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INTERNAL REVENUE SERVICE
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CHIEF COUNSEL

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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR

FROM: Jerry E. Holmes, Chief, CC:TEGE:EOEG:ET2

SUBJECT: Request for Advice Regarding Rig Welders.

This Field Service Advice responds to your memorandum dated September 5, 2000. Field Service Advice is not binding on Examination or Appeals and is not a final case determination. This document is not to be used or cited as precedent.

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LEGEND

Company =

ISSUES

1. Whether rig welders who performed services for Company were common law employees of Company.

2. If the rig welders were common law employees of Company, whether payments by Company to the rig welders characterized as “rig rentals” were payments made under an arrangement separate from the employment relationship.

3. If the rig rental arrangement was in connection with the employment relationship, whether the payments were excludable from wages as payments made under an accountable plan.

CONCLUSIONS

1. Further factual development is necessary to determine whether the rig welders were common law employees of Company.

2. If the rig welders were common law employees of Company, the rig rental payments were not made under an arrangement that was separate from the employment relationship.

3. If the rig rental payments were made in connection with the employment relationship, the rig rentals were not made pursuant to an accountable plan, and thus were wages for employment tax purposes.

FACTS

During the years at issue, Company was a general engineering contractor. Company contracted to construct and maintain tanks, pipeline, and related equipment in oilfields and at other manufacturing plants. Company hired rig welders and single-hand welders to perform services. Rig welders and single-hand welders are highly skilled workers hired to perform tasks on specialized industrial equipment.

The rig welders provided all of their own equipment, including a pick-up truck (usually a ½ or 3/4 ton pick-up), welder, welding tanks, and other equipment such as gauges, hoses, torches, and hand tools. The value of a rig welder’s truck varies depending upon its make and model and whether it is new or used. Rig welding equipment in new condition costs in the range of $5,000 to $8,000. The rig welders also provided their own supplies, such as welding rods and various gases. Single-hand welders performed the same services as rig welders, but used equipment provided by Company.

The rig welders paid all the costs associated with obtaining, operating, and maintaining the equipment. The rig welders purportedly were compensated for these costs in the form of "rig rentals." The rig welders submitted a "rig ticket" at the end of each week reporting the number of hours worked. The amount of rig rentals were based solely upon a flat rate applied to the number of hours worked; the rig rental payments were not based upon expenses incurred. The rig welders did not submit documentation to Company substantiating expenses incurred.

In addition to rig rentals, the rig welders received payments that Company treated as hourly wages. The rig welders received separate checks each pay period for the rig rentals and the hourly wages. Single-hand welders were paid wages in a single check at the same hourly rate as rig welders. The hourly rates for wages and rig rentals appear to be consistent with the rates paid by other companies in the industry. The amounts Company treated as wage payments to the rig welders and single-hand welders were reported on Forms W-2. The amounts Company treated as rig rentals were reporting on Forms 1099.

Company classified rig welders as independent contractors until a state agency found that, for state law purposes, the workers were employees. Pursuant to the state agency's determination, Company began treating rig welders as employees and withheld employment taxes from the portion of total compensation it treated as wages.

The revenue agent who examined Company's employment tax returns proposed an adjustment asserting that the rig rental payments were wages because they were not paid under an accountable plan within the meaning of section 62(c) of the Internal Revenue Code (the "Code"). Company asserts that the rig welders were independent contractors. Alternatively, Company asserts that even if the rig welders were employees, the rig rentals were separate from the employment relationship. Company relies on Rev. Rul. 68-624, 1968-2 C.B. 424, as authority for the proposition that a portion of an employee's compensation may be treated as rental payments and not wages.

LAW AND ANALYSIS

Issue 1. Whether rig welders who performed services for Company were common law employees of Company.

The issue of whether the rig welders were employees or independent contractors was first raised by Company after this case was transferred to the appeals office. Consequently, there has been no development by the Service of the facts underlying the relationship between Company and the rig welders. It is therefore not appropriate to issue technical advice containing a conclusion as to the

proper classification of the workers. We do, however, provide the following information which we hope proves useful.

