

UNITED STATES  
AGENCY FOR INTERNATIONAL DEVELOPMENT  
(USAID)  
EMPLOYMENT TAX REVIEW  
REGARDING EMPLOYMENT CLASSIFICATION  
OF  
PERSONS PROVIDING SERVICES



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EXECUTIVE SUMMARY

As an integral part of the review process, the Internal Revenue Service Federal Agency Employment Tax Review Team traveled to Guatemala, Barbados, and Cairo to review United States Agency for International Development (USAID) employment tax practices at these three missions. These sites were selected based on input from USAID management, size of mission and geographic considerations, and the deemed necessity to obtain representation of USAID operations worldwide. For example, Cairo was selected for review because it is the largest USAID mission in the world and thus would provide a variety of situations to review. USAID has 68 different missions/offices throughout the world with total worldwide staffing exceeding 12,000 employees with an appropriated budget of \$5.8 billion

Prior to analyzing the employment tax practices at these missions, the IRS team reviewed USAID headquarters operations and met with USAID officials in Washington, D.C. Specifically, the review team looked at: procedural memoranda, directives and guidance provided by headquarters to all the mission offices overseas relating to contract procedures; hiring practices; information reporting; and, employment tax compliance.

The review's purpose was to assess compliance, to discuss all areas of IRS concern with the particular mission/office being reviewed, and to recommend action(s) for improved agency compliance with Internal Revenue Service laws and regulations. Of equal importance, the IRS team provided assistance and education at the reviewed sites and also identified agency needs where additional assistance to USAID personnel and managers in the area of employment taxes is necessary.

The key areas of concern identified and addressed in this report include:

- 1) inconsistent and inadequate consideration given when determining the classification of a worker as an employee or independent contractor;
- 2) misclassification of certain contractors as independent contractors rather than as government employees;
- 3) less than total compliance in issuing and filing information returns;

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- 4) delinquent reporting and paying of employment taxes; and,
- 5) foreign earned income exclusion abuse by USAID employees.

Upon analyzing various individual non-personal service and personal service contracts entered into for services and applying the common law factors utilized by the IRS, the team determined that USAID contracting personnel are relying on internal contracting regulations, i.e., AIDAR, that provide insufficient or inadequate guidance with regard to the employment status of workers. When evaluating whether services are "personal" or "nonpersonal," USAID contracting personnel are not following the guidelines mandated by IRC 3121(d)(2) in making this determination. In addition, the team also found that some categories of workers, due to unclear or ambiguous contract language, were not certain of their employment status with USAID.

In contracting for the personal services of some workers, USAID has entered into unique arrangements with other U.S. Government agencies called Participating Agency Service Agreements (PASA's). After a review of a number of PASA's, interviews with PASA workers and USAID mission officials, and a consideration of the common law factors, it is the conclusion of the IRS team that workers in this category are employees of USAID irrespective of the funding process used for providing remuneration for their services. The IRS team is requesting technical advice from IRS Chief Counsel's Office, and their opinion will be incorporated into the final IRS team's recommendation.

USAID is also making payment to certain individuals providing personal services where funding is provided by the USG and/or a foreign country in what is called a host country contract (HCC). The IRS team found that USAID does not provide any payment information or report to the IRS with respect to HCC's on US nationals and/or US firms performing services in participating countries under the terms of the HCC. The IRS team recognized, however, that the HCC is an unusual and complex arrangement not previously considered by the IRS. Therefore, IRS Chief Counsel's Office is being asked to provide technical advice in order to clarify the employment status of individuals involved in HCC's.

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The team ascertained, however, that when the agency correctly classified the worker as either an employee or independent contractor, the agency did not always fulfill its requirement to correctly report the remuneration paid to the individual worker to the IRS. The IRS team analyzed the agency's compliance for information reporting on Forms 1099, Miscellaneous Income Statement. The team found that total payments and benefits provided to a contractor were not being adequately reported to IRS on Form 1099-MISC. In addition, USAID missions are not attempting to identify "green card holders" for the purposes of determining the proper tax withholding rates. The IRS team also found that compensation paid to some PSC's has not been reported by USAID as wages to the IRS on Forms W-2. The team has concluded from its findings in this area that perhaps as much as \$ 7.6 million in FICA taxes and \$10.1 million in income taxes per annum have been lost because of USAID's reporting failures.

There were USAID employees and PASA contractors at some of the missions visited claiming the Foreign Earned Income Exclusion. The IRS (A/C - International) has initiated examination of 341 USAID employees and from such examinations completed, i.e., 128, \$639,000 in additional income taxes have been assessed. It is expected that the total impact from all 341 examinations will exceed \$1.7 million. These individuals believed, in part due to ambiguity in their perception of their employment status, that they were not employees of the United States Government and thus entitled to the exclusion discussed in IRC 911.

Of major concern to the IRS team was the lack of agency compliance with regard to reporting, depositing, and paying withheld income and FICA taxes for its employees. At every mission/office visited, the team found that Forms 941, Employer's Quarterly Federal Tax Return, were not being filed timely or not being prepared correctly. In addition, each mission reviewed was not making Federal Tax Deposits as required by the IRS. This was a major problem identified at USAID headquarters in Washington as well. To demonstrate the magnitude of the problem, IRS has a current inventory of collection and delinquent return investigations for 39 USAID missions/offices. These return investigations include 53 unfiled employment tax returns and unresolved delinquent accounts exceeding \$8.9 million. There were also errors in preparing and processing Forms W-4 and W-2. The pattern which emerged revealed that responsible technicians are not

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sufficiently cognizant of their duties to properly and accurately fulfill employer duties for satisfying IRS employment tax-related requirements.

Recommendations of the IRS review are broadly summarized as follows:

1) With regard to employment status determinations, AID Acquisition Regulations (AIDAR) should include a discussion of the twenty common law factors so the appropriate contracting official can use them in determining worker relationships. USAID Personal Service Contract language needs to clarify employee status with regard to Federal income tax and FICA withholding requirements as well as worker eligibility for the section 911 exclusion. The Contracting Officer should be the point of determination for worker classification, and he/she should utilize these common law factors in arriving at every worker's employment status decision. When there is a question as to the proper determination for a particular category of worker, USAID manuals should stipulate procedures for securing SS-8 determinations from Internal Revenue Service or seeking assistance from the appropriate Revenue Service Representative serving a particular mission.

2) Procedures for completing, issuing, and filing of information returns (i.e., Forms 1099, Forms W-2) should be enhanced and personnel continually trained to fulfill accurately the IRS reporting requirements. A stronger degree of internal control should be developed to monitor compliance by field activities for accurate, timely information reporting. Forms 1099 should be compared with appropriate contracts and to pay data to insure that they accurately record all remuneration paid to payee/contractor. Forms W-2 should be reviewed to insure that proper amounts of taxes are withheld. USAID headquarters internal directives and manual guidelines should be reviewed and revised accordingly to insure that they adequately detail the correct procedures necessary for information reporting with regard to employment taxes. Furthermore, controls should be established and monitoring procedures instituted to insure that these guidelines are available to and followed by the appropriate mission technicians overseas and in USAID headquarters.

3) USAID's written procedures for preparation and filing of Forms 941, Employer's Quarterly Federal Tax

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Return, should control and enhance performance of overseas technical personnel as well as stress awareness of the importance for accurate reporting and preparation of these tax returns and the requirement for timely filing. In addition, USAID guidelines for the proper depositing of withheld Federal income and FICA taxes need to be adhered to, and USAID should develop a control system to monitor field missions' compliance with IRS filing and deposit requirements.

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ABSTRACT

This report provides guidance and comments on USAID's compliance with respect to: determining employment status of workers; complying with informational reporting; and, ascertaining if possible abuse of the foreign earned income exclusion exists. The report discusses specific findings of noncompliance within USAID headquarters and at certain overseas posts detected by the IRS review team.

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AUTHORITY

This employment tax review of a sample of Federal agencies was done to develop information to be used in providing government sector guidance. A basis for such an effort or review is found in a May 15, 1985 memorandum signed by then-President Reagan who directed the SSA and IRS to provide guidance to departments and agencies concerning Social Security coverage and Social Security taxation for Federal personnel.

The IRS review was initiated by memorandum on July 22, 1988 from the IRS Commissioner to high-level agency officials; and, its review was conducted in coordination with designated financial and/or Inspector General personnel from the sampled agencies. IRS personnel from A/C Examination, A/C Collection, and A/C International were utilized to conduct the review. Results were to be shared with reviewed agencies and findings and recommendations subsequently generalized for use by all agencies. A premise of the review was to discover operating situations about which procedural guidance was warranted. Such guidance could be utilized in considering revision to agency directives and/or fiscal reporting manuals.

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REVIEW GUIDELINES

The IRS conducted this review subject to certain broad guidelines. These guidelines or policies are as follows:

1. Agencies found to be erroneously classifying employees as independent contractors will be advised of the IRS position and requested to adopt consistent, substantiated positions for years forward. No prior year adjustments will be proposed for the agency.

2. Agencies making substantiated determinations concerning workers providing services through an independent contractor arrangement will be reviewed to assure correct and complete information reporting. Where such reporting is incomplete, prior year documents will be secured. Penalties would not be assessed against the agency.

3. In instances where agencies are classifying workers as employees for employment tax purposes [but may or may not be doing so for FICA], employee tax returns will be checked to determine if the agency's employees have erroneously claimed the section 911 exclusion. Prior year adjustments will be made to the employee's individual income tax return(s) where the foreign earned income exclusion under IRC section 911 was erroneously claimed.

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## METHODOLOGY OF REVIEW

The agency reviews were, in general, conducted as follows by the review team.

1. An opening meeting with high-level officials in USAID was held to set up the structure and conditions of the review.
2. Follow-up meetings were held with mid-level USAID officials to discuss initial team requirements.
3. Review team participants held meetings with USAID headquarters technical personnel to learn about:
  - a. organizational structure;
  - b. accounting systems;
  - c. policies, practices and procedures which address personal service contracts; and,
  - d. recent Internal Audit/Inspector General reports or findings dealing with employment tax issues or employee classification.

Note: This was a precontact analysis, i.e., a study of USAID headquarters information for the purpose of identifying agency policy and guidance relative to the issues. It included a review of all related directives, manuals, regulations, etc., indicated by USAID headquarters as used by operating personnel of the agency. Such review supplemented the initial examination plan effort. This examination plan consisted of and identified the procedures necessary to evaluate areas, i.e., issues, for noncompliance in either direction or application.

4. On-site reviews of 3 agency overseas posts.
5. Preparation of a review report and closeout with USAID officials

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BACKGROUND - IRS Involvement

As part of its compliance program, A/C International of the IRS has been working to identify in a systematic way persons who are inappropriately claiming the foreign earned income exclusion. Section 911 of the Internal Revenue Code (IRC) allows individual taxpayers to exclude annually from taxable income up to \$70,000, subject to meeting certain qualifying conditions. However, amounts "paid by the United States or an agency thereof to an employee of the United States or an agency thereof" do not qualify as foreign earned income.

Working with Federal agencies and personnel abroad, A/C International began to make examination contacts with employees claiming the exclusion of U.S. government income in instances where the employment status of the workers was clear.

Under its Employment Tax Examination Program, the Assistant Commissioner Collection of IRS uncovered situations where certain Federal agencies were treating employees as independent contractors while other agencies were treating their workers as employees but failing to withhold income tax.

In addition, a memorandum dated May 15, 1985 from the President directed the Internal Revenue Service and the Social Security Administration to provide guidance to federal agencies concerning Social Security coverage and taxation of federal personnel.

Section 3122 of the Internal Revenue Code allows the head of a federal agency or such agents as the head may designate to make the determination whether services performed by an employee of that agency constitute "employment" and whether remuneration for such services constitute "wages" for FICA purposes. But, this applies only for FICA purposes. An agency head cannot under section 3122 create an employment status that did not otherwise exist. The worker is still to be an employee for income tax withholding purposes regardless of any agency determination for FICA purposes. However, a provision of Section 8015 of the Technical and Miscellaneous Revenue Act of 1988 clarifies that the Secretaries of HHS and Treasury, not the heads of any other federal agencies, have the authority to make the final determination as to whether an individual's service constitutes social security covered employment. Section 3306(c)(6) of the Internal Revenue Code excepts from the definition of employment for FUTA purposes services performed in the employ of the USG or

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an instrumentality of the US. Irrespective of any determinations with respect to FICA, the worker is still a common law employee for all other purposes of the Internal Revenue Code.

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BACKGROUND - Overview of USAID Mission

The Agency for International Development [hereafter referred to as the "agency"] carries out economic assistance programs designed to help the people in developing countries. The agency directs U.S. foreign and economic operations in more than 65 countries. The Foreign Assistance Act (FAA) of 1961, as amended, [22 U.S.C. 2151] authorizes USAID to administer on a bilateral basis two kinds of foreign assistance: (1) development assistance and (2) economic support funding. With the cooperation of the Departments of Agriculture and State, USAID carries out the provisions of the Agricultural Trade Development and Assistance Act of 1954. In other words, USAID's main objective is to help developing countries to help themselves.

