and College nondiscrimination policies, among other topics.

The Agreement provides that the College will pay the instructor a lump sum in two installments--the first at the semester midpoint, and the second at the end of the semester after the College has received the grade report from the instructor. The lump sum amount (currently \$700 per three-credit course) is not calculated by reference to the amount of tuition attributable to the course. The College pays all of its instructors the same amount, regardless of experience, education or course difficulty. Instructors receive an additional \$100 when class enrollment exceeds 16 students to compensate for extra work that may be required by the larger class size.

The Agreement further provides that the College may terminate the contract "at its option" should the instructor fail to fulfill the conditions of the Agreement, without liability for payment for services not satisfactorily performed. If the College terminates the Agreement without cause, it pays the instructor for the full semester.

Instructors are evaluated by the College through student evaluations. The College's Coordinators of Instruction and Advisement try to randomly visit one third of the classes taught by new instructors once during the course of the semester as part of the College's quality control program. A Coordinator may also observe a class if the College has received student complaints about an instructor or if an instructor notifies the College that a course is not progressing well.

During the years under examination, the College treated its instructors as independent contractors.

APPLICABLE LAW AND RATIONALE

Employee Status

Under section 3101 of the Internal Revenue Code, taxes are imposed on employees on wages received with respect to employment. Under section 3111, excise taxes are imposed on employers with respect to wages paid to employees with respect to employment.

Section 3121(a) of the Code provides, with certain exceptions, that for Federal Insurance Contributions Act (FICA) purposes, the term "wages" means all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash.

Section 3121(b) of the Code defines the term "employment". Section 3121(b)(7) of the Code excepts from the definition of the term employment service performed in the employ of a state, or any political subdivision thereof, or any instrumentality of any one or more of the foregoing which is wholly owned thereby. However, section 3121(b)(7)(E) of the Code provides that service included under an agreement entered into pursuant to section 218 of the Social Security Act constitutes employment. Section 218 of the Social Security Act provides that social security coverage may be obtained for state or local government employees only pursuant to an agreement between the state and the Secretary of Health and Human Services (Section 218 Agreement). It is our understanding that the services performed by the instructors in question are not covered by a Section 218 Agreement.

Section 3121(d)(2) of the Code provides that the term "employee" means any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of employee.

Section 3121(u)(2) of the Code provides that state and local employees whose services are not included in a Section 218 Agreement are none-the-less subject to the taxes imposed by sections 3101(b) and 3111(b) of the Code. These are the so called medicare tax portion of the social security taxes. An exception to section 3121(u)(2) is provided for service performed by an individual who was performing substantial and regular service for remuneration for an employer before April 1, 1986, and who is a bona fide employee of that employer on March 31, 1986, if the employment relationship has not been terminated after March 31, 1986, and the employment relationship was not entered into for purposes of meeting the requirements of the exception.

Section 3306(c)(7) of the Code provides that there is no liability for the taxes imposed under the Federal Unemployment Tax Act (FUTA) with respect to services performed for a state or any political subdivision thereof.

There are no similar exceptions for income tax withholding purposes under section 3401 of the Code. Section 3401(c) provides that for income tax withholding purposes the term "employee" includes an officer, employee, or elected official of a state or any political subdivision thereof, or any agency or instrumentality thereof.

The question of whether an individual is an independent contractor or an employee under common law rules is one of fact to be determined upon consideration of the facts and the application of the law and regulations in a particular case. Guidelines for determining whether the employer-employee relationship exists are found in three substantially similar sections of the Employment Tax Regulations: sections 31.3121(d)-1, 31.3306(i)-1 and 31.3401(c)-1, relating to the FICA, the FUTA, and federal income tax withholding, respectively.

Section 31.3121(d)-1(a)(3) of the regulations provides that if an employer-employee relationship exists, the designation or description of the parties as anything other than that of employer and employee is immaterial. Thus, if that relationship exists, it is of no consequence that the employee is designated as partner, coadventurer, agent, independent contractor, or the like.