Section 530 Relief

Before considering the proper classification of the workers as employees or independent contractors, it must first be determined whether relief is available under Section 530 of the Revenue Act of 1978, as amended by the Small Business Job Protection Act of 1996. Section 530 provides businesses with relief from federal employment tax obligations if certain requirements are met. It is not necessary for the business to claim section 530 relief for it to be applicable. Additionally, the business need not concede or agree to the determination that the workers are employees in order for section 530 relief to be available.

To qualify, the business must meet the consistency test and reasonable basis test. To meet the consistency test, the taxpayer must have filed all required Forms 1099 on a basis consistent with the treatment by the business of the worker as not being an employee (reporting consistency) and have treated all workers in similar positions the same (substantive consistency).

It appears that the taxpayer filed Forms W-2 for these workers for the period in question. Because the filing of Forms W-2 would not satisfy the reporting consistency test, the taxpayer would not qualify for Section 530 relief.

Definition of Employee

Section 3121(d)(2) of the Internal Revenue 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 an employee. See Avis Rent A Car System, Inc. v. United States, 503 F.2d 423, 426 (2d Cir. 1974). The burden of establishing a worker's status as an independent contractor rests upon the employer. Marvel v. United States, 719 F.2d 1507, 1516 (10th Cir. 1983).

Section 31.3121(d)-1(c)(2) of the Employment Tax Regulations provides that, generally, the relationship of the employer and employee 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 result to be accomplished by the work, but also as to the details and means by which that 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 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 or she has the right to do so.

Determination of Worker Status

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

In determining whether an individual is an employee under the common law rules, twenty factors have been identified as indicating whether sufficient control is present to establish and employer-employee relationship. The twenty factors have been developed based upon an examination of cases and rulings considering whether an individual is an employee. The degree of importance of each factor varies depending upon the occupation and the factual context in which the services are performed. See Rev. Rul. 87-41, 1987-1 C.B. 296, 298-99.

Because of the difficulty in strictly applying the twenty factor test in determining whether an individual is an employee or an independent contractor under the common law, all evidence of both control and lack of control or autonomy must be considered. In doing so, one must examine the relationship of the worker and the business. Relevant facts generally fall into three categories: (1) behavioral controls, (2) financial controls, and (3) relationship of the parties.

1. *Behavioral Control*. The right to control contemplated by section 31.3121(d)-1(c)(2) and the common law requires only such supervision as the nature of the work requires. The key fact to consider is whether the business retains the right to direct and control the worker in how the worker performs the specific tasks for which the worker is hired, regardless of whether the business actually exercises that right. General Investment Corp. v. United States, 823 F.2d 337, 341 (9th Cir. 1987). Facts that show behavioral control include the type and degree of instructions given to the worker and the training the business gives the worker.

2. *Financial Control*. The financial control factor concerns whether a firm retains the right to direct and control how the business aspects of the worker's activities are conducted. Facts that show financial control include (1) whether the worker has a significant investment, (2) whether the worker incurs significant unreimbursed expenses in his business, (3) whether the worker provides his services to the relevant market (4) the method of paying the worker, and (5) the worker's opportunity for profit or loss. Financial control does not refer to whether

the worker is economically dependent or independent of the firm. See Nationwide Mutual Insurance Co. v. Darden, 503 U.S. 318 (1992).

3. *Relationship of the Parties*. This category of evidence includes facts which illustrate how the parties perceive their relationship. Relevant facts include those which show the intent of the parties with respect to their relationship and whether the parties were free to terminate their relationship at will. A mere contractual designation, in and of itself, is not sufficient evidence for determining worker status. In close cases, however, the intent of the parties is an effective way to resolve the issue. See Illinois Tri-Seal Prods., Inc. v. United States, 353 F.2d 216 (Ct. Cl. 1965).

The permanency of the relationship between the worker and the business is also relevant in assessing the relationship. Generally, if the expectation is that the relationship will continue indefinitely, this is considered evidence of an intent to create an employment relationship. In contrast, an intent to create a long-term, as opposed to indefinite, relationship is a neutral fact that should be disregarded.

