

PROPOSED RULES
DEPARTMENT OF THE TREASURY

Internal Revenue Service
26 CFR Parts 1 and 31
[LR-214-82]

Treatment of Qualified Real Estate Agents and Direct Sellers as Nonemployees;
Determination of Employer Liability for Certain Employment Taxes; Information
Reporting of Direct Sales and Payments of Remuneration for Services

Tuesday, January 7, 1986

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed amendments to the Employment Tax Regulations under section 3508, relating to the treatment of qualified real estate agents and direct sellers as nonemployees for Federal income and employment tax purposes, and under section 3509, relating to the determination of employer liability for income tax withholding and employee social security taxes where the employer treated an employee as a nonemployee for purposes of such taxes. It also contains proposed amendments to the Income Tax Regulations under section 6041A, relating to information reporting of direct sales and payments of remuneration for services. Sections 3508, 3509, and 6041A were added to the tax law by sections 269, 270, and 312, respectively, of the Tax Equity and Fiscal Responsibility Act of 1982 (96 Stat. 551, 553, 601). The regulations would provide the public with the guidance needed to comply with the applicable tax law.

DATES: Written comments and requests for a public hearing must be delivered or mailed by March 10, 1986. The regulations under section 3508 are proposed to be effective for services performed after December 31, 1982, and the regulations under section 6041A are proposed to be effective for payments and sales made after December 31, 1982. The regulations under section 3509 are proposed to be effective for any income and employee social security taxes required to be deducted and withheld, except with respect to assessments made before January 1, 1983.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-214-82), Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: Robert E. Shaw of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224 (Attention: CC:LR:T) (202-566-3297), not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

The determination of whether an individual is an employee or independent contractor for Federal tax purposes is important for several reasons. Wages paid to employees generally are subject to social security taxes imposed on the employer and the employee under the Federal Insurance Contributions Act (FICA) and to unemployment taxes imposed on the employer under the Federal Unemployment Tax Act (FUTA). Compensation paid to independent 51 FR 619-01 contractors is subject to the tax on self-employment income (SECA), but not to FICA or FUTA taxes. The SECA is generally paid only by self-employed individuals. In addition, Federal income tax must generally be withheld from compensation paid to employees but not from compensation paid to independent contractors.

Except for sections 3121(d)(3) and 3306(i), which establish categories of statutory employees for social security and Federal unemployment tax purposes, prior to the enactment of the Tax Equity and Fiscal Responsibility Act of 1982, the determination of an individual's status as an employee or independent contractor generally was made under common-law (i.e., nonstatutory) rules. Under the common-law test, an individual generally is an employee if the person for whom the individual performs services has the right to control and direct that individual, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. Thus, the most important factor under the common law is the degree of control, or right of control, which the employer has over the manner in which the work is to be performed. The Service applies various factors that have evolved from the common law to determine whether the requisite control exists. Because of the difficulty that often arises in applying these factors, several bills introduced in both the House and the Senate during 1982 set forth statutory "safe-harbor" tests which, if satisfied with respect to an individual, would result in that individual being classified as an independent contractor. The proposed safe-harbor requirements, generally applicable to post-1982 services, related to: (1) Control of hours worked, (2) place of business, (3) investment or income fluctuation, (4) written contract and notice of tax responsibilities, and (5) the filing of required returns. S.Rep. No. 97-494, 97 Cong., 2d Sess. 364 (1982). Workers who did not meet the safe-harbor tests still would have had their employment tax status determined under the common-law rules.

In enacting the Tax Equity and Fiscal Responsibility Act of 1982 (Pub.L. 97- 248), Congress rejected the broader safe-harbor tests proposed by these bills and instead partially resolved the employee-independent contractor controversy by creating two categories of statutory nonemployees—qualified real estate agents and direct sellers. Thus, notwithstanding the common-law rules, an individual is an independent contractor for services that satisfy the statutory requirements of section 3508. Other employment situations generally must continue to be evaluated under common-law principles.

In response to the serious tax deficiencies that may arise when a worker erroneously treated as an independent contractor is reclassified as an employee, Congress enacted section 3509, which fixes an employer's liability for income tax withholding and employee social security taxes generally at a fraction of the amount of taxes which should

have been deducted and withheld. Section 3509 provides relief to employers who would otherwise be liable for the full amount of such taxes which should have been deducted and withheld and provides a sanction for an employer's erroneous treatment of a worker in situations in which the employer would otherwise be able to escape liability for such taxes under the statutory offset provisions of sections 3402(d) and 6521.

To assure increased compliance by direct sellers with the income tax law, Congress added section 6041A (section 312 of the Tax Equity and Fiscal Responsibility Act of 1982) which, in addition to other requirements, imposes an obligation on direct sellers of consumer products to report gross sales totalling \$5,000 or more in a calendar year to any buyer for resale in the home or some place other than a permanent retail establishment. Congress also provided a penalty for failure to file this return (section 6652) and a penalty for failure to furnish certain statements (section 6678).

Explanation of Provisions

In General

The proposed regulations provide that an individual performing services as a qualified real estate agent or a direct seller will not be treated as an employee and the service-recipient will not be treated as an employer for Federal income and employment tax purposes. In order to qualify for such treatment substantially all the remuneration paid by a service-recipient to an individual for services as a real estate agent or direct seller must be directly related to sales or other output and such services must be performed pursuant to a written contract providing that such individual will not be treated as an employee for Federal tax purposes.

