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[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 31

[REG-102966-10]

RIN 1545-BJ31

Designation of Payor as Agent to Perform Acts Required of an Employer

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 3504 of the Internal Revenue Code (Code) providing circumstances under which a person (payor) is designated as an agent to perform the acts required of an employer and is liable for employment taxes with respect to wages or compensation paid by the payor to individuals performing services for the payor's client pursuant to a service agreement between the payor and the client.

DATES: Written or electronic comments must be received by **[INSERT DATE 90 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-102966-10), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC, 20044.

Submissions may be hand delivered Monday through Friday, between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-102966-10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Additionally, taxpayers may

submit comments electronically via the Federal eRulemaking Portal at [www.regulations.gov](http://www.regulations.gov). (Indicate IRS and REG-102966-10.)

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, contact Jeanne Royal Singley at (202) 622-0047; concerning the submission of comments or requests for a hearing, contact Oluwafunmilayo (Fumni) Taylor at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

**Background**

Employment Taxes in General

Employers generally are required to deduct and withhold federal income tax and Federal Insurance Contributions Act (FICA) taxes from wages paid to their employees under sections 3402(a) and 3102(a), and are separately liable for the employer's share of FICA taxes under section 3111 and Federal Unemployment Tax Act (FUTA) taxes under section 3301. Instead of FICA taxes, railroad employers are required to deduct and withhold Railroad Retirement Tax Act (RRTA) taxes from their employees' compensation under section 3202, and are separately liable for the employer's share of RRTA tax under section 3221. These taxes are collectively referred to for purposes of these proposed regulations as employment taxes. Sections 31.3102-1(d), 31.3202-1(e) and 31.3403-1 establish that the employer is the person liable for the withholding and payment of employment taxes, whether or not amounts are actually withheld.

When an individual performs services for another person, an employer-employee relationship may exist. Generally, the Code determines the existence of an employer-employee relationship by applying the common law test to the particular facts and

circumstances of each case. See section 3121(d)(2). The Code, however, also provides for other categories of employees, such as corporate officers in section 3121(d)(1).

Under the common law test, an employment relationship 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. An employment relationship exists if an employee is subject to the will and control of the employer not only as to what shall be done but 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 the employer has the right to do so. See §§31.3121(d)-1(c), 31.3231(b)-1(a)(2), 31.3306(i)-1(b), and 31.3401(c)-1(b). This test is also applicable in determining which of two parties in a three-party arrangement is the employer. See for example, Professional and Executive Leasing, Inc. v. Commissioner, 89 T.C. 225 (1987), *aff'd*, 862 F.2d 751 (9th Cir. 1988).

While other factors are helpful in analyzing the common law test, the critical factor in determining whether a person is the common law employer of an individual who performs services is whether the individual is subject to the will and control of the person receiving the services both as to the work to be done and how it is to be done. Thus, the person's control of the individual's actual job performance, rather than merely control of certain administrative functions related to the individual performing services at the worksite, is paramount under the common law analysis. In unique circumstances, an individual may be an employee of more than one employer (concurrent employment)

with regard to the same services. See Rev. Rul. 66-162, 1966-1 C.B. 234 (citing Rest. 2d Agency, §226). However, in order for an individual to be concurrently employed by two entities, each entity must separately satisfy the common law control test.

An employer must file an employment tax return reporting employment taxes for each employment tax return period. Generally, an employer files Form 941, Employer's QUARTERLY Federal Tax Return to report wages the employer paid -- during a quarter of a calendar year -- that are subject to federal income tax withholding and FICA taxes. Wages an employer pays that are subject to FUTA tax are reported annually on Form 940, Employer's Annual Federal Unemployment Tax (FUTA) Return. Employers that pay compensation subject to the RRTA file Form CT-1, Employer's Annual Railroad Retirement Tax Return, as well as Form 941 to report federal income tax withholding. All employers that pay wages or compensation subject to federal income tax withholding, FICA tax, or RRTA tax must file Forms W-2, Wage and Tax Statement, and a Form W-3, Transmittal of Wage and Tax Statements, with the Social Security Administration (SSA) and furnish a Form W-2 to each employee. The employer must obtain an employer identification number (EIN) using Form SS-4, Application for Employer Identification Number, for use in filing the forms. An EIN is a nine-digit number used by the Internal Revenue Service (IRS) to identify an employer's tax account. See section 6109.