Effect of State Agency Determinations of Worker Status

State laws, or determinations of state or federal agencies, may characterize a worker as an employee for purposes of various rules and regulations. Characterizations based on these laws or determinations should be disregarded, because the laws or regulations involved may use different definitions of "employee" for these purposes, including definitions that often are broader than under the common law rules. See Private Letter Ruling 9648003.

Prior Guidance Addressing Rig Welders

Private Letter Rulings 9413001 and 9121006 addressed the proper classification of rig welders as employees or independent contractors. These rulings were issued prior to the Service's issuance of the more recent guidance stating the general three-prong analytical framework for addressing worker classification issues. Therefore, the analytical framework would not be exact for this case. The rulings would be useful, however, in demonstrating what types of factors were considered as evidence of an employment relationship, and what type of factors were considered as evidence of an independent contractor status.

Private Letter Ruling 9413001 found rig welders to be independent contractors under the facts upon which that ruling is based. The fact that the rig welders (1) were paid on an hourly basis, (2) were supervised by the firm, and (3) had the right to terminate their relationship with the firm at any time without incurring any liability supported a finding of an employee-employer relationship.

These factors were outweighed, however, by the facts that the rig welders (1) paid all the costs associated with obtaining and maintaining the materials, equipment and supplies used in the performance of their services for the firm, (2) represented themselves to the public as being in the business of performing similar services for others, (3) advertised their availability to perform similar services, (4) performed similar services for a number of persons or firms, (5) could incur a loss as a result of their financial investment, and (6) were not provided training by the firm. The ruling noted that although the supervision of the workers would typically be an indication that the employer-employee relationship existed, the firm apparently only supervised the workers in this instance to insure that their product met the firm's client's specifications, and the firm was not concerned with the methods used to accomplish the result.

Private Letter Ruling 9121006 also addressed the classification of rig welders, finding the welders to be independent contractors. In finding that the workers were independent contractors, the ruling distinguished the welders from the piano repairmen at issue in Revenue Ruling 68-348, 1968-1 C.B. 431. Among other factors distinguishing the two rulings, the piano repairmen found to be employees performed their services for the most part on a continuing basis and the services they provided were the same as the firm provided to its customer. In contrast, the welders provided the same or similar services for multiple firms during the year, and welding services were only one part of the services provided by those firms to the firms' customers. In addition, while the potential existed for the welders to incur a loss due to the significant overhead expenses, the piano repairmen had no significant expenses and were paid a percentage of the service charge to the customer, an arrangement found to be similar to a salary.

Issue 2. If the rig welders were common law employees of Company, whether payments by Company to the rig welders characterized as "rig rentals" were payments made under an arrangement outside of the employment relationship.

Relying on Rev. Rul. 68-624, Company asserts that even if the rig welders were its common law employees, the rig rental payments did not relate to the employment relationship, but rather were compensation for the use of the rig welders' equipment. Thus, Company maintains that the rig rentals were not wages subject to employment taxes.

Rev. Rul. 68-624 considered what portion of the total amount paid by a corporation for the use of a truck and the services of a driver is allocable as wages of the driver for employment tax purposes. Under the ruling's facts, the corporation hires a truck and driver to haul stone from its quarry to its river loading dock at a fixed amount per load and allocates one-third of the amount paid to the employee as wages and two-thirds as payment for the use of the truck. The ruling holds that

an allocation of the amounts paid to an individual when the payment is for both personal services and the use of equipment must be governed by the facts in each case. If the contract of employment does not specify a reasonable division of the total amount paid between wages and equipment, a proper allocation may be arrived at by reference to the prevailing wage scale in a particular locality for similar services in operating the same class of equipment or the fair rental value of similar equipment.

We believe that Rev. Rul. 68-624 provides an incomplete analysis under current law. The ruling does not analyze whether the rental arrangement is separate from the employment relationship. It assumes that the rental arrangement is separate, and discusses the appropriate allocation given that assumption. In addition, Rev. Rul. 68-624 was issued before the enactment of sections 67 and 62(c) of the Code. Moreover, courts in recent decisions have declined to separate an employment relationship from a rental arrangement, and thus have found section 62(c) to be applicable despite taxpayer assertions that the rental arrangement was separate from the employment relationship.

