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Actors and Entertainers: Employees, Independent Contractors, or Statutory Employees? A Matter of Form (W-2) Over Substance

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PRACTITIONER'S NOTES

ACTORS AND ENTERTAINERS: EMPLOYEES, INDEPENDENT CONTRACTORS, OR STATUTORY EMPLOYEES? A MATTER OF FORM (W-2) OVER SUBSTANCE

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I. INTRODUCTION	143
II. HISTORICAL ANALYSIS	144
III. THE PROBLEM	146
IV. PRIOR ACTOR RULINGS	150
V. EXISTING SOLUTIONS	154
VI. A PROPOSED SOLUTION	156

I. INTRODUCTION

For decades, the courts, Congress, and the Treasury have attempted to articulate a comprehensive test to determine whether an individual is an employee or an independent contractor. The various common law tests, Internal Revenue Code¹ provisions, and Treasury Regulations which have developed, though suitable for non-actors, have been oddly ill-suited to actors and entertainers. A primary reason is that actors and entertainers are hybrids of a sort, difficult to categorize and possessing traits common to both employees and independent contractors. This Note proposes that neither classification is completely correct and that an ideal solution may be to treat actors as statutory employees.

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1. Unless otherwise stated, all citations to the Internal Revenue Code shall refer to the Internal Revenue Code of 1986.

II. HISTORICAL ANALYSIS

Early on, the distinction between an employee versus an independent contractor was most important for purposes of resolving agency and *respondeat superior* questions.² Years later, when Congress decided to shift the responsibility for deducting and paying taxes withheld from wages to employers,³ the decision as to whether an individual was an employee subject to employer withholding or an independent contractor exempt from such withholding took on even greater significance.⁴

The Internal Revenue Code provides that "every employer making payment of wages shall deduct and withhold upon such wages a tax determined . . . by the Secretary."⁵ Wages are defined as "all remuneration . . . for services performed by an employee for his employer."⁶ The definition of "employee" in the Code is less than all-inclusive.⁷ Accordingly, the Secretary of the Treasury sought to further explain the meaning of Section 3401(c) in the Regulations.

However, the Regulations, at first blush, fail to shed much additional light on the meaning of the term "employee," beginning with the rather circular definition that "'employee' includes every individual performing services if the relationship between him and the person for whom he performs such services is the legal relationship of employer and employee."⁸ Upon closer inspection, the Regulations do set out certain factors, culled from prior case law and Revenue Rulings, which can be useful in making a determination as to whether an employer/employee relationship exists. Specifically, the Regulations provide:

[g]enerally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual 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 that result is accom-

2. Ringling Bros.-Barnum & Bailey Combined Shows, Inc., v. Higgins, 189 F.2d 865, 868 n.2 (2d Cir. 1951).

3. I.R.C. §§ 3402(a)(1) and 3403 (1986).

4. Treas. Reg. § 31.3403-1 (1957).

5. I.R.C. § 3402(a)(1) (1986).

6. I.R.C. § 3401(a) (1986).

7. Internal Revenue Code § 3401(c) (1986) defines the term "employee" to include "an officer, employee, or elected official of the United States, a State, or any political subdivision thereof, or the District of Columbia, or any agency or instrumentality of any one or more of the foregoing," as well as an officer of a corporation.

8. Treas. Reg. § 31.3401(c)-1(a) (1957).

plished. 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 . . . are the furnishing of tools and the furnishing of a place to work.⁹

The Internal Revenue Service (hereinafter referred to as "IRS") has clearly illustrated that, even though specific Code provisions and Regulations have been drafted to resolve the employer/employee conflict, it has no intention of discarding wholesale the prior common law tests for ascertaining employee status.¹⁰ In fact, in Revenue Ruling 87-41, the Secretary of the Treasury states that "[a]n individual is an employee for federal tax purposes if the individual has the status of an employee under the usual common law rules applicable in determining the employer/employee relationship."¹¹ That Ruling summarized common law factors previously considered in making a determination as to whether an individual was an employee or not. The factors were indicia of whether the person for whom the services were performed had the right to control and direct the individual who performed the services.¹²

Specifically, the Ruling lists twenty separate factors to be considered, including: (1) the instruction given to the worker;¹³ (2) the training given to the worker;¹⁴ (3) the integration of the worker's services into the business operations;¹⁵ (4) whether the services must be performed personally;¹⁶ (5) whether the person for whom the services are performed hires, supervises, and pays for assistants;¹⁷ (6) whether the relationship between the worker and the person receiving the services is continuing;¹⁸ (7) whether the person for whom the services are performed sets the hours of work by

