

Home Care Company Had Reasonable Basis for Treating Home Care Workers as Independent Contractors and Was Entitled to a Refund of Employment Taxes

By [John B. Waters](#), Counsel

In 2016, the U.S. District Court for the Eastern District of Pennsylvania held in *Nelly Home Care, Inc. v. United States*, that a home care company and its predecessor were entitled to refunds of employment taxes relating to their home care workers because they had a “reasonable basis” for treating their workers as independent contractors under the safe harbor provisions of Section 530 of the Revenue Act of 1978 (“Section 530”).

The case involved a refund action brought by Nelly Home Care, Inc. and its predecessor, Nelly LLC, (“Nelly”) against the United States to recover employment taxes they paid after the IRS determined on audit that they had incorrectly classified their home care workers as independent contractors.

In its refund suit, Nelly sought relief under Section 530 which allows a taxpayer to avoid liability for employment taxes relating to misclassified workers if the taxpayer consistently filed returns treating the workers (and those holding substantially the same position) as independent contractors and had a reasonable basis for not treating the workers as employees. A “reasonable basis” exists if the company’s decision to treat its workers as independent contractors is based on reasonable reliance upon any of the following:

- (1) judicial precedent, published rulings, technical advice with respect to the taxpayer, or a letter ruling to the taxpayer;
- (2) a past Internal Revenue Service audit of the taxpayer in which there was no assessment attributable to the treatment (for employment tax purposes) of the individuals holding positions substantially similar to the position held by this individual; or
- (3) long-standing recognized practice of a significant segment of the industry in which such individual was engaged.

In addition to the three “safe-harbors” described above, a taxpayer can qualify for relief from liability for employment taxes if it can demonstrate some other reasonable basis for not treating its workers as employees.

The IRS conceded that Nelly consistently filed returns treating its home care aides as independent contractors, leaving the sole issue for determination whether Nelly had a reasonable basis for treating its workers as independent contractors. In addressing that issue, the court held that although Nelly did not satisfy any of the first three safe-harbors described above, it did have a reasonable basis for not treating its workers as employees based on the following:

- Before forming Nelly LLC, its owner Mary Carney (“Carney”) was a home health aide who provided her services as an independent contractor, and who had learned from other home health aides that they also provided their services as independent contractors.
- Carney conferred with three other home care companies and learned that at least two of them treated their aides as independent contractors.

- Carney conducted a survey of home care companies which showed that seven of the twenty companies she surveyed treated their home care aides as independent contractors.
- Carney had her attorney draft an independent contractor agreement to be used for Nelly's home health aides which was based on one used by another home care company.
- The IRS had audited Carney's individual returns several years before its audit of Nelly and during that audit it requested and reviewed numerous documents regarding Nelly LLC, including copies of contracts with independent contractors, but did not question the treatment of such persons as independent contractors.
- Carney registered Nelly Home Care in Pennsylvania as a home care registry and attended a mandatory conference conducted by the Pennsylvania Department of Health where it informed attendees that the regulatory definition of a "home care registry" was a business that "supplies, arranges or refers independent contractors to provide home care services..."

Based on its finding that Nelly qualified for Section 530 relief, the court awarded Nelly a refund of the employment taxes paid with respect to their home care workers.

As shown in *Nelly*, Section 530 should be considered as a preliminary defense whenever the IRS asserts an employment tax liability against a taxpayer for misclassifying workers as independent contractors, as it affords relief from such liability upon a mere showing that the taxpayer had a reasonable basis for treating its workers as independent contractors, irrespective of whether that treatment was correct.

As *Nelly* illustrates, it is important that before a taxpayer determines to treat a class of workers as independent contractors it should establish and document a reasonable basis for treating those workers as independent contractors and should be consistent in that treatment for those workers and other similarly situated workers.

If you have any questions regarding this topic, please contact one of the listed Roetzel attorneys below.

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