The Tax Reform Act of 1986, Pub. L. 99-514, section 132, added section 67 to the Code to limit miscellaneous itemized deduction to amounts exceeding 2 percent of adjusted gross income. Section 62(c) was enacted by the Family Support Act of 1988, Pub. L. 100-485, section 702(a), in order to prevent an employee from avoiding the 2 percent limit on miscellaneous itemized deductions by the mere fact that the employee's employer maintained a nonaccountable expense reimbursement arrangement. After section 62(c) was enacted, employees whose employers maintained a nonaccountable plan became subject to the 2 percent limit on miscellaneous itemized deductions, as did employees of employers that maintained no reimbursement arrangement. In addition, at Congress' suggestion, the employment tax regulations were amended to provide that payments must be made under an accountable plan in order to be excepted from employment taxes.[1] If expense reimbursements are treated as separate from the employment relationship, then such reimbursements would not be subject to the limitations under section 67(a), and would not be wages, regardless of whether the payments are made under an accountable plan. We believe these changes

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[1]See H. R. Rep. No. 998, 100th Cong., 2d Sess. 201, 206 (1988); T.D. 8324, 55 F.R. 51696 (December 17, 1990). Compare Employment Tax Regulations §§ 31.3121(a)-3 and 31.3401(a)-4 (effective for amounts received on or after July 1, 1990) with regulations §§ 31.3121(a)-1(h) and 31.3401(a)-1(b)(2) (effective for amounts received before July 1, 1990). Under §§ 31.3121(a)-1(h) and 31.3401(a)-1(b)(2), whether advances or reimbursements were wages was not contingent upon meeting the substantiation or return of excess requirements under § 62(c) of the Code.

underscore the importance of determining whether reimbursements are received in connection with an employment relationship.

In Escobar de Paz et. al. v. Commissioner, T.C. Memo 2000-176, the Tax Court considered whether compensation paid to truck owner-operators was correctly separated into a component representing compensation for services and a component representing compensation (rent) for the use of equipment. Each petitioner in this consolidated case was treated as an independent contractor by the trucking company for which the petitioner performed services. Mr. Escobar netted the amount he received for trucking services against related expenses and reported this amount as wages on line 7 of Form 1040. The other petitioners reported on Schedule C of Form 1040 income equal to the expenses incurred in carrying-on the trucking activity, and reported the remaining portion of their total compensation as wages on line 7 of Form 1040. The Government conceded that each petitioner was an employee of the trucking company for which the petitioner performed services. Consistent with employee status, however, the Government asserted that the total compensation was reportable as wages, and related expenses were properly reported on Schedule A, subject to the limitations set forth under section 67(a) of Code.

Each petitioner entered into an agreement with a trucking company regarding his working relationship. The court noted that the purpose of each document was to enable the trucking companies to obtain transportation services through the lease of tractor equipment along with a qualified driver. Under the agreements, each petitioner purported to lease his truck to the trucking company. Each petitioner warranted that the truck would be in good condition, and that he would be responsible for all costs of maintaining the equipment. The agreements provided that based upon industry practice, fees would be split 60/40 in favor of the trucking company. Under each agreement, the petitioner was responsible for all expenses necessary for the operation of the equipment. In addition, although the agreements provided that the trucking company assumed liability for negligent operation, maintenance, or use of the equipment, the cost of insurance covering such liabilities was deducted from the owner-operator's pay.

The petitioners asserted that they engaged in two activities: (1) leasing their trucks to the trucking company, and (2) providing driving services for wages. The Government asserted that the petitioners were engaged in a single activity; namely, providing transportation services to the trucking companies by the use of their trucks. The court was thus called upon to determine whether the leases had independent significance for tax purposes. The court noted initially that labels used in formal documents do not automatically control the tax consequences of a transaction. The court found that the use of the trucks was not separate from the performance of services. The court reasoned,

> The carriers and owner-operators agreed to enter into a business relationship for the purpose of transferring cargo from one point to another using the latter's vehicles. The payments for the services provided were to be based upon published schedules relating to the weight of the cargo and the distance transferred. Petitioners were not paid for the use of their vehicles if they did not drive, and petitioners did not receive wages for driving if they did provide their own vehicles. As a practical matter, petitioners retained control of the use of their vehicles at all times and were responsible for all operating expenses. The carriers never acquired possession of the vehicles. . . . Moreover, there was no definite lease term. Petitioners were always free to use their trucks how and for whom they wished . . . . They could accept or reject loads as they wished. They could earn as much or as little as wanted because they were free to use the equipment as much or as little as they wanted.