9. Treas. Reg. § 31.3401(c)-1(b) (1957).

10. I.R.C. § 3121(d)(2) (1986).

11. Rev. Rul. 87-41, 1987-1 C.B. 296.

12. *Id.*

13. See, e.g., Rev. Rul. 68-598, 1968-2 C.B. 464; See, e.g., Rev. Rul. 66-381, 1966-2 C.B. 449.

14. See Rev. Rul. 70-630, 1970-2 C.B. 229.

15. See *United States v. Silk*, 331 U.S. 704 (1947).

16. See Rev. Rul. 55-695, 1955-2 C.B. 410.

17. Compare Rev. Rul. 63-115, 1963-1 C.B. 178 with Rev. Rul. 55-593, 1955-2 C.B. 610.

18. *United States v. Silk*, 331 U.S. 704 (1947).

the worker;¹⁹ (8) whether the worker must devote his full time to the person to whom the services are provided;²⁰ (9) whether the work is performed on the employer's premises;²¹ (10) whether the worker must perform the services in the order or sequence designated by the employer;²² (11) whether the worker must submit oral or written reports to the person for whom the services are performed;²³ (12) whether the worker is paid by the hour, week, or month;²⁴ (13) whether the person for whom the services are performed pays for the worker's business and/or travel expenses;²⁵ (14) whether the person for whom the services are performed supplies tools and materials needed for the job;²⁶ (15) whether the worker invests in facilities that are used by the worker in performing the services;²⁷ (16) whether the worker can realize a profit or a loss as a result of his services;²⁸ (17) whether the worker performs services for more than one firm at a time;²⁹ (18) whether the worker makes his services available to the general public;³⁰ (19) whether the person for whom the services are provided has the right to discharge the worker;³¹ and (20) whether the worker has the right to terminate his relationship with the person to whom he is supplying the services without incurring liability.³²

III. THE PROBLEM

Classifying an actor or entertainer as an employee or independent contractor is a complex determination by virtue of the structure of the business of acting. Most actors and entertainers during any one year are engaged by many different persons desiring their services. Accordingly, it is not uncommon for a single actor to have twenty or more sources of income in a single year.³³ The relationship between an actor and persons using his services is often

19. See Rev. Rul. 73-591, 1973-2 C.B. 337.

20. See Rev. Rul. 56-694, 1956-2 C.B. 694.

21. See Rev. Rul. 56-660, 1956-2 C.B. 693.

22. See Rev. Rul. 73-591, *supra* note 19.

23. See Rev. Rul. 70-309, 1970-1 C.B. 199; see Rev. Rul. 68-248, 1968-1 C.B. 431.

24. See Rev. Rul. 74-389, 1974-2 C.B. 330.

25. See Rev. Rul. 55-1144, 1955-1 C.B. 483.

26. See Rev. Rul. 71-524, 1971-2 C.B. 346.

27. *Id.*

28. See Rev. Rul. 73-591, *supra* note 19.

29. See Rev. Rul. 70-572, 1970-2 C.B. 221.

30. See Rev. Rul. 56-694, *supra* note 20.

31. See Rev. Rul. 75-41, 1975-1 C.B. 323.

32. See Rev. Rul. 73-591, *supra* note 19.

33. Consequently, active actors may receive dozens of payment reporting Forms W-2 and 1099-MISC relating to a single year.

ephemeral. Frequently, actors doing "voice-over"³⁴ work will complete a project in under an hour.³⁵ Such short engagements may often be the only time that the parties work with each other. Even so, wage reporting statements later issued to the actor typically connote an employer/employee relationship from the IRS's perspective.³⁶

Typically, a potential user of an actor's services will insist that the actor complete a withholding exemption certificate³⁷ before the actor begins working. Penalties³⁸ and contractual obligations³⁹ play a pivotal role in employers requiring the actor to complete the withholding exemption certificate. An actor, like others, cannot legally claim more withholding allowances than those to which he is

34. A "voice-over" describes the process whereby an actor's voice is heard but the actor is off-camera. Voice-overs are a popular method of earning income for actors who want neither to be over-exposed to the media nor to be inextricably tied to the product they tout.

35. Screen Actors Guild Commercials Contract ¶ 20(B)(1) (1991), however, provides that for compensation purposes, each off-camera recording session shall be treated as no less than two hours in duration.

36. Treasury Regulation § 31.3401(c)-1(e) (1957) provides:

[i]f 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[n] . . . independent contractor, or the like.

