ISSUE:

Whether workers engaged by the taxpayer and its predecessor to sell insurance and financial products are employees or independent contractors.

FACTS:

This case was initiated when the workers submitted requests for determinations concerning their employment tax status with regard to services they performed for the taxpayer. After reviewing the information provided by the taxpayer and the workers, significant factual discrepancies made it impossible for the National Office to issue a determination. The case was returned for further development of the facts and resolution of the factual discrepancies. Upon completion of the investigation the case was returned to the National Office for Technical Advice.

According to the information obtained from the taxpayer, the above named workers, and other workers, both the taxpayer and its predecessor engaged in the business of selling insurance and other financial products. The workers involved in this determination began performing services for the taxpayer's predecessor and continued performing services for the taxpayer after it completed the purchase of the business on November 1, 1989.

Individuals become associated with the taxpayer as sales representatives. As such, they are required to obtain and maintain all necessary licenses allowing them to engage in the sale of insurance, securities and other financial products in the states in which they operate. The individuals are not restricted to a specific territory, but are allowed to solicit sales anywhere within the state or states in which they are licensed. Individuals may move up in the sales hierarchy by producing sales and by recruiting others to work in their individual sales hierarchies. At the lowest level of the sales hierarchy are Sales Representatives. As the individual produces sales and recruits others, the individual may become a District Leader, Division Leader, Regional Leader, Regional Vice President, Senior Vice President, National Sales Director, and ultimately, Senior National Sales Director. As individuals move up, they become responsible for recruiting, training, and supervising others who work under them. In addition, they earn the right to receive commissions on their own sales as well as the sales of those below them. The workers whose status is at issue in this determination all achieved the level of "Regional Vice President" or "Senior Vice President," but were not officers of the taxpayer's corporation.

The workers performed their services for the taxpayer pursuant to a written contract which provided that the workers were independent contractors rather than employees of the taxpayer. The contract did not limit the time period that the workers would perform services for the taxpayer or its predecessor but allowed either party to terminate the contract at any time. The workers performed services for the taxpayer and its predecessor for an extended period of time. One worker, in fact, performed services for the taxpayer and its predecessor for nine years.
The terms of the contract required the workers to perform their services for the taxpayer on a full-time basis but the contract did not specify the number of hours or the hours of work. In a manual dated April 4, 1994, that the taxpayer provided to the workers, the taxpayer specifically stated that full-time "does not mean you [*4] must spend a set number or hours a day or week or keep any regularly scheduled hours." The workers were free to determine when and for how long they performed their services for the taxpayer. They were required to maintain a minimum level of sales and a minimum number of individuals in their sales hierarchy to remain in their position. The workers were prohibited from performing services of any nature for any other company and were specifically prohibited from performing similar services for other firms including firms engaged in multi-level marketing of unrelated products.

The workers stated that they received product training as well as extensive training in sales techniques from the taxpayer and its predecessor on an on-going basis and that the training was mandatory. The workers also stated that they received detailed instructions from the taxpayer and its predecessor concerning the performance of their services and that they were required to adhere to the instructions. However, other workers, who were interviewed by the District Director's office in the course of its investigation, stated that instructions provided by the taxpayer were not detailed and that they were not required [*5] to follow instructions provided by the taxpayer. The taxpayer stated that it provided only optional product training and that it did not instruct the workers on how to perform their services but offered "suggestions" that the workers were not obligated to adhere to. In addition, the documentation, including training materials and other documents provided by the workers, indicates that training and instructions provided by the taxpayer were intended to insure that the workers complied with all the federal, state and local laws, regulations and rules governing the sale of insurance, securities and financial products. No information could be obtained from the taxpayer's predecessor concerning training and instructions it provided the workers. However, the documents provided by the workers indicate that the taxpayer's predecessor placed a greater emphasis on training and instructions than does the taxpayer.

The workers claim that the taxpayer and its predecessor exercised a significant degree of direction and control over their day to day business activities. However, the taxpayer contends that it asserted no such control over the day to day activities of the workers. Information obtained [*6] by the district in the course of its investigation indicates that the workers were free from direction and control in their day to day activities.