For various reasons, an employer may choose to enter into an agreement with a third party (such as a payroll service provider or a professional employer organization (PEO)), sometimes referred to as a third-party payor. Under the agreement the third-party payor remits the wages to employees and takes steps to ensure the employer's

employment tax withholding, reporting, and payment obligations are satisfied. However, employment tax liability cannot be altered by private agreement between an employer and a third-party payor. See In re Professional Security Services, Inc., 162 B.R. 901 (Bankr. M.D. Fla. 1993). Rather the liability of the employer and/or the third-party payor for employment taxes is determined under the Code and depends on all of the facts and circumstances, including the terms and substance of the arrangement between the employer and the third-party payor. There are limited circumstances in a three-party arrangement when the third-party payor may be considered the person responsible for the withholding and payment of employment taxes in addition to, or in lieu of, the common law employer. A description of some common three-party arrangements follows.

#### Section 3401(d)(1) Employers

Section 3401(d)(1) provides that for purposes of federal income tax withholding, the term employer means the person for whom an individual performs or performed any service, of whatever nature, as an employee of such person, except that, if the person for whom the individual performs or performed the services does not have control of the payment of wages for such services, the term employer means the person having control of the payment of such wages. For purposes of section 3401(d)(1), the term control means legal control. See §31.3401(d)-1(f). Thus, when one person is the common law employer of an individual because it controls the day-to-day performance of services by the individual, another person may be the employer liable to collect, report, and pay employment taxes because it is the entity solely in control of the payment of wages to the individual. See Winstead v. United States, 109 F.3d 989 (4th

Cir. 1997). Whether an entity is in control of the payment of wages is determined by considering the facts and circumstances related to each payment of wages. Thus, an entity can be in control of the payment of wages for one employment tax return period, but not in control of the payment of wages for a prior or subsequent employment tax return period.

The legislative history to section 3401(d)(1) specifies that section 3401(d)(1) was intended solely to meet unusual situations and was not intended as a departure from the basic structure of centralizing employment tax obligations with the common law employer. See S. Rep. No. 221, 78th Cong. 1st Sess., May 10, 1943. Accordingly, an entity is not in control of the payment of wages if the payment of wages is contingent upon, or proximately related to, the entity having first received funds from its clients.

The FICA, FUTA, and RRTA do not contain a definition of the term employer similar to the definition contained in section 3401(d)(1); however, courts have applied the section 3401(d)(1) definition to determine liability for the payment of FICA tax under sections 3102 and 3111 and FUTA tax under section 3301. See Otte v. United States, 419 U.S. 43, 95 S. Ct. 247, 42 L. Ed. 2d 212 (1974); In re Armadillo Corp., 410 F. Supp. 407 (D. Colo. 1976), aff'd, 561 F. 2d 1382 (10th Cir. 1977). Due to the similarity between the purpose and scope of the RRTA and the purpose and scope of the FICA, the same definition also applies to the RRTA. Accordingly, section 3401(d)(1) shifts the liability for all the employment taxes due on wages or compensation from the common law employer to the third-party payor with control of the payment of those wages or compensation.

#### Section 3504 Agents

Under section 3504, if a payor pays wages or compensation to employees who are employed by one or more employers, the Secretary is authorized, in accordance with regulations prescribed by the Secretary, to designate such payor to perform acts required of employers under the Code. Section 3504 further provides that, except as otherwise prescribed by the Secretary, all provisions of law (including penalties) applicable with respect to an employer are applicable to the person so designated, but the employer for whom the person acts remains subject to the provisions of law (including penalties) applicable with respect to employers. Accordingly, both an employer and the payor designated in accordance with regulations under section 3504 are liable for the employment taxes on wages or compensation paid by the payor.

Current regulations issued under section 3504 permit district directors and service centers in the IRS to authorize a payor to perform acts required of employers with respect to chapters 21 (FICA tax), 22 (RRTA tax), and 24 (federal income tax withholding) of the Code if the payor applies for such authorization. See Treas. Reg. §31.3504-1(a). The Treasury Department and the IRS have separately proposed updating these regulations to remove the references to the district director and service center and to provide that the application by the payor (referred to therein as an “agent”) must be signed by both the payor and employer and made on the form prescribed by the IRS and according to the instructions provided by the IRS. See Proposed Regulations §31.3504-1(a), published in the Federal Register on January 13, 2010, (75 FR 1735-01).