Conversely, it has been the experience of the author that once the user of an actor's services issues a wage statement Form W-2 in lieu of a Form 1099-MISC, it is of no consequence that the underlying legal relationship between the parties is that of principal and independent contractor. As part of the Internal Revenue Service's matching program, once a payer issues to the actor a Form W-2, the actor must report such income as wages, notwithstanding the fact that such income would be classified as trade or business income under the common law tests.

37. 1992 U.S. Form W-4.

38. Treasury Regulation § 31.3402(d)-1 (1957) provides that an employer who fails to deduct and withhold tax remains liable for penalties and additions to tax even when the employee pays the tax due. Internal Revenue Code § 6672 (1986) provides:

[a]ny person required to collect, truthfully account for, and pay over [such] tax . . . who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

But cf. I.R.C. § 3509 (1986) (providing relief to payers facing draconian retroactive assessments of employment taxes).

39. Rule 18(A) of the Actors' Equity Association Agreement and Rules Governing Employment in Chicago Area Theatres (1992), ¶ 30(C) of the American Federation of Television and Radio Artists National Code of Fair Practice for Non-Broadcast/Industrial/Educational Recorded Material (1990), and ¶ 46 of the Screen Actors Guild Commercials Contract (1991), all require that the producer, during the term of the actor's contract, shall pay any and all employer taxes including federal social security and unemployment tax.

entitled.⁴⁰ Yet, in order to get a job, the actor must complete the withholding exemption certificate.⁴¹

From the actor's perspective, there are two negative consequences to this treatment. First, actors who work steadily for many different persons will be victims of over-withholding for federal and state income and FICA⁴² tax purposes. Although the taxpayer is able to secure a refund of such overpayments⁴³ when he later files his income tax returns, he has lost the time value of that money and has, until he is repaid, effectively loaned his tax overpayment to the government, interest-free. Second, by completing the withholding exemption certificate, the actor is assured of receiving a Form W-2 wage reporting statement at year end. The IRS takes the position that the issuance of a Form W-2 creates a presumption that the recipient is an employee of the issuer, notwithstanding the governing Regulation⁴⁴ and the fact that the underlying relationship between the parties may be more accurately described as that of principal and independent contractor under the tests set forth in Revenue Ruling 87-41.⁴⁵ Therefore, the IRS would have the actor report all income for which Forms W-2 issue as wages⁴⁶ and not as earnings from a trade or business.⁴⁷ Correspondingly, the IRS would have the actor report and deduct, as non-reimbursed employee business expenses,⁴⁸ all expenses incurred in the production of the income reported on Forms W-2. Deductible non-reimbursed employee business expenses are lim-

40. Internal Revenue Code § 3402(f)(2)(A) (1986) provides that:

[o]n or before the date of the commencement of employment with an employer, the employee shall furnish the employer with a signed withholding exemption certificate [Form W-4] relating to the number of withholding exemptions which he claims, which shall in no event exceed the number to which he is entitled.

Internal Revenue Code § 6682(a) (1986) provides that:

[i]n addition to any criminal penalty provided by law, if (1) any individual [who] makes a statement under section 3402 or section 3406 which results in a decrease in the amounts deducted and withheld . . . and, . . . (2) as of the time such statement was made, there was no reasonable basis for such statement, such individual shall pay a penalty of \$500 for such statement.

41. Paragraph 9(E) of the Screen Actors Guild Commercials Contract (1991), requires that "[t]here shall be attached to all standard employment contract forms . . . a W-4 form to be signed by principal performer for delivery to Producer."

42. Federal Insurance Contributions Act, as codified at I.R.C. §§ 3101-3126 (1986).

43. Treas. Reg. § 1.31-2 (1956).

44. Treas. Reg. § 31.3401 (c)-1(h) (as amended by T.D. 7068, 1970-2 C.B. 252).

45. Rev. Rul. 87-41, *supra* note 11.

46. 1992 U.S. Form 1040, Line 7.

47. 1992 U.S. Form 1040 Schedule C, Line 1.

48. 1992 U.S. Form 2106 is used to deduct non-reimbursed employee business expenses.

ited to that amount which exceeds two percent of the actor's adjusted gross income.⁴⁹ Conversely, amounts deducted as business expenses⁵⁰ are not similarly limited based upon the actor's adjusted gross income. Consequently, the overall effect of making an actor complete a Form W-4 as a condition precedent to securing a job is that the actor is subject to over-withholding and will lose deductions equal to two percent of his adjusted gross income.

