



*Expansion of the Gig Economy
Warrants Focus on Improving
Self-Employment Tax Compliance*

February 14, 2019

Reference Number: 2019-30-016

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HIGHLIGHTS

EXPANSION OF THE GIG ECONOMY WARRANTS FOCUS ON IMPROVING SELF-EMPLOYMENT TAX COMPLIANCE

Highlights

**Final Report issued on
February 14, 2019**

Highlights of Reference Number: 2019-30-016
to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

With economic trends increasing the number of self-employed taxpayers, it is important that the IRS provide accurate guidance and notices about self-employment tax obligations.

WHY TIGTA DID THE AUDIT

The IRS last estimated the self-employment portion of the annual Tax Gap at \$69 billion. The gig economy has since emerged and grown considerably, with thousands of new taxpayers each year being responsible for self-employment taxes. This audit was initiated to evaluate the self-employment tax compliance of taxpayers who earn income in the gig economy and assess the IRS's processes and controls that identify and address noncompliance with self-employment tax requirements.

WHAT TIGTA FOUND

TIGTA reviewed cases in the IRS's Automated Underreporter (AUR) program for taxpayers who work in the gig economy and who have discrepancies between what is reported on their income tax returns and payments reported to the IRS on Tax Years 2012 through 2015 Forms 1099-K, *Payment Card and Third Party Network Transactions*, by payers. The review was limited to nine commonly recognized gig economy payer companies and identified 264,346 cases with potentially underreported payments included on Form 1099-K. The number of discrepancies involving Forms 1099-K from these gig economy payers increased 237 percent from 2012 to 2015.

Like other types of AUR inventory, many cases were not selected to be worked by the AUR

program due to the large volume of discrepancies that were identified. Specifically, 59 percent of taxpayers were not selected to be worked by the AUR. This includes 2,817 taxpayers with potential underreporting of their Form 1099-K income in all four tax years, involving \$2.7 billion in potentially underreported payments included on Form 1099-K.

AUR employees removed thousands of cases from inventory without justification or with justification that was inaccurate. Many of the cases that were worked included errors by IRS examiners. Also, AUR employees rarely refer questionable deductions claimed by taxpayers on amended returns filed in response to receiving a notice from the AUR program to the Examination function.

Treasury Regulations do not require certain gig economy businesses to issue Form 1099-K unless workers earn at least \$20,000 and engage in at least 200 transactions annually. Consequently, many taxpayers who earn income in the gig economy do not receive a Form 1099-K; therefore, their income is not reported to the IRS. When income is not reported to the IRS, taxpayers are more likely to be noncompliant.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS take several corrective actions to improve how the AUR program addresses self-employment tax noncompliance, selects cases, and conducts quality reviews. Additionally, TIGTA recommended that the IRS Office of Chief Counsel develop and issue guidance to help clarify current third-party reporting regulations and work with the Department of the Treasury Office of Tax Policy to pursue regulatory or legislative change to reduce the information reporting gap.

The IRS agreed or partially agreed with nine of our 11 recommendations. Management's disagreement with two recommendations was mainly due to other work priorities and the cost and difficulties associated with making changes to IRS systems. TIGTA contends that the implementation of these recommendations would be in the best interest of improving taxpayer compliance.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

February 14, 2019

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Expansion of the Gig Economy Warrants Focus
on Improving Self-Employment Tax Compliance (Audit # 201730014)

This report presents the results of our review to evaluate the compliance of taxpayers who earn income in the gig economy with their self-employment tax requirements and assess the Automated Underreporter program's processes and controls that identify and address noncompliance with self-employment tax requirements. This audit is included in our Fiscal Year 2019 Annual Audit Plan and addresses the major management challenge of Protecting Taxpayer Rights.

Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the Internal Revenue Service managers affected by the report recommendations. If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Table of Contents

Background	Page 1
Results of Review	Page 6
Billions in Potential Tax Discrepancies Involving Taxpayers Who Earn Income in the Gig Economy Are Not Worked	Page 6
Recommendation 1:	Page 13
Recommendation 2:	Page 14
The Automated Underreporter Program Removed Cases From Inventory Without Justification, and Examiners Made Errors on the Cases That Were Worked	Page 14
Recommendations 3 and 4:	Page 29
Recommendations 5 through 7:	Page 30
Recommendations 8 and 9:	Page 31
The Emergence and Expansion of the Gig Economy Has Expanded the Information Reporting Gap	Page 31
Recommendations 10 and 11:	Page 37
 Appendices	
Appendix I – Detailed Objective, Scope, and Methodology	Page 38
Appendix II – Major Contributors to This Report	Page 40
Appendix III – Report Distribution List	Page 41
Appendix IV – Outcome Measures	Page 42
Appendix V – Glossary of Terms	Page 46
Appendix VI – Management’s Response to the Draft Report	Page 49



