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AOD 2020-1: IRS nonacquiescence in payroll tax refund, professional employment organizations

An Action on Decision (AOD) reflects the IRS nonacquiescence to a decision of a federal district court that had found that professional employment organizations were statutory employers and were entitled to refunds of the employer portion of Social Security taxes.

AOD 2020-1 appears in [Internal Revenue Bulletin 2020-12](#) [PDF 2.8 MB] (March 16, 2020).

In announcing its nonacquiescence, the IRS stated its position is that an entity is not in control of the payment of wages within the meaning of section 3401(d)(1) if the payment of wages is contingent upon, or proximately related to, the entity having first received funds from the common law employer.

The case is: *Paychex Business Solutions, LLC v. United States*, 2017 WL 2692843 (M.D. Fla. 2017)

Background

In a tax refund suit, the issue was whether professional employer organizations (PEOs) were the statutory employers (as defined by section 3401(d)(1)) of the clients' employees.

The PEOs entered into client service agreements with each client company customer to provide all employer payroll functions and certain human resource functions. The agreements provided that the PEOs were responsible for paying wages to the employees without regard to whether the client companies first paid these amounts to the PEOs. Also, the agreements provided that the PEOs were fully responsible for reporting, collecting and paying the federal payroll taxes to the IRS.

Under the process for paying the employees, the initiation of wage payments occurred before the PEOs had confirmation that the client companies had sufficient funds to cover these amounts in their bank accounts. In some instances, when there were insufficient funds, the PEOs would have to seek payments from the client companies through collection actions (which did not guarantee recovery of these payments from the companies).

The PEOs used their own bank accounts to make wage payments as well as to remit payroll taxes to the IRS. The client companies had no access to these bank accounts.

The PEOs reported their payment of the employer portion of the Social Security tax on Forms 941 using their own taxpayer information. The client companies no longer filed these federal employment tax returns. After the PEOs realized that they had mistakenly made overpayments of the employer's portion of Social Security taxes for several tax periods, they filed claims for refunds which the IRS denied.

The PEOs then filed suit in federal district court, which in 2017 granted their motion for summary judgment and concluded that the PEOs were the statutory employers of the worksite employees because the PEOs actually controlled and had exclusive control over the bank accounts from which the wage payments were made.

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