Another facet of the business of acting, the paymaster,⁵¹ highlights the absurdity of the premise that the mere issuance of a Form W-2 makes the recipient an employee and the issuer an employer *a priori*. According to the IRS, the paymaster, which has little, if any, relationship with the actor, but which ultimately issues the Form W-2 to the actor, should be treated as his employer. Several different companies desiring an actor's services may use the same paymaster during any one year. Therefore, for example, a

49. I.R.C. § 67(a) (1986). This expense deduction limitation applies only to the extent that the actor does not qualify for relief under the Qualified Performing Artist provisions discussed *infra* note 89.

50. Internal Revenue Code § 62(a)(1) (1986) provides in part that in the case of an individual, "adjusted gross income" means gross income minus deductions allowed "which are attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee."

51. Paymasters are organizations which have evolved to fill an administrative function in the entertainment industry. The need for paymasters arose by virtue of the myriad short-term relationships which form between actors and persons coveting the actors' services. Typically, an organization desiring the use of an actor's services anticipates that the relationship will be fleeting; perhaps, only the length of time required to produce a single television or radio commercial. The organization which hires the actor seeks to avoid the administrative burden associated with adding a new worker to its internal payroll, health insurance, and retirement plans.

A paymaster's function, then, is fundamentally that of payroll service in that it withholds and pays over to the various taxing authorities amounts due based upon the level of the actor's compensation. A paymaster is, however, distinguishable from a typical payroll agency in several key respects. First, in addition to withholding and paying taxes, the paymaster must pay amounts to the actor's agent, the union health plan, and pension plan. Second, depending upon the type of work performed, the obligation to make the aforementioned payments may go on for years after the actor has completed the job. For example, if the actor produces a popular commercial, the actor may be entitled to residuals each time the commercial is aired, which could be years after the time that the actor performed the work associated with producing the commercial. Third, unlike traditional payroll services, the paymaster's name appears as the name of the payer on the Form W-2 issued at the end of the year. Fourth, and finally, the paymaster is often the legal assignee of the rights and obligations of the producer. Although the unions do allow a producer to assign his rights and responsibilities as a signatory of the union contract (Screen Actors Guild Commercial Contract, ¶ 54 (1991) and American Federation of Television and Radio Artists National Code of Fair Practice for Non-Broadcast/Industrial/Educational Recorded Material, ¶ 38 (1990)), he is not relieved of his responsibilities under the contract unless the union approves of, in writing, the financial responsibility of the transferee and the producer utilizes a specific assignment clause.

Form W-2 issued by the paymaster may represent twenty separate jobs performed by the actor for twenty different companies at twenty different locations. Furthermore, the actor may receive Forms W-2 from several different paymasters. Applying the IRS's theory to the aforementioned circumstances, the actor is an employee of each of those paymasters for purposes of reporting income and associated expenses incurred. Therefore, although the actor never performed a single hour of work for the paymaster, was never trained by the paymaster, never operated under the direction and control of the paymaster, and never used any tools or facilities of the paymaster, the IRS would treat him as an employee of the paymaster.

Alternately, if the IRS views the paymaster in its true capacity as an administrative intermediary, and still maintains the actor is an employee, who then is his employer? Often, in situations similar to those described above, an additional party, the advertising agency, is involved. Typically, an actor's agent calls the actor and informs him of a job opportunity for which the actor must generally audition. Assuming the actor performs well, the advertising agency will inform the actor that his services are desired.⁵² Thereafter, the actor appears at the advertising agency to tape the commercial for the advertising agency's client. The client pays the advertising agency, which pays the paymaster, which pays the agent⁵³ and the actor. The end result is that the actor who works dozens of jobs during any given year can end up with hundreds of parties who could be construed as employers. Should the actor do as the IRS does and merely let the Form (*W-2 v. 1099-MISC*) determine the substance of the relationship? Or, should the actor and his tax advisers attempt to apply the Code, Regulations, and common law to make the determination?

IV. PRIOR ACTOR RULINGS

A review of the rulings specifically dealing with actors, entertainers, and similarly situated individuals sheds some light, but also proves that there is not complete agreement among the

52. Screen Actors Guild Commercials Contract, ¶ 9 (1991).

53. Each actor typically works with an agent who will receive a commission of ten percent for union jobs. The agent is generally entitled to receive commissions on all pay received by client actors even if the actors secure the jobs without the assistance of their agents. An exception exists, however. Agents licensed by Actors' Equity Association are required by contract to renounce any contractual right to a commission under circumstances in which the actor receives only scale (minimum) wages. See H. A. Artists & Assocs., Inc. v. Actors' Equity Ass'n, 451 U.S. 704, 709 (1981).

authorities.