USAID's organizational structure consists of the Office of the Administrator and various bureaus and offices which assist the Administrator in managing the agency. Geographic bureaus in Washington oversee the development and implementation of programs; and, USAID Missions have field responsibility for the programs in recipient countries. Agency-wide responsibility for the accounting and budgeting activities of USAID resides in the Office of Financial Management.

For the FY 1988 bilateral economic assistance programs, USAID requested an appropriation in excess of \$5.8 billion. This request included funding for Development Assistance (DA) and the Economic Support Fund (ESF).

FY 1986 Actual =====	FY 1987 Appropriated =====	FY 1988 Appropriation Request =====
\$5,827,286,000	\$5,666,083,000	\$5,809,259,000

Each USAID Mission is responsible for ensuring that all U.S. personnel and foreign national employees of the agency are properly paid in full and in a timely manner. Missions are required to exercise proper control of time and attendance and make biweekly payroll reports to USAID office in Washington, DC (AID/W). At the end of 1988, the authorized staffing for USAID totalled 12,266 throughout the world; and, there were some 68 USAID offices.

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Worldwide USAID Staffing		[12/31/88]
	<u>United States</u>	<u>Overseas</u>
<u>Direct Hire</u>		
US Nationals	2,304	1,253
Foreign Nationals		1,153
<u>Non-Direct Hire</u>		
US Nationals	417	1,178
Foreign Nationals		5,961
Total Staffing	2,721 =====	9,545 =====

Mission Controllers are to utilize a system that entails the establishment of individual pay cards to record all entitlements and changes in pay status. Payments to foreign nationals by the Mission are always made in local currency. Mission Controllers are also in charge of non-taxable allowances of all mission employees.

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Issues for the Review Team

The purpose of the review was to provide reasonable assurance that workers in the Federal sector have an employment status which parallels the private sector. To arrive at such an assurance, review team participants secured evidence to determine the propriety of conclusions reached regarding the following issues or questions.

I. Whether employment status determinations are being made in a manner that is questionable, unsubstantiated, or inconsistent with the Internal Revenue Code as it relates to social security taxes, withholding for income tax purposes, or proper wage or income information reporting regardless of the "funding" arrangements utilized by the agency.

II. Whether agency determinations regarding employment status, i.e., employee or independent contractor relationship, are consistent with the common law factors or rules applicable in determining employer-employee relationship.

III. Whether Federal agency determinations regarding employment status have affected the eligibility of workers for tax benefits available to bona fide independent contractors, e.g., Section 911, Exclusion of Foreign Earned Income.

IV. Whether Federal agencies treat a worker as an independent contractor and/or enter into an agreement with a shell corporation established by a worker to fulfill specified duties of the worker.

V. Whether Federal agencies inconsistently classify workers in comparable positions resulting in differing treatment with respect to FICA withholding, income tax withholding and/or information reporting.

VI. Whether Federal agencies are treating their workers as employees but are failing to withhold income tax.

VII. Whether Federal agencies properly determine workers excepted from FICA taxation under section 3122; and, even where so excepted the workers are still employees for income tax withholding purposes and for all other purposes of the IRC (including IRC section 911), but the agency has failed to consider such workers as employees.

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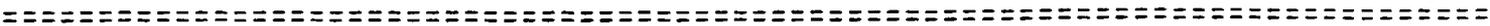
VIII. Whether agency or employer/contractor determinations regarding employment status have, for overseas workers, been made to affect worker entitlement to the Foreign Earned Income Exclusion.

IX. Whether Federal agencies have sufficient, specific guidance from the IRS in the area of employment status to assist in determinations of employment status and employment tax responsibility, e.g., return filing and tax deposit requirements, etc.

X. Whether the agency is providing sufficient information and monitoring the preparation of the documents relating to payroll withholding so as to insure correct and timely adherence to filing and deposit requirements set forth by the Internal Revenue Service.

[NOTE TO ISSUE IV: Prior to review of USAID, it was alleged from various sources that a circumvention of Federal employment tax laws may be occurring by the use of corporations--sometimes referred to as "body shops." Such "body shops" bid/solicit for and are awarded employment contracts but then may not follow usual information reporting and withholding requirements specified by the Internal Revenue Code. It has been observed that some corporations bid on all contract work offered by USAID and that these corporations bid on contracts completely out of their area of expertise. A list of body shops that consistently make such bids has been obtained. A sample of these firms will be queried to ascertain: (1) if "body shop" entities exist and are being used to circumvent any employment tax responsibilities of USAID; (2) whether corporate employees are receiving W-2's or 1099's; and, (3) whether the employees have reported the income earned through the corporation. As of the date the draft report was issued to USAID, insufficient information had been developed to present any findings pertinent to this issue, but if available for the final report, such information will be included in the agency's final report].

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I. Employment Status [Employee vs. Independent Contractor]

A. Topic Background

1. EMPLOYEE DEFINED

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.

A worker is an employee under the usual common law rules if the relationship between him and the person for whom he performs services is the legal relationship of employer and employee. Generally such relationship exists when the person for whom services are performed has the right to direct and control the person 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 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 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 he has the right to do so. The right to discharge is also an important factor indicating that the person possessing that right is an employer.

Other factors characteristic of an employer, but not necessarily present in every case, are the furnishing of tools and the furnishing of a place to work, to the individual who performs the services. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor. An individual performing services as an independent contractor is not as to such services an employee under the usual common law rules. Whether the relationship of employer and employee exists under the usual common law rules will in doubtful cases be determined upon an examination of the particular facts of each case.

"If the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than that of employer and employee is immaterial. Thus; if such relationship exists, it is of no consequence that the employee is designated as a partner, agent, independent contractor, or the like." (Employment Tax Regulations Section 31.3121(d)-1)

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## 20 COMMON LAW FACTORS

Listed below are the twenty common law factors that have been developed for use in the determination of the employer/employee relationship as required by IRC section 3121(d)(2). All factors are not always present in every case, and the degree of importance of each factor may vary depending on the occupation and the reason for its existence. These factors were published by the IRS in Rev. Rul. 87-41, 1987-1, C.B. 296.

1. **INSTRUCTIONS:** A worker who is required to comply with other persons' instructions about when, where, and how he/she is to work is ordinarily an employee. This control factor is present if the person or persons for whom the services are performed have the right to require compliance with instructions. (Rev.Rul. 68-598, 1968-2, C.B. 464) (Rev.Rul. 66-381, 1968-2, C.B. 449)
2. **TRAINING:** Training the worker by requiring an experienced employee to work with the worker, by corresponding with the worker, by requiring the worker to attend meetings, or by using other methods, indicates that the person or persons for whom the services are performed want the services performed in a particular method or manner. (Rev.Rul. 70-360, 1970-2, C.B. 229)
3. **INTEGRATION:** Integration of the workers services into the overall business operations generally shows that the worker is subject to direction and control. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the workers who perform those services must necessarily be subject to a certain amount of control by the owner of the business. (U.S. vs Silk, 331 U.S. 704 (1947), 1947-2 C.B. 167)
4. **SERVICES RENDERED PERSONALLY:** If the services must be rendered personally, presumably the person or persons for whom the services are performed are interested in the methods used to accomplish the work as well as in the results, and the control factor is satisfied. (Rev.Rul. 55-695, 1955-2 C.B. 410)
5. **CONTINUING RELATIONSHIP:** A continuing and regular relationship between the worker and the person or persons for whom the services are performed indicates that an employer-employee relationship exists. A continuing and

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regular basis may exist where work is performed at frequently recurring although irregular intervals. (U.S. v Silk, 311 U.S. 704 (1947))

6. SET HOURS OF WORK: The establishment of set hours of work by the person or persons for whom the services are performed is a factor indicating and showing necessary control. (Rev.Rul. 73-591, 1973-2 C.B. 337)
7. DOING WORK ON EMPLOYER'S PREMISES: If the work is performed on the premises of the person or persons for whom the services are being performed, that factor suggests control over the worker, especially if the work could be done elsewhere. Work done off the premises of the person or persons receiving the services, such as at the office of the worker, indicates some freedom from control. However, this fact by itself does not mean that the worker is not an employee. The importance of this factor depends on the nature of the service involved and the extent to which an employer generally would require that employees perform such services on the employer's premises. Control over the place of work is indicated when the person or persons for whom the services are performed have the right to compel the worker to travel a designated route, to canvass a territory within a certain time, or to work at specific places as required. (Rev.Rul. 56-660, 1956-2 C.B. 693) (Rev.Rul. 56-694, 1956-2 C.B. 694)
8. ORDER OR SEQUENCE SET: If a worker must perform services in the order or sequence set by the person or persons for whom the services are performed, that factor shows that the worker is not free to follow the worker's own pattern of work but must follow the established routines and schedules of the person or persons for whom the services are performed. Often, because of the nature of an occupation, the person or persons for whom the services are performed do not set the order of the services or set the order infrequently. It is sufficient to show control, however, if such person or persons retain the right to do so. (Rev. Rul. 56-660, 1956-2 C.B. 694)
9. ORAL OR WRITTEN REPORTS: A requirement that the worker submit regular or written reports to the person or persons for whom the services are performed indicates a degree of control appropriate for an employee. (Rev.Rul. 70-309, 1970-1 C.B. 199) (Rev.Rul. 68-248, 1968-1 C.B. 431)

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10. **PAYMENT OF BUSINESS and/or TRAVELING EXPENSES:** If the person or persons for whom the services are performed ordinarily pay the worker's business and/or traveling expenses, the worker is ordinarily an employee. An employer, to be able to control expenses, generally retains the right to regulate and direct the worker's business activities. (Rev.Rul. 55-144, 1955-1 C.B. 483)
11. **FURNISHING OF TOOLS AND MATERIALS:** The fact that the person or persons for whom the services are performed furnish significant tools, materials, and other equipment tends to show the existence of an employer/employee relationship. (Rev.Rul. 71-524, 1971-2 C.B. 346)
12. **RIGHT TO DISCHARGE:** The right to discharge a worker is a factor indicating that the worker is an employee and the person possessing the right is an employer. An employer exercises control through the threat of dismissal, which causes the worker to obey the employer's instructions. An independent contractor, on the other hand, cannot be fired so long as the independent contractor produces a result that meets the contract specifications. (Rev.Rul. 75-41, 1975-1 C.B. 323)
13. **RIGHT TO TERMINATE:** If the worker has the right to end his or her relationship with the person for whom the services are performed at any time he or she wishes without incurring liability, that factor indicates an employer/employee relationship. (Rev.Rul. 70-309, 1970-1 C.B. 199)
14. **SIGNIFICANT INVESTMENT:** If the worker invests in facilities that are used by the worker in performing services and are not typically maintained by employees (such as the maintenance of an office rented at fair value from an unrelated party), that factor tends to indicate that the worker is an independent contractor. On the other hand, lack of investment in facilities indicates dependence on the person or persons for whom the services are performed for such facilities and accordingly, the existence of an employer/employee relationship. Special scrutiny is required with respect to certain types of facilities such as home offices. (Rev.Rul. 71-524, 1971-2 C.B. 346)

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15. **REALIZATION OF PROFIT OR LOSS:** A worker who can realize a profit or suffer a loss as a result of the worker's services (in addition to the profit or loss ordinarily realized by employees) is generally an independent contractor, but the worker who cannot if an employee. For example, if the worker is subject to a real risk of economic loss due to significant investments or a bona fide liability for expenses, such as salary payments to unrelated employees, that factor indicates that the worker is an independent contractor. The risk that the worker will not receive payment for his or her services, however, is common to both independent contractors and employees and thus does not constitute a sufficient economic risk to support treatment as an independent contractor. (Rev.Rul. 70-309, 1970-1 C.B. 199)
  
16. **WORKING FOR MORE THAN ONE FIRM AT A TIME:** If a worker performs more than de minimis services for a multiple of unrelated persons or firms at the same time, that factor generally indicates that the worker is an independent contractor. However, a worker who performs services for more than one person may be an employee of each of the persons, especially where such persons are part of the same service arrangement. (Rev.Rul. 70-572, 1970-2, C.B. 221)
  
17. **MAKING SERVICES AVAILABLE TO GENERAL PUBLIC:** The fact that a worker makes his or her services available to the general public on a regular and consistent basis indicates an independent contractor relationship. (Rev.Rul. 56-669, 1956-2 C.B. 693)
  
18. **HIRING, SUPERVISING, AND PAYING ASSISTANTS:** If the person or persons for whom the services are performed hire, supervise, and pay assistants, that factor generally shows control over the workers on the job. However, if one worker hires, supervises, and pays the other assistants pursuant to a contract under which the worker agrees to provide materials and labor and under which the worker is responsible only for the attainment of a result, this factor indicates an independent contractor status. (Rev.Rul. 63-115, 1963-1 C.B. 178) (Rev.Rul. 55-593, 1955-2 C.B. 610)

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19. FULL TIME REQUIRED: If the worker must devote substantially full time to the business of the person or persons for whom the services are performed, such person or persons have control over the amount of time the worker spends working and thereby restricts the worker from doing other gainful work. An independent contractor, on the other hand, is free to work when and for whom he or she chooses. (Rev.Rul. 56-694, 1956-2 C.B. 694)
20. PAYMENT BY HOUR, WEEK, MONTH: Payment by the hour, week, or month generally points to an employer-employee relationship, provided that this method of payment is not just a convenient way of paying a lump sum agreed upon as the cost of a job. Payment made by the job or on a straight commission generally indicates that the worker is an independent contractor. (Rev.Rul. 74-389, 1974-2 C.B. 330)

In summary, when determining the existence of a common law employer-employee relationship, "the crucial test lies in the right of control, or lack of it, which the employer may exercise respecting the manner in which the service is to be performed and the means to be employed in its accomplishment, as well as the result to be obtained." Reed v. Commissioner, 13 B.T.A. 513 (1928), rev'd. and remanded 34 F.2d 263 (3d Cir. 1929), rev'd. per curiam 281 U.S. 699 (1930). The Reed right-to-control test is still the master test. Azad v. United States, 388 F.2d 74, 76 (8th Cir. 1968) "Contracts, however 'skillfully devised' (Lucas v. Earl, 281 U.S., 111, 115), should not be permitted to shift tax liability as definitely fixed by the statutes." (U.S. v. Silk, supra)

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2. EMPLOYMENT DEFINED

IRC Section 3121(b) defines "employment" as any service, of whatever nature, performed by an employee for the person employing him, irrespective of the citizenship or residence of either. In addition to service within the United States, this definition also applies to service outside the United States by a citizen or resident of the United States as an employee of an American employer. An American employer is defined in IRC Section 3121(h) and includes, among others, the United States or any instrumentality thereof.