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Abbreviations

AUR	Automated Underreporter
CISA	Case Inventory Selection and Analytics
CP	Computer Paragraph
EQRS	Embedded Quality Review System
FY	Fiscal Year
I.R.C.	Internal Revenue Code
IRCS	Information Return Case Selection
IRDM	Information Reporting and Document Matching
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
NQRS	National Quality Review System
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
TPSO	Third-Party Settlement Organization
TY	Tax Year



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Background

The difference between what taxpayers owe and what they pay timely is referred to as the Tax Gap. The gross Tax Gap is the amount that is owed by taxpayers before collections from Internal Revenue Service (IRS) enforcement actions and other late taxpayer payments are taken into account.¹ IRS studies have shown that the self-employment tax underreporting portion of the Tax Gap was \$39 billion for Tax Year (TY) 2001, which accounted for about 11 percent of the overall \$345 billion Tax Gap.² This increased to \$57 billion for TY 2006, which accounted for about 13 percent of the overall \$450 billion Tax Gap. The most recent Tax Gap estimate, which is an average for TYs 2008 through 2010, estimated the nonfiling self-employment tax portion of the Tax Gap to be \$4 billion and the underreporting self-employment tax portion of the Tax Gap to be \$65 billion, for a total of \$69 billion. This accounts for about 15 percent of the overall \$458 billion Tax Gap.

The most recent Tax Gap estimates put the underreporting self-employment tax portion of the Tax Gap at \$65 billion.

Self-employment income is frequently underreported for income tax purposes. Tax Gap studies, based on IRS National Research Program data, have found that sole proprietors underreported their net income by 64 percent (based on the average for TYs 2008 through 2010), which is up from 57 percent in the TY 2001 estimate.³ With the growth of online platform companies in recent years, which allow people easy and convenient ways to obtain needed services and others to work as self-employed individuals providing those services (also known as the “gig economy”), it is likely that self-employment tax underreporting will continue to be a growing problem if not addressed.⁴

The gig economy is comprised of online platform companies such as Uber, Lyft, Etsy, Handy, and TaskRabbit. The IRS commonly uses the term “sharing economy,” but it is also “referred to as the on-demand, gig, or access economy.” The IRS states that the sharing, or gig, economy “allows individuals and groups to utilize technology advancements to arrange transactions to generate revenue from assets they possess (such as cars and homes) or services they provide

¹ Hereafter the gross Tax Gap is referred to as the Tax Gap.

² See Appendix V for a glossary of terms.

³ The National Research Program supports measurement of taxpayer compliance with Federal tax laws that require accurate reporting of tax liabilities, timely filing of returns, and timely and complete payment of taxes owed.

⁴ For the purposes of this audit, we are reporting on the current state of the gig economy and how many gig economy workers are currently classified as independent contractors or self-employed individuals. The scope of this review did not include a determination as to whether or not this is the correct classification. We have a separate audit (Audit No. 201730016) involving worker classification within the gig economy.



Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance

(such as household chores or technology services).”⁵ In this model, the online platforms act as facilitators that bring together people offering a good or service with others that need such goods or services. One major implication of this arrangement is that the platform company typically does not withhold money from the service provider’s payments for tax purposes, *i.e.*, income tax withholding and employment tax withholding. This creates a more complicated tax situation for individuals who, in many cases, may not understand the tax obligations of their activities, such as the possible obligation to pay self-employment tax.

In traditional employment arrangements, the employer provides a Form W-2, *Wage and Tax Statement*, at the end of the calendar year, reporting to both the taxpayer and the IRS the amount of money the taxpayer made and what taxes were withheld, such as Social Security, Medicare, and income taxes. Throughout the year, that employer takes these taxes out of the taxpayer’s paycheck and sends the money to the IRS on the taxpayer’s behalf.

However, when taxpayers are working in the gig economy, the online platform companies are not considered to be their employers. Issues sometimes arise for tax purposes between businesses and workers as to whether or not a worker is correctly classified as an employee or an independent contractor;⁶ however, with the growth of the gig economy, there are many more people now engaging in this type of temporary, independent work. Unfortunately, there is no universally accepted definition of the range of activities that fall into the gig economy or who should be counted as a gig worker. Because of this, research on this subject has produced a wide range of estimates of how many people are using digital platforms to work or otherwise earn money, including studies by JP Morgan Chase Institute, the Brookings Institute, the Pew Research Center, and others. For example, in a recent study, it was estimated that 8 percent of Americans reported in 2016 that they earned money on some sort of digital platform by taking on a job or task, while nearly 18 percent of Americans earned money by selling something online. With more workers engaging in self-employment, it is important that the IRS provide accurate guidance and notices about taxpayers’ self-employment tax obligations.

