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Payroll Services Company Was Not Employer For Employment Tax Purposes

Recently, the United States Court of Federal Claims determined that a company providing payroll services and worker placements was not the workers' employer. *Cencast Services L.P., et al. v. United States*, No. 02-1916 (Fed. Cl. 2004). Accordingly, the company was not entitled to aggregate the workers' wages for the purpose of calculating FICA and unemployment taxes. The court's decision may impact companies that provide payroll or placement services as well as companies that utilize the services of individuals whose payroll withholding is handled by another entity.

The Internal Revenue Code classifies employment taxes as excise taxes levied on both employers and employees based upon the wages that an employee receives. The two employment taxes that were at issue in the *Cencast* case were Federal Income Contribution Act taxes ("FICA") and Federal Unemployment Tax Act taxes ("FUTA"). An employer must pay 6.2% of an employee's wages for FICA and an additional 6.2% of an employee's wages for FUTA. However, both FICA and FUTA provide "wage caps" that limit the amount of taxes an employer must contribute on behalf of an employee. More specifically, an employer need only pay FUTA taxes on the first $7,000 in wages paid to an employee, and the cap for FICA is set on an annual basis by the Social Security Act. However, if the employee received wages from two employers during the year, the analysis is conducted upon the dollars paid by each employer even if the employee's aggregate wages exceed the cap.

In the *Cencast* case, E.P. Talent Services, L.P. ("EP") provided payroll and placement services to production companies that developed motion pictures, television programs, and commercials. EP handled the tax withholding for the production workers and aggregated all of an employee's wages for the purpose of computing FICA and FUTA taxes even if the employee worked for multiple production companies throughout the year. Thus, EP applied the wage caps for its payment of FICA and FUTA taxes and, in so doing, limited the amount of taxes it paid for each employee.

The IRS assessed EP for additional FICA and FUTA taxes as well as penalties and interest. The IRS took the position that only "employers" are permitted to utilize the wage caps for the purpose of computing FICA and FUTA taxes and argued that EP was not the production workers' employer.

EP brought suit against the IRS seeking a ruling that it did not owe additional FICA and FUTA taxes. EP argued that it was considered the production workers' employer for withholding purposes and the IRS contended that the production workers were employed by the various production companies. Accordingly, EP and the IRS encouraged the United States Court of Federal Claims to adopt different definitions of the term "employer." EP argued that "employer" is defined as the entity providing the wages, while the IRS contended that "employer" is defined as the entity that is the recipient of an employee's services.

The Court of Federal Claims engaged in a complex and lengthy discussion of the parties' arguments as well as the history of various statutes and regulations. Ultimately, the court determined that the IRS was correct and that, for the purpose of computing FICA and FUTA taxes, EP was not the production workers' employer. Therefore, EP was not permitted to aggregate the employees' wages and take advantage of the FICA and FUTA wage limits.

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