



# Employment Tax Updates: Free Lunch in the Tax Court?

Jennifer Ray

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# IRS focus on employee meals

- Two tax issues
  - Does the employee have income
  - Does the employer get a 100% deduction
- 2015-2016 Priority Guidance Plan includes regulations under sections 119 and 132
- Recent expansion of Tax Court jurisdiction



# Employee meals: income

- Employee cafeteria
- Consequences if taxable fringe benefit
  - Withholding
  - Reporting
- Provided for the convenience of the employer?
  - Employees on call for emergencies
  - Workers in remote locations

# Emergency call and remote locations





# Convenience of the employer?

“Insanely Awesome”

“Gorgeous and Exclusive New Cafeteria”

“High-End Meal Perks”





# Employee meals: deduction

- Deduction for food expenses
  - Often limited to 50%
  - Exception for de minimis fringe benefits
- Employee cafeteria
  - Employer operated eating facility
  - Located on or near the employee's business premises
  - Operated at or above cost (or section 119 applies)

## Potential IRS arguments

- Benefit is taxable to employees
  - Section 119?
  - De minimis fringe benefit?
  - Working condition fringe?
- Employer's deduction is limited to 50%
  - De minimis fringe benefit?
    - Employer operated eating facility AND operated at cost or section 119 applies
  - Treated as compensation to employees?



## Tax Court jurisdiction

- Limited jurisdiction.
- Jurisdiction to review notice of deficiency involving subtitle A taxes (income taxes).  
Section 6213(a).
- Limited jurisdiction to review determinations involving subtitle C taxes (withholding and employment taxes).  
Section 7436.





## Section 7436

- Jurisdiction over subtitle C taxes requires:
  - “Actual controversy”
  - Involving a “determination” by the IRS as part of an “examination”
  - Involving employment status or section 530 relief
  - Filing of appropriate pleading
  - If IRS sends “notice” of its determination by registered or certified mail, the pleading must be filed within 90 days after the notice is mailed

# IRS cafeteria arguments

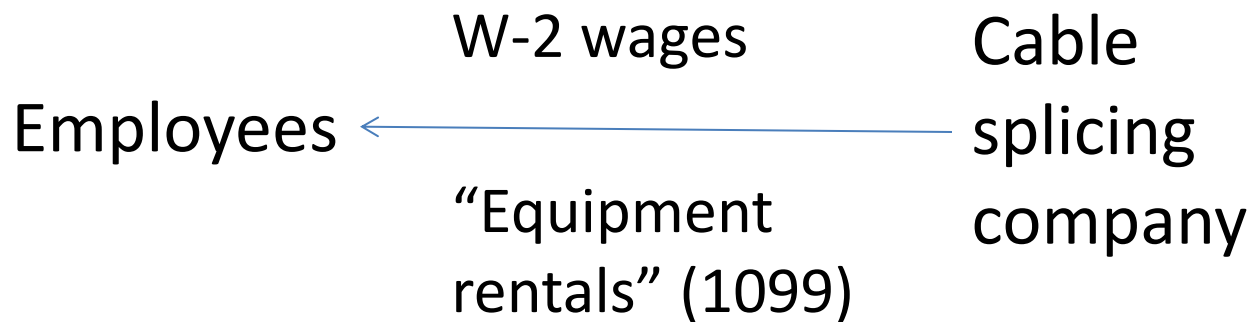
- If the IRS raises alternative arguments:
  - Notice of deficiency → Tax Court jurisdiction for the deduction
  - Assessment → refund jurisdiction for the withholding and employment taxes
- Incentive to raise worker classification or section 530 issues to create jurisdiction?



## Notice 2002-5

- Section 7436: “If, in connection with an audit of any person, there is an actual controversy involving a determination by the Secretary as part of an examination”
- IRS position:
  - Actual controversy: doesn’t exist if Forms W-2 issued
  - Determination: Notice of Determination of Worker Classification
  - Examination: must be an audit (e.g., Form SS-8 does not confer jurisdiction)

## SECC Corp. v. Commissioner, 142 T.C. 12 (2014)



- IRS reclassified the equipment rentals as taxable wages because accountable plan rules not met





## SECC Corp.

- SECC argued in its protest that workers were independent contractors with respect to wages and the equipment rentals.
- IRS sent a 30-day letter, not a NDWC.
  - “These changes to your employment taxes are not based on a worker classification determination.”
- Exam’s responses to questions from Appeals:
  - “There is no evidence to support taxpayer’s position that the workers were in business for themselves.”
  - “There is no evidence to support taxpayer’s argument that the workers worked under a dual capacity.”



## SECC Corp.

- Appeals Closing Letter
  - “Unfortunately, we were unable to reach an agreement on your case. The employment tax liability, as determined by Appeals, will be assessed . . . .”
  - “If you would like to challenge our determination in court, you may file a complaint in the United States District Court or the United States Court of Federal Claims.”
- No notice sent by certified or registered mail



## SECC Corp.

- 10 months later, SECC filed a petition in Tax Court
- SECC and IRS both filed motions to dismiss for lack of jurisdiction
  - IRS argued no NDWC so no jurisdiction
  - SECC argued employment tax assessment was invalid because no NDWC



## SECC Corp.

- Tax Court held that no “particular title or format” is necessary for a “determination”
- Appeals Closing Letter was evidence of a “determination” in connection with an “actual controversy”
- Administrative record showed that worker classification was at issue
- No 90-day filing period





## SECC Corp.

- Dissent:
  - “The IRS could have reasonably concluded that the worker classification arguments were frivolous and did not justify a determination.”
  - “Instead of permitting this result, the Court combs through the administrative record to discover whether the IRS should have issued a notice of determination.”
  - “This approach sets a dangerous precedent that may require us to review the administrative record every time a taxpayer makes a worker classification argument and the IRS chooses not to issue a notice of determination.”

## IRS response: CC Notice 2015-001

- IRS will continue to follow Notice 2002-5
  - IRS position is that section 7436 applies only when the taxpayer did not treat its worker as an employee during the applicable period
- If no NDWC is issued, IRS attorneys should file a motion to dismiss for lack of jurisdiction

## American Airlines v. Commissioner, 144 T.C. 2 (2015)

- Foreign flight attendants on routes between South America and Miami
- Airline did no U.S. tax withholding or reporting with respect to the flight attendants
- Procedural history
  - IRS granted section 530 relief in previous audit
  - Documented in Appeals Case Memorandum



## American Airlines

- IRS took position that section 530 was not properly at issue
- Appeals Case Memorandum:
  - “The classification of the NRA flight attendants (under section 530) is not relevant in this case, other than it was cited by Appeals as a basis for granting complete relief in a prior cycle. Accordingly, although Appeals has concluded that entitlement to relief under section 530 is not properly at issue, it has been addressed since it was the basis for concession when last considered.”
- Taxpayer continued to claim section 530 relief



## American Airlines

- IRS alternative arguments
  - Taxable U.S. wages and no section 530 relief → assessment (no NDWC issued)
  - Section 1441 withholding → notice of deficiency
- Airline petitioned Tax Court and raised both issues



## American Airlines

- “Actual controversy” demonstrated by administrative records from 1992-1996 and current audits
- Section 530 at issue:
  - “disagreement between the parties”
  - “failure to agree”



## Conclusion

- When employment tax issues are raised, consider jurisdictional issues early in process
- Administrative record is important

# Questions

Jennifer A. Ray

Crowell & Moring LLP

1001 Pennsylvania Avenue NW

Washington, D.C. 20004

[jray@crowell.com](mailto:jray@crowell.com)

(202) 624-2589