The income that is earned through the gig economy, whether or not it was reported on any of the Forms 1099 series information returns, should be reported by the taxpayer on Schedule C, *Profit or Loss from Business (Sole Proprietorship)*, as well as any business expenses related to that income.⁷ These taxpayers then owe self-employment tax, meaning they must determine and pay their own Social Security and Medicare taxes, using Schedule SE (Form 1040), *Self-Employment*

⁵ See: <https://www.irs.gov/businesses/small-businesses-self-employed/sharing-economy-tax-center>.

⁶ See TIGTA, Ref. No. 2018-30-077, *Improvements to the SS-8 Program Are Needed to Help Workers and Improve Employment Tax Compliance* (Sept. 2018), which describes the IRS’s efforts to provide assistance to workers who believe they have been wrongly classified as independent contractors.

⁷ The Form 1099 series includes various information returns such as Form 1099-MISC, *Miscellaneous Income*; Form 1099-INT, *Interest Income*; Form 1099-DIV, *Dividends and Distributions*; Form 1099-OID, *Original Issue Discount*; and Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

*Tax.*⁸ If these taxpayers are used to traditional employment arrangements and are only participating in the gig economy because it is an easy way to earn extra income, they may be unaware of, or confused by, all of the tax requirements for self-employed individuals. This misunderstanding or unawareness of tax liabilities is further compounded if the taxpayer does not receive a tax information return, such as Form 1099-K, *Payment Card and Third Party Network Transactions*, from the online platform company. Some taxpayers may not report the income if they do not believe the IRS has received an information return. The IRS's Tax Gap analyses indicates that there is higher compliance when amounts are subject to information reporting (93 percent compliance). Compliance is even higher when also subject to tax withholding (99 percent compliance). When there is no information reporting, the compliance rate is only 37 percent.

Internal Revenue Code (I.R.C.) Section (§) 6050W requires reporting of certain payments made in settlement of payment card and third-party network transactions.⁹ The rationale for the provision was as follows:

*The Committee believes that requiring information reporting with respect to receipts from credit card and other electronic payment transactions will improve compliance and IRS enforcement efforts. Generally, business receipts that are subject to information reporting are less likely to be underreported by taxpayers. The Committee believes that expanding information reporting requirements will encourage the filing of timely and accurate income tax returns and improve overall tax administration.*¹⁰

In response, the IRS developed Form 1099-K for submission by payment settlement entities starting in Calendar Year 2012. This information reporting was intended to assist the IRS in matching income from sales to income reported on tax returns in an effort to reduce the Tax Gap. The law requires information reporting to the IRS on payment card transactions by “merchant acquiring entities” and third-party network transactions by “third-party settlement organizations” (TPSO); however, annual thresholds of \$20,000 and 200 transactions were established for TPSOs.¹¹ Additionally, I.R.C. § 6050W(b) also sets forth special rules for two other entities: “aggregated payees” and “electronic payment

⁸ Form 1040, *U.S. Individual Income Tax Return*, series.

⁹ In Calendar Year 2008, Congress passed the Housing and Economic Recovery Act of 2008 (Pub. L. No. 110-289, 122 Stat. 2908). Among other provisions, this act created I.R.C. § 6050W, which established the rules that require payment settlement entities to issue Form 1099-K statements to payees who meet the criteria of § 6050W(e).

¹⁰ H.R. Rep. No. 110-728, at 35 (2008).

¹¹ I.R.C. § 6050W(b) provides that merchant acquiring entities include banks and other organizations that must fulfill credit card transaction payments. I.R.C. § 6050W(e) defines TPSOs as the central organizations that have the contractual obligation to make payment to participating payees of third-party network transactions.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

facilitators.”¹² These other entities are also required to report the gross amount of all reportable payment transactions on Form 1099-K, *i.e.*, there are no *de minimis* reporting thresholds for these entities as there are for TPSOs.¹³

The growing gig economy and the challenges it presents to tax compliance have been the subject of Congress’s attention for a number of years and were discussed at length in two congressional hearings in Calendar Year 2016. During her May 26, 2016, testimony at the U.S. House of Representative’s Committee on Small Business *The Sharing Economy: A Taxing Experience for New Entrepreneurs, Part II* hearing, the National Taxpayer Advocate stated: “The service provider may not have been aware of the consequences of being classified as a nonemployee and may not have set aside money for self-employment tax or have made quarterly estimated payments. . . . If we operate under the premise that most taxpayers want to comply with the law, the IRS needs to expand its presence within the sharing economy to enable that compliance.”¹⁴ However, the National Taxpayer Advocate believes that “much of the compliance burden can be alleviated if tax is collected by third parties and reported to the IRS and to the service providers” in a similar way that the employer-employee relationships work with Form W-2.¹⁵

To help alleviate some of the confusion for taxpayers earning income in the gig economy who want to be compliant, the IRS has created the “Sharing Economy Tax Center” web page, which is designed to provide tax information related to a number of areas associated with the various gig economy platforms.¹⁶ This web page was created in consultation with the Office of Chief Counsel, the Small Business/Self-Employed (SB/SE) Division, the Taxpayer Advocate Service, and Communications and Liaison divisions. There were also presentations on the gig economy that were delivered at the 2016 and 2017 IRS Nationwide Tax Forums. Additionally, information pertaining to the gig economy has been shared by the IRS on Twitter, Tumbler, and the IRS YouTube tax tips web page in an effort to increase communication and outreach to taxpayers.