The first case addressing the issue of whether actors are independent contractors or employees was *Radio City Music Hall Corp. v. United States*.⁵⁴ In *Radio City*, the United States Court of Appeals for the Second Circuit affirmed the district court's entry of summary judgment for the plaintiff, an operator of a theater exhibiting motion pictures and stage shows, where certain actors were deemed independent contractors.⁵⁵ The plaintiff entered into weekly, primarily oral, contracts with the actors, who were required to audition if plaintiff's agent had not seen the "acts" involved.⁵⁶ Plaintiff furnished the stage, scenery, lighting, orchestral music, attendants, and, on occasion, costumes.⁵⁷ Plaintiff's agent could delete parts of any act, reduce or amplify a singer's voice, direct the staging of any act, fix times for rehearsal, and determine the time any act would appear on the stage.⁵⁸ The actors involved "traveled about from theatre to theater seeking employment where they could get it, making contracts for stated periods, and severing connections with the producer, at least for the time being, as soon as the production was over."⁵⁹

Judge Learned Hand, relying upon prior authority,⁶⁰ found that whether the actors were employees or independent contractors was to be determined by the degree to which the theatre operator could intervene in the details of the actors' performances.⁶¹ Although the theatre operators did intervene to a certain degree, the court likened the degree of intervention to a general contractor's intervention in the work of his subcontractors in that:

he decides how the different parts of the work must be timed, and how they shall be fitted together; if he finds it desirable to cut out this or that from specifications, he does so. Some such supervision is inherent in any joint undertaking, and does not make the contributing contractors employees.⁶²

Seven years later, the Acting Commissioner of the IRS issued

54. 135 F.2d 715 (2d Cir. 1943).

55. *Id.* at 716.

56. *Id.* at 717.

57. *Id.*

58. *Id.*

59. *Id.*

60. *Singer Mfg. Co. v. Rahn*, 132 U.S. 518, 523 (1889); *Texas Co. v. Higgins*, 118 F.2d 636, 638 (2d Cir. 1941); *Jones v. Goodson*, 121 F.2d 176, 179 (10th Cir. 1941); *Williams v. United States*, 126 F.2d 129, 132 (7th Cir. 1942).

61. 135 F.2d at 717.

62. *Id.* at 718.

an opinion relating to the status of individuals similarly situated to actors discussing whether such individuals are employees or independent contractors for purposes of employment and income tax withholding.⁶³ In the Mimeograph Opinion, the Acting Commissioner stated that, although the Bureau had previously treated individuals performing modeling services for photographic illustrators, advertising agencies, merchandising establishments, and others as employees for purposes of employment and withholding taxes, IRS collectors were advised not to treat such models as employees for such purposes henceforth.⁶⁴ The shift in the Bureau's position was a result of its acquiescence in the holding of *Barnaba Photographs Corp. v. United States*.⁶⁵ In *Barnaba*, plaintiff, a photographic illustrator, engaged professional models to pose for photographs for his clients.⁶⁶ The similarity between the *Barnaba* models and most actors and entertainers is striking:

The models performed services which required professional training and experience; they held themselves out through their booking agents as available for modeling engagements with anyone desiring their services; they worked for the plaintiff and for numerous other photographic illustrators and similar operators in single engagements of one or several hours' duration and of irregular occurrence; they had no continuing or permanent relationship with the plaintiff as each engagement involved a new and separate agreement; they charged for their services at hourly rates fixed in advance by the models or their agents in accordance with their ability, experience, and popularity; they reserved the right to decline engagements personally distasteful or unsuitable to them and to cancel at their discretion any bookings made for them by their agents; they maintained extensive wardrobes and generally furnished the wearing apparel, accessories, and make-up used by them in their engagements; and while they complied with instructions relative to the result to be accomplished by their work, they used their own initiative, ability,

63. Mim. 6495, C.B. 1950-1, 137; See Rev. Rul. 71-144, 1971-1 C.B. 285 (superseding Mim. 6495 solely to update to the current statute and regulations); but see Rev. Rul. 74-332, 1974-2 C.B. 327; (holding that models who were graduates of modeling agency's school under oral agreements with the agency after graduation, could accept or reject modeling assignments and furnish their own transportation and cosmetics but were prohibited from free lance modeling, were supervised by the agency, and were paid at an hourly rate determined by the agency which could terminate the models because of client complaints or rejection of to many assignments were employees of the agency for purposes of employment tax withholding).

