I.R.C. Section 3509—Determination of Employer's Liability for Certain Employment Taxes
(Also: I.R.C. Section 7436 and Section 530 of the Revenue Act of 1978)

Rev. Rul. 2025-3

ISSUES

1. Whether section 530 of the Revenue Act of 1978, Pub. L. No. 95-600, as amended (section 530), or the reduced rates of § 3509 of the Internal Revenue Code (the Code) apply in the five situations set out below.

2. Whether the Internal Revenue Service (IRS) will issue a Notice of Employment Tax Determination Under IRC § 7436 (§ 7436 Notice) in the five situations, set out below.

FACT SITUATIONS

Situation 1. Taxpayer (TP) hires individuals who provide services to TP during the year. For those services, TP pays each individual a weekly fixed amount and a weekly bonus amount. TP does not withhold or pay federal employment taxes with regard to any of the payments and reports the total amount of the fixed weekly amounts and the weekly bonus amounts on Form 1099-NEC “Nonemployee Compensation.” During an audit of TP by the IRS for the year, the IRS determines (1) that TP does not meet the statutory requirements for section 530 relief, and (2) that the individuals are employees of TP. The IRS proposes to assess federal employment taxes on the

weekly fixed amounts and the weekly bonus amounts, which should have been reported as wages on Form 941 "Employer's QUARTERLY Federal Tax Return," and Forms W-2 "Wage and Tax Statement." TP claims it satisfies the statutory requirements for section 530 relief and does not agree that the individuals are its employees.

Situation 2. TP employs individuals who perform services during the year. TP treats the individuals as employees for the services that they perform. For those services, TP pays each individual a weekly salary and a weekly bonus amount. TP treats the weekly salary as wages for federal employment tax purposes. TP withholds and pays federal employment taxes with respect to the weekly salary and reports the salary and federal employment taxes on Form 941 and Forms W-2. TP does not treat the weekly bonus amounts as wages for federal employment tax purposes. It does not withhold or pay any federal employment taxes with regard to the bonus amounts and reports the bonus amounts on Forms 1099-NEC. During an audit of TP by the IRS for the year, the IRS concludes that the bonus amounts are wages. The IRS proposes to assess federal employment taxes on the bonus amounts, which should have been reported as wages on Form 941 and Forms W-2. TP claims it satisfies the statutory requirements for section 530 relief with respect to the bonus amounts and does not agree that the bonus amounts are wages.

Situation 3. Same facts as situation 2 except TP does not report the weekly bonus amounts on Forms 1099-NEC or any other information return.

Situation 4. Same facts as situation 2 except TP does not report the weekly bonus amounts on Forms 1099-NEC or any other information return and does not claim it satisfies the statutory requirements for section 530 relief with respect to the bonus amounts.

Situation 5. TP employs individuals who perform services during the year. TP enters into a contract with a third party (3P) to pay each individual a weekly salary, withhold and pay federal employment taxes, and file federal employment tax returns.[1] 3P pays the weekly salaries, withholds, pays federal employment taxes, and reports the weekly salaries and taxes on Form 941 and Forms W-2 using its own employer identification number (EIN). In December of that same year, TP pays a year-end bonus amount directly to each individual for the individual's services during the year but does not treat the year-end bonus amounts as wages. TP does not withhold or pay any federal employment taxes or report the bonus amounts on any information return. During an audit of TP by the IRS for the year, the IRS concludes that the bonus amounts are wages. The IRS proposes to assess federal employment taxes on the bonus amounts, which should have been reported as wages on Form 941 and Forms

[1] A taxpayer may choose to enter into an agreement with a third party in which the third party agrees to perform some or all of the employer's federal employment payment, withholding, and reporting responsibilities. For purposes of simplicity, this revenue ruling does not address the different variations of third-party payor arrangements, and assumes 3P correctly used its own EIN. However, depending on the facts and circumstances and the type of arrangement, an employer who uses a third party to perform federal employment tax functions on its behalf may remain solely liable for federal employment taxes, may become jointly and severally liable for such taxes, or may be relieved of liability for such taxes. This revenue ruling does not address which party will be ultimately liable for any unpaid employment taxes, as these discussions are beyond the scope of this revenue ruling.

W-2. TP claims it satisfies the statutory requirements for section 530 relief with respect to the bonus amounts and does not agree the bonus amounts are wages.

LAW AND ANALYSIS

An employer is liable for federal employment taxes on wages paid to employees. Federal employment taxes include Federal Insurance Contributions Act (FICA) taxes, Railroad Retirement Tax Act (RRTA) taxes,[2] Federal Unemployment Tax Act (FUTA) taxes, and the collection of income tax at source on wages (income tax withholding).