This review was performed in the SB/SE Division Examination function at the Automated Underreporter (AUR) program campuses in Philadelphia, Pennsylvania, and Ogden, Utah, during the period August 2017 through July 2018. We conducted this performance audit in accordance

¹² I.R.C. § 6050W(b) provides that an aggregate payee is treated as the payee with respect to the payment settlement entity making the initial payment but is itself viewed as the payment settlement entity with respect to the participating payees to whom it distributes the aggregated payment. An electronic payment facilitator is a third party that makes payments in settlement of reportable payment transactions on behalf of the payment settlement entity.

¹³ I.R.C. § 6050W(e) provides an exception for *de minimis* payments by TPSOs whereby they have to report to the IRS payments to a taxpayer only if that TPSO paid the taxpayer more than \$20,000 and has more than 200 transactions in a year with that taxpayer.

¹⁴ *The Sharing Economy: A Taxing Experience for New Entrepreneurs, Part II*, Hearing Before the H. Comm. on Small Business, 114th Cong. (May 26, 2016) (statement of Nina E. Olson, National Taxpayer Advocate).

¹⁵ *The Sharing Economy: A Taxing Experience for New Entrepreneurs, Part II*, Hearing Before the H. Comm. on Small Business, 114th Cong. (May 26, 2016) (statement of Nina E. Olson, National Taxpayer Advocate).

¹⁶ <https://www.irs.gov/businesses/small-businesses-self-employed/sharing-economy-tax-center>.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Results of Review

Billions in Potential Tax Discrepancies Involving Taxpayers Who Earn Income in the Gig Economy Are Not Worked

There is an enhanced risk of reporting noncompliance in the gig economy because much of the gig economy activity is not reported to the IRS due to high thresholds in the information return reporting obligations of many web platform businesses. Specifically, many web platform businesses only report a provider's income to the IRS if the payments they received exceed \$20,000 annually and consist of more than 200 transactions. In such cases, the company is required to send both the provider and the IRS a Form 1099-K listing gross payments, although some companies voluntarily report using lower thresholds.¹⁷ Even under these reporting criteria, the growth of Form 1099-K receipts by the IRS since their inception has been substantial. Specifically, from TY 2015 to TY 2016, nine online businesses that are commonly recognized as gig economy payers that report using Form 1099-K increased the number of forms filed with the IRS from 1.3 million to 2.8 million (115 percent increase).¹⁸

Even when Forms 1099-K are filed with the IRS on behalf of gig economy workers, those workers may not understand that they are required to pay self-employment tax on the income earned or they may intentionally fail to report self-employment tax due.¹⁹ Although there is both the risk of underreporting of income for income tax purposes and self-employment tax purposes, this report is focused on underreporting of self-employment tax due by gig economy workers.

In order to analyze compliance with self-employment tax requirements by taxpayers who earn income in the gig economy, we identified a population of 3,779,329 individual taxpayers who

¹⁷ Form 1099-K thresholds are established by I.R.C. § 6050W.

¹⁸ Includes only Forms 1099-K issued to valid Taxpayer Identification Numbers (both individual and business). These nine gig economy payers issue Forms 1099-K and are some of the largest and well known online platform companies. These payers were often referenced in other outside research on the gig economy, such as studies by JP Morgan Chase Institute, the Brookings Institute, the Pew Research Center, and others. We did not include payers that issue Forms 1099-K to people who participate in the short-term rental segment of the gig economy due to the varying tax requirements for rental income.

¹⁹ The Form 1099-K assists the IRS in matching gross income to the gross sales/receipts reported on tax returns and it does not account for separately reported tax deductions that reduce the gross income amount. Net income, not gross, is subject to self-employment tax.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

received a Form 1099-K from at least one of the nine gig economy payers for TYs 2012 through 2016.²⁰ Figure 1 shows the filing trends of this population.

