

PLR 8925018, 1989 WL 593723 (IRS PLR)

Internal Revenue Service (I.R.S.)

Private Letter Ruling

Issue: June 23, 1989
March 23, 1989

Section 3121 -- Definitions3121.00-00 Definitions

3121.04-00 Employees

3121.04-18 Insurance Salesmen

Section 3306 -- Definitions3306.00-00 Definitions

3306.50-00

Section 3401 -- Definitions3401.00-00 Definitions

3401.04-00 Employer-Employee Relationship

CC:EE:2:5-TR-31-4964-88

LEGEND:

Insured = * * *

TIN = * * *

Program = * * *

Dear * * *

This is in response to your ruling request dated November 15, 1988, submitted on behalf of Insurer, in which rulings were requested concerning the federal employment tax status of insurance salespersons under a new program to be instituted by Insurer.

Insurer, which is engaged in the business of underwriting various types of insurance, intends to change the status of substantially all of its sales force under a new agent program (the 'Program'). Insurer has determined that both its profits and the income of its agents could be increased if they are given the opportunity to (1) operate independent businesses virtually free of any direction from Insurer, (2) have a more direct stake in the profits and losses attributable to their personal efforts, and (3) build an economic interest in their customer accounts. Insurer has further determined that making its agents fully independent will enable it to compete more effectively with other major companies in the insurance industry when recruiting and retaining the services of the most talented agents. The concepts underlying the Program respond to these concerns.

The Program will begin with an employee phase that will last for a full months. During this period it is proposed that

new agents will serve as employees of Insurer and be trained by Insurer to run independent insurance agencies. While employees, the agents will be supervised and controlled by Insurer in their daily activities and compensated in a manner that is intended to tide them over until they can be established as independent agents.

Those agents who successfully complete the employee phase of the Program and show outstanding entrepreneurial abilities will be offered the opportunity to participate in the independent contractor phase of the Program. Agents in the independent contractor phase will be free to run their agencies in virtually any manner they choose with no direction from Insurer. Qualified present agents may enter the Program at their own election. Substantially all future agents will be required to enter the Program upon affiliation with Insurer. Current agents who have shown an ability to operate independently will be allowed to participate in the Program without having to complete the employee phase. Details of the Program are as described below.

THE EMPLOYEE PHASE

Agents in the employee phase of the Program will enter into employment agreements with Insurer under which they agree to solicit the purchase of insurance, notes, and other financial-related products as agents of Insurer in the state or states in which they are appointed, provided they comply with the applicable state licensing requirements. They will be contractually required to perform such services subject to Insurer's supervision, direction, and control during the employee phase. During this phase they will be contractually precluded from working for competitors of Insurer and for companies outside the insurance industry.

Agents during the employee phase will be required to participate in a structured orientation program and attend, actively participate in, and complete all courses seminars, tests, and other training activities sponsored by Insurer. They will work closely with management to develop their product knowledge and sales skills and management will formally evaluate their progress. Agents will be required to maintain detailed records of their sales activities and these reports will serve as a basis for discussion during their meetings with management. In order to ensure that the agents devote their full business time to Insurer, gain sufficient experience, and develop proper sales skills, they will be required to sell a minimum amount of insurance. Agents may be dismissed from employment if they do not meet these quotas. The agents will be expected to work an average of b hours per week during their first c weeks of employment and continue to work on a full-time basis thereafter for the remainder of the employee phase.

Agents will receive a fixed salary, plus overtime, during the first c weeks of the employee phase. For the remaining portion of the employee phase the agents will have a guaranteed salary. In lieu of the guarantee, agents will be eligible to receive a monthly fee if such amount exceeds the guarantee. The monthly fee will resemble a commission in that it generally will be computed as a specified percentage of the new and certain renewal premiums that an agent was responsible for during the previous month. The agents will also be entitled to certain employee fringe benefits as well as vacation leave.

In general, Insurer will either pay directly or reimburse substantially the office-related expenses incurred by agents during the employee phase, as long as such expenses are reasonable. Moreover, Insurer will pay directly or reimburse the agents for their reasonable travel expenses incurred while away from home on business trips required by Insurer.

Insurer will select the office location of a particular agent during the employee phase based on market conditions, the availability of office space in his or her geographic region, and the office locations of existing agents. It will also prescribe the hours during which an agent's office must be kept open. Insurer will reserve the right to relocate agents to other office sites during this period. It is anticipated that the agents will use their own names and Insurer's in operating their agencies. Insurer will have the right to approve signs and other materials that contain its name.

