

May 17, 2006

Re: Request for Ruling
Unincorporated Business Tax
Anonymous
FLR-064848-005

Dear _____ :

This letter is in response to your request, received on February 24, 2006, for a ruling on hypothetical facts regarding the treatment for purposes of the New York City Unincorporated Business Tax (the "UBT") of real estate salespersons treated as independent contractors for federal tax purposes under section 3508 of the Internal Revenue Code (IRC).

HYPOTHETICAL FACTS

The Taxpayer is a major real estate brokerage entity that is carrying on business in New York City (the "City") and is subject to the UBT. All of the Taxpayer's real estate salespersons are considered employees for common law purposes and for state and local tax purposes, including UBT purposes. However, for purposes of federal taxes, these real estate salespersons are treated as independent contractors pursuant to section 3508 of the IRC. To qualify for independent contractor treatment under section 3508, the Taxpayer and each of its real estate salespersons must enter into a written contract providing that the real estate salesperson is an independent contractor for federal tax purposes.

ISSUES

You have requested rulings that 1) the Taxpayer's treatment of its real estate salespersons as independent contractors for federal tax purposes under IRC section 3508 has no bearing on the status of these salespersons as employees or independent contractors for UBT purposes; and 2) the execution of a written agreement declaring these real estate salespersons to be non-employees for federal tax purposes to satisfy the requirements of

IRC section 3508 has no bearing on the status of these salespersons as employees or independent contractors for UBT purposes.

CONCLUSIONS

- 1) The Taxpayer's treatment of its real estate salespersons as independent contractors for federal tax purposes under IRC section 3508 has no bearing on the status of these real estate salespersons as employees or independent contractors for UBT purposes.
- 2) The execution of a written agreement declaring these real estate salespersons to be non-employees for federal tax purposes in order to satisfy the requirements of IRC section 3508 has no bearing on the status of these salespersons as employees or independent contractors for UBT purposes.

DISCUSSION

Section 11-503(a) of the Administrative Code of the City of New York (the "Code") imposes a tax "on the unincorporated business taxable income of every unincorporated business wholly or partly carried on in the [C]ity." Section 11-502(a) of the Code provides that the services by an individual as an employee are not deemed to be an unincorporated business for purposes of the UBT, unless these services constitute part of a business regularly carried on by that individual. Common law principles generally determine if an individual is an employee or an independent contractor.

Under section 28-02(e)(2) of Title 19 of the Rules of the City of New York ("RCNY"), an employee for UBT purposes is "an individual performing services for an employer under an employer-employee relationship." Ordinarily, an "employer-employee relationship" will exist if the person for whom the services are performed has the right to direct and control the individual who performs the services, not only as to the result to be accomplished, but also the details and means by which that result is to be accomplished. 19 RCNY § 28-02(e)(2).

Whether there is sufficient direction and control to create an employer-employee relationship turns on the particular facts and circumstances of each case, and the parties' designation or description of the relationship, in a contract or otherwise, is not necessarily determinative for UBT purposes. 19 RCNY § 28-02(e)(3).

IRC Section 3508 does not affect this analysis. Congress enacted section 3508 in 1982 in response to litigation as to who was responsible for meeting withholding and FICA requirements. *Cleveland Inst. of Electronics v. United States*, 787 F. Supp. 741, 743 (N.D. Ohio 1992). This section created a special federal rule that, if certain conditions are satisfied, "licensed real estate agents and ... direct sellers [are] treated for [f]ederal income and employment tax purposes as self-employed persons..." and not as employees from whom income and employment tax amounts must be withheld. *Id.* Section 3508 was not intended to eliminate common law tests typically used to determine whether an individual is an employee of independent contractor, but only to provide a special federal

rule to guarantee [for federal tax purposes] independent contractor status for those taxpayers who [meet the section's] conditions.” *Id.* At 741-743.

The Department of Finance (the “Department”) has long recognized that the treatment of a real estate salesperson as an independent contractor under the special federal rule set forth in section 3508 should not be considered relevant to the determination of whether that salesperson is an employee exempt from tax or an independent contractor subject to tax for UBT purposes. *See* Letter of Maria Jones, Deputy Commissioner of Legal Affairs, Department of Finance (May 25, 1983).

In light of this situation, the Department, in 1996, issued Statement of Audit Procedure (“SAP”) 96-2 (2-21-96) which established a safe harbor for individuals to be considered employees for UBT purposes. If the safe harbor in the SAP does not apply, the Department will look at all of the particular facts and circumstances in determining whether the Taxpayer’s real estate salespersons are employees for UBT purposes who are not subject to any separate UBT liability. If the Department concludes the Taxpayer exercises sufficient direction and control over the real estate salespersons, the Department will treat them as employees, regardless of the fact that the Taxpayer treats these salespersons as independent contractors for federal tax purposes under section 3508¹. Further, the employment agreements executed by Taxpayer and each real estate salesperson stating that the salesperson is an independent contractor for federal tax purposes, which are required under section 3508, will not affect the real estate salespersons’ status for UBT purposes.

Sincerely,

Dara Jaffee,
Assistant Commissioner
Office of Legal Affairs

¹ If the Department concludes that sufficient direction and control is not exercised over the salesperson, he or she will be treated as an independent contractor and will be subject to the UBT.