In Trans-Box Systems, Inc. v. United States, 86 A.F.T.R.2d (RIA) 5015, 2000 U.S. App. LEXIS 12595 (unpublished opinion, June 2, 2000), the Ninth Circuit considered whether an automobile allowance paid to couriers was separate from the employment relationship. The employer designated 45% of the owner-operators' compensation as wages and the remaining 55% as rental payments. The Service determined that the entire amount of compensation was wages. The employer argued that, inter alia, the owner-operators acted as independent contractors with respect to the portion of compensation designated as rentals.

The court recognized that in some cases courts have found that a worker acted in dual capacities; but in the cases where services were found to have been performed in an independent contractor capacity, the services were not necessary to the performance of services as an employee. The court noted that the lease was valid only during the hours of employment, and it was integral to the owner-operator's duties as a courier. Moreover, the serial nature of the leases suggested that they were not independent arrangements; rather, they were contingent upon the owner-operator's continued employment. Finally, the court noted that the "illusory" nature of the leases was reflected in the fact that the rental payments bore no relationship to the fair rental value of the equipment, but were instead based solely upon the owner-operator's hourly pay rate.

These decisions suggest that the following factors are relevant in determining whether a "rental" arrangement has independent significance for tax purposes:

- Whether a worker is compensated for services regardless of whether the worker provides equipment. In other words, whether providing equipment is integral to providing services.
- Conversely, whether the worker is paid for the rental of equipment regardless of whether the worker performs services.
- Whether the worker retains control over the equipment.
- Whether the worker is responsible for all operating expenses incurred while the equipment is being leased.
- Whether there is a definite lease term, or whether the lease is valid only during the hours of employment.
- Whether the worker is free to use the equipment in performing services for any person.
- Whether the rental payments bear a reasonable relationship to the fair rental value of the equipment.

In addition, we believe the following factors are relevant:

- Whether the purported leases were put in place for some regulatory reason (other than federal taxes) such as, for example, to minimize overtime wages.[2]
- Whether the worker rents the equipment to another person under an arrangement that does not call for the worker's services.
- Whether the employer treated the activities as separate activities for reporting purposes.

The facts in the present case suggest that the rental arrangement would not have existed but for the provision of services. In addition, the facts suggest the rig welders retained control over the equipment at all times, and the rig welders were responsible for maintenance costs with respect to the equipment. Finally, the purported equipment leases were valid only during the hours of employment. On the other hand, consistent with its assertion that the rig rentals were separate from the employment relationship, Company did report rig rental payments on Form 1099. In addition, the rig welders were paid the same wage as single-hand welders. This suggests that the wage payments may have been at fair value. However, we believe that whether rental payments or wage payments were at fair market value has little relevance in determining whether a rental arrangement was separate from an employment relationship; rather, this inquiry is relevant mainly to determine whether an allocation was reasonable after it has been determined that an arrangement was separate. Considering all the available facts, we believe the rig rentals were not correctly viewed as separate from the employment relationship. We believe that when a purported rental arrangement would not have existed but

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[2] See e.g., Baker v. Barnard Construction Co. Inc., 146 F.3d 1214 (10th Cir. 1998); Reich v. Bay, Inc., 23 F.3d 110 (5th Cir. 1994).

for the provision of services, a strong presumption exists that the arrangement is not separate from the employment relationship.[3]

Therefore, whether the payments were excludable from income and wages depends upon whether the payments were made pursuant to an accountable plan under section 62(c) of the Code and regulations thereunder.

Issue 3. If the rig rental payments were not separate from the employment relationship, whether the payments were excludable from wages as payments made under an accountable plan.