**Figure 1: Tax Filing Statistics for Taxpayers
Who Earned Income in the Gig Economy²¹**

Tax Year:	2012	2013	2014	2015	2016	Total
Individual Taxpayers Who Received a Form 1099-K	147,732	165,349	402,623	1,082,142	1,981,483	3,779,329
Individual Taxpayers Who Filed a Form 1040, U.S. Individual Income Tax Return	131,975	146,311	359,256	944,452	1,653,185	3,235,179
Percentage of Taxpayers Who Filed a Form 1040	89%	88%	89%	87%	83%	86%
Number of Forms 1040 With Income Reported on a Schedule C	106,798	117,359	273,247	663,899	1,148,572	2,309,875
Percentage of Forms 1040 With Income Reported on a Schedule C	81%	80%	76%	70%	69%	71%
Number of Forms 1040 With No Income Reported on Schedule C and No Line 21 Income ²²	21,032	24,642	72,972	243,738	449,634	812,018
Percentage of Forms 1040 With No Income Reported on Schedule C and No Line 21 Income	16%	17%	20%	26%	27%	25%
Number of Forms 1040 With No Schedule SE (Excludes Returns With a Combined Schedule C Profit of < \$400 and Taxpayers Whose Total Gig Economy Income was < \$400 Who Did Not File Schedule C)	16,308	19,280	35,602	118,188	237,665	427,043
Percentage of Forms 1040 With No Schedule SE (Excludes Returns With a Combined Schedule C Profit of < \$400 and Taxpayers Whose Total Gig Economy Income was < \$400 Who Did Not File Schedule C)	12%	13%	10%	13%	14%	13%

Source: Treasury Inspector General for Tax Administration (TIGTA) analysis of data obtained from the Information Return Master File and Individual Return Transaction File.

Of the 3,779,329 individual taxpayers who received a Form 1099-K, 3,235,179 (86 percent) filed a Form 1040 tax return. From this population of Forms 1040, 2,309,875 (71 percent) reported

²⁰ For the purposes of this population, each tax year consists of unique taxpayers. Therefore, if a taxpayer received three different Forms 1099-K from different payers in TY 2012, they would be listed in the TY 2012 population only one time. However, if a taxpayer received a Form 1099-K from one of the payers in both TY 2012 and TY 2013, they would be in the total population twice – once for TY 2012 and once for TY 2013.

²¹ Based on analyses of nine gig economy payers. Includes only Forms 1099-K issued to a valid Social Security Number.

²² According to the Form 1040 Instructions, line 21 is where taxpayers report any taxable income not reported elsewhere on the return. While payments reported on a Form 1099-K should be reported on Schedule C, we considered taxpayers who reported Form 1099-K payments on line 21 as compliant because the AUR accepts Form 1099-K payments reported on line 21 when they meet criteria outlined in the Internal Revenue Manual (IRM).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

income on a Schedule C.²³ When an individual receives a Form 1099-K, the income should be reported on Schedule C; however, AUR employees explained that it is very common for taxpayers to report the income on line 21 of the Form 1040 tax return. Therefore, to identify individuals who did not report their Form 1099-K gross payments, we identified taxpayers who did not report income on a Schedule C and who did not report income on line 21.²⁴ Our analysis revealed that 812,018 (25 percent) of the taxpayers who received a Form 1099-K and filed a Form 1040 tax return did not report income on either Schedule C or line 21.²⁵ In addition, 427,043 (13 percent) did not file a Schedule SE and pay self-employment taxes.²⁶

With the risk of underreported gig economy income, it is important that the IRS have a strategy to identify and address this noncompliance to reduce the Tax Gap and increase taxpayer understanding of their tax requirements. The IRS uses the AUR program within the SB/SE Division Examination function as one way to identify and address cases of self-employment tax noncompliance. The AUR program provides for the analysis and manual review of potential underreported income and overclaimed deductions and credits on an individual's tax return identified through information return matching.

Within the AUR program, there are numerous types of inventory that are subject to self-employment tax, such as nonemployee compensation, fishing income, agriculture income, bartering, and merchant card and third-party network payments. Figure 2 shows the total number of cases each year for which the AUR program assessed self-employment tax (from all inventory types) and the total dollar amounts of self-employment tax that was assessed.²⁷

²³ For the purposes of this analysis, TIGTA analyzed Schedule C because it is where most self-employment income should be reported. Other sections of the return, such as Schedule D, *Capital Gains and Losses*; Schedule E, *Supplemental Income and Loss*; and the wage line of the return, were not reviewed because they were not material relative to the amount reported on the Form 1099-K received by gig economy workers. Schedule F, *Profit or Loss From Farming*, was also considered, and the number of taxpayers in the population who filed a Schedule F was immaterial.

²⁴ To account for the complexity of tax returns, we considered income to be reported if the Schedule C contained a positive or a negative number in either the gross receipts, other income, or gross income fields or if Form 1040, line 21, contained either a positive or a negative number.

²⁵ While these taxpayers were not compliant with reporting the payments they received, they may not have owed self-employment tax if their net self-employment income was less than \$400.