In general, § 3102 of the Code requires an employer to withhold and pay to the IRS the employee share of FICA taxes from wages when paid to the employee. Furthermore, § 3111 generally also requires the employer to pay to the IRS the employer share of FICA taxes at the same time. Section 3121(a) defines “wages” for FICA tax purposes as all remuneration for employment, including the cash value of all remuneration (including benefits) paid in any medium other than cash, unless specifically excepted. Section 3121(b) generally defines "employment" as any service, of whatever nature, performed by an employee for the person employing him unless a specific exception applies. Similarly, § 3301 imposes on every employer an obligation to pay FUTA taxes on wages as defined in § 3301b). Section 3306(b) and (c) contain similar definitions to FICA for “wages” and “employment,” respectively, for FUTA tax

[2] For purposes of simplicity, this revenue procedure does not discuss the application of these rules to RRTA. However, rules similar to those discussed with respect to Section 530 apply for purposes of determining whether a taxpayer will not be liable for RRTA taxes, with respect to an individual or class of workers (though the reduced rates of § 3509 discussed in this revenue procedure do not apply for purposes of RRTA).

purposes. Section 3402(a) imposes the obligation on an employer to withhold income taxes from wages as defined in § 3401(a). Section 3401(a) provides that the term "wages" means all remuneration for services performed by an employee for his employer including the cash value of all remuneration (including benefits) paid in any medium other than cash, unless a specific exception applies.

The definitions of "wages" and "employment" for FICA, FUTA, and income tax withholding purposes are premised on an individual being an employee and are not applied when an individual is properly classified as an independent contractor or has some other non-employee status. If an individual is properly classified as an independent contractor, the individual's earnings are subject to self-employment tax, which consists of social security and Medicare taxes, if the other requirements for reporting self-employment taxes are met. There is no FUTA tax for self-employed individuals.

For employment tax purposes, an employee generally is any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. *See* §§ 31.3121(d)-1(c), 31.3306(i)-1, and 31.3401(c)-1 of the Employment Tax Regulations. Generally, an employer-employee relationship exists when the person for whom 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 by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the direction and control of the

employer not only as to what shall be done but how it shall be done. Individuals who are not employees under the common law rules may still be employees by statute under certain FICA, FUTA, and income tax withholding provisions. *See, e.g.,* § 3121(d) and the accompanying regulations.

Section 530 provides that a taxpayer will not be liable for federal employment taxes, with respect to an individual or class of workers, if certain statutory requirements are met.[3] Under section 530, the taxpayer, not the individual worker[4], is entitled to relief from the employment tax liability that would otherwise apply under subtitle C of the Code, and any related interest or penalties attributable to that employment tax liability. The taxes imposed by subtitle C include FICA taxes, RRTA taxes, FUTA taxes, and income tax withholding.

Section 530 relief applies only if the taxpayer did not treat the individual as an employee for federal employment tax purposes for the period at issue and meets each of the following requirements for such period: (1) the taxpayer filed[5] all required federal tax returns, including information returns, consistent with the taxpayer's treatment of the

[3] Section 530 (entitled "Controversies Involving Whether Individuals are Employees for Purposes of Employment Taxes") was originally enacted as a temporary measure to provide relief for taxpayers who were involved in employment status (worker classification) disputes with the IRS, and who faced large employment tax assessments as a result of the IRS's proposed reclassifications of workers. Section 530 was extended indefinitely by the Tax Equity and Fiscal Responsibility Act of 1982. Section 530 is not part of the Internal Revenue Code (Code).

[4] Section 530 relief does not extend to individual workers, who remain liable for their personal income taxes and the employee share of FICA taxes.

[5] In no event will a return filed after the date on which the IRS first contacts the taxpayer concerning an examination of the period to which the return relates be considered as filed on a basis consistent with good faith treatment by the taxpayer of an individual as a non-employee. Additionally, section 530 relief is not available for any year and for any worker for whom the taxpayer did not file the required returns.

individual as not being an employee (reporting consistency requirement); (2) the taxpayer did not treat the individual or any individual holding a substantially similar position as an employee (substantive consistency requirement); and (3) the taxpayer had a reasonable basis for not treating the individual as an employee (reasonable basis requirement). A taxpayer will be treated as having a reasonable basis if the taxpayer's treatment was in reasonable reliance on any of the following:

(a) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer (judicial precedent);

(b) a past IRS audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding substantially similar positions (prior audit);

(c) long-standing recognized practice of a significant segment of the industry in which that individual was engaged (industry practice); or

(d) some other reasonable basis for not treating the individual as an employee.