Section 31.3121(d)-1(c) of the regulations provides that every individual is an employee if under the usual common law rules the relationship between him and the person for whom he performs services is the legal

relationship of employer and employee. Generally, that relationship exists when the person for whom the services are performed has the right to control and direct the individual who performs the services, not only as to the results to be accomplished by the work but also as to the details and means by which the result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done, but also as to how it shall be done. In this connection, it is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is the employer. Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor. Whether the relationship of employer and employee exists under the usual common law rules will, in doubtful cases, be determined upon an examination of the particular facts of each case.

Twenty factors have been identified as indicating whether sufficient control is present to establish an employer-employee relationship under the common law rules. These factors have been developed based on an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed. See, Rev. Rul. 87-41, 1987-1 CB 296.

The requisite degree of direction and control may depend upon the worker's occupation. The methods by which professionals work are prescribed by the techniques and standards of their profession. The high degree of skill required of a professional sometimes makes it difficult or impossible for the employer to supervise the work. Therefore, the control of an employer over the manner in which professional employees carry out their work must necessarily be more general than the control over nonprofessional employees. See, Wendell E. and Evelyn C. James v. Commissioner, 25 T.C. 12% (1956).

A person who is required to comply with instructions about when, where, and how he is to work is ordinarily an employee. This control factor is present if the person or persons for whom the services are performed have the right to require compliance with instructions. See, for example, Rev. Rul. 68-598, 1968-2 CB 464 and Rev. Rul. 66-381, 1966-2 CB 449. Similarly, training a person--by an experienced worker, by correspondence, by required attendance at meetings, and by other methods--indicates that the employer wants the services performed in a particular manner. See, Rev. Rul. 70-630, 1970-2 CB 229. The Agreement entered into by the College and the instructors provides that instructors must "meet with a college representative for course planning...comply with all College rules, regulations and directives...and perform such other responsibilities and services as may be appropriate to the responsible completion of the foregoing duties." The College provides instructors with basic course objectives for Core Classes and reviews instructor-derived objectives for non-Core Classes. The College Catalog instructs faculty in the College's academic policies and administrative procedures. The College's evaluation process, the per semester duration of the Agreement, and the College's ability to terminate the Agreement "at its option" if the instructor fails to fulfill its conditions provide sufficient opportunity for the College to require that instructors comply with the College's policies and procedures.

Integration of a person's services into the business operations generally shows that the person is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the people who perform those services must necessarily be subject to a certain amount of control by the owner of the business. See, United States v. Silk, 331 U.S. 704 (1947), 1947-2 CB 167. The College is an accredited institution of higher education. The instructors are engaged to educate students at the College. A student who is taught by an instructor is not merely a student of that instructor but is a student of the College. It is the College, not the faculty, that grants degrees. Accordingly, the services of the instructors are an integral part of the College's business.

If services must be rendered personally, presumably the person or person for whom the services are performed are interested in the methods used to accomplish the work as well as in the results. See, Rev. Rul. 55-695, 1955-2 CB 410. While the Agreement between the College and the instructors does not expressly require

that instructors personally render the teaching services, industry practice indicates that teachers are hired for services to be rendered personally, except for an occasional substitute or guest lecturer. There are no facts in this instance to indicate otherwise.

Hiring, supervising and paying for assistants is also a factor used to determine whether an employment relationship exists. Compare, Rev. Rul. 63-115, 1963-1 CB 178 with Rev. Rul. 55-593, 1955-2 CB 610. However, as on the question of personal service, the Agreement is silent with respect to assistants. Industry practice indicates that an occasional substitute or guest lecturer may be provided by either the institution or the teacher without affecting the decision as to whether the employment relationship exists.

A continuing relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing relationship may exist where work is performed at frequently recurring although irregular intervals. See, United States v. Silk. College courses are taught by the instructors at regular intervals during the contract period.

The establishment of set hours of work by the person or persons for whom services are performed is a factor indicating control. See, Rev. Rul. 73-591, 1973-2 CB 337. Class schedules are established by the College, after negotiation with the instructors and are published in the College's Course List.

If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and impliedly restrict the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses. See, Rev. Rul. 56-694, 1956-2 CB 694. Most instructors devote only a few hours per week to their teaching for the College and many have other full-time employment, businesses or professional practices. However, while full-time work is indicative of the status of employee, part-time work is not necessarily indicative of the status of independent contractor.

