

## DEPARTMENT OF STATE REVENUE

Revenue Ruling #2013-02 ST  
March 19, 2013

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**ISSUES**

Income Tax Withholding – "Employee vs. Independent Contractor" Determination

A company ("Taxpayer") is seeking an opinion as to whether a certain group of workers that it pays for services rendered should be classified as "employees" or "independent contractors" for purposes of Taxpayer's Indiana income tax withholding obligations.

Authority: [IC 6-3-1-6](#); [IC 6-3-1-11](#); [IC 6-3-4-8](#); I.R.C. 3401 et seq.; Mortgage Consultants, Inc. v. Mahaney, 655 N.E.2d 493 (Ind., 1995); Jug's Catering, Inc. v. Indiana Dept. of Workforce Development, Unemployment Ins. Bd., 714 N.E.2d 207 (Ind.App., 1999); Ridgewell's Inc. v. United States, 655 F.2d 1098 (Ct. Cl., 1981); Revenue Act of 1978 Section 530.

**STATEMENT OF FACTS**

Taxpayer provides the following facts regarding its request for a revenue ruling. Taxpayer was incorporated in 1982 as a catering business. In particular, Taxpayer further provides:

Taxpayer was previously audited by the Internal Revenue Service ("IRS") for the years 1990, 1991, and 1992. With regards to its officers, Taxpayer had been treating them as "independent contractors." The IRS, however, determined that Taxpayer's officers should be treated as "employees." Taxpayer was not required to remit withholding tax due to this retroactive reclassification, though, because of the safe harbor provisions found in Section 530 of the Revenue Act of 1978. With regards to the rest of its workers, Taxpayer had been treating them as "independent contractors," a determination with which the IRS agreed. Taxpayer has remained consistent ever since this initial IRS audit regarding its treatment of both its workers and its officers.

Taxpayer was once again audited by the IRS for the years 2004 and 2005 and it has had several inquiries from the IRS over the years regarding worker status. In all of the aforementioned cases, the IRS has determined that Taxpayer's treatment of both (a) its officers as "employees," as well as (b) its workers as "independent contractors," are correct under the relevant Internal Revenue Code ("IRC") provisions.

The Indiana Department of Revenue ("Department") audited Taxpayer for the years 2007, 2008, and 2009. Despite the history of treatment and evaluation by the IRS with regards to Taxpayer's classification of its workers as "independent contractors," the Department found to the contrary and indicated that Taxpayer should "treat these workers as employees and withhold state and local taxes beginning 1/1/2011." It is with this particular determination by the Department that Taxpayer takes issue.

**DISCUSSION**

Taxpayer has phrased its request in terms of whether or not it is eligible for "Section 530 relief" with regards to its classification of its workers as "independent contractors" and the Department's subsequent characterization of them as "employees."

The classification of a worker as an "employee" or "independent contractor" has mainly been made under the common law control test. See *Mortgage Consultants, Inc. v. Mahaney*, 655 N.E.2d 493 (Ind., 1995) (discussing the analysis in Indiana as to whether there is an employer-employee or independent contractor relationship created). During the 1960s, the IRS significantly increased enforcement in the area of employment tax with significant resulting turmoil. *Ridgewell's Inc. v. United States*, 655 F.2d 1098 (Ct. Cl., 1981). Congress subsequently enacted Section 530 of the Revenue Act of 1978 ("Section 530") to provide temporary relief for employers involved in a retroactive classification controversy with the IRS. Section 530 has never been incorporated into the IRC. In pertinent part, Section 530 prevented the IRS from reclassifying "independent

contractors" as "employees" if the terms of the safe harbor provisions were met, regardless of whether the workers would or would not be treated as employees under the common law analysis. Revenue Act of 1978, Pub. L. No. 95-600, Sec. 530 (1978). Section 530(a)(1) provides, in pertinent part, that

"[i]f (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." (Emphasis added.)

As it concerns the circumstances herein at issue, Section 530 is absolutely inapplicable. "Section 530, by its very terms, 'is a relief provision available only to employers who erroneously classify their employees.'" *Jug's Catering, Inc. v. Indiana Dept. of Workforce Development, Unemployment Ins. Bd.*, 714 N.E.2d 207, 210 (Ind.App., 1999) (emphasis in original). "Moreover, Section 530 'merely eliminates liability for those discrete periods of time during which the employer erroneously but reasonably failed to treat an individual as an employee. It does not grant perpetual immunity.' Id. That Taxpayer was once granted Section 530 relief has no bearing on future periods. All that Section 530 relief means is that if the safe harbor provisions are satisfied, the IRS may not retroactively reclassify "independent contractors" as "employees," thereby protecting employers from retroactive imposition of income tax withholding liability.