The workers were required by both the taxpayer and its predecessor to maintain an office outside their home and to pay all the expenses associated with maintaining and operating their office. In addition to their business expenses, the workers were liable for any amounts owed to the taxpayer by themselves or any other individuals below them in their sales hierarchy. The workers were paid on a commission basis, earning commissions on their own sales as well as the sales of individuals within each worker's sales hierarchy. The workers were not guaranteed a minimum level of compensation. Any amounts owed to the taxpayer by the workers or any individuals in their sales hierarchy were deducted from the commissions paid to the workers by the taxpayer. The workers have asserted that this method of compensation constituted control and that it was used as a lever to control the day to day activities of the workers. The workers did not receive any employee type benefits such as a pension, health insurance, or paid vacation days.

The taxpayer and its [*7] predecessor retained the right to terminate the workers for any violations of the contract terms. The workers were free to terminate their relationship with the taxpayer or its predecessor at any time and for any reason. Upon termination, all accounts remained property of the taxpayer rather than property of the worker. The workers did not have
a vested interest in their book of business and did not have the right to sell or transfer their business to anyone.

LAW:

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 employee.

The question of whether an individual is an independent contractor or an employee is one of fact to be determined upon consideration of the facts and 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 the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act [*8] (FUTA), and federal income tax withholding on wages at source, respectively.

Section 31.3121(d)-1(c)(2) of the regulations provides that generally, the relationship of 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 results to be accomplished by the work, but also as to the details and means by which the 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 also 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 services are performed; it is sufficient if he or she has the right to do so. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished and not as to the means and methods for accomplishing the result, he is an independent contractor.

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, [*9] one must examine the relationship of the worker and the business. Facts which illustrate whether there is a right to direct or control how the worker performs the specific tasks for which he or she is hired, whether there is a right to direct or control how the business aspects of the worker's activities are conducted, and how the parties perceive their relationship provide evidence of the degree of control and autonomy.

Section 31.3121(d)-1(a)(3) of the regulations provides that if the relationship of an employer and employee exists, the designation or description of the parties as anything other than that of employer and employee is immaterial. Thus, if an employer/employee relationship exists, the designation of the employee as a partner, coadventurer, agent, independent contractor must be disregarded.

In Butts v. Commissioner, T.C. Memo 1993-478 [CCH Dec. 49,340(M)], aff'd per curiam, 49 F. 3d 1173 [713] (11th Cir. 1995) [95-1 USTC P50,213], the Court considered the federal employment tax status of an individual engaged as an agent to solicit the sale of various insurance products. The agent, Mr. Butts, performed his services for the insurance company, Allstate Insurance Company, [*10] for more than twenty years under a written contract that described him as an employee of the company. In addition, he received employee benefits and was treated as an employee for federal employment tax withholding and reporting purposes. The contract required that he devote all his business time to selling the company's insurance products and he was required to maintain regular office hours. Mr. Butts was prohibited from selling any other insurance products without the company's prior written approval.
Mr. Butts was paid on a commission basis. He was required to remit all premiums collected by him to Allstate, without any deductions regardless of the amount of commissions owed to him. Mr. Butts had no vested interest in the business he produced. All business records remained the property of Allstate. Although he received an office allowance, Allstate was not obligated to pay all his office expenses. In fact, Mr. Butts paid most of his office expenses himself. Allstate provided Mr. Butts with start-up office furniture, which remained the property of Allstate, but Mr. Butts was required to provide all office equipment such as, copiers, fax machines, telephones, etc. Mr. Butts was free to hire others to assist him and did, in fact, hire other agents and clerical help. Mr. Butts made all decisions whether to hire anyone to assist him. He interviewed, hired, supervised, and paid all assistants. Allstate reserved the right to approve of anyone hired by Mr. Butts, but only to the extent necessary to insure compliance with laws governing the insurance industry.

Allstate provided Mr. Butts with occasional training and development programs to keep him up to date with changes in the insurance industry and to introduce new insurance products. Allstate did not provide any training regarding the manner or method by which Mr. Butts was to perform his services. Mr. Butts generally met twice a year with an Allstate manager to review his past year's sales performance, set sales goals for the current year, and to review his progress towards meeting his sales goals. Allstate reserved the right to impose a "work plan" on low producing agents. The purpose of the work plan was to provide the low producing agent with ideas on how to improve production and to give the agent an opportunity to achieve his or her sales goals. Allstate retained the right to terminate agents for unacceptable sales performance, but only after informing them that their performance was unsatisfactory and giving them the opportunity to bring their sales up to an acceptable level. Allstate did not terminate agents as a result of the method or manner by which the agents performed their services.