If the work is performed on the premises of the person or persons for whom the services are performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Rev. Rul. 56-660, 1956-2 CB 693. Most College classes are held at College-provided facilities. The fact that the College does not own the facilities is irrelevant. The College makes the necessary arrangements for booking class sites and pays any rent charged.

If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker's own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom the services are performed do not set the order of the services or set the order infrequently. It is sufficient to show control, however, if such person or persons retain the right to do so. See, Rev. Rul. 56-694. Ordinarily, the order or sequence for presenting material in a college-level course is left to the discretion of the course instructor. The College retains the right to control by requiring that all course objectives be approved by the College, in part as a result of the Association's threatened accreditation revocation.

A requirement that the worker submit regular oral or written reports to the person or persons for whom the services are performed indicates a degree of control. See, Rev. Rul. 70-309, 1970-1 CB 199, and Rev. Rul. 68-248, 1968-1 CB 431. Like most college teachers, instructors must submit attendance and grade reports to the College.

Payment by the hour, week or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump-sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor. See, Rev. Rul. 74-389, 1974-2 CB 330. Instructors are paid a lump sum by the College in two installments. Industry practice indicates that a teacher's compensation usually is based on a specific sum to be

paid for services performed over a semester, term or academic year. Payment of a lump sum therefore does not preclude the existence of an employment relationship.

If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's business activities. See, Rev. Rul. 55-144, 1955-1 CB 483. There is no indication that the College's instructors incur any business or traveling expenses.

The fact that the person or persons for whom the services are performed furnish significant tools, materials and other equipment tends to show the existence of an employer-employee relationship. See, Rev. Rul. 71-524, 1971-2 CB 346. The College furnishes all of the significant tools, materials and other equipment needed by the instructors, including computers, copying machines and other equipment it deems necessary. Any other teaching aids which are provided by the instructors (e.g., worksheets, quizzes and exams) have not been shown to be of any significant expense. Although instructors select course textbooks, the College orders most books, bears any costs involved, and makes the books available for purchase by students.

A worker's investment in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party) tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and, accordingly, the existence of an employer-employee relationship. See, Rev. Rul. 71-524. Instructors do not have a significant investment in facilities. All facilities, including computer labs, are provided by the College and any rent or other expenses are paid by the College.

A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot is an employee. See, Rev. Rul. 70-309. The risk that a worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient risk to support treatment as an independent contractor. The College bears most risk of profit or loss in this instance. Instructors are paid the same whether or not tuition payments and other funds raised cover the College's expenses.

If a worker performs more than de minimis services for a multiple of unrelated persons or firms at the same time, independent contractor status is generally indicated. See, Rev. Rul. 70-572, 1970-2 CB 221. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement. In Rev. Rul. 61-178, 1961-2 CB 153, a physician was engaged, part-time, to provide medical services. He was paid a salary and was entitled to the same fringe benefits as the employees of the firm that engaged him. At the same time, he maintained a medical practice that was not related to the firm. His services for the firm were integrated into the business of the firm and were substantial, regular and continuing. Because the firm retained sufficient control to require compliance with its policies, the physician was held to be an employee of the firm.

The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship. See, Rev. Rul. 56-660. Many instructors have other businesses, employment or practices. However, those instructors for the most part provide accounting or other services rather than educational services, to the general public. Accordingly, their status as practicing accountants, for example, is not a factor indicating their status as independent contractors with respect to the educational services they provide to the College. The means by which members of the faculty earn other compensation does not indicate that the College lacks control over them when they provide educational services for the College.

The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so

long as the independent contractor produces a result that meets the contract specifications. See, Rev. Rul. 75-41, 1975-1 CB 323. If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer-employee relationship. See, Rev. Rul. 70-309. The Agreement between the College and the instructor provides that the College may terminate the contract "at its option" should the instructor fail to fulfill the conditions of the Agreement, without liability for payment for services not satisfactorily performed. If the College terminates the Agreement without cause, it pays the instructor for the full semester. Similarly, if an instructor terminates the Agreement without cause, the instructor would be liable to the College for damages. However, the College apparently finds it more cost effective to find an immediate replacement instructor than to pursue a former instructor for breach of contract. These facts indicate that an instructor may be an independent contractor, but they are not by themselves determinative.