Section 530 relief applies only to controversies involving the proper classification of individuals as employees or non-employees. Section 530 is not applicable when a taxpayer treated an individual as an employee and then paid additional compensation to the employee for the same services but failed to characterize the payment as wages. This includes situations where the taxpayer contends that the payment does not meet the definition of wages because the payment is a lease payment, bonus,

reimbursement, severance payment, dividend, or other comparable characterization, but the payment is, in fact, paid solely for the individual's service as an employee.

Section 530(a)(1)(A) provides that a taxpayer is entitled to relief if the taxpayer "did not treat an *individual* as an *employee* for any period" for purposes of employment taxes (emphasis added). Legislative history demonstrates that section 530 applies exclusively to taxpayers involved in employment status controversies with the IRS. The legislative history explains that the relief measure was for taxpayers that were "involved in employment tax *status* controversies with the [IRS], and who potentially face large assessments, as a result of the [IRS's] proposed reclassifications of workers" and explains that the bill prevents the IRS from reclassifying as employees certain individuals whom the taxpayer has previously treated as independent contractors. S. Rep. No. 95-1263, at 210 (1978).

In determining whether a taxpayer did not "treat" an individual as an employee within the meaning of section 530, Rev. Proc. 2025-10, 2025-4 IRB XX, modifying and superseding Rev. Proc. 85-18, 1985-1 CB 518, provides a list of guidelines used to determine whether there was "treatment" of an individual as an employee for a period within the meaning of section 530(a)(1). Among other actions, with respect to any individual, the following indicate "treatment" of the individual as an employee: the withholding of income tax or FICA taxes from any payments made; the filing of an original or amended employment tax return; the filing or issuance of a Form W-2; and the contracting with a third party to perform acts required of employers.

In enacting section 530, Congress looked to the taxpayer's treatment of the individual, not to the characterization of particular payments made to the individual. If an employer treated the individual as an employee, section 530 relief is not applicable to a dispute involving characterization of particular payments because the worker is not being reclassified from non-employee to employee status.[6] Thus, section 530 does not apply to controversies concerning whether a particular type of payment made to an employee constitutes "wages" as defined under the FICA, FUTA, or income tax withholding provisions, or whether particular services performed by an employee constitute "employment," as defined under the FICA, FUTA, or income tax withholding provisions.

If an employer failed to properly treat an individual as an employee, and the employer does not meet the statutory requirements for section 530 relief, the employer may be eligible for relief under § 3509 of the Code. Section 3509(a) allows an employer to remit unpaid taxes at reduced rates if an employer fails to deduct and withhold income tax or the employee share of FICA tax with respect to any of its employees because the employer treated that employee as a non-employee. Pursuant to § 3509(c), the reduced rates do not apply to the determination of the employer's liability

[6] In unusual cases, an individual may perform services for a taxpayer that are completely separate and distinct from the services giving rise to the employment relationship, and is separately compensated for those services. To be completely separate and distinct, there must be no interrelation either as to duties or remuneration in the two capacities. Compare Rev. Rul. 58-505, 1958-2 CB 728, with Rev. Rul. 2004-109, 2004-2 CB 958, and Rev. Rul. 2004-110, 2004-2 CB 960. In these circumstances, the status of the individual as an employee or non-employee, and the application of section 530, will be considered separately with respect to the distinct relationships under which the separate services are provided.

for income tax withholding or the employee portion of FICA tax if such liability is due to the employer's intentional disregard of the requirement to deduct and withhold such taxes.

The concept of "treatment" of an individual as not being an employee in § 3509 is similar to "treatment" in section 530. The legislative history indicates that § 3509 of the Code was intended to provide relief for employers in cases in which a worker treated as a non-employee by the employer is reclassified by the IRS as an employee, and to deter employers from misclassifying employees to avoid employment taxes.[7]

Similar to section 530, if an employer treated an individual as an employee, § 3509 of the Code will not apply since the worker is not being reclassified from non-employee to employee.[8] Thus, § 3509 is not applicable when determining whether particular payments made to an employee are "wages" or whether particular services performed by an employee are "employment" as defined under the FICA, FUTA, or income tax withholding provisions.

Section 7436 of the Code provides that the Tax Court may review two types of employment tax determinations made by the IRS and the proper amount of employment tax, penalties, and additions to tax resulting from the determinations.