Insurer will keep track of all accounts that an agent has written. Under normal circumstances it will not have a unilateral right to transfer these accounts to any other agent. However, Insurer may transfer accounts if an agent is relocated or if a policyholder requests a new agent from Insurer. During the employee phase Insurer, on occasion, may

provide the agents with leads on prospective customers. It may also transfer unrepresented accounts to an agent. It will have the right to require agents to follow up on the leads and handle the unrepresented accounts. An agent will not have an economic interest in his or her customer accounts during the employee phase.

The terms, prices, and conditions of the insurance, notes, and other financial-related products offered by Insurer will remain within Insurer's control, subject to regulatory approval. Similarly, all insurance contracts solicited by agents will be subject to approval by Insurer. Insurer will provide the agents with forms, questionnaires, and promotional materials, as well as manuals, bulletins, and other resources necessary for the agents to function as representatives of Insurer. An agent may supplement the advertising provided by Insurer and direct public attention to his or her particular agency. However, all such advertising by an agent during the employee phase will be subject to Insurer's prior approval, regardless [of] whether the promotional material contains Insurer's name.

An agent's employment contract with Insurer will automatically terminate at the end of a months. It will also be terminable at will by either Insurer or the agent at any time during this phase. Upon termination, an agent will be entitled to receive his or her guarantee or monthly fee (whichever is greater) earned up to the termination date and certain employee benefits determined in accordance with Insurer's employee benefit plans.

THE INDEPENDENT CONTRACTOR PHASE

Agents who successfully complete the employee phase of the program may enter into independent contractor arrangements with Insurer under contracts that establish the basic framework of their relationships. The agents will solicit insurance, notes, and other financial-related products on behalf of Insurer in the state or states that they are both appointed to represent Insurer and properly licensed during the independent contractor ('IC') phase of the Program, just as they will do during the employee phase. However, the contracts will stipulate that agents in the IC phase will be free of IC's direction, supervision, and control and permitted to perform their services in virtually any manner they deem appropriate. They will also be allowed to work for other companies as long as they do not sell insurance products of Insurer's competitors without Insurer's consent.

Agents will not be trained by Insurer during the IC phase, although Insurer may send them educational literature and invite them to voluntarily [sic] sales seminars and advanced educational programs. Agents will be free to run their agencies according to their own professional judgement. They generally will have complete control over the hours they work and the hours during which their offices remain open. No reports will be required of the agents except for remittance reports used to transmit premiums and other funds they receive that belong to Insurer. Insurer will not impose minimum production requirements on the agents during the IC phase.

Unlike the employee phase, an agent in the IC phase will not receive any guarantee or minimum amount of compensation. Rather, all the agent's remuneration will consist of commissions equal to a specified percentage of new or renewal premiums attributable to his or her customer accounts and other forms of compensation also based solely upon the agent's productivity (such as bonuses and prizes). Insurer will not provide the agents with fringe benefits. Agents may take vacations when they choose.

Agents will free to select any location that they desire for an office site subject to Insurer's approval. It is expected that many agents who complete the employee phase will simply retain their office location during the IC phase. Once a site is selected Insurer will reserve no right to relocate the agent. Like the employee phase, it is expected that the agents will use their own names and Insurer's in operating their agencies. Unlike the employee phase, agents will be allowed to supplement Insurer's advertising without getting approval from Insurer. Only advertising that contains Insurer's name must be approved by Insurer.

Insurer will not pay any agent expenses nor will it have a reimbursement arrangement during the IC phase of the Program. Agents will be responsible for all their expenses during this period including the purchase price or rental of their offices. Agents will have the discretion to hire secretaries and solicitors (as well as any other support workers)

and will be free to determine their own policies regarding the binding authority granted to their solicitors. Insurer will have no input into hiring and firing decisions and agents will have full responsibility for establishing wage levels for their employees.

Participating agents in the employee phase, along with existing agents who elect into the Program, will retain their customer accounts when they enter the IC phase. Like the employee phase Insurer may provide leads to an agent or offer to transfer unrepresented accounts. However, Insurer will have no right to require an agent to follow up on such leads or handle such unrepresented accounts. Agents in the IC phase will have an economic interest in their customer accounts. They will be able to realize such interest upon termination of their relationships with Insurer through either (1) consideration from a third party in the case of a sale or transfer of their businesses or (2) the receipt of termination payments from Insurer based on a formula structured to yield the fair market value of their accounts.

In the IC phase agent contracts will not be terminable at will. Rather, they will normally only be terminated by either party upon d days prior written notice to the other. To protect its reputation, Insurer reserves the right to stop an agent from selling insurance during this period although the agent will still be entitled to commissions for the duration of the d days. The agent contracts may also be terminated (1) at any time by mutual agreement of the parties, (2) immediately for cause, or (3) upon the death or permanent disability of the agent.