Additionally, the nature of Taxpayer's argument makes a claim for Section 530 relief even more misplaced. Taxpayer is objecting to the Department's request that it treat its workers as employees going forward from the year 2009 for purposes of Indiana income tax withholding purposes. By its very terms, Section 530 only applies to "Federal tax returns," thus placing Indiana tax returns completely beyond its scope.

Further making improper Taxpayer's invocation of Section 530 for relief is that Taxpayer is not attempting to avoid retroactive imposition of income tax withholding liability. Rather, it is attempting avoid the prospective classification, urged by the Department, of its workers as "employees." Section 530 relief does not function to preclude prospective changes in classifications. All that Section 530 does is prevent the retroactive imposition of income tax withholding liability where the employer had reasonable grounds upon which it classified its workers as "independent contractors" as opposed to "employees." Thus, even assuming that Section 530 applied to state returns (which it does not), the relief sought is not something that can be granted under Section 530.

The failure of Taxpayer's Section 530 argument is not the end of our inquiry, for Taxpayer has alternatively directed the Department to two provisions of the Indiana Code. I.C. 6-3-1-11 provides in relevant part:

"(b) Whenever the Internal Revenue Code is mentioned in this article, the particular provisions that are referred to, together with all the other provisions of the Internal Revenue Code in effect on January 1, 2011, that pertain to the provisions specifically mentioned, shall be regarded as incorporated in this article by reference and have the same force and effect as though fully set forth in this article. To the extent the provisions apply to this article, regulations adopted under Section 7805(a) of the Internal Revenue Code and in effect on January 1, 2011, shall be regarded as rules adopted by the department under this article, unless the department adopts specific rules that supersede the regulation."

Taxpayer also makes note of I.C. 6-3-4-8, which provides in relevant part:

"(a) Except as provided in subsection (d), every employer making payments of wages subject to tax under this article, regardless of the place where such payment is made, who is required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid by such employer to such employee, shall, at the time of payment of such wages, deduct and retain therefrom the amount prescribed in withholding instructions issued by the department...." (Emphasis added.)

Consequently, a taxpayer's Indiana income tax withholding obligations are to a large extent predicated upon the taxpayer's income tax withholding obligation for federal income tax purposes.

For purposes of determining an employer's income tax withholding responsibilities pursuant to IRC Section 3401 et seq., the IRS looks to IRC Section 3401(c) to determine whether or not a worker should be classified as an "employee." As stated above, the IRS, in various audits and inquiries, approved of Taxpayer's classification of its workers as "independent contractors" and not as "employees" pursuant to IRC Section 3401(c). This

determination, though not dispositive, is given great weight by the Department, as I.C. 6-3-1-6 indicates that "[t]he term 'employee' means 'employee' as defined in Section 3401(c) of the Internal Revenue Code."

Using the terminology as it is employed in the Indiana Code, the IRS has determined that Taxpayer is not "required under the provisions of the Internal Revenue Code to withhold, collect, and pay over income tax on wages paid" to these independent contractors. The IRS made this determination through statutory construction and interpretation of IRC Section 3401(c), a statute which it is charged with construing and enforcing. Accordingly, because of the weight given to the reasonable interpretation of said statute by the IRS, the Indiana Department of Revenue will abide by this interpretation and acquiesce to Taxpayer's classification of its workers as "independent contractors" for Indiana income tax withholding purposes, but only so long as the IRS approves of such classification. While the IRS continues to approve of Taxpayer's treatment of its workers as "independent contractors," Taxpayer must issue to those workers 1099s. However, should the IRS change its determination with regards to the classification of these workers, then so, too, shall the Department.

### **RULING**

Taxpayer shall be required to withhold, collect, and pay over income tax as required by the Internal Revenue Code. To the extent that worker classifications are at issue for purposes of Taxpayer's Indiana income tax withholding obligations, the Department agrees to follow the determinations of the IRS as to whether or not a worker is an "employee" or an "independent contractor."

### **CAVEAT**

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances as stated herein are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling a change in statute, regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

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