Pursuant to section 3504 and the regulations, the IRS has established administrative procedures under which a payor may request authorization to file

employment tax returns and perform other acts for the employer. Specifically, Revenue Procedure 70-6, 1970-1 CB 420, provides the general procedures for a payor to request authorization to act as an agent under section 3504 for FICA, income tax withholding, and RRTA purposes, and describes the agent's resulting reporting and filing requirements. Each employer for whom the agent is to act provides the payor with a signed IRS Form 2678, Employer/Payer Appointment of Agent. A payor seeking to act as an agent under section 3504 submits these Forms 2678 to the IRS. The IRS sends a letter to the agent once it has approved the application, and the appointment remains in effect until terminated by one of the parties. An agent with an approved Form 2678 files an aggregate Form 941 reporting FICA tax and income tax withholding for each tax return period using the agent's own EIN (regardless of the number of employers for whom the agent acts). Effective for periods on or after January 1, 2010, an agent with an approved Form 2678 must also complete and attach to the aggregate Form 941 a Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers. The agent uses Schedule R (Form 941) to allocate the aggregate information reported on Form 941 to each employer. Schedule R (Form 941) is attached to the Form 941 in every quarter for which the agent files an aggregate Form 941. See §601.601(d)(2)(ii)(b). If an agent with an approved Form 2678 is acting for employers under the RRTA, the agent must report for each employer the taxable compensation as determined under RRTA with respect to each employer on an aggregate Form CT-1.

Consistent with the limitations in the current regulations, an agent with an approved Form 2678 is generally not authorized to perform the employment tax obligations of an employer with respect to the FUTA tax. Thus, an employer generally



must continue to satisfy its FUTA tax obligations by filing a Form 940 using its own EIN. Proposed Regulation §31.3504-1(b), however, provides a limited exception to the general rule regarding FUTA, which employers may rely on for periods beginning on or after January 1, 2010. The proposed regulation allows agents acting on behalf of employers receiving home care services to perform the acts of an employer required under Chapter 23 (FUTA tax). An agent that files an aggregate Form 940 under the limited exception must complete and attach to the Form 940 a Schedule R (Form 940), Allocation Schedule for Aggregate Form 940 Filers.

Generally, Forms W-2 filed with the SSA and furnished to employees must reflect the name and EIN of the agent with an approved Form 2678; however, special rules may apply if the agent is acting as an agent for two or more employers.

#### Payroll Service Providers (PSPs) and Reporting Agents

An employer may enter into an agreement with a payroll service provider (PSP) to prepare employment tax returns (including Forms 940 and 941) using the EIN of the employer for the signature of the employer. A PSP may also process the withholding, deposit, and payment of the associated employment taxes for the employer. A PSP is not liable under subtitle C of the Code as the employer, or as an agent of the employer, for the employer's employment taxes. An employer's use of a PSP does not relieve the employer of its employment tax obligations or liability for the taxes.

Generally, a reporting agent is a PSP that is authorized to sign and file certain employment tax returns on behalf of the employer using the employer's EIN, including Forms 940 and 941. A reporting agent may also process the withholding, deposit, and payment of the associated employment taxes for the employer. The IRS has prescribed

Form 8655, Reporting Agent Authorization, as the appropriate authorization form for an employer to use to designate a PSP as a reporting agent. Additional information concerning reporting agent authorizations may be found in Rev. Proc. 2012-32, 2012-35 I.R.B. 1. A reporting agent is not liable under subtitle C of the Code as the employer, or as an agent of the employer, for the employer's employment taxes. An employer's use of a reporting agent does not relieve the employer of its employment tax obligations or liability for the taxes.

### Analyzing Three-Party Arrangements

In certain instances, an employer may mistakenly believe it is relieved of employment tax liabilities merely because it has entered into an agreement with a third-party payor (for example, a PEO or employee leasing company) for assistance in fulfilling its employment tax obligations. However, an employer remains liable for employment taxes irrespective of any agreement it may enter into that purports to place the employment tax obligations and liabilities with the payor, except in the limited circumstances when the payor satisfies the conditions to be liable under section 3401(d)(1). In this regard, status as the employer of the worker is determined based on all the facts and circumstances under the common law test (or under other specific Code provisions related to particular types of employees, such as corporate officers). Neither claims by a payor that it is the employer (or "co-employer") of the worker for federal employment tax or other purposes nor the fact that the payor may file employment tax returns under its own EIN are determinative under the Code for purposes of identifying the employer liable for employment taxes.