The proposed regulations make clear that a statutory employee (that is, an individual treated as an employee under section 321(d)(3) of the Code) who also qualifies as a nonemployee under section 3508 will be treated as a nonemployee for FICA, FUTA, and Federal income tax withholding purposes with respect to services described in section 3508. For example, an agent-driver (statutory employee) who qualifies as a direct seller (statutory nonemployee) will be treated as a nonemployee for FICA, FUTA, and income tax withholding purposes with respect to services performed as a direct seller. The regulations also make clear that the written contract requirement is not met unless the contract specifically states that the individual will not be treated as an employee for Federal tax purposes. For this purpose, it is not sufficient that the contract merely states that the individual will not be treated as an employee.

“Substantially All” Remuneration Requirement

Section 3508 requires in order for an individual to be treated as a qualified real estate agent or a direct seller substantially all of the remuneration received for services as a real estate agent or direct seller must be directly related to sales or other output. The proposed regulations provide that the “substantially all remuneration” test is satisfied with respect to services performed as a real estate agent or direct seller if at least 90 percent of the total remuneration received during the calendar year by the individual for services performed as a real estate agent or direct seller is directly related to sales or other output rather than to the number of hours worked. The proposed regulations also provide rules

for applying the “directly related to sales or other output” requirement to pooled remuneration arrangements, remuneration received in advance of sales or performance, and remuneration dependent on the productivity of others.

Direct Sellers

A direct seller is any salesperson who, in addition to meeting the “substantially all” remuneration and written contract requirements, sells consumer products, either directly or through a middleperson (i.e., a buyer) for ultimate resale, in the home or in a place other than in a permanent retail establishment. The proposed regulations defined “consumer product” as any tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes (including any such property intended to be attached to or installed in any real property without regard to whether it is so attached or installed). This definition corresponds to the definition provided in 15 U.S.C. 2301, and the limitation to tangible property is consistent with others definitions of consumer products found in the United States Code (15 U.S.C. 2052; 18 U.S.C. 1365; 42 U.S.C. 6291). The proposed regulations define “permanent retail establishment” as any business operating in or from a structure or facility which remains stationary for a substantial period of time to which consumers go to purchase consumer goods. The proposed regulations also clarify that vendors operating within, or on the grounds of, a permanent structure or facility such as a sports arena or amusement park are considered to operate in a permanent retail establishment for purposes of section 3508. Thus, the term “direct seller” may include door-to-door salespersons of not only products 51 FR 619-01 traditionally thought of as consumer products (e.g., personal toiletry items, vacuum cleaners, kitchen products) but also products which require installation or construction on the consumer’s property (e.g., residential swimming pools, aluminum siding, kitchen cabinets, storm windows, insulation, carpeting) and products not used in or around the home. The term also includes salespersons who sell consumer goods directly to consumers through an exchange medium other than a permanent retail establishment (e.g., mobile meal wagons or street vendors). The term does not include door-to-door salespersons of intangible products (e.g., insurance, cable television subscription).

Persons who provide services generally are not direct sellers. For example, persons who provide services that do not involve the use of a product (e.g., polltakers) or services that involve parts or materials which are incidental to providing services (e.g., painting, carpet cleaning, septic tank cleaning, lawn care, pest control services, or appliance repair) are considered service providers rather than direct sellers.

Services of Real Estate Agent and Direct Seller

The proposed regulations provide that the services performed as a direct seller are activities generally associated with the sale of consumer products in the home or otherwise than in a permanent retail establishment. These services include activities that are necessary to increase the sale efforts of other individuals, such as providing motivation, encouragement, training, recruitment, or counseling. Installation services performed by a direct seller in connection with the sale of a consumer product generally are not service performed by a direct seller. However, the proposed regulations provide that installation services rendered by a seller in conjunction with the sale of a consumer

product will be service performed as a direct seller if the value of the installation services is 10 percent or less of the purchase price of the product (including installation).

The services performed as a real estate agent are those activities generally associated with the sale of real property. Such services include appraising property, advertising and showing property, closing sales, acquiring a lease to the property, and recruiting, training and supervising other salespersons. The services performed as a real estate agent do not include the management of property.

Retirement Plans for Self-Employed Individuals

The proposed regulations make clear that the fact that an individual is treated as a nonemployee under section 3508 for employment tax purposes will not prevent the individual from being covered under a qualified retirement plan for self-employed individuals.

Employer Liability Under Section 3509

An employer's liability for failure to deduct and withhold income tax or employee social security taxes by reason of treating an employee as a nonemployee for purposes of such taxes is generally determined under section 3509. The employer's liability for income tax withholding is determined as if the amount required to be deducted and withheld was equal to 1.5 percent (3 percent where the employer disregards certain reporting requirements) of the wages paid to the individual erroneously treated as nonemployee. The employer's liability for employee social security taxes is determined as if such taxes imposed were 20 percent (40 percent where the employer disregards certain reporting requirements) of the amount imposed without regard to section 3509. The increased percentages are applicable where an employer fails to timely file any return or statement under section 6401(a), 6041A, or 6051 that would be required consistent with the employer's treatment of the worker as a nonemployee.

The proposed regulation clarify that, for purposes of section 3509, an employer fails to withhold taxes when the employer fails to pay over the full amount of tax required to be deducted and withheld during a calendar year on or before the due date for the return relating to such taxes for the final quarter of such calendar year. Thus, section 3509 is generally applied with respect to each calendar year as a unit.

Under section 3509 and the proposed regulations, if an employer's liability for any tax is determined under section 3509, the employer: (i) May not collect from the employee any amount of tax so determined, and (ii) is not entitled to any offset of liability under section 3402(d) or 65621. An employee's liability for taxes is not affected by application of section 3509 to the employer and the offset provisions of section 6521 may, where applicable, apply with respect to the employee's liability for employee social security taxes. An employer's liability for employer social security taxes is not affected by section 3509.