The Court, in concluding that Mr. Butts performed his services for Allstate as an independent contractor, found nothing to indicate that Allstate directed and controlled, or had the right to direct and control, the method and means by which Mr. Butts performed his services. In fact, the Court found that it was clear from the record that Mr. Butts operated his own business and that Allstate was concerned only with results, not the manner in which the results were achieved.

In reaching its conclusion, the Court considered a number of factors, several of which are often considered to be indicative of an employment relationship, and others that are generally considered to be indicative of an independent contractor relationship. Although Mr. Butts was required to maintain regular office hours, the Court found that this requirement simply reflected Allstate's concerns in providing a high level of customer service but was not a mandate that Mr. Butts work certain hours. The Court also found that the training provided by Allstate was designed to inform agents about new products only, not to dictate how agents were to sell insurance. The requirement that Allstate approve of anyone hired by Mr. Butts was found by the Court to be only for the purpose of complying with State law. And the Court did not find the facts that Mr. Butts had a long-term relationship with Allstate, that he did not have a vested interest in his book of business, that the parties had the right to terminate the relationship at any time, or that Mr. Butts' written agreement with Allstate characterized him as an employee to be significant.

The Court was persuaded to hold that Mr. Butts was an independent contractor based on the high degree of control Mr. Butts exercised over his day to day activities and the fact that Allstate did not have the right to control Mr. Butts' professional behavior. In addition, the fact that he incurred significant business expenses in the performance of his services for Allstate, was paid
strictly on a commission basis, and bore the risk of loss from his business as an insurance agent weighed heavily \[*14\] in the Court's decision.

Several courts reached the same conclusion in several other cases. In Smithwick v. Commissioner, T.C. Memo 1993-582 [CCH Dec. 49,457(M)], aff'd per curiam, 49 F. 3d 713 (11th Cir. 1995) [95-1 USTC P50,213]; Ware v. Unit-ed States, 850 F. Supp. 602 [94-1 USTC P50,126], aff'd 1995 U.S. App. LEXIS 28744 (6th Cir., Oct. 16, 1995) [95-2 USTC P50,533]; Mosteirin v. Commissioner, T.C. Memo 1995-367 [CCH Dec. 50,809(M)]; and, Feivor v. Commis-sioner, T.C. Memo 1995-107 [CCH Dec. 50,519(M)] insurance agents engaged in the sale of insurance products were also held to be independent contractors based on the decision in Butts.

RATIONALE:

The information obtained from the workers and the taxpayer was considered in light of the Butts line of cases applying the common law. As is the case in almost all worker classification cases, some facts point to an employment relationship while other facts indicated independent contractor status. The determination of the workers' status, therefore, rests on the weight given to the factors under the common law, keeping in mind that no one factor is determinative of a worker's status. In weighing the evidence, careful consideration has been \[*15\] given to the decisions in Butts, Smithwick, Ware, Mosteirin, and Feivor.

Under the common law, the relationship of employer and employee exists when the person for whom the services are performed has the right to control not only what is done, but how it is done. Evidence of control generally falls into three categories: behavioral controls, financial controls, and relationship of the parties.

Factors which illustrate whether there is a right to control how a worker performs a task include training and instructions. In this case the taxpayer and the workers agree that the workers received training and instructions from the taxpayer and its predecessor. However, the extent and degree of the training is disputed. The workers contend that the training and instructions they received from the taxpayer and its predecessor were intended to control not only what they did, but also how they did it. The taxpayer, on the other hand, contends that the training and instructions consisted of only product training and instructions intended to insure that the workers were in compliance with the myriad of laws and regulations governing the industry. Manuals and documents provided by the workers indicate \[*16\] that training and instructions were generally intended to insure compliance with laws and regulations governing the industry. Inter-views with other workers conducted by the District Director's office support that conclusion.

Factors which illustrate whether there is a right to direct and control the financial aspects of the worker's business include significant investment, unreimbursed expenses, making services available to the relevant market, the method of payment, and the opportunity for profit or loss. In this case, as in the Butts line of cases, the parties agree that the workers had a significant investment in their businesses and that they incurred significant expenses operating and maintaining their businesses. Although the workers did not perform similar services for other firms, they were paid on a com-mission basis and assumed the risk of realizing a profit or incurring a loss as a result of their services for the taxpayer.