²⁶ Number excludes taxpayers who filed a Schedule C with a profit of less than \$400 and taxpayers who earned less than \$400 on their combined Forms 1099-K (and did not file a Schedule C) because these taxpayers would not owe self-employment taxes.

²⁷ The AUR program is still working cases within TY 2015; therefore, those numbers are likely to increase over time. The figures in the chart are as of July 9, 2018.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Figure 2: AUR Self-Employment Tax Assessments

Tax Year	Cases for Which Self-Employment Tax Was Assessed	Total Self-Employment Tax Assessed
2011	405,974	\$370,661,157
2012	364,352	\$405,860,925
2013	388,552	\$477,710,700
2014	418,564	\$550,073,879
2015	395,837	\$525,246,734

Source: Data provided by Information Return Case Selection (IRCS) program team.

To identify inventory for the AUR program, taxpayer income and deductions submitted on information returns by third parties (*e.g.*, employers, banks, brokerage firms) are systemically matched against amounts reported by taxpayers on their individual income tax returns to identify discrepancies. For example, when a taxpayer working in the gig economy receives a Form 1099-K for the payments they received and the dollar amount shown on the form is misreported on the taxpayer's return, it is a discrepancy. The discrepancies are identified by the Information Reporting and Document Matching Case Inventory Selection and Analytics (IRDM CISA) system, which the IRCS program team uses to select cases to be worked by the AUR program.²⁸ Additionally, the matching requirements used in this process also identify self-employment tax noncompliance when amounts of \$400 or more are present on Form 1040, line 12 (Business Income), line 18 (Farm Income), or line 21 (Other Income), and no self-employment tax was paid.²⁹ Therefore, the AUR program can work cases involving self-employment tax noncompliance when there is no third-party reporting in instances that the taxpayers still report the income on their return.

However, due to resource constraints and the large number of returns that the IRDM CISA system identifies, the AUR program cannot review every discrepancy. For TY 2012 through TY 2015, the AUR program selected and worked an average of 15 percent of the cases identified by the IRDM CISA system as having potential discrepancies. It is therefore essential that the AUR program identifies the most productive cases to work and that the selection criteria is responsive to changes in the overall economy.

As such, additional data analyses are performed on the population of individual tax returns with identified discrepancies to select the inventory that will be reviewed by AUR tax examiners. The IRCS program team is supposed to select cases that will: 1) yield the highest assessments, 2) address repeat offenders (taxpayers who have had potential discrepancies in more than one tax

²⁸ The IRDM CISA system is an SB/SE Division Compliance function application used to identify discrepancies in tax return money amounts and create a universe of potential underreported cases. The IRCS program team is the group within the SB/SE Division's Examination function that handles case selection for the AUR program.

²⁹ IRM 4.19.3.5(9) Note (August 22, 2017).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

year), and 3) provide balanced coverage among all the different types of inventory that the AUR program works. The most frequently identified discrepancies among the overall selected inventory involved underreported securities sales, wages, taxable pensions, unemployment compensation, and nonemployee compensation.

Like other types of AUR inventory, even when potential noncompliance amongst gig economy participants was identified, many cases were not selected to be worked by the AUR program due to the large volume of discrepancies that the program identified. The number of discrepancies involving Forms 1099-K substantially increased from TY 2012 to TY 2015.³⁰ In total, over the four-year period, the nine gig economy companies issued Forms 1099-K to approximately 1.8 million taxpayers, and the IRDM CISA system identified 455,090 taxpayers (25 percent) with potential discrepancies.³¹ For these 455,090 taxpayers, 264,346 had a potential discrepancy related to Form 1099-K. Specifically, the number of discrepancies involving Forms 1099-K from these gig economy companies increased from 34,624 discrepancies in TY 2012 to 116,547 discrepancies in TY 2015, which is a 237 percent increase over that period. The IRCS program team selected 134,614 (30 percent) of the 455,090 taxpayer cases for the AUR program to work, including 109,518 (41 percent) of the 264,346 taxpayers with a potential discrepancy related to Form 1099-K.

The remaining 320,476 (70 percent) of 455,090 taxpayer cases were not sent to be worked by the AUR program, including 154,828 (59 percent) of the 264,346 taxpayers who had a potential discrepancy related to Form 1099-K. The IRCS program team routed 20,739 of the Form 1099-K cases for some other treatment, such as Examination, Accounts Management, and various pilot programs. However, the remaining 134,089 taxpayers with a potential Form 1099-K discrepancy were not worked by any IRS function. These cases involved potential discrepancies amounting to nearly \$12 billion of merchant card and third-party network payments. The number of taxpayers for which no actions were taken by either the AUR program or the Examination function increased by 173 percent in TY 2015 compared to TY 2012. In addition, 2,817 taxpayer cases not worked had potential discrepancies related to Form 1099-K in all four years, and these cases involved \$2.7 billion in potentially discrepant merchant card and third-party network payments. This occurred even though the IRCS program team is supposed to address repeat offenders as part of the case selection process. Management explained that this is due to other case selection criteria and the estimated potential tax assessment that is calculated for each case.