64. Mim. 6495, C.B. 1950-1, 137.

65. No. 107-21493, *aff'd*, 178 F.2d 402 (2d Cir. 1949).

66. Mim. 6495, *supra* note 63.

and experience in interpreting and enacting the roles assigned to them in the illustrations for which they pose.⁶⁷

The following year, the Second Circuit again had an opportunity to address the status of certain performers in *Ringling Bros.-Barnum & Bailey Combined Shows, Inc. v. Higgins*.⁶⁸ In contrast with its prior *Radio City* holding, the Second Circuit in *Ringling Bros.* held that certain clowns, featured artists, and members of specialty acts were employees of the circus corporation.⁶⁹ The performers entered into contracts with the corporation for the seven month duration of the circus season.⁷⁰ Under the contracts, the corporation could renew the original contracts on the same terms for the succeeding season, and, if such option was exercised, the performers were prohibited during the off-season from performing in any other circus, theater, or wild west show without the express written consent of the corporation.⁷¹ The corporation paid circus acts weekly, and the amount of compensation had no relation to the success of the circus tour.⁷² The corporation provided meals, lodging, and transportation for the performers and their equipment.⁷³ In addition, the corporation selected the acts, suggested changes or improvements, shortened acts, and deleted objectionable portions.⁷⁴ Finally, the corporation set the locations and times of shows and determined the order and duration of the acts presented.⁷⁵

Over a decade later in *Club Hubba Hubba v. United States*,⁷⁶ the district court, comparing *Ringling Bros.* and *Radio City*, determined that certain entertainers were night club employees for purposes of employment taxes.⁷⁷ The club had written contracts of six months' duration with an option to renew with most of its performers.⁷⁸ In addition, the club performers were contractually prohibited from working for any other night clubs both during and after their employment terminated with Club Hubba Hubba.⁷⁹ The

67. *Id.*

68. 189 F.2d 865 (2d Cir. 1951).

69. *Id.* at 870.

70. *Id.* at 869.

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. 239 F. Supp. 324 (1965).

77. *Id.* at 329.

78. *Id.*

79. *Id.*

government had also argued that the club's furnishing of transportation, food, and lodging,⁸⁰ and the fact that plaintiff's counsel "referred to the club as 'the employer'" in an unrelated document filed with the government,⁸¹ supported the assessment.

Three years later, the Treasury acquiesced to the holdings in *Ringling Bros.* and *Radio City* without supplementing or diminishing the information contained in the published opinions.⁸² Moreover, subsequent Treasury statements relating to actors have not substantially altered the factors set forth in the Second Circuit cases.⁸³

V. EXISTING SOLUTIONS

Existing solutions to actors' problems of reporting income and expenses fall short. Any actor has the option of forming a qualified personal service corporation.⁸⁴ Incorporating eliminates the problem of IRS matching program letter audits which often occur when the actor reports as trade or business income, income for which he receives a Form W-2. The qualified personal service corporation becomes the contracting party which loans out the actor's services to the organization desiring such services. Payments to the actor's

80. *Id.*

81. *Id.* The government's Exhibit A was a letter from plaintiff's counsel to the District Director of Immigration and Naturalization protesting the granting of a visa to an entertainer who had finished her contract with plaintiff and wanted to remain in the United States and work for another night club, in which the plaintiff is referred to as the "employer." *But cf.* *Matcovich v. Anglim*, 134 F.2d 834, 837 (9th Cir. 1943) (Appellant club owner's reference to dancers as "licensees" in contracts not controlling); *See* *Treas. Reg. § 31.3121(d)-1(a)(3)* (1960).

82. *Rev. Rul. 68-428*, 1968-2 C.B. 444.

83. *See* *Priv. Ltr. Rul. 82-02-020* (Sept. 30, 1981) (holding that where the taxpayer, a dinner theatre, paid its actors weekly and provided them with props, most of their costumes, living accommodations, and dinner, the actors are employees for purposes of employment tax withholding); *See also* *Priv. Ltr. Rul. 80-37-026* (June 9, 1980).