Prior to January 1, 1984, service performed in the employment of the United States or any instrumentality thereof that was covered by a retirement system established by a law of the United States was excepted from the definition of employment and therefore was not subject to the tax under the Federal old age and survivors insurance system. Section 101.(a)(1) of the Social Security Amendments of 1983 amended IRC Section 3121(b) to remove this exception. Therefore, service performed in the employ of the United States or any instrumentality of the United States by individuals hired after December 31, 1983 is not exempt from the Federal old age and survivors insurance system. The exemption was not removed for employees engaged in employment before that date and for employees who had left such employment and after being separated therefrom, regardless of whether the period of separation began before, on, or after December 31, 1983, if the period of such separation does not exceed 365 consecutive days. Those employees are subject only to the hospital insurance portion of FICA taxes [See IRC section 3121(a)].

3. WAGES DEFINED

The term "wages" is defined in the Treasury Regulations at Section 31.3121(a)1(c) and (d):

- (c) "The name by which the remuneration is designated is immaterial. Thus, salaries, fees, bonuses, and commissions on sales or on insurance premiums, are wages paid as compensation for employment."
- (d) "Generally the basis upon which the remuneration is paid is immaterial in determining whether the remuneration constitutes wages. Thus, it may be paid on the basis of piecework, or a percentage of profit

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and it may be paid hourly, daily, weekly, monthly, or annually."

4. REVENUE RULING 75-343, 1975-2, C.B. 402

Revenue Ruling 75-343 is a good example of the provisions of sections 3121(b) and 3122 at work as they relate to Federal civilian employment. An individual performed services pursuant to a contract executed with a Federal agency. The contract stated the individual was not an employee of the agency, and that his remuneration was not wages for Federal employment tax purposes. The facts in the case showed that the agency retained the right to exercise over the individual the degree of control and direction necessary to establish the relationship of employer and employee. The individual, except for sections 3122, would have been subject to the Federal Insurance Contributions Act. The individual was subject to the Collection of Income Tax at Source on Wages and was not a self-employed person subject to the tax imposed by section 1401 of the Self-Employment Contributions Act. The worker's remuneration was excepted from the taxes imposed by the FICA since the head of the agency has exercised his authority under sections 3122. There are no provisions in the Collection of Income Tax at Source on Wages (chapter 24 of the Code) that are analogous to the provisions of section 3122.

5. FEDERAL UNEMPLOYMENT TAX ACT (FUTA)

Subsection (6) of section 3306(c) excepts from the definition of employment, service performed in the employ of the United States Government or of an instrumentality of the United States which is wholly or partially owned by the United States. This exception was not affected by the Social Security Amendments of 1983. Therefore, wages of employees of the United States Government or instrumentalities of the United States are not subject to the FUTA.

6. INCOME TAX WITHHOLDING AT SOURCE ON WAGES

Wages, under IRC section 3401(a) relating to the withholding of income tax at the source of payment, means all remuneration for services performed by an employee for his employer, including the cash value of all remuneration paid in any medium other than cash.

There are no provisions in the Collection of Income Tax at

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Source on Wages that are analogous to the exceptions under the FICA. Therefore, a determination under section 3122 of the FICA does not have any effect with respect to the application of the income tax withholding provisions.

Remuneration of a civilian employee in the employ of the United States or an instrumentality of the United States is wages subject to the Collection of Income Tax at Source on Wages.

7. INDEPENDENT CONTRACTORS

An individual performing services as an independent contractor is not as to such services an employee under the usual common law rules. Generally, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor. Generally, individuals such as physicians, lawyers, dentists, veterinarians, construction contractors, public stenographers, and auctioneers, engaged in the pursuit of an independent trade, business, or profession, in which they offer their services to the public, are independent contractors and not employees.

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B. ISSUES:

1. Whether agency determinations regarding employment status, i.e., employee or independent contractor relationship, are consistent with the common law factors or rules applicable in determining employer-employee relationship.
2. Whether employment status determinations are being made in a manner that is questionable, unsubstantiated, or inconsistent with the Internal Revenue Code as it relates to social security taxes, withholding for income tax purposes, or proper wage or income information reporting regardless of the "funding" arrangements utilized by the agency.
3. Whether agency determinations regarding employment status have affected the eligibility of workers for tax benefits available to bona fide independent contractors, e.g., Section 911, Exclusion of Foreign Earned Income.
4. Whether the agency has sufficient, specific guidance in the area of employment status to assist in determinations of employment status and employment tax responsibility, e.g., return filing and tax deposit requirements, etc.

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C. DETERMINATIONS:

I.C.1(a) FINDING: The procedures and practices of USAID in advising its PSC's of the employment status of PSC's are not clear; and, USAID has not effectively advised the PSC's that irrespective of Title 5, USC, regarding employee status of PSC's, a PSC is an employee for Internal Revenue Code purposes.

I.C.1(b) DISCUSSION: USAID has had a long-standing practice of securing personal services by using persons with whom it enters into a contractual agreement, which USAID properly asserts as "a contract which establishes an employer-employee relationship for the performance of services personally by the contractor." [AID Handbook 14] The FAA authorizes the agency to enter into such personal services contracts with individuals for personal services abroad. In its handbook [AID Handbook 14, App F], the agency states in paragraph 2(a):

Section 636(a)(3) of the FA Act authorizes the Agency to enter into contracts with individuals for personal services abroad and provides further that such individuals "shall not be regarded as employees of the U.S. Government for the purpose of any law administered by the Civil Service Commission."

Section 2396, Availability of funds, of the FA Act states, in part:

"(a) General expenditures. Appropriations for the purposes of or pursuant to this Act...shall be available for: (3) contracting with individuals for personal services abroad: Provided, That such individuals shall not be regarded as employees of the United States Government for the purpose of any law administered by the Civil Service Commission."

On some of its PSC contracts (form AID 1420-36A), the following is inserted:

SPECIAL NOTE: As an employee under 22 U.S.C. 2396(a)(3), the Contractor is subject to both FICA and Federal Income Tax withholding."

Reference to section 2396 in personal service contracts sends a mixed and confusing signal to persons with whom USAID

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enters into a PSC. Furthermore, the use of this section of the USC may have caused or led many PSC's to believe that since they are not employees "for the purpose of any law administered by the Civil Service Commission" (i.e., Title 5), they are not USG employees. Hence, some USG employees, e.g., PSC's, may have inappropriately claimed the exclusion specified in IRC section 911 for the foreign earned income exclusion.

I.C.1(c) RECOMMENDATION: Since it is the agency's intention and proper purpose of USAID to advise PSC's that even though referred to as a "contractor" or "PSC" there is an employer-employee relationship existing for income tax and Social Security tax purposes, then the following statement would be more appropriate for insertion in PSC contracts.

SPECIAL NOTE: As an employee for purposes of the Internal Revenue Code [26 USC 3121(d)(2) and 26 USC 3401(c)], the Contractor is subject to withholding for both FICA and Federal Income tax.

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I.C.2(a) FINDING: Although USAID accepts (App. D, AID Handbook 14) and recognizes that a personal services contract means a contract which establishes an employer-employee relationship for the performance of services personally by the contractor, it has been determined that compensation paid to some PSC's has not been reported by USAID as wages to the IRS.

I.C.2(b) DISCUSSION: At least since March, 1987 (Contract Information Bulletin 87-20), all USAID overseas procuring activities have (where a PSC situation exists) identified such PSC contracts with "S" in the numbering of such procurement documents. Using the guidance provided in Federal Acquisition Regulations (FAR), paragraph 37.104, USAID contracting officials evaluate and label, i.e., show the contract type, PSC contracts with "S" in the 8th position of the twenty-one (21) alpha-numeric procurement document number.

Contracts initiated at post C during the period November 1, 1987 through December 31, 1988 were sampled and compared to W-2s (Wage and Earnings Statements) prepared by the controller's office for non-direct hire, U.S. nationals or "green card holders" who were PSC's. At this post it was determined that although the contracting office had properly identified and processed the contracts as PSC's, the controller's office had failed to report PSC payments via a form W-2. While the contracting office had identified 78 PSC's, the controller only reported to the IRS (via form W-2) 37 such arrangements for the period. It was interesting to observe that even though the contracting office used "S" to identify PSC's, the controller's office seemed to place reliance of PSC recognition on accounting technicians who were not given guidance or instructions that the "S" in the contract number indicated a PSC situation.

Upon inquiry by the IRS review team, USAID advised that only the value of PSC's with US citizens or residents charged to operating expense could be identified. Information on PSC's funded from program expense is not separately maintained. In other words, not included in the USAID operating expenses (FY 1988 estimate of \$2.593 billion) as personnel costs, i.e., compensation [object class 11] and benefits [object class 12], are the costs of many PSC's. Instead, PSC costs are generally included in individual project costs incurred for each country or region and the costs are not identifiable by USAID through its budget or accounting system structure.

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The number of PSC's utilized worldwide by USAID has been estimated by the IRS team to be in the range of 3,500 to perhaps as high as 4,265, with a value approaching \$113.4 million for FY 1988. This estimate is for both operating and program expenses. [Note: USAID has confirmed 364 with a value of \$11.6 million for PSC's with US citizens or resident aliens charged to operating expense for FY 1988.

Since the IRS team was unable to delve into no more than three of the 68 USAID overseas field posts and USAID accounting records can not accommodate an inquiry to statistically predict the outcome of USAID's less than complete reporting of PSC income, it is not possible to confidently predict the potential of understated taxes. However, the IRS team has conservatively concluded or estimated that perhaps as much as \$7.6 million in FICA taxes and \$10.1 million in income taxes, per annum, have been lost by USAID's failure to properly record, report and withhold on amounts paid to PSC's as a result of the finding heretofore discussed.

I.C.2(c). RECOMMENDATION: USAID should insure that an interface of information between the contracting office and the paying/accounting office occurs so as to prevent PSC's identified as employees in accordance with the acquisition regulations from not being reported as employees by the accounting function to the IRS. Sufficient administrative checks should be in-place to enable the paying/accounting office to reconcile its identified PSC's with authorized PSC's stipulated by the contracting office.

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I.C.3(a) FINDINGS: The general policy and procedures for acquiring services by contract are prescribed by the Federal Acquisition Regulations (FAR) and AID Acquisition Regulations (AIDAR), but such regulations appear to be incomplete and/or insufficient as to guidance on employment status of workers. The contracting officer and others are responsible for ensuring that a proposed contract for services is proper and adheres to the law. To this purpose, the contracting officer must determine whether the service sought is for a "personal" or "nonpersonal" service contract using the definition in FAR 37.101 and FAR 37.104. The mandate set forth by IRC section 3121(d)(2) should be used in making such determinations.

I.C.3(b) DISCUSSION: USAID has a long-standing practice of securing personal services by using individuals with whom it enters into a contractual agreement which traditionally USAID properly asserts as a "contract which establishes an employer-employee relationship for the performance of services personally by the contractor." USAID also uses the same practice of securing N-PSC's by using individuals with whom it enters into a contractual relationship which establishes a relationship within which the person rendering the services are not subject -- either by contract's terms or by the manner of its administration, to the supervision and control usually prevailing in relationships between the USG and its employees. In distinguishing a "personal" services and a "nonpersonal" services situation, the evaluation process does not follow the guidelines mandated by IRC 3121(d)(2).

The Internal Revenue Code provides that the term "employee" includes any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee.