The application of the employment tax obligations in a three-party arrangement often requires an analysis of complex facts and circumstances that can vary widely. Consequently, the parties to an arrangement may not always understand which party or parties will be liable for any unpaid employment taxes. Even when there is no underlying dispute about the status of the workers as employees or that employment taxes are due with respect to the wages paid to the employees, the IRS must expend substantial resources to develop the facts to determine the liabilities of the parties. The Treasury Department and the IRS intend that these proposed regulations assist taxpayers and the IRS in determining the parties' employment tax obligations in a three-party arrangement when a payor has represented to its client that it will pay the employment taxes with respect to wages or compensation it pays to employees for services performed by employees for the client.

## **Explanation of Provisions**

### In General

The proposed regulations provide rules regarding employment tax obligations in certain three-party arrangements when the employer enters into an agreement with a third-party payor under which the payor performs the employment tax obligations of the client with regard to wages or compensation paid by the payor to individuals performing services for the client, but the payor does not meet the legal conditions necessary to be a section 3401(d)(1) employer, does not obtain an approved Form 2678, and is not a PSP or reporting agent. More specifically, the proposed regulations provide that, unless one of the enumerated exceptions discussed below applies, a payor is designated as an agent under section 3504 to perform the acts required of an employer with respect to

wages or compensation paid by the payor to any individual performing services for any client pursuant to a service agreement (as defined in these proposed regulations) between the payor and the client.

The designation of a payor as an agent to perform acts of an employer under the proposed regulations addresses all federal employment taxes. Thus, for purposes of the proposed regulations, the term wages includes wages as defined for purposes of Chapters 21 (FICA tax), 23 (FUTA tax), and 24 (federal income tax withholding) of the Code, and the term compensation means compensation as defined for purposes of Chapter 22 (RRTA tax) of the Code. The rules in the proposed regulations regarding the designation of a payor as an agent required to perform acts of an employer are provided solely for purposes of determining liability for employment taxes under section 3504. No inference is intended that the same rules would apply for any other provision of the Code.

As required by section 3504 and consistent with the rules relating to agents authorized under §31.3504-1(a), the proposed regulations provide that if a payor is designated as an agent to perform the acts of an employer, all provisions of law (including penalties) applicable with respect to an employer are applicable to that payor and that each employer for whom the payor is designated to act remains subject to all provisions of law (including penalties) applicable to an employer. However, consistent with the IRS's position on administering the section 6672 trust fund recovery penalty, under the proposed regulations the employment tax liability of an employer will be collected only once, whether from the payor or the employer.

#### Scope and Effect of Designation

Subject to the exceptions set forth in the proposed regulations, a payor is designated as an agent under section 3504 to perform the acts of an employer in any case in which the payor entered into a service agreement with a client. For this purpose, the term service agreement means a written or oral agreement pursuant to which the payor (1) asserts it is the employer (or “co-employer”) of individuals performing services for the client, (2) pays wages or compensation to the individuals for services the individuals performed for the client, and (3) assumes responsibility to collect, report, and pay, or assumes liability for, any employment taxes with respect to the wages or compensation paid by the payor to the individuals who performed services for the client.

The first component of a service agreement is that the payor asserts it is the employer (or “co-employer”) of individuals performing services for another individual or entity (the client). For purposes of these regulations, a payor may implicitly or explicitly assert it is the employer (or “co-employer”) of individuals performing services for a client, including by agreeing to: 1) recruit and hire employees or assign employees as permanent or temporary members of the client’s workforce, or participate with the client in these actions; 2) hire the client’s employees as its own and then provide them back to the client to perform services for the client; or 3) file employment tax returns using its own EIN that include wages or compensation paid to the individuals performing services for the client. A payor that is the common law employer of the individuals performing services for a client under all of the facts and circumstances, however, is not designated under the proposed regulations to perform the acts of an employer with respect to

wages or compensation paid to such individuals (see “Exceptions to Designation”) but is liable for employment taxes as the employer.