84. Treasury Regulation § 1.448-1T(e)(3) (1987) defines the term "qualified personal service corporation" as "any corporation that meets the function test . . . and the ownership test . . . of this section." Treasury Regulation § 1.448-1T(e)(4) (1987) provides that, "a corporation meets the function test if substantially all the corporation's activities for a taxable year involve the performance of services in . . . [p]erforming arts." "Substantially all" the corporation's activities are involved in the performance of services in performing arts "only if 95 percent or more of the time spent by employees of the corporation, . . . is devoted to the performance of services in [performing arts]." Treasury Regulation § 1.448-1T(e)(5)(i) (1987) provides:

[a] Corporation meets the ownership test, if at all times during the taxable year, substantially all the corporation's stock, by value, is held, directly or indirectly by employees performing services for such corporation in connection with activities involving . . . 'performing arts.' 'Substantially all' stock means an amount equal to or greater than 95 percent.

corporation are gross; paying organizations are not required to withhold taxes or issue payment reporting statements to the government.⁸⁵ Consequently, the actor avoids the over-withholding problem associated with operating as a sole proprietor. Furthermore, expenses associated with making the income are deducted at the corporate level. The actor effectively avoids the two percent limitation on non-reimbursed employee business expenses⁸⁶ which the IRS would attempt to impose if the actor was not incorporated. After paying all other business expenses associated with making the income, the qualified personal service corporation pays the actor the balance remaining as salary and bonus. Assuming the actor's compensation is reasonable,⁸⁷ payment thereof reduces corporate taxable income to zero. The actor has indirectly received the full benefit of deductions taken at the corporate level. In addition, the actor's individual return is less likely to be audited because he receives a single wage reporting statement from his qualified personal service corporation and he claims no deductions for trade or business expenses or non-reimbursed employee business expenses.

The downside of incorporating for the actor is primarily the additional cost and administrative burden. The additional costs include legal and accounting fees, costs associated with incorporating, and preparation of annual reports, payroll, and corporate income tax returns. Moreover, the actor must be certain the corporation pays out all excess earnings as salary or face severe tax consequences.⁸⁸

Congress acknowledged, to a degree, the plight of actors when it passed the qualified performing artist⁸⁹ legislation as part of the

85. *Contra* G.C.M. 39553 (holding that a professional hockey player was an employee of the hockey team and not his personal service corporation. Thus, the team was liable for withholding and employment taxes on all money paid to the player's personal service corporation.).

86. 87 I.R.C. § 67 (1986).

87. Treasury Regulation § 1.162-7(a) (1958) provides that the test of deductibility of compensation paid purely for services is whether amounts paid are reasonable.

88. Internal Revenue Code § 11(b)(2) (1986) provides that the amount of tax imposed "on the taxable income of a qualified personal service corporation . . . shall be equal to 34 percent of the taxable income." Furthermore, I.R.C. § 541 (1986) provides that "[i]n addition to other taxes imposed . . . there is hereby imposed for each taxable year on the undistributed personal holding company income . . . of every personal holding company . . . a personal holding company tax equal to 28 percent of the undistributed personal holding company income."

89. Internal Revenue Code § 62(b)(1) (1986) defines "qualified performing artist" as any individual if - (A) such individual performed services in the performing arts as an employee during the taxable year for at least 2 employers, (B) the aggre-

Tax Reform Act of 1986.⁹⁰ However, despite good intentions in creating the exception to the two percent limitation on deduction of non-reimbursed employee business expenses, Congress inadvertently gave the IRS an additional method of attacking successful actors. Internal Revenue Service examiners now argue that, by carving out an exception for persons making not more than \$16,000, Congress intended that those persons making more than that amount⁹¹ can only deduct related expenses to the extent that they exceed two percent of the actor's adjusted gross income.⁹² Therefore, actors making in excess of \$16,000 who qualify as independent contractors under prior rulings and report their income and expenses accordingly must now clear the additional hurdle of the qualified performing artist exception.

VI. A PROPOSED SOLUTION

A solution exists to the actors' income and expense reporting dilemma which should satisfy the IRS, the unions, and the actors. The Internal Revenue Code⁹³ and the Treasury Regulations⁹⁴ acknowledge that certain individuals who are not employees under the common law are to be treated as statutory employees for purposes of withholding social security taxes.

Moreover, under Revenue Ruling 90-93,⁹⁵ a statutory em-

gate amount allowable as a deduction under section 162 [allowable business deductions] in connection with the performance of such services exceeds 10 percent of such individual's gross income attributable to the performance of such services, and (C) the adjusted gross income of such individual for the taxable year . . . does not exceed \$16,000.

90. Internal Revenue Code § 62(a)(2)(B) (1986) provides, in part, that in the case of an individual, adjusted gross income means "gross income minus . . . [t]he deductions allowed by section 162 which consist of expenses paid or incurred by a qualified performing artist in connection with the performances by him of services in the performing arts as an employee."

91. If Forms W-2 are issued to the actor, examiners believe the expenses are subject to the adjusted gross income limitation. Conversely, if Forms 1099-MISC are issued, examiners believe that the income is properly reportable as trade or business income and that expenses are deductible without the adjusted gross income limitation.