Direction and Control: Under the common law test, a worker is an employee if the person for whom he/she works has the right to direct and control the worker in the way works -- both as to the final result and as to the details of when, where, and how the work is to be done. The employer need not actually exercise control, it is sufficient that he has the right to do so.

USAID criteria (widely used when acquiring services by contract) does not follow the guidelines as mandated by the IRC to determine whether an award for services should be classified as a PSC or N-PSC contract, or whether there

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exists an employer-employee relationship. During its review, in one instance the team was advised by a contracting official at a post that if a person works in an USAID building then the person is more than likely an employee. Such an assumption is obviously only one of those factors generally accepted to discern between an employee and an independent contractor.

Furthermore, there is evidence that headquarters USAID, i.e., Office of Employee and Public Affairs, is frequently reversing previously made field, i.e., contracting office, determinations of personal service contracts to now advise that the proper guidelines were not followed by the Regional Contracting Office (RCO) or Contracting Officer (CO) in originally making PSC determinations. It is being stated in these reversal decisions that some contracts written as a PSC (thereby asserting an employer-employee relationship) have not, after a later review -- when the PSC now is being individually examined by the IRS for having claimed the exclusion discussed in IRC section 911, been found to not be personal service contracts. Such reversal action is explained that such contracts should have been written as a N-PSC. Although reconsideration and reversal may be warranted, usually the reversal arguments are limited only to certain aspects of the contractual relationship omitting such points or factors as:

- a. Integration of services;
- b. Significant investment by a person in facilities used by him in performing services for another;
- c. Whether the person is in a position of making a profit or incurring a loss;
- d. Services rendered personally;
- e. Devotion of full time to the business of the employer;
- f. Payment by the employer of the worker's business and/or travel expenses; or,
- g. Whether services can be made available to the general public while engaged by USAID.

USAID adheres to FAR and AIDAR for service contracting and it distinguishes between contracts for personal and nonpersonal services. The USG is normally required to obtain its employees by direct hire under competitive appointment or other procedures stipulated and required by law. Obtaining personal services by contract other than by direct hire circumvents those laws -- unless Congress has specifically authorized acquisition of the services by contract. Such is

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the case where section 636(a)(3) of the FAA authorizes the agency to enter into contracts with individuals for personal services.

FAR section 37.101 provides: "Personal services contract means a contract that, by its express terms or as administered, makes the contractor personnel appear, in effect, to be Government employees." Also, it defines a nonpersonal services contract as a contract under which the personnel rendering the services are not subject, either by the contract's terms or by the manner of its administration, to the supervision and control usually prevailing in relationship between the Government and its employees."

The FAR, section 37.104(d), states the elements that are used as a guide in assessing whether or not a proposed contract is personal in nature. Such elements shown, however, do not fully address the common law factors required by IRC 3121(d)(2). The following is a comparison of the FAR factors and the common law factors used by the IRS and the Courts to evaluate employment situations.

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FAR Descriptive Elements =====	IRS Factor Number (See above for text) =====
1. Performance on site.	7
2. Principal tools and equipment furnished by USG.	11
3. Services are applied directly to the integral effort of agencies or an organizational subpart in furtherance of assigned function or mission.	3
4. Comparable services, meeting comparable needs, are performed in the same or similar agencies using civil service personnel.	
5. The need for the type of service provided can reasonably be expected to last beyond one year.	5
6. The inherent nature of the service, or the manner in which it is provided reasonably requires directly, or indirectly, Government direction or supervision of contractor employees	

FAR elements 1, 2, 3 and 5 compare favorably with the common law factors 7, 11, 3 and 5, respectively. Certain common law factors which are very important in determining whether there is an employer-employee relationship, i.e.,

<u>Number</u>	<u>Description</u>
9	Oral or written reports;
12	Right to discharge;
13	Right to terminate;
14	Significant investment;
15	Realization of profit or loss;
16	Working for more than one firm at a time;
17	Making services available to the general public;
19	Full time required.

are not included in the FAR elements used as guidelines in

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assessing whether or not a proposed contract is personal in nature and, consequently, the contractor is an employee.

I.C.3(c) RECOMMENDATION: Since the Internal Revenue Code is the law and the courts and various Revenue Rulings have provided practical guidelines for applying the Code, it is recommended that USAID revise the AIDAR to include the usual common law rules/factors and re-draft its handbook to include all common law factors.

USAID should review all its procurement guidelines and regulations applicable to personal and nonpersonal services contracting and:

(1) establish written procedures which incorporate the 20 common law factor as discussed herein, i.e., supplement FAR 37.104(d);

(2) redraft the USAID handbook on service contracting so as to consider the factors mandated by the Internal Revenue Code;

(3) designate the contracting officer as the point of determination for evaluating contracts for services as to type, i.e, PSC or N-PSC, of contract;

(4) obtain IRS guidance by submitting form SS-8, Information for Use in Determining Whether a Worker is an Employee for Federal Employment Taxes and Income Tax Withholding, when questionable situations exist; and,

(5) train contracting personnel on employee versus independent contractor procedures and determinations.

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I.C.4(a) FINDING: The general policy and procedures of USAID for acquiring services by contract also include agreement with other U.S. Government agencies. Such agreements are called Participating Agency Service Agreements or PASA's. The question is whether or not individuals engaged in performing services under a PASA agreement have the status of a U.S. Government employee or whether they are carrying on an independent "trade or business" (thus self-employed and entitled to the section 911 exclusion). PASA individuals have been awarded and paid certain benefits (allowances) in addition to basic pay. Such benefits constitute additional compensation and may be taxable or non-taxable depending on how the individual employment status is determined. It is the IRS position that PASA contractors are employees of USAID irrespective of any circuitous process used for actually paying the PASA contractor.

I.C.4(b) DISCUSSION: A PASA agreement constitutes an agreement between USAID and another, i.e; participating U.S. Government agency, e.g., the USDA or Department of Commerce. It is the responsibility of the participating agency to independently identify and select contractors and consultants in accordance with its own procedures.

In the identification and selection process, the participating agency may enter into an agreement with a third party--such as an educational institution or private organization, to provide the contractor or consultant or to recommend a list of names for selection purposes by the participating agency. Costs associated with PASA's are funded by USAID. Compensation for services (salaries and wages) are paid by either the participating agency or the third party, i.e; private institution or university, but such payments are reimbursed by USAID. Level of supervision by USAID varies according to the complexity of the project and the degree of direction and control needed. Such level is judged or determined on a case by case basis. PASA contractors or consultants usually work under the direction, control and supervision of the Chief of the Project Development Office. USAID considers such individuals as U.S. Government employees. A statement is usually included in the Project Implementation Order/Technical Services (PIO/T) "the contractor is a full time U.S. Government employee of the PASA agency and is entitled to the same privileges and immunities as a U.S. Direct Hire Foreign Service Officer."

The PASA arrangement and benefits paid to the PASA

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contractor by USAID also creates another interrogative and depending on the employment status of the PASA contractor, the interplay of IRC section 911 and 912 comes into being. If the PASA contractor is a U.S. Government employee then he is not entitled to the exclusion of IRC 911 (Foreign Earned Income Exclusion); but, conversely, he is entitled to the benefits of IRC section 912 (Exemptions for Certain Allowances). Those cost of living allowances, etc., awarded to an employee as additional compensation can be considered as non-taxable allowances.

On the other hand, if the employment status is that of an independent contractor, the worker could be entitled to the IRC section 911 exclusion, but must include in gross income those allowances awarded to him in addition to his base pay because such allowances will now be taxable income.

The position of the IRS based on the information available and after review of contracts and interviews with PASA contractors is that such individuals are employees of the USG under IRC Section 3121(d)(2) and are not entitled to the foreign earned income exclusion. During the review process several PASA contractors were interviewed, more than half of those interviewed claimed that their status was not that of an employee of the U.S. Government. Their arguments were as follows:

- 1) They are employees of the third party, i.e., private organization or university;
- 2) Are not entitled to retirement benefits and other benefits awarded to career government employees;
- 3) Base pay is paid by the institution or university and not the USG;
- 4) They have never been advised that they have the status of that of an employee by the PASA agency or USAID.

PASA-type individuals are considered by USAID as full time, U.S. Government employees of the respective PASA agency and are entitled to the same privileges and immunities as U.S. Direct Hire Foreign Service Officers. Also, allowances, such as housing, education, travel, per diem, temporary living, COLA, FICA, etc., are paid by USAID directly to the PASA contractor and treated as non-taxable in accordance with section 912 of the IRC.

I.C.4(c) RECOMMENDATION: The PASA agreement poses an unusual

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and complex situation and there could be some points not considered during the review which need to be evaluated; therefore, technical advice is needed to carefully analyze and clarify the status of the individuals involved. At present, the IRS team's opinion is that the PASA workers are employees of the USG. The final IRS team's recommendation will be based on the response of the technical advice to be prepared by the IRS review team and submitted to the IRS Chief Counsel's Office for consideration.

[NOTE: If the above workers are in fact under the common law rules employees of the USG but their pay is controlled by a third party, then under section 3401(d)(1) and the Supreme Court decision in Otte the third party is responsible for income tax withholding and the FICA.]

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I.C.5(a) FINDING: Individuals were paid as USAID employees (and received W-2's) while at the same time they were paid for performing services as independent contractors and received 1099's for such service payments.

I.C.5(b) DISCUSSION: During the IRS review of USAID, a test check was performed of forms 1099 issued. In the selection process only forms 1099 in excess of \$10,000 were selected for review [109 -- the total value of which exceeded \$1,794,300, were selected]. The 1099's selected were then compared to the "AID Internal ALPHA List - D07" and to the "SSAN/POSNO/NAME List, AID-A/PM-B03" and the following was detected.

1) Of the 109 individuals, 14 (12.8%) were also listed on the employee rosters.

2) Of the 14, five (35.7% of the 14; and, 4.6% of the 109 selected) of the individuals were found to be performing services under a contract while at the same time were employed as a PSC by USAID. The total value of these 14 reporters via 1099's equals \$247,702.

The identified situation discloses an unlikely situation where a worker in USAID can receive a payment for services performed as a regular USG employee while receiving payments (ostensibly for services other than those required as an employee) as if the employee is self employed and carrying on an independent trade or business.

By doing such, USAID presents the opportunity for a portion, i.e., the amount shown on the form 1099, to be excluded from income by virtue of IRC section 911.

Although a worker can simultaneously have a dual status, unless it can be demonstrated that the alleged contractor duties are outside the duties performed as a USG employee, compensation alleged to be for contractual efforts should be considered and reported as wages.

I.C.5(c) RECOMMENDATION: USAID should review all existing guidelines, regulations and rules, especially those pertinent to Titles 5 and 26 of the United States Code; and, insure that 1099's are only issued to bona fide contractors, such recipients are not in an

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~~fide contractors, such recipients are not in an~~  
employment status with the USG and possibly prohibited  
thereby from simultaneously providing contractor  
services to the USG. Monies paid to an USAID employee  
for services performed represent wages subject to  
withholding and Social Security taxes and reportable to  
the IRS, the Social Security Administration, and the  
employee on Form W-2.

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I.C.6(a) FINDING: In instances where funding is from or provided by the USG and/or a foreign country for which USAID is making payment to certain individuals providing personal services who would otherwise be an employee of the USG, such payments are not being reported as employee compensation by USAID.

I.C.6(b) DISCUSSION: A host country contract (hereafter referred to as "HCC") is a legally binding agreement between the contracting agency and an entity -- institution, firm or individual, whereby the latter undertakes to provide the specified goods or services required to carry out a USAID approved project in return for payment therefor. Listed below are various financing methods used by USAID in the implementation of HCC's.

1. Direct reimbursement to the host country.
2. Direct letter of commitments to supplier/contractor.
3. Letter of commitment to a US bank.
4. Special letter of credit.
5. Trust fund.

"Trust fund" represents the host country financing. USAID regulations require that funds in trust for the host government be subject to generally the same requirement of use, fiscal responsibilities and management that apply to AID appropriated dollar funds. This is so even though USAID is not a party to the HCC.

Mandatory clause number 2 for AID-Financed Host Country Contracts states, in part:

"The parties hereto understand that the contract has reserved to AID certain rights such as , but not limited to the right to approve the terms of this contract, and any or all plans, reports, specifications, subcontracts, bid documents, drawings or other documents related to this contract and the project to which is part. The parties hereto further understand and agree that AID, in reserving any or all of the foregoing approval rights, has acted solely as a financing entity to assure the proper use of USG funds and that any decision by AID to exercise or refrain from exercising these

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approval rights shall be made as the financier in the course of financing this project and shall not be construed as making AID a party to the contract."

It was further ascertained and determined that HCC's usually provide that the contractor and its employees, who are not citizens or permanent residents of the host country, are being paid free of all taxes, fees, levies or impositions imposed under laws in effect in the host country with respect to all work and services performed under the HCC contract.

USAID does not provide any payment information or report to the IRS with respect to HCC's on US nationals and/or US firms performing services in participating countries under the terms of the HCC.

US national's and US firm's participation in HCC's, and such involvement coupled with the unique HCC arrangement creates an unusual situation, i.e., such individuals or firms are performing services for the host country but payment is made by AID, as a result the following must be resolved:

--- Since the funding of HCC's is provided by the USG, shall such funding be construed as the controlling factor for employment status purposes?