Section 3509 does not apply where an employer deducts income tax but not employee social security taxes or where the employer intentionally disregards the requirements to withhold and deduct Federal income tax or employee social security taxes. Section 3509 does not apply to employee social security taxes with respect to statutory employees described in section 3121(d)(3). The proposed regulations clarify that if an employer's

liability for any tax is determined under section 3509 the employer may still be liable for penalties with respect to his or her failure to deduct and withhold such tax. The amount of such penalties, however, is based on the amount of the employer's liability for such tax under section 3509.

The proposed regulations also clarify that the amount of an employer's liability for tax determined under section 3509 will be considered satisfied to the extent of the amount of such tax which was actually withheld and deducted from the employee and paid. If the amount withheld, deducted, and paid exceeds the employer's liability as computed under section 3509, however, the employer may not claim a refund or credit of such excess amount.

New Reporting Requirements

Section 6041A added two reporting requirements relating to payments as remuneration for services and gross sales of consumer products to a buyer for resale in the home or otherwise than in a permanent retail establishment. Section 6041A(a) requires that a service-recipient engaged in a trade or business, who, in the course of that trade or business, makes payments to a person as remuneration for services, report such payments if the total remuneration paid to that person by the service-recipient during the calendar year is \$600 or more. The proposed regulations provide that such remuneration does not include any amounts which the service-recipient knows are excludable from the gross income of the person performing services (e.g., qualified foster care payments under section 131). Section 6041A(b) requires a direct seller to report gross sales of consumer products totaling \$5,000 or more in a calendar year to any buyer who resells the product in the home or any place other than a permanent retail establishment. All sales of consumer products to a buyer for resale to another person are taken into account in determining the aggregate amount of sales to that buyer during the calendar year, even if the buyer resells some of the products in a permanent retail establishment. The proposed regulations clarify that the aggregate amount of sales of consumer products to a buyer during a calendar year includes the sale of products used by the buyer for the buyer's personal use or consumption (including products disposed of in a manner other than resale such as gifts to friends or relatives). However, the aggregate amount of sales does not include the sale of goods that cannot be resold, such as catalogs and samples.

The proposed regulations make clear that an information return is required with respect to any person who sells consumer products in the home or otherwise than in a permanent retail establishment regardless of whether that person purchases the product from the company and resells it to the consumer or is a company salesperson (other than an employee) who does not acquire title to a product before selling it. The proposed regulations provide that the regulatory exceptions to the reporting requirement under section 6041, as set forth in § 1.6041-3, are applicable to the reporting requirement under section 6041A(a).

Comments and Public Hearing

Before adoption of these proposed regulations, consideration will be given to any written comments that are submitted (preferably eight copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public

hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

The collection of information requirements contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget (OMB) for review under section 3504(h) of the Paperwork Reduction Act. Comments on these requirements should be sent to the Office of Information and Regulatory Affairs of OMB, Attention: Desk Officer for Internal Revenue Service, New Executive Office Building, Washington, DC 20530. The Internal Revenue Service requests that persons submitting comments on these requirements to OMB also send copies of those comments to the Service.

Special Analyses

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required.

Although this document is a notice of proposed rulemaking which solicits public comment, the Internal Revenue Service has concluded that the regulations proposed herein are interpretative and that the notice and public comment requirements of 5 U.S.C. 553 do not apply. Accordingly, these proposed regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. Chapter 6).

Drafting Information

The principal authors of these proposed regulations are Robert E. Shaw of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service, and Donald W. Stevenson, formerly of that Division. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

List of Subjects

26 CFR 1.6001-1-1.6109-2

Administration and procedure, Filing requirements, Income taxes.

26 CFR Part 31

Direct seller, Employment taxes, Income taxes, Lotteries, Qualified real estate agent, Railroad retirement, Social security, Unemployment tax, withholding.

Proposed Amendments to the Regulations

The proposed amendments to 26 CFR Parts 1 and 31 are as follows:

Employment Tax Regulations

PART 31--[AMENDED]

Paragraph 1. The authority for Part 31 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Sections 31.3508-1 and 31.3509-1 are inserted immediately after § 31.3507-2 to read as follows:

§ 31.3508-1 Treatment of qualified real estate agents and direct sellers as nonemployees.

(a) In general. For Federal income and employment tax purposes.

(1) An individual who performs services after December 31, 1982, as a qualified real estate agent or as a direct seller shall not be treated as an employee with respect to such services, and

(2) The service-recipient shall not be treated as an employer with respect to such services.

(b) Qualified real estate agent defined--(1) In general. For purposes of section 3508 and this section, the term “qualified real estate agent” means any individual who is a sales person (including an individual who does not personally make sales but who recruits, trains, or supervises other individuals who make sales) if—

(i) Such individual is a licensed real estate agent,

(ii) Substantially all of the remuneration (whether or not paid in cash) for the services performed by such individual as a real estate agent is directly related to sales or other output (including the performance of services) rather than to the number of hours worked, and

(iii) The services performed by such individual as a real estate agent are performed pursuant to a written contract between such individual and the service-recipient and the contract provides that such individual will not be treated as an employee with respect to such services for Federal tax purposes.

(2) Services performed as a real estate agent. For purposes of this section, the services performed by an individual as a real estate include any activities that customarily are performed in connection with the sale of an interest in real property. Such services include the advertising or showing of real property, the acquisition of a lease to real property, and the recruitment, training, or supervision of other real estate sales persons. Such services also include the appraisal activities of a licensed real estate agent in connection with the sale of real property. Services performed as a real estate agent do not include the management of property.