92. The House Ways and Means Committee Report, No. 99-426, Dec. 7, 1985, the Senate Finance Committee Report, No. 99-313, May 29, 1986, and the House Conference Report No. 99-841, Sept. 18, 1986, do not substantiate the IRS's position. In fact, Senator Wilson of California, in suggesting Amendment No. 2157, opined that "big-name actors, musicians and others, have most often formed personal service corporations . . . [o]r such people [who] may perform their work as independent contractors" are "unaffected by this one particular change". 132 CONG. REC. 58,132 (1986).

93. I.R.C. § 3121(d) (1986).

94. Treas. Reg. § 31.3401 (c)-1(h)(as amended by T.D., 7068, 1970-2 C.B. 252).

95. Rev. Rul. 90-93, 1990-2 C.B. 33; *but cf.* Priv. Ltr. Rul. 91-25-003 (March 14, 1991) (statutory employee found to be an employee for purposes of the Self-Employment Contri-

ployee⁹⁶ who is not an employee under common law rules and is similarly not an employee for purposes of Sections 62⁹⁷ and 67⁹⁸ of the Internal Revenue Code, can report all income and expenses on Schedule C of Form 1040 despite the fact that such income was reported to the actor on Forms W-2. Thus, the statutory employee's expenses incurred in producing income are not subject to the two percent limit for miscellaneous itemized deductions. Most importantly, Revenue Ruling 90-93 states that "[t]his holding also applies to all other statutory employees described in Section 3121(d)(3)."⁹⁹

Congressional recognition of the long-standing legal precedents supporting the premise that actors, although not purely independent contractors, at least possess several traits inherent to independent contractor status, would pave the way to an ideal compromise. To eliminate the ambiguity for IRS examiners, Con-

butions Act of 1954, codified at I.R.C. §§ 1401-1403 (1986)).

96. Internal Revenue Code § 3121(d) (1986) defines the term "employee" as:

- (1) any officer of a corporation; or
 - (2) any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee; or
 - (3) any individual (other than an individual who is an employee under paragraph (1) or (2)) who performs services for remuneration for any person —
 - (A) as an agent-driver or commission-driver engaged in distributing meat products, vegetable products, fruit products, bakery products, beverages (other than milk), or laundry or dry-cleaning services, for his principal;
 - (B) as a full-time life insurance salesman;
 - (C) as a home worker performing work, according to specifications furnished by the person for whom the services are performed, on materials or goods furnished by such person which are required to be returned to such person or a person designated by him; or
 - (D) as a traveling or city salesman, other than as an agent-driver or commission-driver, engaged upon a full-time basis in the solicitation on behalf of, and the transmission to, his principal (except for side-line sales activities on behalf of some other person) of orders from wholesalers, retailers, contractors, or operators of hotels, restaurants, or other similar establishments for merchandise for resale or supplies for use in their business operations;
- if the contract of service contemplates that substantially all of such services are to be performed personally by such individual; except that an individual shall not be included in the term "employee" under the provisions of this paragraph if such individual has a substantial investment in facilities used in connection with the performance of such services (other than in facilities for transportation), or if the services are in the nature of a single transaction not part of a continuing relationship with the person for whom the services are performed, or
- (4) any individual who performs services that are included under an agreement entered into pursuant to section 218 of the Social Security Act.

97. Internal Revenue Code § 62 (1986) defines the term "adjusted gross income."

98. Internal Revenue Code § 67 (1986) provides that miscellaneous itemized deductions are deductible to the extent that they exceed two percent of adjusted gross income.

99. Rev. Rul. 90-93, 1990-2 C.B. 33.

gress should include full-time actors in the Section 3121(d)(3) list of statutory employees. The IRS and the unions would thereby be assured that withholding for social security and federal unemployment taxes would be maintained. At the same time, the unions would preserve their members' status as employees for purposes of the National Labor Relations Act and unemployment compensation. Finally, as statutory employees, treatment of actors would be governed by Revenue Ruling 90-93 which would allow actors to report all acting income and expenses on Schedule C, thus avoiding the limitation on otherwise deductible expenses to those which exceed two percent of their adjusted gross incomes.

In short, if Section 3121(d)(3) is amended to include actors as statutory employees, IRS examiners who lack legal training will no longer be forced to make a difficult case-by-case determination as to whether an actor is an employee or an independent contractor under common law. The examiners would thus be prohibited from elevating the Form (W-2) over the substance of the underlying relationship of the contracting parties.