In Revenue Ruling 70-308, 1970-1 CB 199, part-time instructors at a school offering courses for certain occupations in the airline industry were held to be employees of the school. The instructors taught during hours that did not conflict with their regular jobs. Each had work experience in his area of instruction. The school determined the courses offered, advertised and otherwise offered the courses in its own name, enrolled the students, and provided the classrooms and other facilities and materials used. Course fees were paid directly to the school. Instructors performed the teaching services on the school's premises, reported in person when classes were to be conducted and were subject to periodic observation by representatives of the school. Instructors had no direct monetary relationship with the students in regard to their teaching services. An instructor could terminate his relationship with the school at any time and the school could also terminate the relationship if the instructor did not follow the curriculum. We find these circumstances similar to those of the instructors at the College.

Revenue Ruling 70-338, 1970-1 CB 200, dealt with two different teaching arrangements at a music conservatory. Under the first arrangement, teachers performed services as instructors of the regular classes of the conservatory for a regular remuneration. They were required to spend certain designated hours in the conservatory each day instructing the classes, conducting examinations and performing such other duties as the conservatory, from time to time, imposed upon them. Under the second arrangement, the conservatory agreed to furnish a studio for the teacher's use, to insert the name of the teacher and the tuition fee agreed upon in the catalog of the conservatory, to register on its books all persons applying for instruction from the teacher, to keep a proper record of the lessons given and the charges made by the teacher and to use its best efforts to collect all tuition charges made by the teacher. The teacher agreed not to teach elsewhere within the city limits without the consent of the conservatory and to allow the conservatory to retain a specified percentage of the amount collected from his pupils, guaranteeing that the portion so retained would amount to a specified sum. The teacher could not be dismissed during the life of the contract. The conservatory did not guarantee to furnish any students to the teacher. Approximately 80 percent of all students enroll as a result of the teacher's activities. The conservatory had no control over the teachers in the second arrangement as to the time or manner in which the lessons were given. The teachers had a right to reject any students. Tuition fees collected by the conservatory were deposited in a separate trust account. No refunds were made without the consent of the teacher. Notwithstanding frequent changes of teachers, a student following one teacher could not be diverted to another.

Rev. Rul. 70-338 holds that the conservatory had sufficient right to direct and control the manner of performance of services by the teachers under the first arrangement but that the second arrangement contemplated the performance by the conservatory of certain administrative and operative services in return for a specified percentage of the tuition fees collected. Accordingly, the teachers in the first group were employees but those in the second were independent contractors. In the present case, the College is not simply performing administrative or operative services in return for a specified percentage of tuition fees collected. The circumstances under which the instructors perform teaching services for the College are far different from those under which the second group of music instructors in Rev. Rul. 70-338 taught at the conservatory.

Section 530 Relief

Section 530(a)(1) of the Revenue Act of 1978 provides that if an employer did not treat an individual as an employee for any period for purposes of the federal employment taxes imposed under the FICA, the FUTA, or income tax withholding, the individual will be deemed not to be an employee for that period unless the taxpayer had no reasonable basis for not treating the individual as an employee. See Rev. Proc. 85-18, 1985-1 CB 518, which provides instructions for implementing the provisions of section 530.

However, government agencies and instrumentalities are not entitled to relief under section 530. When section 530 was enacted by Congress, federal, state and local governments were not subject to the taxes imposed under the Federal Insurance Contributions Act (FICA) or the Federal Unemployment Tax Act (FUTA), nor were their employees subject to the taxes imposed under FICA. Government employers were required only to withhold income tax from the wages of employees. In passing the Revenue Act of 1978, Congress clearly intended to provide relief to employers faced with economic difficulties because of failure to properly treat the workers as common law employees. It is also clear that Congress intended the Act to apply to entities in a commercial setting.

CONCLUSIONS

- (1) The instructors are employees of the College for federal employment tax purposes, including income tax withholding. Under section 3121(b)(7) of the Code, wages paid to the instructors, who are not covered by a 218 agreement, are subject to the hospital insurance (medicare) tax imposed under sections 3101(b) and 3111(b) of the Code unless they have been continuously employed by the College within the meaning of section 3121(u)
 - (2). Under section 3306(c)(7) of the Code, the College is not liable for FUTA taxes.
- (2) The College is not entitled to relief under section 530 of the Revenue Act of 1978.