Direct seller defined--(1) In general. For purposes of section 3508 and this section, the term “direct seller” means any person if—

(i) Such person—

(A) Is engaged in the trade or business of selling (or soliciting the sale of) consumer products to any buyer on a buy-sell or deposit-commission basis for resale by the buyer or any other person in the home or in some other place that does not constitute a permanent retail establishment, or

(B) Is engaged in the trade or business of selling (or soliciting the sale of) consumer products in the home or in some other place that does not constitute a permanent retail establishment,

(ii) Substantially all the remuneration (whether or not paid in cash) for the performance of the services described in paragraph (c) (2) of this section is directly related to sales or other output (including the performance of services) rather than to the number of hours worked, and

(iii) Such person performs the services described in paragraph (c) (2) of this section pursuant to a written contract between such person and the service- recipient, and the contract provides that such person will not be treated as an employee with respect to such services for Federal tax purposes.

(2) Services performed as a direct seller--(i) In general. The services described in this paragraph (c) (2) are any services that customarily are directly related to the trade or business of selling (or soliciting the sale of) consumer products in the home or in any other location that does not constitute a permanent retail establishment. Such services include any activity to increase the productivity of other individuals engaged in such sales, such as recruiting, training, motivating, and counseling such individuals. Except as provided in paragraph (c) (2)(ii) of this section, such services do not include the installation or construction on the customer's property of a consumer product. See paragraphs (f) and (g)(3) of this section for the inapplicability of section 3508 where the sale or use of consumer products is only incidental to the rendering of services.

(ii) Installation of consumer product in conjunction with the sale of such product. If an individual engaged in the trade or business of selling consumer products performs installation services in conjunction with the sale of a consumer product such services shall be included as services performed as a direct seller only if the value of such installation services is 10 percent or less of the purchase price of such consumer product (including installation). If the value of such installation services exceeds 10 percent of the purchase price of the consumer product (including installation) the installation services shall not be included as services performed as a direct seller. See paragraph (j) of this section for treatment of dual services under section 3508.

(d) Substantially all remuneration directly related to sales or other output-- (1) Substantially all remuneration--(i) In general. The requirement of paragraph (b)(1)(ii) or (c) (1)(ii) of this section is satisfied for any calendar year with respect to the services described in such paragraph if at least 90 percent of the total remuneration, including advances and draws (except as provided in paragraph (d)(1)(ii) of this section), received by the individual from the service-recipient for performing such services during that calendar year is directly related to sales or other output rather than to the number of hours worked.

(ii) Repayment of advances or draws. For purposes of paragraph (d)(1)(i) of this section, total remuneration received by an individual does not include any portion of an advance or draw that is repaid directly or indirectly (including repayment by a debit against the individual's account with the service-recipient) pursuant to a binding written agreement which on the date the advance or draw is received requires repayment of the amount by which such advance or draw exceeds the amount which is directly related to sales or other output (as defined in paragraph (d)(2) of this section). The determination of whether any amounts not excluded under this paragraph (d)(1)(ii) from the total remuneration received by an individual is directly related to sales or other output for purposes of paragraph (d)(1)(i) of this section is made on the basis of all the facts and circumstances (see paragraph (D)(2)(i) of this section).

(2) Directly relating to sales or other output--(i) In general. An item of remuneration is directly related to sales or other output if that item is paid, awarded, or credited to the individual on the basis of the individual's services with respect to one or more specific sales transactions or the accomplishment of one or more specific tasks rather than on the basis of the number of hours worked. Whether an item of remuneration is directly related to sales or other output shall be determined on the basis of all the facts and circumstances. For purposes of this section an item of remuneration that is in the nature of salary, that is, a fixed periodical compensation paid for services rendered without regard to the amount of services rendered, shall be treated as an item of remuneration that is paid, awarded, or credited on the basis of the number of hours worked.

(ii) Directly related to sales or output of some other person. For purposes of this section, remuneration received by an individual based on the sale or productivity of some other individual shall be treated as directly related to sales or other output if it was paid, awarded, or credited on the basis of such other individual's services with respect to one or more particular sales transactions or the accomplishment of one or more specific tasks.

(iii) Remuneration received from a pool. Remuneration received by an individual under an arrangement whereby a service-recipient pools that remuneration of several individuals and a portion of the aggregate pooled remuneration is periodically distributed to each pool participant shall be treated as directly related to sales or other output only to the extent that the amount of remuneration received by that individual from the pool does not exceed the amount of remuneration that, in the absence of the pool arrangement, such individual would have received on the basis of the individual's services with respect to one or more specific sale transactions or the accomplishment of one or more specific tasks. Amounts received from the pool in excess of the amount that person would have ordinarily received for performing services in connection with such specific sales transactions or specific tasks are not directly related to sales or other output.

(e) Written contract requirement--(1) In general. Except as otherwise provided in paragraph (e)(2) of this section, a written contract that states that the individual will not be treated as an employee without specifically stating "for Federal tax purposes" does not meet the written contract requirements set forth in paragraph (b)(1)(iii) and ©(1)(iii).

(2) Existing contracts--(i) In general. A contract which—

(A) Is in effect on or before February 28, 1983, and

(B) States that the individual performing the services will not be treated as an employee but does not specifically include the phrase “for Federal tax purposes,” will be deemed to satisfy the written contract requirement if the service-recipient furnishes to the individual performing the services a written notice that specifically states that the individual will not be treated as an employee “for Federal tax purposes.”