--- Is the employment status one which creates an employer-employee relationship?

--- If an employer-employee relationship exists, who is the employer, i.e., the contracting agency, the host country or USAID which makes the payment?

--- Are the individuals engaged under HCC's compelled to comply with US income tax obligations as US government employees?

I.C.6(c) RECOMMENDATION: The HCC situation poses an unusual and complex arrangement not heretofore considered by the IRS. Therefore, technical advice is needed to clarify the employment status of the individuals involved in HCC's. The outcome of the technical advice, which is to be prepared by Assistant

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Chief Counsel (Employee Benefits and Exempt  
Organization) will serve to guide and format final  
recommendations by IRS on this issue to USAID.

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I.C.7(a) FINDING: Workers who should have been considered as PSC's are being contracted with and paid by purchase orders and some were mis-classified as N-PSC's. Consequently, such workers were not identified and reported as employees.

I.C.7(b) DISCUSSION: It is stated without equivocation in FAR 37.104:

"(a) As indicated in FAR 37.101, Personal Services Contracts is characterized by the employer-employee relationship it creates between the government and the contractors personnel. The government is normally required to obtain its employees by direct hire under competitive appointment or other procedures required by the civil service laws. Obtaining personal service by contract rather than by direct hire circumvents those laws unless Congress has specifically authorized acquisition of the services by contract.

"(b) Agencies shall not award personal services contracts unless specifically authorized by statute (e.g., 5 USC 3109) to do so."

At post "D" 16.7% of the purchase orders to individuals reviewed were found to be mis-classified and for services that are very likely "employee" services. That is, the purchase orders were for recurring services that appeared to be such that an employer-employee relationship existed. Not only does mis-classification or practice avoid reporting of payments as PSC wages, but the process prevents the controller's office from identifying such payments as remuneration and the subsequent withholding of income and Social Security taxes.

I.C.7(c) RECOMMENDATION: Regardless of the funding mechanism used to pay individuals for personal services, USAID should develop guidelines or make changes to existing manual requirements to insure that workers are being classified properly (e.g. using the 20 common law factors) to ensure there is proper withholding, paying over, and reporting of withheld taxes.

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II. Information Reporting and Compliance by the Federal Agency

A. Topic Background

Information returns [Form W-2 and Form 1099 series] are forms that provide information required by the Internal Revenue Service. The principal purpose for information returns is to provide the IRS with a mechanism to match payment information with the recipient's income tax return to see whether the payments were included in income. There are four (4) main categories of information returns:

1. Information returns of persons subject to special provisions of the law;
2. Information returns of employers reporting wages and other payments to employees;
3. Information returns of employee benefit plans; and,
4. Information returns for payments to nonemployees and transactions with other persons.

This review dealt primarily with the second and fourth categories to ascertain compliance by selected Federal agencies to report certain kinds of payments for transactions which must be reported to the recipient and to the IRS for information and matching purposes.

If an employer-employee relationship exists [it does not matter what it is called, i.e., partner, agent, or independent contractor], then a Form W-2 (Wage and Tax Statement) must be completed and given to each employee [Ref: IRS Publication 15, Circular E, Employer's Tax Guide], i.e., the second category.

With respect to the fourth category, reporting, generally, is not required for payments to corporations; however, reporting is required for payments to partnerships. The forms used to report required payments to nonemployees and transactions with other persons are the Form 1099 series.

The most frequently used of this series, Form 1099-MISC, Statement for Recipients of Miscellaneous Income, must be filed with the IRS by the last day of February each year for the following (to name just a few payment types). By the last day of January each year, each payer must also furnish a copy of this form to each recipient. (See section 1.6041 of the Income Tax Regulations for comprehensive instructions.)

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- a. Payments of \$600 or more for rents;
- b. Prizes, awards, etc. of \$600 or more that are not for services rendered;
- c. Payments of \$600 or more for fees, commissions, premiums, remunerations, emoluments, compensations, or other fixed or determinable gains, profits, and income amounts to persons not treated as employees for services rendered in the payer's trade or business (including government agencies and nonprofit activities). [Ref. Internal Revenue Code section 6041] The kinds of nonemployee compensation to be reported on Form 1099-MISC include fees, commissions, prizes, awards, or other forms of compensation for services rendered for the trade or business by an individual who is not an employee.

Examples:

- 1. Payments to nonemployee entertainers for services.
- 2. Attorney's and accountant's fees for professional services.
- 3. A fee paid to a nonemployee and travel reimbursement for which the nonemployee did not account to the payer, if the fee and reimbursement aggregate at least \$600.

For contracts entered into by a Federal executive agency, as defined in 26 CFR 1.6050M-1(b), for the sale of property, rendering of services, or other consideration where the amount of the contractual obligation exceeds \$25,000, the Federal agency must provide specific information to the IRS advising it of such contract. Forms 8596 and 8596A are used to report the required information. A "Federal executive agency" includes any executive agency (defined by the U.S. Code as an executive department, a government corporation, and an independent establishment -- other than the General Accounting Office), military department, U.S. Postal Service and the U.S. Postal Rate Commission.

The requirement for information returns relating to persons receiving contracts from certain Federal agencies was effective January 1, 1987. Thus, all contracts signed on or after that date and all contracts signed prior to that date but still in effect on that date are subject to information reporting. The term "contract" means an "obligation of a Federal executive agency to

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make payment of money (or other property) to a person in return for the sale of property, the rendering of services, or other consideration." [Ref. 26 CFR 1.6050M-1(b)(2)(i)]

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B. ISSUES

1. Whether the agency inconsistently classifies workers in comparable positions resulting in differing treatment with respect to FICA withholding, income tax withholding and/or information reporting.
2. Whether the agency properly determines workers excepted from FICA taxation under section 3122; and, even where so excepted the workers are still employees for income tax withholding purposes and for all other purposes of the IRC (including IRC section 911), but the agency has failed to consider such workers as employees.
3. Whether agency or employer/contractor determinations regarding employment status have, for overseas workers, been made to affect worker entitlement to the Foreign Earned Income Exclusion.

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C. DETERMINATIONS:

II.C.1(a) FINDING: A review of the 941's was made but the 941's could not consistently be reconciled with payroll records and/or pay vouchers for the USAID activities reviewed.

II.C.1(b) DISCUSSION: The 941's were reconciled at three posts. At Post "A" reconciliation was made for years 1986 and 1988. No discrepancies were found on salaries reported on the 941's and payroll records.

At post "B" the IRS review team tried to reconcile years 1987 and 1988. The reconciliation could not be made since payroll records were missing, returns (941's) have not been filed, and copies of 941's could not be found by USAID for the reconciliation.

At post "C" which covers two reporting entities, a reconciliation was made for years 1986 and 1988. On one of the reporting entities minor discrepancies were found between the 941 filed and the pay vouchers. On the other reporting entity the wages reported on the 941 filed did not agree with the amounts on the pay vouchers.

II.C.1(c) RECOMMENDATION: Persons preparing 941 returns must give increased attention to such preparation to ensure that all salaries paid are correctly included on the 941's. The preparer of the 941's should maintain statements of earning records to show mission payments to personal service contractors. This statement should provide for recording of salaries, FICA and Federal Income Tax Withholding.

After review of existing guidelines and directives, a standard set of procedures or steps for 941 preparation and review/audit should be developed and implemented by USAID.

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II.C.2(a) FINDING: When USAID issues a contract to an individual there is no process or provision to determine if the payee or contractor is a U.S. citizen or "green card" holder.

II.C.2(b) DISCUSSION: USAID negotiates contracts with various individuals and entities for a variety of services, i.e. electricians, plumbers, etc. When these contracts are prepared the posts have no way of identifying whether the individuals are U.S. citizens or "green card" holders. Such practices create internal control problems for the agency because USAID must file information returns on payments to certain U.S. citizens or resident aliens. If a 1099 is not issued, the IRS has no way of checking the income that was received against income reported by the individual.

II.C.2(c) RECOMMENDATION: When contracts are prepared, procedures should be established to identify whether the payee is a U.S. citizen or resident alien. In cases where a contractor has been identified as a U.S. company, citizen or "green card" holder, USAID should solicit a Social Security Number or Employer Identification Number and incorporate it into the contract. Once the required information is in the contract, the controller's office can accumulate payment information, as appropriate, for eventual 1099 preparation and submission to the IRS.

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II.C.3(a) FINDING: Review of Miscellaneous Income forms, form 1099-MISC, by the IRS review team disclosed that the total amount of contract payments and benefits provided to contractors by the USG are not being reported thereon.

II.C.3(b) DISCUSSION: At all overseas USAID posts reviewed, 1099's were checked and compared to the procurement documents applicable to such 1099's. A major problem was noted in that the "nonemployee compensation" amounts, item 7, did not include all payments and/or benefits provided to the payees by USAID. The 1099's issued reported only the "salary" or "wages" which usually is a separate line item in the contracts.

Also included in and provided by the contracts are items eventually paid to or for the contractor during the period of service. Some of these items are: per diem, airfare reimbursements, travel and transportation, insurance, education expenses, housing (either in-kind or payment of a housing allowance similar to that paid to direct-hire employees), automobile shipment, etc.

Exclusion of the various benefits and other payments given or made to bona fide contractors by USAID from the 1099's actually issued by the various overseas USAID posts for 1988 has resulted in an estimated understatement of \$923,000 in gross contractor income. Failure to properly include various contractor benefits on the 1099's may have resulted from a misunderstanding of the provisions of 26 USC 912, Exemption for Certain Allowances.

Section 912 is only applicable to civilian officers and employees of the USG, but it is not applicable to contractors paid by the USG.

II.C.3(c) RECOMMENDATION: Before issuing 1099's the applicable contracts should be reviewed to ensure that all payments made by the USG and all in-kind benefits or services provided according to the contract are included in the 1099. Incorrect preparation or the failure of USAID to include on the 1099's all contract items affords contractors with the opportunity to underreport their income on their income tax return and to take deductions for expenses, e.g., travel, education costs, etc., that were reimbursed and not otherwise reported as income by the contractor.

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III. Employee Records Inquiry, i.e., Potential Abuse of Section 911 for Exclusion from Gross Income

A. TOPIC BACKGROUND

1. INTRODUCTION

In past years Congress has provided several tax incentives to encourage U.S. taxpayers, both individuals and corporations, to go overseas. A provision in the tax law passed in the 1920's allowed an unlimited exemption of foreign earned income. In the 1950's, limitations were placed on the exclusion. Then in 1978 the exclusion was replaced by a series of deductions known as excess foreign living costs, and an exclusion of earned income was available to those taxpayers living in hardship area camps. The Economic Recovery Tax Act of 1981 provides that the exclusion of income under section 911 does not apply to amounts "paid by the United States or any agency thereof." Prior section 911 language had applied since 1926. But, effective in 1982 the new exclusion under IRC Section 911 was available to qualifying individuals overseas. This exclusion is still available, even though the yearly amount of the exclusion has changed several times. A taxpayer completes Form 2555 when taking the section 911 exclusion.

2. QUALIFIED INDIVIDUALS

To qualify for the Section 911 exclusion, the individual taxpayer must have a tax home outside the United States and must complete: 1) a period of bona fide residence; or 2) physical presence outside the U.S.

A. Tax Home:

The taxpayer's regular or principal place of business is generally his/her tax home regardless of where the taxpayer maintains his/her family home. For Section 911 the term "tax home" has the same meaning which it has for purposes of Section 162(a)(2) relating to travel expenses away from home.

B. Bona Fide Residence:

The bona fide residence test denotes permanency. A taxpayer's purpose, intent, length, and nature of stay are factors used to establish residency. Section 871 governing the status of a resident alien is the same guideline used to

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determine bona fide residence for a U.S. citizen abroad. Only U.S. citizens can qualify for the bona fide residence status. Resident aliens cannot qualify since they are already residents of the United States. Bona fide residence is not allowable if the taxpayer makes a statement to the foreign country that he is a nonresident of that country and, due to the nonresidency, he is not subject to income tax of that country.

Bona fide residence consists of an uninterrupted period which includes an entire tax year, for calendar year taxpayers it would be January 1 through December 31. If a person arrives in a foreign country on January 1 or after, the qualifying period will begin the following January 1st. Once the taxpayer has established bona fide residence, he/she may claim benefits for the entire period of residence in the foreign country.

C. Physical Presence:

A citizen or resident alien of the U.S. must be present in a foreign country or countries for 330 full days out of any 12 consecutive month period to qualify for the physical presence test. A "full day" begins at midnight after the arrival in the foreign country. The term "12 consecutive months" means any period beginning with any day and ending on the day before that date in the 12th succeeding month.

(Example: July 1 1987 - June 30, 1988 is 12 consecutive months.)

If a person overseas travels from one foreign country to others, the period is still considered foreign unless the travel is in the U.S. at any time.