Unless an agent sells his or her agency to a third party that has been approved by Insurer, the agent (or his or her legal representative in the event of death) will receive termination payments from Insurer. The amount of such payments will be designed to approximate the fair market value of the agent's accounts procured during either phase of the program and intended to compensate the agent for relinquishing his or her economic interest in such accounts.

LAW AND RATIONALE

An individual is an employee for federal employment tax purposes if that individual has the status of employee under the usual common law rules for determining whether an employer-employee relationship exists. Guides for determining that status are set forth in three substantially similar sections of the employment Tax Regulations, namely, [sections 31.3121\(d\)-1](#), [31.3306\(i\)-1](#), and [31.3401\(c\)-1](#). The regulations provide that generally the relationship of employer and employee exists when the person for whom the 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 the result is accomplished. 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 the employer 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. In general, if an individual is subject to the control or direction of another merely as to the result to be accomplished by the work and not as to the means and methods for accomplishing the result, he is an independent contractor. If the relationship of employer and employee exists, the designation or description of the relationship by the parties as anything other than employer and employee, such as independent contractor, is immaterial.

There are 20 common law factors that the courts and the Internal Revenue Service generally consider in determining whether sufficient control is present to establish an employer-employee relationship. No single factor is dispositive of the issue. See [Rev. Rul. 87-41, 1987-1 C.B. 296](#).

[Rev. Rul. 69-288, 1969-1 C.B. 258](#), presents the question whether the agents of a life insurance company are employees or independent contractors. The company enters into a contract with a general agent giving the agent the exclusive right to solicit applications for insurance and annuity contracts within a specified territory. The company has a large number of general agencies, each one of which maintains an office at his own expense and is compensated by commissions and collection fees based on a fixed percentage of insurance premiums. The general agent contracts with district agents and special agents for development of various parts of the territory. All insurance matters, including insurance applications and premium collections, relating to the territory of each general agent pass through the agent's office. The agent's contracts do not permit the company to prescribe rules governing the development of clientele or

the time or place of solicitation, or otherwise control the physical activities of the agent. The agents can come and go as they please and are not required to spend a fixed amount of time working for the company. The company neither furnishes or controls the means of transportation nor pays for the means used by the agent. It has no right to dictate whether an agent advertises, but it has a right to review the advertising copy before it is released. [Rev. Rul. 69-288](#) concludes that the company does not exercise, or have the right to exercise, the amount of control necessary to establish an employer-employee relationship under the common law rules.

Our application of the common law factors to the employee phase of the Program clearly indicates that the agents will be subject to sufficient control by Insurer to be considered employees of Insurer during this period. Insurer will require the agents to participate in a structured orientation program, attend sales meetings, work minimum hours, and meet specified sales quotas. It will pay the agents a guaranteed level of wages, provide a variety of employee benefits, and reimburse them for all or a substantial portion of their business expenses. Insurer will supervise and exercise direct control over them in the details of their office operations. Agents will be subject to frequent performance reviews and possible termination by Insurer. They will not have an economic interest in their customer accounts.

By contrast, application of the common law factors to the IC phase indicates that the agents will not be subject to the requisite control to be considered employees. Operation of the agents' offices will be left to their professional judgement. They will not be subject to Insurer's supervision or review, nor will they be required to attend meetings or meet quotas. Their soliciting services need not be performed personally. Their sole form of remuneration will be commissions (or secondary forms of remuneration also geared to productivity) and they will have an opportunity to build an economic interest from their customer accounts. They will not receive any employee benefits from Insurer and they will not be reimbursed for any expenses incurred in the operations of their agencies. They may solicit for other companies if they do not sell the products of Insurer's competitors without its consent.

RULINGS

Accordingly, based on the accompanying documents and the representations made concerning the Program, we conclude that individuals who sell insurance products for Insurer under the Program will be employees of Insurer during the employee phase for purposes of the Federal Insurance Contributions Act, the Federal Unemployment Tax Act, and federal income tax withholding. However, those individuals who sell insurance during the IC phase will be independent contractors rather than employees.

No opinion is expressed on the federal tax consequences of the above arrangement under any other section of the Internal Revenue Code.

This ruling is directed to the taxpayer that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,
James L. Brokaw
Chief, Branch 5
Office of the Assistant Chief Counsel
(Employee Benefits and Exempt Organizations)

Enclosure:

Copy for section 6110 purposes

This document may not be used or cited as precedent. [Section 6110\(j\)\(3\) of the Internal Revenue Code.](#)

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