(ii) Date contract requirement deemed satisfied. If the notice described in paragraph (e)(2)(i) of this section is mailed or otherwise furnished on or before February 28, 1983, the written contract requirement shall be deemed satisfied as of the date of the original contract. If the notice is furnished after the date, the written contract requirement is deemed satisfied as of the date the notice is furnished.

(f) Trade or business of selling consumer products. For purposes of section 3508 and this section, a person is not engaged in the trade or business of selling (or soliciting the sale of) consumer products if the sale or use of such products is in an incidental part of a trade or business in which such person primarily renders services to clients. Whether the sale or use of a product is an incidental part or a trade or business that primarily consists of rendering services shall be determined on the basis of all the facts and circumstances, taking into account such factors as the cost of the product in relation to the cost of the service. Generally, the sale or use of a product is an incidental part of a trade or business that primarily consists of rendering services if the use of the product is necessary to the performance of the particular service (e.g., insecticide in a pest control business). See paragraph (c) (2) of this section for the applicability of this section to individuals who install consumer products in conjunction with the sale of such products.

(g) Definitions--(1) Buy-sell basis. A transaction is on a buy-sell basis if the buyer performing the services is entitled to retain part or all of the difference between the price at which the buyer purchases the product and the price at which the buyer sells the product as part or all of the buyer’s remuneration for the services.

(2) Deposit-commission basis. A transaction is on a deposit-commission basis if the buyer performing the service is entitled to retain part or all of a purchase deposit paid by the consumer in connection with the transaction as part or all of the buyer’s remuneration for the services.

(3) Consumer product. The term “consumer product” means any tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes (including any such property intended to be attached to or installed in any real property without regard to whether it is so attached or installed). The term “consumer product” does not include any product used in the manufacture of another product to be distributed in commerce or any product used only incidentally in providing a service (e.g., insecticide used in a pest control service, materials used in an appliance repair business).

(4) Permanent retail establishment. A permanent retail establishment is any retail business operating in a structure or facility that remains stationary for a substantial period of time to which consumers go to purchase consumer goods. Examples of these establishments are: grocery stores, hardware stores, clothing stores, hotels, restaurants, drug stores, and newsstands.

In addition, amusement areas, such as amusement parks and sports arenas, at which consumer products are sold are permanent retail establishments. Portable or mobile structures, facilities, or equipment, such as street vendor stands and mobile carts or vehicles, generally do not constitute permanent retail establishments. However, sales of consumer products may occur in a permanent retail establishment for purposes of this section even though portable or mobile structures, facilities, or equipment is used. For example, a vendor who sells consumer products, such as souvenirs or food, in the stands of a sports arena or on the grounds of an amusement park sells consumer products in a permanent retail establishment. Also, a vendor who sells consumer products in a parking lot or other property which is near to and serving a sports arena or other amusement area pursuant to an agreement which grants to the vendor or to the service-recipient the right to sell consumer products on such property sells consumer products in a permanent retail establishment, regardless of whether the sale is made within a permanent structure.

(5) Service-recipient. The term “service-recipient” means the person (other than a client or customer) for whom the services as a qualified real estate agent or direct seller are performed (e.g., a real estate firm or a company whose consumer products are sold door-to-door).

(h) No inference. The fact that an individual does not qualify under section 3508 and this section as a qualified real estate agent or as a direct seller with respect to any services does not create an inference that such individual is an employee or the service-recipient is an employer with respect to such services.

(i) Application to statutory employees. A statutory employee (that is, an individual in one of the categories of workers defined in section 3121(d)(3) or 3306(i) to be employees) who meets the requirements of paragraph (b) or (c) of this section for classification as a qualified real estate agent or as a direct seller shall be treated as a nonemployee for Federal income tax, Federal Insurance Contribution Act (FICA), and Federal Unemployment Tax Act (FUTA) purposes with respect to services performed as a qualified real estate agent or as a direct seller (as described in paragraphs (b)(2) and (c)(2) of this section, respectively).

(j) Dual services--(1) In general. Section 3508 shall apply only with respect to services performed as a qualified real estate agent or a direct seller. Whether an individual is treated as an employee or as a self-employed individual with respect to services other than those performed as a qualified real estate agent or a direct seller shall be determined under common-law principles.

(2) Examples. The following examples illustrate the principles set forth in this paragraph (j).

Example (1). A is a licensed real estate agent who performs services as a real estate agent pursuant to a written contract described in paragraph (b)(1)(iii) of this section. In addition to performing services as a real estate agent A performs general bookkeeping duties for the same service-recipient. All of the remuneration for the services performed as a real estate agent is directly related to sales. A will be treated as a nonemployee under section 3508 only with respect to A’s services as a real estate agent. Whether A is treated as an employee or as a self-employed individual with respect to the bookkeeping duties will be determined under common-law principles.

Example (2). B is engaged in the trade or business of selling aluminum siding. B performs services as a direct seller pursuant to a written contract described in paragraph (c) (1)(iii) of this section. All sales are made in the customer's home and the purchase price includes installation. B installs all aluminum siding which he sells and receives a commission based upon the purchase price as compensation for his services with respect to both the sale and the installation. The value of such installation services exceeds 10 percent of the purchase price of the siding. B will be treated as a nonemployee under section 3508 only with respect to his services as a direct seller. Whether B is treated as an employee or as a self-employed individual with respect to services performed in installing the siding will be determined under common-law principles.