3. QUALIFIED EARNED INCOME

A. Foreign Earned Income:

Foreign earned income is defined as being income earned from sources within a foreign country that is earned during a period for which the taxpayer qualifies under. A foreign country is defined as:

"...any territory under sovereignty of a government other than that of the United States. It includes the air space over any such territory. It does not include a possession or territory of the United States."

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(Regs. Section 1.911-2(h).)

Earned income includes wages, salaries, professional fees, amounts received as compensation for personal services rendered. It also includes noncash remuneration, allowances and reimbursements from an employer. To qualify for the Section 911 exclusion, the income must be foreign earned income.

B. Amounts or Incomes Not Included:

1) Amounts already excluded by Section 119. Meals, lodging, etc. furnished for the employee for the convenience of the employer.

2) Pensions or annuity income.

3) "Paid to an employee by an employer which is the U.S. government or any agency or instrumentality;" (Reg. 1.911-3(c)(3).)

4) Included in gross income by Section 402 (b) or Section 403(c).

5) Included in gross income by reason of Reg. 1.911-6(b)(4)(ii).

6) Amounts received after the close of the taxable year for which the services were rendered in the previous taxable year.

4. DETERMINATION OF THE AMOUNT EXCLUDED

A. Basic Exclusion: The amount to be excluded from gross income is the lesser of:

1) Qualified individuals foreign earned income for the taxable year, multiplied by:

$$\frac{\# \text{ qualifying days in the year}}{\text{-----}} \\ \text{Total \# of days in the year.}$$

or;

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2) Annual Rate (\$70,000 for 1987) multiplied by;

$$\frac{\# \text{ qualifying days in the year}}{\text{Total \# of days in the year.}}$$

B. Housing Cost Amount Exclusion:

1) Housing Cost Amount: These are the reasonable housing expenses paid or incurred by or on behalf of the taxpayer while in a foreign country. The housing expenses must be for that portion of the tax year in which the taxpayer meets the bona fide residence or physical presence test. Treas. Reg. 1.911-4(b) lists the expenses that are to be included and excluded in the housing cost amount.

2) Base Housing Amount: This is an amount used to reduce the housing expenses. The base housing amount is equal to 16% of the annual salary of a U.S. government employee, Grade GS-14, step 1, multiplied by the following fraction:

$$\frac{\# \text{ of qualifying days}}{\text{Total \# of days in the taxable year.}}$$

(Form 2555, line 20 lists the daily base housing amount.)

3) Employer Provided Amounts: These amounts are amounts paid to an employee by an employer which is foreign earned income or any amount incurred on behalf of an employee by an employer which is foreign earned income. Treas. Reg. 1.911-4(d)(2) states what amounts are considered to be employer provided.

4) Computation of the Housing Cost Amount Exclusion: Housing cost amount, reduced by the base housing amount, multiplied by the following fraction:

$$\frac{\text{Employer provided amounts}}{\text{Total foreign earned income.}}$$

C. Housing Cost Amount Deduction:

If all or a portion of a taxpayer's housing cost amount is attributable to self-employment income, and therefore not excludable under the housing cost amount exclusion, the individual may deduct the housing cost amount from gross

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income to the extent the foreign earned income has not been excluded already.

5. MARRIED TAXPAYERS

A. Basic Exclusion:

If both spouses qualify, they both compute their basic exclusion separately.

B. Housing cost amount:

1) Married Filing Separate, the housing expenses must be divided between the spouses.

2) Married Filing Joint, only one spouse can include the housing expenses.

3) Spouses residing apart, if both qualify for separate housing expenses, both spouses can included the expenses.

6. SECTION 911 ADJUSTMENTS

A. A qualified taxpayer that takes the section 911 exclusion from gross income must determine what part of other specific deductions are allocable to the excluded income. That part of the other deductions is considered unallowable and reduces the exclusion. The purpose of this provision is to prevent a double tax benefit. Expenses that are directly allocable to or chargeable against excluded income and are, therefore, completely or partly disallowed are; employee business expense, casualty and theft losses on business property, moving expense, business-related miscellaneous itemized deductions, child care credit, operating business expenses, and an IRA expense.

B. Computation of the Allocable portion of deductions:

The business expense attributable to qualifying earned income, multiplied by the following fraction:

$$\frac{\text{Excluded earned income}}{\text{Qualifying earned income.}}$$

[Note: If the qualifying earned income is fully excluded, none of the related expenses are allowed. Deductions disallowed are entered on Form 2555, line 38.]

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7. MAKING AND REVOKING THE ELECTION FOR THE SECTION 911  
EXCLUSION

In order to take the exclusions, i.e., basic and housing, a qualified taxpayer must make an election separately to each exclusion. The election can be made by completing form 2555. Once the election has been made, it remains in effect until it is revoked. A taxpayer can revoke the election by filing a statement. Once the election has been revoked, the individual may not, without consent of the Commissioner, again make the election until the sixth year following the year the election was revoked.

The election must be made with an income tax return that is timely filed (including extensions) or the amending of a timely filed return. An election with a delinquent filed return will be denied.

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B. ISSUES

1. Whether agency determinations regarding employment status have affected the eligibility of workers for tax benefits available to bona fide independent contractors, e.g., Section 911, Exclusion of Foreign Earned Income.
2. Whether Federal agencies treat a worker as an independent contractor and/or enter into an agreement with a shell corporation established by a worker to fulfill specified duties of the worker.
3. Whether agency or employer/contractor determinations regarding employment status have, for overseas workers, been made to affect worker entitlement to the Foreign Earned Income Exclusion.
4. Whether Federal agencies inconsistently classify workers in comparable positions resulting in differing treatment with respect to FICA withholding, income tax withholding and/or information reporting.

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C. DETERMINATIONS:

III.C.1(a) FINDING: PSC and PASA contractors have erroneously claimed the "foreign earned income exclusion" as prescribed in IRC section 911.

III.C.1(b) DISCUSSION: Interviews conducted by the IRS team at posts "A" and "C" disclosed the following:

1) Seven of nine PSC's were interviewed at post "A." Two of the seven were incorrectly claiming the provisions of the foreign earned income exclusion on their income tax returns. Interviewee argued (including those who were not taking the exclusion) that since they were not entitled to the same benefits, such as FPO privileges, commissary, retirement, etc., then they should not be considered employees for tax reporting purposes.

2) Also at Post "A" there were three PASA contractors. One contractor was in-place as result of an agreement with the Department of Agriculture and a University which had issued the W-2 for wages paid to the PASA contractor. The remainder are employees of a U.S. Government Agency. Of the two interviewed one was taking the foreign earned income exclusion under the assumption that he was not a U.S. Government employee because the educational institution was issuing his pay check; but, USAID considered him as an employee of the PASA agency. Also he claims that he was never notified by USAID that his employment status is that of a U.S. Government employee.

3) At Post "C" PASA agreements reviewed for the period of 1986 through 1988 showed the involvement of eight PASA contractors. Of those only three were still performing services. The IRS team was able to interview only one and he would not commit himself as to whether he took the exclusion or not. Of the remainder, one was unavailable, and the other avoided being interviewed. USAID employees at this post stated that they believed these PASA-type employees were claiming the foreign earned income exclusion.

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Since U.S. Government employees are not entitled to the foreign earned income exclusion benefits under the provision of IRC section 911 and it is the IRS's opinion that PASA contractors and PSC's are U.S. Government employees, such persons are not entitled to the exclusion for foreign earned income.

III.C.1(c) RECOMMENDATION: It is suggested that USAID clearly advise PSC's that even though referred as a PSC or PASA contractor there is an employer-employee relationship existing for income tax purposes. A comprehensive, standard contractual clause should be developed and utilized by the PSC and PASA contractor explaining their status. Such clause should also include information as to the non-availability of IRC 911 benefits to USG employees.

[Note: This clause could read: "This contractor is  
• not eligible to claim the Foreign Earned  
• Income Exclusion as discussed in Internal Revenue Code section 911 on his/her tax return filed with the IRS for amounts paid pursuant to this contractual agreement."]

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IV. Collection Activity and Compliance

A. TOPIC BACKGROUND

At the end of September, 1988, the Collection Division had a total of 158 open cases against various Federal agencies located overseas. The bulk of these were for non-appropriated fund activities. The total liability for these open cases exceeded \$22.8 million.

In addition, there were delinquent investigations for various agencies for 197 unfiled forms 941, Employer's Quarterly Federal Tax Return.

Prior to May, 1987, contacts with the field offices of the agencies were effective in resolving only a small number of these cases; but, because of the widespread geographical locations of these entities, field contacts on all of the inventory were not possible or cost effective.

In May, 1987, the entire inventory of Federal agency cases were assigned to one Collection office so efforts could be coordinated and an effective way could be developed to resolve these cases. As a result of this process, many systemic problems and trends that were unique to this inventory were identified. Specifically, contacts needed to be established at the department/agency headquarters level in Washington, DC. Subsequently, meetings were set up with mid-level managers of the agencies to: 1) present the nature and scope of the compliance problem; 2) solicit assistance from the agencies to resolve the problem through a system of designated liaisons; and, 3) notify the agencies that the IRS would provide whatever assistance necessary to help the agency reconcile and correct the problem.

In January, 1988, initial meetings were held with various agency representatives and executives. Liaisons were identified who would serve as contact points. It was agreed that the IRS would provide a sample of "test" cases for each of these liaisons; and, the IRS would provide simplified transcripts and technical advice to assist the liaisons in resolving the problems. The liaisons, in turn, would contact their appropriate field personnel to reconcile these test cases. During subsequent meetings with the liaisons, the test cases were provided. The results were not what we had hoped for, i.e., no test cases were resolved. Either no response was received (even after several follow-ups), or responses were insufficient to resolve the accounts.

A complete inventory review and analysis was conducted of one

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Department and it was determined that typically these accounts involve multiple EINs, missing or misapplied Federal tax deposits, erroneous interest and penalty assessments, CAWR adjustments, and other credit application problems. In some cases, the constant movement of credits between quarters -- either computer generated or initiated by IRS Service Center personnel, makes a simplified explanation of the account almost impossible. One of the reasons for the failure of our efforts to resolve cases through liaison contacts was the complexity of the cases and the inexperience of agency personnel responsible for making deposits and resolving account problems.

Past experience has shown that the reason credits are misapplied or missing and multiple EIN's exist are: 1) the lack of taxpayer education; and 2) the constant change of agency overseas personnel who are responsible for depositing taxes and preparing returns. Payments being sent in without proper taxpayer identification, use of multiple EIN's, and late deposits are factors that have contributed to the problem. We cannot overlook the fact, however, that there are also instances of non-filing and non-payment -- either intentionally or from oversight. Many of the accounts involve liabilities in the hundreds of thousands of dollars, and a few accounts exceed a million dollars. On the surface these cases do not appear to be adjustment-type cases; but, are instances of non-filing and non-payment that need agency attention.

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B. ISSUES

1. Whether Federal agencies are treating their workers as employees but are failing to withhold income tax.
2. Whether Federal agencies have sufficient, specific guidance from the IRS in the area of employment status to assist in determinations of employment status and employment tax responsibility, e.g., return filing and tax deposit requirements, etc.
3. Whether the agency is providing sufficient information and monitoring the preparation of the documents relating to payroll withholding so as to insure correct and timely adherence to filing and deposit requirements set forth by the Internal Revenue Service.

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C. DETERMINATIONS:

IV.C.1(a) FINDING: The IRS review team conducted a review of the filing of 941's, Employer's Quarterly Tax Return, and discovered that in many instances 941's were not being filed timely.

IV.C.1(b) DISCUSSION: The returns were reviewed at three posts. Posts A & C were current with their filings of 941's although they did have a history of delinquent filings; however, post B's compliance record was poor and several returns were not yet filed. At the three USAID posts which covered seven reporting entities, twenty-eight returns were reviewed. The record of filings is as follows:

941's Reviewed	Timely Filings	Days Delinquent		
		1-60	61-120	120 or more
28	10	5	1	12

Post B had three reporting entities. At the time of our review none of those entities was current with its filings. In one instance only one 941 return was filed to cover the entire year. The 941 return is a return required to be filed quarterly.

In yet another instance one of the entities has not filed the quarterly returns in over a year. The IRS has, since the review began, received the delinquent returns from one of those entities; but, after a review it has been determined that the returns were prepared incorrectly (see II.C.1). The other entity was sent blank returns to be prepared over four months ago but, as of 5/23/89, the IRS still has not received a response nor have the returns been filed.

IV.C.1(c) RECOMMENDATION: USAID should have a procedure where the numerous posts can be monitored to guarantee that the returns are filed and filed timely. The IRS review team has identified 64 EINs for USAID worldwide. Within USAID, there appears to be no control or accountability as to whether the returns are filed or filed timely. The review identified this situation to be a major problem where returns are filed an average of 51 days late. Furthermore, there are several instances where no returns were filed for the entire year.

Based on the filing practices of the seven reporting

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entities reviewed, if the delinquency rate is applied  
universally throughout USAID, worldwide, then USAID would  
have a delinquency rate approaching 38.3% for all reporting  
entities within USAID.

