

## ***T.C. Memo. 2001-125***

An officer of a corporation who performs more than minor services is considered an employee for federal employment tax purposes under Section 3121(d)(1) of the Internal Revenue Code, and relief under Section 530 of the Revenue Act of 1978 is generally not available for statutory employees.

### **Summary**

303 West 42nd Street Enterprises, Inc., an S corporation, contested the IRS's determination that its president and sole shareholder, Mr. Grey, should be classified as an employee for federal employment tax purposes. The company argued that Mr. Grey was not an employee under common law principles and was entitled to relief under Section 530 of the Revenue Act of 1978. The Tax Court rejected these arguments, holding that Mr. Grey, as a corporate officer performing substantial services, was a statutory employee under Section 3121(d)(1) and that Section 530 relief, intended for disputes over common law employment status, did not apply to statutory employees in this case. The court upheld the IRS's determination of employment tax liabilities.

### **Facts**

303 West 42nd Street Enterprises, Inc. (Petitioner) was an S corporation operating as an accounting and tax preparation firm. Joseph M. Grey (Mr. Grey) was the sole shareholder and president of Petitioner. Petitioner rented office space from Mr. Grey's personal residence. Mr. Grey performed all services for Petitioner, including soliciting business, managing finances, performing bookkeeping and tax services, and maintaining client satisfaction. Petitioner did not pay Mr. Grey a fixed salary but rather Mr. Grey took funds from Petitioner's account as needed. Petitioner filed Forms 1099-MISC for Mr. Grey, reporting nonemployee compensation, and did not treat payments to Mr. Grey as wages subject to employment taxes.

### **Procedural History**

The IRS issued a notice of determination classifying Mr. Grey as an employee of Petitioner for federal employment tax purposes and assessed FICA and FUTA taxes. Petitioner challenged this determination in the Tax Court. Initially, Petitioner disclaimed reliance on Section 530 relief but later amended its petition to include this argument. The case was submitted fully stipulated to the Tax Court.

### **Issue(s)**

1. Whether Mr. Grey, as president and sole shareholder of Petitioner, was an employee of Petitioner for purposes of federal employment taxes under Section 3121(d)(1) of the Internal Revenue Code.
2. If Mr. Grey was an employee, whether Petitioner is entitled to relief from employment tax liability under Section 530 of the Revenue Act of 1978.

## **Holding**

1. Yes, Mr. Grey was an employee of Petitioner for federal employment tax purposes because as president, he performed substantial services for the corporation, thus meeting the definition of a statutory employee under Section 3121(d)(1).
2. No, Petitioner is not entitled to relief under Section 530 because Section 530 is intended to address disputes regarding common law employment status, not the status of statutory employees like corporate officers performing more than minor services.

## **Court's Reasoning**

The court reasoned that Section 3121(d)(1) of the Internal Revenue Code defines "employee" to include corporate officers. Treasury Regulations Section 31.3121(d)-1(b) clarifies that generally, a corporate officer is an employee unless they perform only minor services and receive no remuneration. The court found that Mr. Grey, as president, performed extensive services for Petitioner, thus falling under the definition of a statutory employee. The court rejected Petitioner's argument that common law control tests should apply, stating that while some older cases considered common law factors, the statutory definition and subsequent regulations clearly classify officers performing more than minor services as employees.

Regarding Section 530 relief, the court analyzed the legislative history and purpose of the provision. It noted that Section 530 was enacted to provide interim relief in cases where there was uncertainty in applying common law rules to determine worker classification as either employees or independent contractors. The legislative history and the language of subsections (b), (c)(2), and (e)(1) of Section 530, which refer to "common law rules," indicate that Congress intended Section 530 to apply to disputes about common law employment status, not to statutory employees. The court concluded that because Mr. Grey was a statutory employee under Section 3121(d)(1), Section 530 relief was not available to Petitioner. The court stated, "As discussed below, our own analysis of the statute and its history leads us to the conclusion that section 530 is limited to controversies involving the employment tax status of service providers under the common law (i.e., controversies involving persons who are not statutory employees). This conclusion provides an alternative ground for denying petitioner relief under section 530."

## **Practical Implications**

This case clarifies that officers of S corporations, particularly sole shareholders who actively manage and operate the business, will generally be considered employees for federal employment tax purposes. S corporations cannot avoid employment tax obligations by treating active officers solely as non-employee shareholders receiving distributions or by issuing Form 1099-MISC. Furthermore, this decision limits the

scope of Section 530 relief, indicating it is primarily intended for situations where the worker's classification as an employee or independent contractor is ambiguous under common law tests. Section 530 is not a tool to reclassify statutory employees, such as corporate officers performing substantial services, as non-employees. Legal practitioners advising S corporations should ensure that officers performing significant services are properly classified as employees and that appropriate employment taxes are withheld and paid. This case reinforces the IRS's authority to reclassify corporate officers as employees for employment tax purposes and limits the applicability of Section 530 in such statutory employee contexts.