The second component of a service agreement is that the payor pays wages or compensation to the individuals performing services for its client. A payor with legal control of the payment of wages or compensation within the meaning of section 3401(d)(1), however, is not designated under the proposed regulations with respect to such wages or compensation (see “Exceptions to Designation”) but is liable for employment taxes as a section 3401(d)(1) employer.

The third component of a service agreement is that the payor assumes responsibility for the collection, reporting, and payment of, or assumes liability for, any employment taxes with respect to the wages or compensation paid by the payor to the individuals performing services for the client. Under the proposed regulations, a payor assumes the responsibility to collect, report, and pay the applicable taxes if the payor represents to the client that it would make any or all of the federal employment tax deposits and other payments required by law. A payor that is a PSP or reporting agent, however, is not designated under the proposed regulations with respect to such wages or compensation (see “Exceptions to Designation”) if the payor files the employment tax returns reporting such wages or compensation under the client’s EIN.

#### Exceptions to Designation

As mentioned above, the proposed regulations provide exceptions to when a payor is designated under section 3504 to perform the acts of an employer even if the payor has entered into an agreement that includes the components of a service

agreement. The proposed regulations contain eight examples demonstrating the application or non-application of the proposed regulations to various factual scenarios.

First, the proposed regulations do not apply to the extent that the payor files employment tax returns under the client's EIN, reporting the wages or compensation paid to individuals performing services for the client. Thus, a reporting agent or a PSP that prepares returns using the employer's EIN is not designated under the proposed regulations.

Second, the proposed regulations do not affect the application of the common paymaster rules under sections 3121(s) and 3231(i). Therefore, a second exception provides that a common paymaster is not designated under the proposed regulations for wages or compensation it pays within the context of the concurrent employment arrangement described in section 3121(s) or 3231(i) and the related regulations.

Third, a payor is not designated under the proposed regulations if the person is the employer of the employees under the common law test (because the person has the right to control and direct the individual with regard to the details and means of performing services for the client) or under one of the other section 3121(d) provisions, or is a section 3401(d)(1) employer. Thus, a third exception provides that if the payor is the employer of the individuals performing services for a client, it is not designated as an agent under section 3504. The payor remains liable for payment of employment taxes, however, as the employer. For example, if a consulting firm contracts to provide consulting services to a client and the consulting firm directs and controls the employees providing the consulting services under the contract with regard to how to perform those services, the consulting firm is liable for employment taxes as the

common law employer of the employees, not as a payor designated under the proposed regulations.

### Designation Under Proposed Regulations Is Not the Exclusive Remedy for the IRS

The Treasury Department and the IRS recognize that the determination of the employer and the liabilities of the parties in a three-party arrangement is a factually and resource intensive undertaking involving multiple parties. The regulations as proposed will assist the IRS in cases in which a payor has represented to a client that the payor is liable for some or all of the client's employment tax obligations, but the payor has not received authorization to act as an agent through an approved Form 2678. However, the designation of a payor as an agent to perform the acts required of an employer under the proposed regulations will not preclude the IRS from asserting, in the alternative, that the payor is the common law employer (or an employer of an employee under one of the other section 3121(d) provisions) or the section 3401(d)(1) employer of individuals providing services for a client. Additionally, the fact that the IRS does not assert that a payor is designated as an agent to perform the acts required of an employer under the proposed regulations will not preclude the IRS from determining the payor's employment tax-related liability under other Code provisions (for example, the section 6672 trust fund recovery penalty).

### **Effective Applicability Date**

These regulations are proposed to be effective the date the final regulations are published in the **Federal Register** and are applicable to wages or compensation paid by a payor in quarters beginning on or after the effective date to individuals performing services for its client pursuant to a service agreement.



## **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

## **Comments and Requests for Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments that are submitted timely to the IRS.

The IRS and Treasury Department request comments on the proposed regulations and are particularly interested in comments on the following issues.

(1) Whether the application of the definition of service agreement inappropriately results in a payor being designated an agent under section 3504, or inappropriately results in a payor failing to be designated an agent under section 3504;

(2) Whether additional exceptions are warranted; and

(3) Potential additional examples.

All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits

written comment. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

### **Drafting Information**

The principal author of these proposed regulations is Jeanne Royal Singley, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, personnel from other offices of the IRS and Treasury participated in their development.