Factors which illustrate how the parties perceive their relationship include the intent of the parties, as expressed in written contracts; the provision of, or lack of employee benefits; the right
of the parties to terminate the relationship; the permanency [*17] of the relationship; and whether the services performed are part of the service recipients regular business activities.

In this case, in contrast to the Butts line of cases, it is clear that the parties intended to create an independent con-tractor relationship. The workers entered into written contracts designating them as independent contractors. No federal income tax or social security and Medicare taxes were withheld from amounts paid to the workers and no employee-type benefits were provided by the taxpayer. The taxpayer and its predecessor reported the workers' earnings on Form 1099.

The right of a business to discharge its workers is often indicative of an employment relationship. Although the taxpayer retained the right to discharge the workers, it could only do so if their sales performance was not satisfactory, indicating that the taxpayer was only interested in the results to be accomplished and not the manner or method by which the services were performed. Therefore, this factor is not indicative of an employment relationship as either employees or independent contractors may be discharged for failing to accomplish agreed upon results.

The permanency of the relationship is [*18] another factor to consider. If a business engages a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence of the intent to create an employment relationship. However, a long-term relationship may exist between a business and either an employee or an independent contractor.

Whether the services performed by the workers are part of the regular business of the taxpayer or its predecessor is another factor to consider. In this case, as in the Butts line of cases, the taxpayer is engaged in the sale of insurance and financial products and the workers were engaged to perform sales services. Accordingly, the services performed by the workers are part of the regular business of the taxpayer, an indication (but not a conclusive indication) that an employment relationship may have existed between the taxpayer or its predecessor and the workers.

There are significant similarities between this case and Butts, et al. As in Butts et al., the workers had long-term relationships with the taxpayer and its predecessor. Like Mr. Butts, the workers were required to work full-time selling the taxpayer's [*19] products but were free to determine their own hours of work. They were also restricted from engaging in other business activities. The workers also received product training from the taxpayer and its predecessor, as Mr. Butts had received from Allstate. Although the taxpayers and the workers disagree as to the extent and degree of the training and instructions provided by the taxpayer and its predecessor, the workers, like Mr. Butts, operated their own businesses and exercised a great deal of control over their own day to day activities.

As in Butts et al., the taxpayer reviewed and evaluated the workers' business and retained the right to terminate the workers if their performance was not satisfactory. The workers in this case, like Mr. Butts and the agents in the other cases, were paid strictly on a commission basis with no guaranteed minimum amount of pay. In addition, the workers in this case had no vested interest in the business they produced, nor did Mr. Butts.

The workers in this case also incurred significant expenses operating and maintaining their offices, as Mr. Butts and the agents in the other cases had. In fact, the workers in this case incurred even greater expenses than [*20] Mr. Butts. In Butts, Allstate provided Mr. Butts with office furnishings and paid a portion of his operating expenses. In this case, neither the taxpayer or its predecessor provided the workers with any office equipment, furnishings, materials, or supplies, nor did the taxpayer or its predecessor pay any of the workers' operating expenses.
The similarities between this case and the Butts line of cases indicate that for the same reasons identified by the court in Butts, the workers in this case were independent contractors. The differences between this case and the Butts line of cases reinforce this conclusion. In Butts et al., the insurance agents had entered into written contracts indicating that they were employees and had been treated as employees for federal employment tax purposes. In addition, Mr. Butts and the other agents received employee benefits. The workers in this case, on the other hand, had entered into written agreements indicating that they were independent contractors. The workers did not receive any employee benefits and they were not treated as employees for federal employment tax purposes. Rather, their earnings were reported on Form 1099 as non-employee compensation. [*21] At no time were the workers in this case treated as employees for any purpose by either the taxpayer or its predecessor.

In evaluating the facts in this case, it is clear that the workers operated their businesses in a manner consistent with an independent contractor relationship. Under the Butts line of cases, there is some evidence of an employer-employee relationship in the areas of training and instructions. However, the right to control did not involve sufficient day to day control necessary to overcome the independent manner in which the workers operated their businesses. Finally, in contrast to the Butts line of cases, the relationship of the parties points toward an independent contractor relationship.

CONCLUSION:

Applying the law, regulations and principles set forth in various revenue rulings and court cases, particularly Butts, Smithwick, Ware, Mosteirin, and Feivor, we conclude that the workers were independent contractors and not employees of the taxpayer or its predecessors.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.