One factor of consideration in case selection is whether the taxpayer had prior issues with potential discrepancies. In order to identify repeat offenders in the case selection process, one of

³⁰ Case selection for TY 2015 cases occurred in Fiscal Year (FY) 2017. At the time of this review, case selection was not yet complete for TY 2016 or any more recent years.

³¹ The population of 1,797,846 individual taxpayers who received a Form 1099-K from at least one of the nine gig economy payers for TYs 2012 through 2015 includes only Forms 1099-K issued to valid individual (nonbusiness) Taxpayer Identification Numbers.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

four different repeater designations are assigned to every taxpayer with a potential discrepancy that the IRDM CISA system identifies:

- **Egregious repeater.** The IRDM CISA system identified these taxpayers as having the same problem two years in a row, the prior case was selected to be worked by the AUR program, and the prior case resulted in assessed taxes. Of the 134,089 gig economy taxpayer cases in our population that were not worked, 40 taxpayer cases (0.03 percent) were assigned this classification. These taxpayers had \$3.4 million in potentially discrepant merchant card and third-party network payments. When these taxpayers had been previously worked by the AUR program, the tax examiners assessed more than \$387,000.³²
- **Repeater worked.** These are cases in which, within the last three years, the taxpayer was identified by the IRDM CISA system as having a potential discrepancy at least once and the prior case was selected to be worked by the AUR program; 19,942 (15 percent) of the 134,089 taxpayers fell into this category. However, the repeater worked code does not provide information about how the case was resolved, so it is unknown if additional taxes were assessed.
- **Repeater not worked.** These are cases in which, within the last three years, the taxpayer was identified by the IRDM CISA system as having a potential discrepancy at least once and the AUR program did not work the case; 79,471 (59 percent) of 134,089 taxpayers were assigned this designation. This particular code could contain many different types of situations, including taxpayers who had just one occurrence of a potential discrepancy and taxpayers who had five years or more in a row of the same potential discrepancy.
- **Other.** These are all other cases; 34,636 (26 percent) of the 134,089 taxpayers were coded as “other.” In general, these taxpayers have not had discrepancy issues within the past three years.

In total, 99,453 (74 percent) of the gig economy workers with potential discrepancies that were not worked were identified by the IRDM CISA system as being some type of “repeater.” However, these repeater criteria are broadly defined and cannot fully capture the depth of each taxpayer’s past potential discrepancies. We determined the broad definition of the repeater codes offers little information for assessing the risk that taxpayers are engaged in repeated noncompliant behavior. For example, within our population for TY 2015, the “repeater not worked” category includes taxpayers who were identified by the IRDM CISA system as having a potential discrepancy pertaining to Form 1099-K just one prior year as well as taxpayers who have been identified as having this type of discrepancy for the past four years in a row. These codes also do not give any indication as to the severity of the prior discrepancies. For example, the potentially discrepant Form 1099-K income for the 2,817 cases in our population that were

³² This assessment amount includes additional income tax assessed, accuracy-related penalties, assessment of disallowed refundable credits, *etc.* Interest is not included.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

identified as discrepant all four years ranged from less than \$1,000 to more than \$2 million. If one of the goals of case selection for the AUR program is to address repeated noncompliance, the IRCS program team needs to have a better understanding of a taxpayer's repeat history and behavior. IRS officials cannot identify specific reasons why repeater cases are not always selected to be worked by the AUR program. IRS officials generally attributed the non-selection of some cases to the IRDM CISA system programming factoring in all selection criteria and the need to balance selection with declining resources.

Additionally, the IRS does not specifically track noncompliance within the gig economy or have a strategic plan to deal with the noncompliance. AUR program inventory is comprised of different types of income categories, such as wages (*e.g.*, Form W-2), nonemployee compensation (*e.g.*, Form 1099-MISC, *Miscellaneous Income*), and merchant cards and third-party network payments (*e.g.*, Form 1099-K). However, the inventory worked by the AUR program is not representative of the number of information returns received or the dollars reported, or how these numbers are trending. In addition, AUR case criteria does not separately identify gig economy industries. Instead, these taxpayers are grouped together under the "merchant card" category, which includes many other types of taxpayers who receive a Form 1099-K.³³

Notwithstanding the tax implications of the gig economy and the confusion it causes for taxpayers, there have not been related changes within the Examination function. Beyond the website and other forms of educational outreach, the IRS does not currently have a comprehensive strategic plan to address the gig economy and any potential noncompliance that results from gig economy activity.