Example (3). The facts are the same as in example (2) except that B sells and installs personal computers and that the value of the installation services performed by B is less than 10 percent of the purchase price of the computers including installation. B is treated as a nonemployee under section 3508 with respect to both his services in selling the computers and in installing them. See paragraph (c) (2)(ii) of this section.

Example (4). Assume all the requirements of section 3508(b)(1) and paragraph (b) of this section are satisfied with respect to A, a real estate agent, except that A did not obtain a real estate license until March 29. The license was valid for the remainder of the year. A is treated as self-employed under section 3508 for that portion of the year beginning on March 29. Whether for Federal tax purposes A is to be treated as self-employed for the other portion of the year shall be determined under common law.

(k) Coordination with retirement plans for self-employed. This section shall not prevent an individual who is treated as self-employed under section 3508 from being covered under a qualified retirement plan for self-employed individuals pursuant to section 401(c) (1) of the Code.

§ 31.3509-1 Determination of employer's liability for certain employment taxes.

(a) In general. Except as otherwise provided in this section, if during any calendar year any employer fails to deduct and withhold any tax under chapter 24 (relating to withholding of income tax) or subchapter A of chapter 21 (relating to the social security tax on employees) of the Internal Revenue Code of 1954 with respect to any employee by reason of treating such employee as not being an employee for purposes of such chapter or subchapter, the amount of the employer's liability for such tax with respect to such year shall be determined under this paragraph (a).

(1) Income tax withholding. The employer's liability for tax under chapter 24 for such year with respect to such employee shall be determined as if the amount required to be deducted and withheld were equal to 1.5 percent of the wages (defined in section 3401(a)) paid to such employee for such year.

(2) Employee social security taxes. The employer's liability for employee social security taxes under subchapter A of chapter 21 for such year with respect to such employee shall be determined as if the taxes imposed under such subchapter were 20 percent of the amount imposed under such subchapter for such year without regard to this paragraph (a)(2).

Section 3509 and this section do not affect an employer's liability for taxes under subchapter B of chapter 21 (relating to employer social security taxes) of the Internal Revenue Code of 1954. See paragraph (c) of this section for increased employer liability where an employer fails to meet certain reporting requirements.

(b) Definitions--(1) Fails to deduct and withhold any tax--(i) In general. For purposes of section 3509 and this section, an employer fails to deduct and withhold any tax under chapter 24 or under subchapter A of chapter 21 with respect to an employee for a calendar year if such employer fails to pay over the full amount of such tax required to be deducted and withheld during calendar year (determined without regard to section 3509 and this section) on or before the due date for the return relating to such tax for the final quarter of such calendar year.

(ii) Example. The provisions of this paragraph (b)(1) may be illustrated by the following example:

Example. M, an employer, does not deduct and withhold income and social security taxes with respect to A, an employee, for the first quarter of 1985 because of M's erroneous belief that A is not an employee. On April 1, 1985, M ascertains the error and begins to withhold and deduct the full amount of income and social security taxes with respect to A for the remaining three quarters of 1985. M also makes timely adjustments under section 6205 with respect to the first quarter's taxes not deducted and withheld, and pays over the full amount of income and social security taxes which were required to be deducted and withheld during 1985 on or before the due date for the return for the fourth quarter of 1985. M has not failed to deduct and withhold income and social security taxes with respect to A during 1985 for purposes of section 3509 and this section.

(2) Treatment of employee as not being an employee. For purposes of section 3509 and this section, an employer has treated an employee as not being an employee for purposes of the withholding requirements of chapter 24 or subchapter A of chapter 21 if, because of his belief that the employee was not an employee, the employer (i) has failed to deduct and withhold such tax as defined in paragraph (b)(1) of this section for the calendar year and (ii) has also failed to file one or more employment tax returns (including, where applicable, Forms 940 (Employer's Annual Federal Unemployment (FUTA) Tax Return), 941 (Employer's Quarterly Federal Tax Return), 942 (Employer's Quarterly Tax Return for Household Employees), 943 (Employer's Annual Tax Return for Agricultural Employees), and W-2 (Wage and Tax Statement)) for any period during the calendar year with respect to such employee. For purposes of this paragraph (b)(2) an employer who has filed a delinquent or amended employment tax return as a result of Internal Revenue Service compliance procedures (i.e., examination or collection activities) has failed to file an employment tax return.

(c) Employer's liability increased where employer fails to meet reporting requirements--(1) In general. In the case of an employer who fails to meet the applicable requirements of section 6041(a), 6041A, or 6051 with respect to any employee, unless such failure is due to reasonable cause, paragraph (a) of this section shall be applied with respect to such employee:

(i) By substituting "3 percent" for "1.5 percent" in paragraph (a)(1) of this section; and

(ii) By substituting “40 percent” for “20 percent” in paragraph (a)(2) of this section.

(2) Applicable requirement. For purposes of paragraph (c) (1) of this section, an employer has failed to meet the applicable requirements of section 6041(a), 6041A, or 6051 with respect to an employee if—

(i) The employer has treated such employee as not being an employee for purposes of the withholding requirements of chapter 24 or subchapter A of chapter 21, and

(ii) The employer has failed to satisfy any of the requirements described in sections 6041(a), 6041A, and 6051 and the regulations thereunder (relating to information returns and statements) which would be applicable consistent with the treatment described in paragraph (c) (2)(i) of this section.

An employer who has failed to timely file any return or statement required under section 6041(a), 6041A, or 6051 has failed to meet the applicable requirements of that section.