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[7] See Staff of Joint Committee on Taxation, 97th Cong., General Explanation of the Revenue Provisions of the Tax Equity and Fiscal Responsibility Act of 1982 (JCS-38-82), at 384-86 (Comm. Print 1982); H.R. Rep. No. 97-760, at 650-52 (1982) (Conf. Rep.); S. Rep. No. 97-494, Vol. 1, at 370-72 (1982).

[8] As stated in footnote 5, an individual may perform services for a taxpayer that are completely separate and distinct from the services giving rise to the employment relationship, and is separately compensated for those services. In these circumstances, the status of the individual as an employee or non-employee, and the application of § 3509, will be considered separately with respect to each of the distinct relationships under which the separate services are provided.

In order to obtain Tax Court review, the following elements must be present:

(1) an examination in connection with the audit of any person;

(2) a determination that –

(a) one or more individuals performing services for such person are employees of such person for purposes of subtitle C, or

(b) such person is not entitled to relief under section 530(a) with respect to such an individual;

(3) an "actual controversy" involving the determination as part of an examination; and

(4) the filing of an appropriate pleading in the Tax Court.

See American Airlines Inc. v. Commissioner, 144 T.C. 24, at 32 (2015). When the first three elements are met, the IRS will issue a § 7436 Notice. A taxpayer will satisfy the fourth element by filing a timely petition for review of the § 7436 Notice with the Tax Court. Revenue Procedure 2022-13, 2022-6 IRB 477, superseding Notice 2002-5, 2002-1 CB 320, provides guidance concerning when and how the IRS will issue a § 7436 Notice that will document the determination necessary to give the taxpayers the option to petition for Tax Court review. The IRS will not issue a § 7436 Notice if the taxpayer has agreed to the employment tax liabilities. Agreement is generally accomplished using Form 2504-T "Agreement to Assessment and Collection of Additional Employment Tax and Acceptance of Overassessment (Employment Tax Adjustments Subject to IRC 7436)."

HOLDINGS

Holding 1. Section 530 is applicable to this situation because the TP did not treat the individuals as employees, and the IRS is reclassifying the individuals as employees. Whether TP is entitled to section 530 relief depends on whether the TP satisfies the substantive consistency, reporting consistency, and reasonable basis requirements. If section 530 does not apply, § 3509 of the Code may be applicable because the TP treated the individuals as non-employees and did not deduct and withhold federal employment taxes from the weekly fixed amounts and bonus amounts that it paid to the individuals, and the IRS is reclassifying the individuals as employees. Whether TP is entitled to § 3509 reduced rates depends on whether it meets the statutory requirements in § 3509. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) there were determinations that (a) the individuals were employees of TP, and (b) TP was not entitled to relief under section 530 with respect to these individuals[9], and (3) the IRS and TP disagree on the employment status of the workers and whether the statutory requirements for section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

Holding 2. Section 530 is not applicable to this situation because the IRS is not reclassifying the individuals as employees. TP treated the individuals as employees for the services they performed and paid additional wages in the form of bonuses for the

[9] If the IRS were to make only one of these determinations, a § 7436 Notice would still be issued.

same services; there is no controversy over whether the individuals are employees or independent contractors with respect to their services.[10] The reduced rates under § 3509 of the Code are not applicable for the same reason. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under section 530 with respect to the bonuses paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

Holding 3. Section 530 and § 3509 of the Code are not applicable to this situation for the same reasons stated in Holding 2. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under section 530 with respect to the bonuses paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

[10] Compare SECC Corp. v. Commissioner, 142 T.C. 225, 235 (2014) (dispute over "whether petitioner's workers can serve in a dual capacity").

Holding 4. Section 530 and § 3509 of the Code are not applicable to this situation for the same reasons stated in Holding 2. The IRS will not issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached because TP did not claim that TP was entitled to relief under section 530 concerning the bonuses paid to the individuals, and there is no controversy over whether the individuals are employees or independent contractors.

Holding 5. Section 530 is not applicable to this situation because the IRS is not reclassifying the individuals as employees. The year-end bonus amounts are additional wages for the same services performed by the individuals who were treated as employees by TP. The reduced rates under § 3509 of the Code are not applicable for the same reason. The IRS will issue TP a § 7436 Notice at the conclusion of the audit or after Appeals consideration if no agreement is reached. A § 7436 Notice will be issued because (1) there was an examination in connection with an audit, (2) a determination was made that TP was not entitled to relief under section 530 with respect to the year-end bonus amounts paid to the individuals, and (3) the IRS and TP disagree on whether the statutory requirements for section 530 relief have been met (there is an actual controversy involving the determination as part of the audit).

DRAFTING INFORMATION

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