### **List of Subjects in 26 CFR Part 31**

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

### **Proposed Amendments to the Regulations**

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

#### **PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE**

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

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

Par. 2. Section 31.3504-2 is added to read as follows:

#### **§31.3504-2 Designation of Payor as Agent to Perform Acts of an Employer**

(a) In general. A person (as defined in section 7701(a)(1)) that pays wages or compensation (“payor”) to the individual(s) performing services for any client pursuant to a service agreement, except as provided in paragraph (d) of this section, is designated as an agent to perform the acts required of an employer with respect to the wages or

compensation paid. For purposes of this section the term wages has the same meaning as the term wages has for purposes of chapters 21, 23, and 24, and the term compensation has the same meaning as the term compensation has for purposes of chapter 22. This section is not applicable if the payor has been authorized as an agent of the employer under § 31.3504-1.

(b) Definitions--(1) Client. The term client means an individual or entity that enters into a service agreement with the payor.

(2) Service agreement. (i) The term service agreement means an agreement pursuant to which the payor:

(A) Asserts it is the employer (or “co-employer”) of the individual(s) performing services for the client;

(B) Pays wages or compensation to the individual(s) for services the individual(s) perform for the client; and

(C) Assumes responsibility to collect, report, and pay, or assumes liability for, any taxes applicable under subtitle C of the Code with respect to the wages or compensation paid by the payor to the individual(s) performing services for the client.

(ii) For purposes of paragraph (b)(2)(i)(A) of this section, the payor may implicitly or explicitly assert it is the employer (or “co-employer”) of the individual(s) performing services for the client, including by agreeing to:

(A) Recruit and hire employees for the client or assign employees as permanent or temporary members of the client’s work force, or participate with the client in these actions;

(B) Hire the client's employees as its own and then provide them back to the client to perform services for the client; or

(C) File employment tax returns using its own EIN that include wages or compensation paid to the individual(s) performing services for the client.

(c) Effects of designation. If a payor is designated as an agent to perform the acts required of an employer under this section--

(1) A payor must perform the acts required of an employer under each applicable chapter of the Code and the relevant regulations with respect to the wages or compensation paid by such payor. All provisions of law (including penalties) and the regulations applicable to the employer are applicable to the payor so designated with respect to the wages or compensation paid by the payor; and

(2) Each employer for whom the payor is designated as an agent remains subject to all provisions of law (including penalties) and of the regulations applicable to an employer.

(d) Exceptions. A payor is not designated as an agent to perform the acts required of an employer under this section for any wages or compensation paid by the payor to the individual(s) performing services for a client to the extent that--

(1) The wages or compensation are reported on a return filed under the client's employer identification number (as defined in section 6109 and the applicable regulations);

(2) The payor is a common paymaster under sections 3121(s) or 3231(i); or

(3) The payor is the employer of the individual(s).

(e) Examples. The following examples illustrate the application of this section:

(1) Example 1. Corporation P enters into an agreement with Employer, effective January 1, 2013. Under the agreement, Corporation P hires the Employer's employees as its own employees and provides them back to Employer to perform services for Employer. Corporation P also assumes responsibility to make payment of the individuals' wages and for the collection, reporting, and payment of applicable taxes. For all pay periods in 2013, Employer provides Corporation P with an amount equal to the gross payroll (that is, wage and tax amounts) of the individuals, and Corporation P pays wages (less the applicable withholding) to the individuals performing services for Employer. Corporation P also reports the wage and tax amounts on Form 941, Employer's QUARTERLY Federal Tax Return, filed for each quarter of 2013 under Corporation P's employer identification number. Corporation P is not a common paymaster or the employer of the individuals. Corporation P is designated to perform the acts of an employer with respect to all of the wages Corporation P paid to the individuals performing services for Employer for all quarters of 2013. Employer and Corporation P are each subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2013 with respect to such wages.

(2) Example 2. Same facts as Example 1, except that Corporation P only reports the wage and tax amounts on Form 941, Employer's QUARTERLY Federal Tax Return, filed for the 1<sup>st</sup> and 2<sup>nd</sup> quarters of 2013. Neither Corporation P nor Employer files returns for the 3<sup>rd</sup> and 4<sup>th</sup> quarters of 2013. Corporation P is designated to perform the acts of an employer with respect to all of the wages Corporation P paid to the individuals performing services for Employer for all quarters of 2013. Employer and Corporation P are each subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2013 with respect to such wages.