(d) Special rules. For purposes of section 3509 and this section:

(1) Determination of liability. If the amount of any employer’s liability for tax with respect to an employee is determined under section 3509 and this section:

(i) Such employee’s liability for income tax or employee social security taxes shall not be affected by the assessment or collection of any tax so determined and any amount assessed or collected as a result of the application of this section shall not be credited against the employee’s tax liability;

(ii) Such employer shall not be entitled to recover from such employee any tax determined under this section;

(iii) Sections 3402(d) and 6521 shall not apply with respect to such employer’s liability determined under this section, although section 6521 may apply with respect to an employee’s liability regardless of whether the employer’s liability is determined under section 3509; and

(iv) Tax imposed by section 3101 or 3402 (including amounts determined under section 3509) for any calendar year that the employer has reported and paid over with respect to such employee shall be allowed as a credit against tax determined under section 3509 with respect to such employee for such calendar year. If the amount of such reported and paid over tax exceeds the employer’s liability for tax as determined under section 3509, however, such excess does not constitute an overpayment of tax and does not entitle the employer to a refund or credit for the amount of such excess.

(2) Section not to apply where employer deducts and withholds income tax but not social security taxes. Section 3509 and this section shall not apply to any employer with respect to any wages if:

(i) The employer deducted and withheld any amount of the tax imposed by chapter 24 with respect to such wages, but

(ii) Failed to deduct and withhold the amount of the taxes imposed by subchapter A of chapter 21 with respect to such wages.

(3) Section not to apply to social security tax with respect to certain statutory employees. Section 3509 and this section shall not apply to any tax under subchapter A of chapter 21 with respect to an individual described in section 3121(d)(3). For purposes of the preceding sentence, if an individual would be an employee under section 3121(d)(3) but for the fact that such individual is an employee under section 3121(d)(1) or (2), such individual shall be treated as an individual described in section 3121(d)(3).

(4) Section not to apply in cases of intentional disregard. Section 3509 and this section shall not apply to the determination of any employer's liability for tax under chapter 24 or subchapter A of chapter 21 for any calendar year if any part of such liability is due to the employer's intentional disregard of the requirement to deduct and withhold such tax. For purposes of the preceding sentence, an employer has intentionally disregarded the requirement to deduct and withhold a tax if the employer intentionally failed to deduct and withhold the full amount of such tax with respect to any wages paid on or after the date on which the employer ascertained the employee status of a worker.

(5) Section not to apply to assessments made before January 1, 1983. Section 3509 and this section shall not apply to any tax assessed before January 1, 1983.

(6) Penalties. Section 3509 and this section do not relieve an employer from liability for any penalties, additions to tax, or additional amounts otherwise applicable with respect to a failure to deduct and withhold any taxes. However, for purposes of applying any penalty, addition to tax, or additional amount with respect to any tax for which an employer's liability is determined under section 3509, the employer's tax liability as determined under that section shall be treated as the tax the employer should have withheld, deducted, and paid over.

Income Tax Regulations

PART 1--[AMENDED]

Par. 3. The authority for Part 1 is amended by adding the following citation:

Authority: 26 U.S.C. 7805. * * * Section 1.6041A-1 also issued under 26 U.S.C. 6041A.

Par. 4. A new § 1.6041A-1 is added immediately after § 1.6041-7 to read as set forth below:

§ 1.6041A-1 Returns regarding payments of remuneration for services and certain direct sales.

(a) Returns regarding remuneration for services—

(1) In general. If—

(i) Any service-recipient engaged in a trade or business pays in the course of that trade or business during any calendar year after 1982 remuneration to any person for services performed by that person, and

(ii) The aggregate amount of remuneration paid to such person during such calendar year is \$600 or more,

Then the service-recipient shall make a return in accordance with paragraph (e) of this section. For purposes of the preceding sentence, the term “service-recipient” means the person for whom the service is performed (e.g., in the case of a real estate agent, the real estate firm for which such agent performs services). For purposes of this paragraph (a)(1) only, the term remuneration does not include amounts paid to any person for services performed by such person if the service-recipient knows that such amounts are excludable from the gross income of the person performing such services. For example, a return is not required with respect to amounts paid to a foster parent which are known by the service-recipient to constitute foster care payments that are excludable from gross income under section 131. For purposes of this paragraph (a)(1), a service-recipient shall be considered to know facts set forth in a written statement provided to the service-recipient, made under the penalties of perjury and signed by the person performing such services, in the absence of knowledge by the service-recipient that such statement is untrue. See section 6041A(d) for rules relating to the application of section 6041A and this section to governmental units (and agencies or instrumentalities thereof).

(2) Payment attributable to parts and materials. For purposes of section 6041A and this section, the aggregate amount of remuneration paid to any person for services rendered includes any payments for parts or materials used by such person in rendering the services unless the trade or business of such person is primarily that of selling parts or materials. Whether a person is engaged primarily in the trade or business of selling parts and materials rather than of providing services shall be determined on the basis of all the facts and circumstances, taking into account such factors as whether such person holds himself or herself out as a dealer in parts and whether, with respect to the type of services rendered, a service-recipient ordinarily would specify the type or brand of parts or materials to be used.

Example. X Company makes a payment to an unincorporated repair shop for repairs to one of the company’s automobiles. The automobile sustained body damage in an accident. The repair contract requires payment of \$300 for labor and \$400 for new parts that were installed. The repair shop does not hold itself out as a dealer in parts. Generally, customers of the repair shop do not specify the type of brand of replacement parts to be installed. Therefore, the aggregate amount of remuneration that is required to be reported pursuant to section 6041A(a) includes the payment for parts.