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IV.C.2(a) FINDING: A review of the records of Federal Tax Deposits revealed that none of the posts reviewed were making deposits properly or timely. During its review, the IRS review team identified \$46,311,173 in deposits that either have been misapplied due to worldwide USAID errors in making deposits, or deposits have not been associated with returns due to the non-filing of the employment tax returns [See IV.C.1(a)].

IV.C.2(b) DISCUSSION: At post B, there are three reporting entities each with a separate EIN. Two of the EIN's have similar numbers and this may have contributed to the confusion because the deposits when made to the Federal Reserve Bank were not identified properly by the post. Also, the deposits were not made in accordance with IRS deposit regulations. [See 26 CFR 31.6302(c)-1]

At two other posts, the Federal tax deposits were not made timely. Such tardiness may be attributable to the procedure where these posts -- as do most other posts, must rely on an office, i.e., RAMC, in another country to issue checks for any payments. Due to the turnaround period of securing the checks it is difficult to comply with the deposit requirement dates. However, the posts contribute materially to the deposit problem because if the checks are requested (which they seldom are) at the same time the payroll is requested then when the checks are received the posts hold the checks until the end of the month. Additionally, a separate check is requested for each employee's withholding. Later, these checks are then all sent to the Federal Reserve Bank with a Federal Tax Deposit slip.

At times the posts send a separate deposit slip for each employee's withholding checks. This practice creates havoc when trying to reconcile the deposits with the returns. For example, a post may show deposits of \$4,000, but such may have been sent or deposited with 50 checks that total \$4,000. Each check/payment is processed separately by the Federal Reserve Bank.

The outstanding employment tax accounts of USAID with the IRS were also reviewed. At post B, the record keeping was in such a state that it was not possible to resolve the outstanding liabilities. At post A, all the necessary documents were secured for subsequent IRS action; but, the post itself must do considerably more research to resolve the problems.

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Post C had the least number of outstanding collection problems. All necessary documentation to resolve the problems were secured for necessary IRS action.

IV.C.2(c) RECOMMENDATION: (1) At each post visited, a training session was conducted by a participant of the IRS review team to explain the deposit requirements and to provide a procedure for making Federal Tax Deposits (FTD). Periodic training should be provided by knowledgeable individuals to agency technicians. The IRS can provide training materials that can help not only the USG employees but also the FSN's as they generally are the individuals actually performing the function.

(2) Whenever a voucher for payroll is prepared, the posts should request at the same time that one check be issued for the total amount of FICA and FITW due for the employees listed on that particular voucher.

After the check is received from the issuing office, the check should be forwarded along with a FTD coupon immediately. The checks should not be held until the end of the quarter as is the current practice. Further, if a post does not have a FTD coupon, a letter -- which must state the EIN, amount and quarter to which the amount is to be applied, addressed to the Federal Reserve Bank may be sent with the deposit.

(3) Returns should be filed timely. The due dates for the returns are as follows:

Quarter	Period Ending	Due Date
=====	=====	=====
1st	March 31st	April 30th
2nd	June 30th	July 31st
3rd	September 30th	October 31st
4th	December 31st	January 31st

Presently, there seems to be no USAID procedure to determine when the deposits are correct or made timely. Even though no penalties are collected from other Government agencies in these matters, the staff hours expended by both IRS and USAID employees to resolve numerous, recurring deposit problems, i.e., locating payments, transferring payment postings, researching records, copying documents, etc., is quite costly and every effort must be made to prepare returns and submit deposits accurately.

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IV.C.3(a) FINDING: Employee's Withholding Allowances Certificate, form W-4, which claim "exempt" or 10 exemptions or more must be submitted to IRS quarterly; however, a review of USAID posts revealed that the posts are not complying with IRS regulations for W-4 submissions.

IV.C.3(b) DISCUSSION: At three posts the IRS team reviewed the W-4's and found the following:

	<u>W-4's</u> <u>Post Reviewed</u>	<u>Claimed</u> <u>Exempt</u>	<u>Over 10</u> <u>Deductions</u>
A	36	9	1
C	58	12	0
D	50	6	0

No W-4's were submitted to IRS, as prescribed, by post A or C. Further, every employer is also required to secure a new W-4 each year from any employee who claims "exempt". This is not being done at the USAID posts.

IV.C.3(c) RECOMMENDATION: A W-4 must be secured for every employee. For anyone who claims "exempt" or 10 or more exemptions, the W-4 must be submitted to IRS quarterly with the 941's. New W-4's must be secured every year for individuals claiming "exempt".

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IV.C.4(a) FINDING: A review of Wage and Earnings Statements, W-2's, at USAID posts disclosed numerous errors in the preparation of the W-2s, including failure to withhold properly.

IV.C.4(b) DISCUSSION: At one post the W-2's for 1986, but not for 1987 or 1988, were not prepared correctly. The total wages were reported on item (10) -- which should include wages, tips, other compensation; but, the same amount was reported in item 13, Social Security wages. The amount in item 13 is not always the same as item 10. The ceiling for Social Security wages for 1986 was \$42,000. In numerous instances [29.4%] the wages were over that amount. The withholding for Social Security was correct, and the post only withheld up to the maximum of \$42,000. But, a problem exists when reconciliation of the W-2 Social Security wages is attempted; and, the W-2 figures will not reconcile. This situation resulted in \$71,000 of additional wages with over \$10,000 in additional tax due from the post. Furthermore, the post had included in FICA wages the income of individuals who were covered by CSR. For "green card holders" the post neglected to deduct the Old-Age, Survivors, and Disability Insurance (OASDI) and Medicare portion of the Social Security taxes. Even after these problems were identified and taken into consideration, it was still not possible to reconcile the W-2's to the 941's.

IV.C.4(c) RECOMMENDATION: All W-2's should be reviewed for accuracy before they are submitted to the IRS or the employees. The majority of the errors were the result of an absence of effective internal control procedures to detect irregularities.

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IV.C.5(a) FINDING: At all three posts reviewed, the IRS team located green card holders which had no Social Security, Medicare or Income Tax withholding.

IV.C.5(b) DISCUSSION: Resident aliens ("green card holders") for tax purposes are treated the same as U.S. Citizens. They are subject to the same tax rates, OASDI, FICA, Income Tax withholding, and Medicare taxes. At Post C, at least three resident aliens did not have any withholding for Social Security or Medicare. They were issued a W-2, and the post was aware the employees are resident aliens.

At Post A, an individual became a "green card holder" in June, 1988, but did not notify the personnel office. The post learned of the employee's new status in March, 1989. The employee had not been issued a W-2 for 1988, nor was there any withholding being made by the post.

During the IRS review of three sites, it was determined that of all non-direct hire and "green card holders" employed by USAID and not correctly having FICA, withheld from their wages, there are potentially as many as 120 employees in USAID who may be affected. As a result, approximately \$37,800 in Medicare taxes; \$378,504 in OASDI; and, over \$1 million in Income Taxes, are not being withheld from such employees.

IV.C.5(c) RECOMMENDATION: USAID Posts do not have an effective identification process for "green card holders". When a "green card" FSN is hired or subsequently becomes a resident alien the post has no way of knowing the FSN's status change. A procedure should be formulated and instituted to identify resident aliens.

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V. Recommendations

Provided herewith in section V is a restatement of the recommendations made by the IRS review team to USAID. This restatement is merely intended to position or locate the recommendations in a central location for convenience of discussion.

I.C.1(c) RECOMMENDATION: Since it is the agency's intention and proper purpose of USAID to advise PSC's that even though referred to as a "contractor" or "PSC" there is an employer-employee relationship existing for income tax and Social Security tax purposes, then the following statement would be more appropriate for insertion in PSC contracts.

SPECIAL NOTE: As an employee for purposes of the Internal Revenue Code [26 USC 3121(d)(2) and 26 USC 3401(c)], the Contractor is subject to withholding for both FICA and Federal Income tax.

I.C.2(c) RECOMMENDATION: USAID should insure that an interface of information between the contracting office and the paying/accounting office occurs so as to prevent PSCs identified as employees in accordance with the acquisition regulations from not being reported as employees by the accounting function to the IRS. Sufficient administrative checks should be in-place to enable the paying/accounting office to reconcile its identified PSC's with authorized PSC's stipulated by the contracting office.

I.C.3(c) RECOMMENDATION: Since the Internal Revenue Code constitutes the law and the courts and various Revenue Rulings have provided practical guidelines for applying the Code, it is recommended that USAID revise the AIDAR to include the usual common law rules/factors and re-draft its handbook to include all common law factors required by IRC section 3121(d)(2) and the Treasury Regulations.

USAID should review all its procurement guidelines and regulations applicable to personal and nonpersonal services contracting and:

(1) establish written procedures which incorporate the 20 common law factor as discussed herein, i.e., supplement FAR 37.104(d);

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(2) redraft the USAID handbook on service contracting so as to consider the factors mandated by the Internal Revenue Code;

(3) designate the contracting officer as the point of determination for evaluating contracts for services as to type, i.e, PSC or N-PSC, of contract;

(4) obtain IRS guidance by submitting form SS-8, Information for Use in Determining Whether a Worker is an Employee for Federal Employment Taxes and Income Tax Withholding, when questionable situations exist; and,

(5) train contracting personnel on employee versus independent contractor procedures and determinations.

I.C.4(c) RECOMMENDATION: The PASA agreement poses an unusual and complex situation and there could be some points not considered during the review which need to be evaluated; therefore, technical advice is needed to carefully analyze and clarify the status of the individuals involved. At present, the IRS team's opinion is that the PASA workers are employees of the USG. The final IRS team's recommendation will be based on the response of the technical advice to be prepared by the IRS review team and submitted to the Assistant Chief Counsel (Employee Benefits and Exempt Organization) for consideration.

I.C.5(c) RECOMMENDATION: USAID should review all existing guidelines, regulations and rules, especially those pertinent to Titles 5 and 26 of the United States Code; and, insure that whenever 1099's are issued to bona fide contractors, such recipients were not in an employment status with the USG and possibly prohibited thereby from simultaneously providing contractor services to the USG. Monies paid to an USAID employee for services performed represent wages subject to withholding and Social Security taxes and reportable to the IRS and the employee on Form W-2.

I.C.6(c) RECOMMENDATION: The HCC situation poses an unusual and complex arrangement not heretofore considered by the IRS. Therefore, technical advice is needed to clarify the employment status of the individuals involved in HCC's. The outcome of the technical advice, which is to be prepared by Assistant Chief Counsel (Employee Benefits and Exempt Organization), will serve to guide and format final recommendations by IRS on this issue to USAID.

I.C.7(c) RECOMMENDATION: Regardless of the funding mechanism used to pay individuals for personal services, USAID should develop guidelines or make changes to existing

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manual requirements to insure that workers are being classified properly (e.g. using the 20 common law factors) to determine the agency's requirement for the withholding, paying over, and reporting of withheld taxes.

II.C.1(c) RECOMMENDATION: Persons preparing 941 returns must give increased attention to such preparation to ensure that all salaries paid are correctly included on the 941's. The preparer of the 941's should maintain statements of earning records to show mission payments to personal service contractors. This statement should provide for recording of salaries, FICA and Federal Income Tax Withholding.

After review of existing guidelines and directives, a standard set of procedures or steps for 941 preparation and review/audit should be developed and implemented by USAID.

II.C.2(c) RECOMMENDATION: When contracts are prepared, procedures should be established to identify whether the payee is a U.S. citizen or resident alien. In cases where a contractor has been identified as a U.S. company, citizen or "green card" holder, USAID should solicit a Social Security Number or Employer Identification Number and incorporate it into the contract. Once the required information is in the contract, the controller's office can accumulate payment information, as appropriate, for eventual 1099 preparation and submission to the IRS.

II.C.3(c) RECOMMENDATION: Before issuing 1099's the applicable contracts should be reviewed to ensure that all payments made by the USG and all in-kind benefits or services provided according to the contract are included in the 1099. Incorrect preparation or the failure of USAID to include on the 1099's all contract items affords contractors with the opportunity to underreport their income on their income tax return and to take deductions for expenses, e.g., travel, education costs, etc., that were reimbursed and not otherwise reported as income by the contractor.

III.C.1(c) RECOMMENDATION: It is incumbent on USAID to clearly advise and tell PSC's that even though referred as a PSC or PASA contractor there is an employer-employee relationship existing for income tax purposes. A comprehensive, standard contractual clause should be developed and utilized by the PSC and PASA contractor explaining their status. Such clause should also include information as to the non-availability of IRC 911 benefits to USG employees.

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[Note: This clause could read: "This contractor is not eligible to claim the Foreign Earned Income Exclusion as discussed in Internal Revenue Code section 911 on his/her tax return filed with the IRS for amounts paid pursuant to this contractual agreement."]

IV.C.1(c) RECOMMENDATION: USAID should have a procedure where the numerous posts can be monitored to guarantee that the returns are filed and filed timely. The IRS review team has identified 64 EINs for USAID worldwide. Within USAID, there appears to be no control or accountability as to whether the returns are filed or filed timely. The review identified this situation to be a major problem where returns are filed an average of 51 days late. Furthermore, there are several instances where no returns were filed for the entire year.