The three Federal employment taxes are the Federal Insurance Contributions Act (FICA) tax, Federal Unemployment Tax Act (FUTA) tax, and income tax withholding. In general, wages are defined for FICA, FUTA and income tax withholding purposes as all remuneration for employment unless otherwise excluded. I.R.C. sections 3121(a), 3306(b) and 3401(a). There is no statutory exception from wages for amounts paid by employers to employees for employee business expenses. However, regulations section 1.62-2(c)(4) provides that amounts an employer pays to an employee for employee business expenses under an "accountable plan" are excluded from the employee's gross income, are not required to be reported on the employee's Form W-2, and are exempt from the withholding and payment of employment taxes. Sections 31.3121(a)-3, 31.3306(b)-2, and 31.3401(a)-4 of the Employment Tax Regulations, and section 1.6041-3(h)(1) of the Income Tax Regulations.

Section 62(a)(2)(A) of the Code provides that the term "adjusted gross income" means gross income minus deductible expenses paid or incurred by the taxpayer, in connection with the performance by him of services as an employee, under a reimbursement or other expense allowance arrangement with his employer. Section 62(c) of the Code provides that for purposes of subsection (a)(2)(A), an arrangement shall not be treated as a reimbursement or other expense allowance arrangement if (1) such arrangement does not require the employee to substantiate the expenses covered by the arrangement, or (2) such arrangement provides the employee the right to retain any amount in excess of the substantiated expenses.

Under section 1.62-2(c)(1) of the regulations, a reimbursement or other expense allowance arrangement satisfies the requirements of section 62(c), if it

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[3]Section 1.183-1(d) of the Income Tax Regulations provides that for purposes of determining whether multiple undertakings constitute a single activity it is appropriate to look to the “degree of organizational and economic interrelationship of the various undertakings.”

meets the three requirements of business connection, substantiation, and returning amounts in excess of expenses, set forth in paragraphs (d), (e), and (f), respectively, of section 1.62-2 of the regulations ("the three requirements").

Section 1.62-2(c)(2)(i) of the regulations provides that if an arrangement meets the three requirements, all amounts paid under the arrangement are treated as paid under an "accountable plan." The regulations further provide that if an arrangement does not satisfy one or more of the three requirements, all amounts paid under the arrangement are paid under a "nonaccountable plan." Amounts paid under a nonaccountable plan are included in the employee's gross income for the taxable year, must be reported to the employee on Form W-2, and are subject to withholding and payment of employment taxes. See regulations sections 1.62-2(c)(5), 31.3121(a)-3(b)(2), 31.3306(b)-2(b)(2) and 31.3401(a)-4(b)(2).

An arrangement meets the business connection requirement of section 1.62-2(d) of the regulations if it provides advances, allowances or reimbursements for business expenses that are allowable as deductions by Part VI (section 161 and the following), subchapter B, Chapter 1 of the Code, and that are paid or incurred by the employee in connection with the performance of services as an employee. Thus, trade or business expenses deductible under section 162 of the Code and depreciation expenses deductible under section 167 may be reimbursed under an accountable plan. Section 1.62-2(d)(3)(i) provides that the business connection requirement will not be satisfied if the payor arranges to pay an amount to an employee regardless of whether the employee incurs or is reasonably expected to incur deductible business expenses.

Section 1.62-2(e) of the regulations provides that the substantiation requirement is met if the arrangement requires each business expense to be substantiated to the payor (the employer, its agent or a third party) within a reasonable period of time. As for the third requirement that amounts in excess of expenses be returned to the payor, the general rule of section 1.62-2(f) of the regulations provides that this requirement is met if the arrangement requires the employee to return to the payor within a reasonable period of time any amount paid under the arrangement in excess of the expenses substantiated.

Section 1.62-2(k) of the regulations provides that if a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of section 62(c) and the regulations sections, all payments made under the arrangement will be treated as made under a nonaccountable plan.