(b) Returns regarding direct sales of \$5,000 or more. (1) In general. If—

(i) Any person engaged in a trade or business in the course of such trade or business during any calendar year sells consumer products to any buyer on a buy-sell, deposit-commission, or other commission basis for resale (by the buyer or any other person) in the home or otherwise than in a permanent retail establishment, and

(ii) The aggregate amount of such sales made by such person to such buyer during such calendar year is \$5,000 or more, Then such person shall make a return with respect to such buyer in accordance with paragraph (e) of this section. This requirement shall apply to sales made in any calendar year after 1982.

(2) Sale defined. For purposes of this paragraph (b), a person will be considered to sell a product to a buyer for resale even though such buyer does not acquire title to the product

prior to selling it to the consumer. For example, a company sales person, paid on a commission basis, who does not acquire title to a product before selling it to the consumer is considered to have bought the product for resale for purposes of section 6041A(b) and this paragraph.

(3) Acquisition for resale in a permanent retail establishment. Section 6041A(b) and this paragraph do not apply to sales of a product to a buyer who resells the products only in a permanent retail establishment, as defined in § 31.3508-1(g)(4) of this chapter (Employment Tax Regulations). If a buyer acquires consumer products from a person for resale both in the home (or otherwise than in a permanent retail establishment) as well as in a permanent retail establishment, then such person shall, for purposes of determining the aggregate amount of sales made to such buyer under paragraph (b)(1)(i) of this section, take into account all sales of such products made to such buyer during the calendar year.

(4) Products purchased for personal use or consumption. All sales to a buyer of consumer products on a buy-sell, deposit-commission, or other commission basis that are suitable for resale to another person shall be taken into account in determining the aggregate amount of sales made to such buyer under paragraph (b)(1)(i) of this section even if buyer purchases some of the products for the buyer's personal use or consumption or disposes of some of the products other than by resale (for example, gifts to relatives). Sales of products that cannot be resold, such as samples and catalogues, are not taken into account in determining the aggregate amount of sales to a buyer during the calendar year.

(5) Consumer product defined. For purposes of section 6041A(b) and this paragraph, the term "consumer product" means any tangible personal property which is distributed in commerce and which is normally used for personal, family, or household purposes (including any such property intended to be attached to or installed in any real property without regard to whether it is so attached or installed). The term "consumer product" does not include any product used to manufacture another product to be distributed in commerce or any product used only incidentally in providing a service (e.g., insecticide used in a pest control service, materials used in an appliance repair business).

(c) Engaged in trade or business. For purposes of section 6041A(a)(1) or (b)(1) and this section, whether a service-recipient or other person is engaged in a trade or business shall be determined under the rules set forth in § 1.6041-1(b).

(d) Exceptions to return requirement--(1) Return required under another section. No return shall be required under paragraph (a) of this section if a statement with respect to the services is required to be furnished under section 6051, 6052, or 6053.

(2) Transactions exempt from reporting under section 6041. No return shall be required under paragraph (a) of this section with respect to a payment which is exempted under § 1.6041-3 from the reporting requirement of section 6041, and no return shall be required under paragraph (b) of this section with respect to sales made to a corporation.

(e) Time and manner of filing--(1) Form. The return required to be filed under section 6041A(a) or (b) and paragraph (a) or (b) of this section shall be filed on Forms 1096 and 1099 in accordance with the instructions accompanying those forms.

(2) Time for filing. The return shall be filed on or before February 28 of the year following the calendar year for which the return is filed.

(3) Place of filing. The return shall be filed with the appropriate Internal Revenue Service Center, at the address listed in the instructions for Forms 1096 and 1099.

(4) Contents--(i) In general. Unless otherwise provided in the instructions to Form 1099, the return required under section 6041A(a) or (b) and paragraph (a) or (b) of this section shall set forth the information contained in paragraph (e)(4)(ii) or (iii) of this section.

(ii) Return required under section 6041A(a). The return required to be filed under section 6041A(a) and paragraph (a)(1) of this section shall set forth the aggregate amount of remuneration paid to the person with respect to whom the return is made during the calendar year for services rendered, the name, address, and taxpayer identification number of the person making the payment, and the name, address, and taxpayer identification number of the recipient of the remuneration.

(iii) Return required under section 6041A(b). A return required to be filed under section 6041A(b) and paragraph (b)(1) of this section shall set forth the name, address, and taxpayer identification number of the person making the sales, and the name, address, and taxpayer identification number of the buyer.

(f) Statements to be furnished to persons with respect to whom information is required to be furnished--(1) In general. Every person required to file a return pursuant to section 6041(A)(a) or (b) and paragraph (a) or (b) of this section shall furnish a written statement to each person whose name is required to be set forth in that return.

(2) Time and for furnishing statement. The written statement required under paragraph (f)(1) of this section shall be furnished to the person on or before January 31 of the year following the calendar year for which the return under section 6041A(a) or (b) was made.

(3) Contents of statement. The statement shall contain—

(i) The name and address, and taxpayer identification number of the person required to make the return, and

(ii) In the case of a return required to be filed under section 6041A(a) and paragraph (a)(1) of this section, the aggregate amount of payments to the person required to be shown on the return.

(g) Recipient to furnish name, address, and identification number. Any person with respect to whom a return or statement is required to be made pursuant to section 6041A and this section by another person shall furnish to that other person his name, address, and identification number upon demand by the person required to make the return.

(h) Penalties. For provisions relating to the penalties for failure to file a return or to furnish a statement under section 6041A and this section, see sections 6652 and 6678 of the Code. For provisions relating to the penalty for failure to supply identification numbers under this section, see section 6676.

Roscoe L. Egger, Jr.,
Commissioner of Internal Revenue