

Administration

Coaches as Independent Contractors: A Tax Payer Victory

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Any business does not look forward to an Internal Revenue Service audit. When the audit focuses, not on illegal activities, but on the common and ordinary operations of the business, it makes it even more frustrating for the small business owner.

A little over a year ago, Aerial Gymnastics Club of Lombard Illinois (Donald McPherson, owner) was selected for audit by the IRS. McPherson's gym was selected, as many were during the past year, based on an IRS "Market Segment Specialization Program" (MSSP). The basis for this selection was a computer match of the industry code required to be listed on the business' tax return. In this case the code was 8557, which encompasses "physical fitness facilities," but comes under the general category of Services: Personal, Professional, and Business - Amusement and Recreational Services. There is no specific industry code covering only gymnastics training facilities.

After failing to find any substantive income tax issues (unwarranted deductions, unreported income, etc.) the revenue agent decided to question the independent contractor status of the coaches at the gym. Aerial Gym Club had consistently treated all its coaches as independent contractors for 17 years, since its inception in 1977. The earning of the coaches had faithfully been reported to the IRS on from 1099 each January. Each year I discussed with Mr. McPherson the potential for IRS disagreement with the classification of the coaches as independent contractors. Each year we would discuss the extent to which the coaches were independent of McPherson's control in the performance of their functions as coaches. Each year he would convince me that they were in fact independent contractors.

At the completion of the IRS audit, the agent concluded that all the coaches were employees of the gym and not independent contractors. The agent proposed a tax assessment for three years of back withholding and Social Security taxes. The IRS determination was based on a 20 item test (available on IRS form SS-8). The 20 questions delineated in the IRS test are based on prior court decisions and the IRS Manual (Exhibit 46401). Of the 20 questions, not all are weighted equally; for this reason, the specific number of questions answered correctly is not as significant as which questions they are. The focus of most of the questions is on control: how much control does the gym exercise over the coaching?

Our central argument was that the gym exercises very little control, since the coaches are members of USA Gymnastics and their coaching is controlled by USA Gymnastics, the FIG, and the International Olympic Committees. These organizations, not the owner of the gym control how, when, and why coaches do what they do. The standards, methods, and criteria developed and fostered by these organizations forms the central theme of what gymnastics coaches impart to their students. Because there is an agreed-upon set of standards for judging gymnastics performance, the gym owner simply provides the setting, not the control.

Our backup position was reliance on Section 530 of the Revenue Act of 1978 which provides in part that "for purposes of employment taxes... [if] a taxpayer did not treat an individual as an employee for any period then the individual will be deemed not to be an employee for that period, unless the taxpayer had no reasonable basis for not treating the individual as an employee." We obviously felt we had a reasonable basis for treating the coaches as independent contractors.

After the audit, we expressed our disagreement with the auditor's findings by filing a protest with the Appeals Division of the Internal Revenue Service. The function of the Appeals Division is to determine the likelihood that the IRS or the taxpayer would win should the case be taken to court. After a wait of almost nine months, we received a call from the Appeals Officer indicating that the IRS was conceding the case and that no further action was to be taken by them. The strength of our arguments demonstrated that the coaches were, in fact, independent contractors.

This taxpayer victory is not only good news for Aerial Gymnastics Club, but for the gymnastics community in general and other gyms - in particular those employing independent contractors as coaches. Also helped by this case are judges who hold themselves out as independent contractors, since the same arguments would hold for them.

Mr. McPherson and I would be happy to supply interested club owners with a copy of the audit protest, or discuss the matter with any affected parties, if this would be of benefit to you in supporting your position that your coaches (or judges) are independent contractors.

This article appears in the November/December 1996 issue of *Technique*, Vol. 16, No. 10.