(3) Example 3. Same facts as Example 1, except that neither Corporation P nor Employer reports the wage and tax amounts on Form 941, Employer's QUARTERLY Federal Tax Return for any quarter of 2013. Corporation P is designated to perform the acts of an employer with respect to all of the wages Corporation P paid to the individuals performing services for Employer for all quarters of 2013. Employer and Corporation P are each subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2013 with respect to such wages.

(4) Example 4. Same facts as Example 1, except that Employer provides only net payroll (that is, wages less tax amounts) to Corporation P for each pay period. Corporation P is designated to perform the acts of an employer with respect to all of the wages Corporation P paid to the individuals performing services for Employer for all quarters of 2013. Employer and Corporation P are each subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2013 with respect to such wages.

(5) Example 5. Same facts as Example 1, except that after Corporation P reports the wage and tax amounts on Form 941, Employer's QUARTERLY Federal Tax Return, filed for each quarter of 2013 under Corporation P's employer identification number, Corporation P files a claim for refund of the employment taxes it paid for each

quarter of 2013 that are related to wages Corporation P paid to the individuals performing services for Employer. The basis for Corporation P's refund claim is that Corporation P is not the employer of the individuals that performed services for Employer. Corporation P is designated to perform the acts of an employer with respect to all of the wages Corporation P paid to the individuals performing services for Employer for all quarters of 2013. Accordingly, Corporation P is not entitled to a refund. Employer and Corporation P are each subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2013 with respect to such wages.

(6) Example 6. Corporation S enters into an agreement with Employer, effective January 1, 2013. Under the agreement, Corporation S provides payroll services, including payment of wages to individuals performing services for Employer, and assumes responsibility for the collection, reporting, and payment of applicable taxes. For all pay periods in 2013, Employer provides Corporation S with an amount equal to the gross payroll (that is, wage and tax amounts) of the individuals, and Corporation S pays wages (less the applicable withholding) to the individuals performing services for Employer. Corporation S also reports the wage and tax amounts on Form 941, Employer's QUARTERLY Federal Tax Return, filed for each quarter of 2013 under Employer's employer identification number. Corporation S is not designated to perform the acts of an employer with respect to all of the wages Corporation S paid to the individuals performing services for Employer for all quarters of 2013. Corporation S did not assert it was the employer and filed Forms 941 using Employer's employer identification number. Accordingly, Corporation S is not liable for the applicable employment taxes under this section. Employer remains subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2013 with respect to such wages.

(7) Example 7. Corporation V enters into a consulting agreement with Manufacturer effective January 1, 2013, to provide consulting services to Manufacturer. Corporation V is responsible to pay wages to the individuals providing the consulting services to Manufacturer and to collect, report, and pay the applicable taxes. Corporation V has the right to direct and control the individuals as to when and how to perform the consulting services and, thus, is the common law employer of the individuals providing the consulting services. Corporation V is not designated to perform the acts of an employer with respect to all of the wages Corporation V paid to individuals providing consulting services to Manufacturer. However, as the common law employer of the individuals, Corporation V is subject to all provisions of law (including penalties) applicable in respect of employers with respect to such wages.

(8) Example 8. Corporation U and Employer execute and submit a Form 2678, Employer/Payer Appointment of Agent, to the Service, requesting approval to authorize Corporation U to report, deposit, and pay taxes with respect to wages it pays, as agent of Employer for purposes of Form 941, Employer's QUARTERLY Federal Tax Return. The Form 2678 is approved by the Service and effective for all quarters of 2013. Accordingly, Corporation U reports the wages it pays to individuals performing services for Employer and related tax amounts on Form 941 and Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers, filed for each quarter of 2013 under Corporation U's employer identification number. Corporation U is not designated under this section to perform the acts of an employer with respect to all of the wages Corporation U paid to the individuals performing services for Employer for all quarters of 2013. However, as an agent authorized under §31.3504-1(a), Corporation U is subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2013 with respect to such wages. Employer also remains subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2013 with respect to such wages.

(f) Effective/applicability date. These regulations apply to wages or compensation paid by a payor in quarters beginning on or after the date of publication of the final regulations in the **Federal Register** to individuals performing services for the payor's client pursuant to a service agreement.

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Deputy Commissioner for Services and Enforcement

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