Based on the filing practices of the seven reporting entities reviewed, if the delinquency rate is applied universally throughout USAID, worldwide, then USAID would have a delinquency rate approaching 38.3% for the 64 reporting entities within USAID.

IV.C.2(c) RECOMMENDATION: At each post visited, a training session was conducted by a participant of the IRS review team to explain the deposit requirements and to provide a procedure for making Federal Tax Deposits (FTD). Periodic training should be provided by knowledgeable individuals to agency technicians. The IRS can provide training materials that can help not only the USG employees but also the FSN's as they generally are the individuals actually performing the function.

Whenever a voucher for payroll is prepared, the posts should request at the same time that one check be issued for the total amount of FICA and FITW due for the employees listed on that particular voucher.

After the check is received from the issuing office, the check should be forwarded along with a FTD coupon immediately. The checks should not be held until the end of the quarter as is the current practice. Further, if a post does not have a FTD coupon, a letter -- which must state the EIN, amount and quarter to which the amount is to be applied, addressed to the Federal Reserve Bank may be sent with the deposit.

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Returns should be filed timely. The due dates for the returns are as follows:

Quarter =====	Period Ending =====	Due Date =====
1st	March 31st	April 30th
2nd	June 30th	July 31st
3rd	September 30th	October 31st
4th	December 31st	January 31st

Presently, there seems to be no USAID procedure to determine when the deposits are correct or made timely. Furthermore, the attitude of some USAID personnel is that since the IRS does not charge penalties to other Government agencies, then there is no need to be concerned. Even though no penalties are collected from other Government agencies in these matters, the staff hours expended by both IRS and USAID employees to resolve numerous, recurring deposit problems, i.e., locating payments, transferring payment postings, researching records, copying documents, etc., is quite costly and every effort must be made to prepare returns and submit deposits accurately.

IV.C.3(c) RECOMMENDATION: A W-4 must be secured for every employee. For anyone who claims "exempt" or 10 or more exemptions, the W-4 must be submitted to IRS quarterly with the 941's. New W-4's must be secured every year for individuals claiming "exempt", or when an employee has previously claimed 10 or more exemptions.

IV.C.4(c) RECOMMENDATION: All W-2's should be reviewed for accuracy before they are submitted to the IRS or the employees. The majority of the errors were the result of carelessness and an absence of effective internal control procedures to detect irregularities.

IV.C.5(c) RECOMMENDATION: USAID Posts do not have an effective identification process for "green card holders". When a FSN is hired and then becomes a resident alien, unless the employee notifies personnel, the post has no way of knowing about the status change. A procedure should be formulated and instituted to identify resident aliens.

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SRA = Supervisory Revenue Agent  
SRO = Supervisory Revenue Officer

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OVERSEAS IRS ASSISTANCE POINTS

Countries or Areas of RSR Jurisdiction Internal Revenue Service	ADDRESS: Revenue Service Representative Internal Revenue Service
Mexico Costa Rica Honduras	Guatemala El Salvador Belize Nicaragua
	c/o Department of State, Mexico City Washington, DC 20521 TELE: 001-525-211-0042, ext. 3465
Phillipines China Marshall Islands	Macao Caroline Islands Hong Kong Taiwan
	c/o U.S. Embassy (Manila) APO San Francisco 96528 TELE: 011-632-521-7116, ext. 613
Singapore India Brunei Indonesia	Malaysia Bangladesh Thailand Burma Sri Lanke
	c/o U.S. Embassy (Singapore) FPO San Francisco 96699 TELE: 011-65-737-0526/0527
United Kingdom Norway Denmark	Ireland Finland Sweden Iceland
	c/o U.S. Embassy Box 40 (London) FPO New York 09510 TELE: 011-441-499-9000, ext. 2485
Venezuela Surinam Barbados Netherlands Antilles Trinidad and Tabago Windward and Leeward Islands British Virgin Islands All of Sub-Sahara Africa	Colombia Panama French Guiana Ecuador Guyana
	c/o U.S. Embassy Box (Caracas) APO Miami 34037 TELE: 011-582-284-6111, ext. 333
Saudi Arabia Afghanistan Bahrain Iraq Syria Kuwait Trucial States United Arab Emirates	Pakistan Ethiopia Lebanon Qatar Egypt Oman Sudan Somalia Lybia Iran Jordan Yeman
	American Embassy (Riyadh) APO New York 09038-0001 TELE: 011-9661-488-3800

NOTE: The above telephone numbers are shown for origination from CONUS.

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Countries or Areas of RSR Jurisdiction Internal Revenue Service	ADDRESS: Revenue Service Representative Internal Revenue Service
Australia      New Zealand      Fiji Western Somoa   New Hebrides	c/o American Consulate General (Sydney) APO San Francisco 96209 TELE: 011-612-261-9200
Brazil            Argentina          Chile Paraguay        Peru                Bolivia Uruguay         Falkland Islands	c/o American Consulate General (Sao Paulo) APO Miami 34030 TELE: 011-5511-881-6511
Canada            New Foundland	Suite 401 60 Queen Street Ottawa, Ontario, Canada K1P5Y7 TELE: 613-563-1834
Bahamas          Jamaica            Bermuda Dominican Republic            Haiti Grand Cayman Islands	P.O. Box N8197 Nassau, Bahamas TELE: 809-322-1095/1181/1183
France            Belgium Monaco            Spain Algeria            Morroco Luxembourg        Lichtenstein Portugal           Switzerland	c/o U.S. Embassy (Paris) APO New York 09777 TELE: 011-3314-296-1202
West Germany    Austria Poland            Hungary Netherlands     East Germany Soviet Union     Czechoslovakia	c/o U.S. Embassy Box 225 (Bonn) APO New York 09080 TELE: 011-49-228-339-2101
Italy              Greece              Israel Cyprus             Turkey              Bulgaria Romania           Albania Yugoslavia        Malta	c/o U.S. Embassy (Rome) APO New York 09794-0007 TELE: 011-396-4674-2607
Japan              South Korea North Korea	c/o U.S. embassy (Tokyo) APO San Francisco 96503 TELE: 001-813-583-7141

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GLOSSARY

ACTIVITY: Something occurring over a period of time and using resources; that which defines the work to be performed; a unit of effort within an agency or organization.

ALIEN: An individual who is not a U.S. citizen.

APPROPRIATION: An act of Congress permitting Federal agencies to incur obligations for specified purposes.

CASUAL LABOR: Physical services with a limited purpose or objective of short duration provided at irregular intervals by natural persons for others.

COMMERCIAL ACTIVITY: One which is operated by a Federal department or agency and which provides a product or service which could be obtained from a commercial source. A commercial activity is not a Government function. (Note: This definition is consistent with the definition provided in OMB Circular No. A-76.)

DIRECT HIRE: An officer or an individual who is appointed, i.e., hired, under an OPM-approved plan to the USG civil service in an official capacity to engage in the performance of a Federal function under authority of law or an Executive act. Usually a direct hire is employed in the US for employment overseas or abroad.

DUAL STATUS: When an alien can be classified both as a non-resident alien and a resident alien during the same tax year. This situation usually occurs for the year that the individual arrives or departs from the United States.

EMPLOYMENT STATUS: For purposes of this review, employment status refers to the manner, i.e., employee or independent contractor, in which a Federal department or agency holds a person in its relationship to such person. Such manner may be discernible through the payment recognition process, but is governed by the common law rules.

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FINDING: Identification of a situation or practice, through observation or record review, and disclosure of such activity which does not comply with Internal Revenue Service rules or regulations. For purposes of this review, a finding is sometimes categorized as "major" (i.e., situation identified at more than one site; or, headquarters USAID guidance, instructions or procedures in error or conflict with the IRS) or "minor" (i.e., situation identified at only one site and situation not determined to be endemic to USAID). Such categorization is only provided to assist in weighing the relative importance of the finding discussed.

FOREIGN ASSISTANCE ACT (FAA): The Foreign Assistance Act of 1961, as amended (USAID's present authorizing legislation).

FOREIGN EARNED INCOME: For purposes of Internal Revenue Code section 911, the term "foreign earned income" with respect to any individual means the amount received by such individual from sources within a foreign country or countries which constitute earned income attributable to services performed by such individual during the period described in subparagraph (A) or (B) of subsection (d)(1), whichever is applicable.

FOURTH COUNTRY NATIONAL: A person who is neither a citizen nor a resident of either the country of hire or the place of employment, but otherwise meets the definition of third country national. (Ref: 20 CFR 25.6)

GREEN CARD: Permanent residency permit issued an alien.

GREEN CARD TEST: An individual who, according to the immigration laws, has been given the privilege of residing permanently in the United States as an immigrant.

INDEPENDENT CONTRACTOR RELATIONSHIP: A contract relationship in which the contractor is not subject to the supervision and control prevailing in the relationship between the Government and its employees.

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ISSUE: A point or question to which action has been narrowed for inquiry so as to validate action or inaction which complies with the rules and regulations of the tax laws.

LOCAL NATIONAL: A person who is neither a citizen nor resident of the United States who is hired by the United States in the person's country of citizenship or residence for employment in the country of hire.

NONAPPROPRIATED FUND ACTIVITY: A function or unit of activity to which the government initially provided funds to permit it to begin operation and for which governmental loan may be repaid out of profits earned by such activity; thus, the activity is created by government with governmental funds for governmental personnel and is administered by governmental employees for use and benefit of United States. (Ref: Bowen v Culotta, 294 F Supp 183)

NON-DIRECT HIRE: A US citizen or "green card" holder who at the time hired resided in the overseas country in which employment was intended. This type of employee may also be referred to as "resident hire" or "indirect hire."

NONPERSONAL SERVICES CONTRACT: A contract which directly engages the time and effort of a contractor whose primary purpose is to perform an identifiable task.

NON-RESIDENT ALIEN: An alien who does not qualify for treatment as a resident alien. Such person is usually subject to U.S. income tax only on income from sources from within the United States. Non-resident aliens file form 1040NR, U.S. Nonresident Alien Income Tax Return.

PERSONAL SERVICES CONTRACT: An agreement between a department/agency and one or more persons which creates an obligation for a human being to provide or perform certain activities for or in behalf of the department/agency. Such an agreement may also be referred to as a "contract for personal services."

PROCEDURES: Methods, steps, or ways adequate evidence was obtained, i.e., inspection, observation, inquiry, and

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confirmation, for a course of action which provides sufficient foundation to arrive at a conclusion regarding the issue.

**PROJECT:** A group of tasks performed in a definable time period in order to meet a specific set of objectives. Specifically in USAID, a single activity designed to generate specific results; and, a project is USAID's basic unit of management.

**RESIDENT ALIEN:** A person who meets the green card test or the substantial presence test, and is generally taxed in the same manner as a U.S. citizen, i.e., such person must report income derived from all worldwide sources. If such person is a resident alien for the entire year, form 1040EZ, 1040A, or 1040 must be filed. Resident aliens may exclude up to \$70,000 of income earned abroad (unless the source of such earned income is the U.S. government or an agency/instrumentality thereof) if they are physically present in a foreign country for at least 330 full days during any period of 12 consecutive months.

**SCOPE:** The nature of the inquiry into an issue to include: the period covered; and, the extent to which transactions, records or accounts examined serve as a basis of adequate testing and substantiation. The "scope" is a general statement of purpose which broadly describes work to be undertaken in the way of substantiating or examining transactions, schedules or some particular aspect of the agency.

**SUBSTANTIAL PRESENCE TEST:** A resident alien test for resident alien status, whereby a person must be physically present in the U.S. for: 1) 31 days during the current calendar year; and, 2) 183 days during the period consisting of the current calendar year and the two preceding calendar years, to qualify as a resident alien.

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TAXES: As used in this Report, the term "taxes" means:

- (a) The employee's share of FICA tax withheld under IRC section 3102;
- (b) The employer's tax under IRC section 3111; or,
- (c) The income tax withheld under IRC section 3402.

THIRD COUNTRY NATIONAL: A person who is neither a citizen nor resident of the United States who is hired by the United States in the person's country of citizenship or residence for employment in a possession or territory of the United States.

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ACRONYMS

- AID - Agency for International Development
- AIDAR - Agency for International Development Acquisition Regulations
- CONUS - Continental United States
- CSR - Civil Service Retirement
- EIN - Employer Identification Number
- FAA - Foreign Assistance Act of 1961, as amended
- FAR - Federal Acquisition Regulations
- FICA - Federal Insurance Contributions Act
- FITW - Federal Income Tax Withheld
- FRB - Federal Reserve Bank
- FSN - Foreign Service National
- FTD - Federal Tax Deposit
- FUTA - Federal Unemployment Tax Act
- IRC - Internal Revenue Code
- IRS - Internal Revenue Service
- N-PSC - Nonpersonal Services Contract
- OMB - Office of Management and Budget
- OPM - Office of Personnel Management
- PASA - Participating Agency Service Agreement
- PSC - Personal Services Contract(or)
- RAMC - Regional Administrative Management Center
- SSA - Social Security Administration
- SSAN - Social Security Account Number
- TIN - Taxpayer Identification Number
- USG - United States Government
- USAID - United States Agency for International Development