In the present case, Company arranged to pay rig rentals to the rig welders regardless of whether it was reasonably expected that they would incur deductible business expenses. Thus, the business connection requirement was not met. In

addition, the rig welders did not substantiate expenses incurred nor did they return amounts received in excess of expenses incurred. Submitting rig tickets reporting hours worked was not sufficient to satisfy the substantiation requirement. In order to satisfy the substantiation requirement, an employee must substantiate actual costs that are paid or incurred unless the regulations specifically permit expenses to be substantiated based upon per diem rates (e.g., standard mileage, lodging, and meals and incidental expenses per diem rates). Finally, since Company's rental arrangement did not bear any logical relationship with actual expenses incurred, the arrangement evidences a pattern of abuse as described under regulations section 1.62-2(k)and thus all payments were made pursuant to a nonaccountable plan. See Shotgun Delivery v. United States, 85 F. Supp.2d 962 (N.D. Ca. 2000).

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Although the taxpayer did not present the argument in its protest, the taxpayer may at some point argue that section 530 relief is available, at least as to the amounts of rental payments paid to the employees for which Forms 1099 were issued. The taxpayer would argue that because Forms 1099 were issued, the consistency requirement was met. It is our view, however, that the consistency requirement is met only if the Forms 1099 were issued consistent with treatment of the workers as independent contractors. Based on the facts presented, it is our view that the Forms 1099 were issued not because the taxpayer considered the workers to be independent contractors, but because the taxpayer considered the amounts paid as "rental payments" to be other than wages. The taxpayer may respond, however, that the issuance of Forms 1099 stemmed from the taxpayer's view that the workers had dual status as employees for services performed, and as independent contractors for purposes of tool rentals. Whether Section 530 relief could be bifurcated in such a manner is not clear.

The taxpayer asserted reliance on Rev. Rul. 68-624. In addition, the taxpayer noted that the Service's Audit Technique Guide for the Hardwood Timber Industry provides that the rent of a skidder (a large piece of equipment of substantial value) is not subject to the accountable plan rules. Thus, the taxpayer may assert that it had a reasonable, good faith, belief, based upon existing guidance, that it was appropriate to bifurcate payments made to the rig welders. Consistent with reliance on the Rev. Rul., the taxpayer issued Forms 1099 reporting rig rental payments, and apparently paid wages to the rig welders at the prevailing market rate of pay for single-hand welders.

The taxpayer may assert that in light of Service guidance its obligation to withhold was not clear, and thus it was not required to withhold employment taxes. As support, the taxpayer may cite Central Illinois Public Service v. United States,

435 U.S. 21 (1978). In Central Illinois, the Supreme Court considered "whether an employer, who in 1963 reimbursed lunch expenses of employees who were on company travel but not away overnight, must withhold federal income tax on those reimbursements." 435 U.S. at 21-22. The Court held that the reimbursements–while includible in the employees' gross income–did not constitute wages and were not subject to income tax withholding.

The Government asserted that, inter alia, section 31.3401(a)-1(b)(2), which excludes from wages amounts reimbursed for traveling and other bona fide ordinary and necessary expenses incurred in the business of the employer, applied only to business expenses that were deductible under section 162(a). Since only expenses incurred during overnight travel were deductible under § 162(a), the Government asserted that the reimbursements were wages.

The Court held that since "[i]n 1963 not one regulation or ruling required withholding on any travel expense reimbursement" and that "[n]o employer, in viewing the regulations in 1963, could reasonably suspect that a withholding obligation existed," the reimbursements for lunch expenses while on nonovernight travel were not wages. 435 U.S. at 32. The court stated, "Because the employer is in a secondary position as to liability for any tax of the employee, it is a matter of obvious concern that, absent further specific congressional action, the employer's obligation to withhold be precise and not speculative." 435 U.S. at 31-32.

[redacted] Rev. Proc. 89-14, section 7.01(5), 1989-1 C.B. 814, provides that taxpayers may generally rely on revenue rulings. However, the Rev. Proc. further provides that

> taxpayers, Service personnel, and others concerned are also cautioned to determine whether a revenue ruling . . . on which they seek to rely has been revoked, modified, declared obsolete, distinguished, clarified, or otherwise affected by subsequent legislation, treaties, regulations, revenue rulings, revenue procedures or court decisions (emphasis added).

Please call if we can provide further assistance.