The SB/SE Division Examination function's Field Case Selection operation informed us that the most recent Compliance Initiative Project on self-employment income/tax ended in Calendar Year 2013, and there are currently no open Compliance Initiative Projects related to self-employment tax.³⁴ Additionally, the AUR program's IRCS program team informed us that it has no pilots or programs planned related to the gig economy. While on site visits, not all AUR employees we interviewed had heard the terms "gig economy" or "sharing economy;" therefore, some of them did not understand what we were asking about until we explained that this meant taxpayers such as Uber drivers, Etsy sellers, TaskRabbit workers, *etc.*³⁵

The growth of the gig workforce has been driven by the development of new technologies that enable transactions directly between providers and consumers. App-based technology platforms allow service providers to connect with consumers and producers quickly and easily, allowing

³³ IRS management informed us that systemic limitations do not allow the IRCS program team to identify cases by industry.

³⁴ Compliance Initiative Projects are authorized activities outside of the planned strategies involving taxpayer contact for the purpose of correcting noncompliance that meet the mission, standards, and resources of the Service.

³⁵ Merchant card (Form 1099-K), nonemployee compensation (Form 1099-MISC), or self-employment tax cases worked by AUR employees can include gig economy workers.



Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance

individuals to perform a variety of tasks for customers based on real-time demand. People are increasingly drawn toward this nontraditional sector of employment either to supplement their current income or because they cannot find traditional, full-time, salaried positions.³⁶

According to one study, the share of the U.S. workforce in alternative work arrangements (which would include the gig economy) rose from 10.7 percent in 2005 to 15.8 percent in 2015, and leading experts have expressed the opinion that we are only in the early stages of an emerging and evolving gig economy.³⁷ For TYs 2012 through 2015, the IRS did not work cases involving approximately \$12 billion of payments reported on Forms 1099-K by the nine gig economy companies, but the gig economy workers had potentially not reported these payments on their tax returns. As the gig economy grows and there is less reliance on traditional employer tax withholding responsibilities, a strategic and effective plan to address tax compliance in this sector is essential to keep the IRS from falling even further behind.

Recommendations

Recommendation 1: The Deputy Commissioner for Services and Enforcement should develop a strategic plan to address tax administration for the gig economy, including the assessment and collection of self-employment tax, and consider developing initiatives such as pilots or soft notice programs geared towards gig economy workers with repeated noncompliance.

Management's Response: The IRS agreed with the recommendation. In November 2018, the IRS initiated an effort to develop and implement a compliance strategy. As part of this effort, the IRS will determine examination and outreach opportunities to address noncompliance in the gig economy.

The IRS did not agree with the measurable impact (outcome measure) that our recommended corrective action will have on tax administration. IRS management stated that they have been unable to replicate this calculation, and asserts that the presence and extent of noncompliance cannot be confirmed without taking compliance actions. The IRS also stated that the increased revenue protection estimate fails to account for the opportunity costs to work these cases.

Office of Audit Comment: TIGTA provided the IRS with a detailed, step-by-step methodology guide as to how we arrived at this outcome measure. IRS officials offered no questions, comments, or concerns. Additionally, the information presented within this section of the report points to the presence of noncompliance among taxpayers who earn

³⁶ Ms. Molly Turner, Lecturer, Haas School of Business, University of California Berkeley and the former Director of Public Policy for Airbnb (see: <http://www.naco.org/featured-resources/future-work-rise-gig-economy#ref1>).

³⁷ Lawrence Katz and Alan Krueger, *The Rise and Nature of Alternative Work Arrangements in the United States, 1995–2015*, NBER Working Paper No. 22667, September 2016; Hagel, John. (see: http://edgeperspectives.typepad.com/edge_perspectives/2017/03/the-future-of-the-gig-economy.html).



Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance

income in the gig economy, and the potential discrepancies that this outcome measure is based on were calculated and identified by the IRS's own IRDM CISA system. Further, we would also expect to see an increase in Federal income tax revenue as a result of these discrepancies being addressed (meaning the increased revenue would be greater than we report in our outcome measure). As we acknowledged in Appendix IV of this report, IRS resources would have to be shifted from other types of work in order to address gig economy taxpayer noncompliance; however, the scope of the expanding gig economy warrants a focus on improving self-employment tax compliance.

Recommendation 2: The Commissioner, SB/SE Division, should revise the repeater codes used in AUR case selection to account for more taxpayer situations, such as taxpayers who have a long history of high-dollar discrepancies and taxpayers who have the same type of discrepancy every year but have never been selected to be worked by the AUR program.

Management's Response: The IRS disagreed with the recommendation. The IRS stated that it already has a repeater profile built into its current process, and the addition of more repeater codes would add minimal value to its existing process. Also, the IRS's Information Technology organization advised it would be extremely difficult, timely, and costly to implement additional repeater codes.

Office of Audit Comment: The existing repeater profile the IRS has offers little information for assessing the risk that taxpayers are engaged in repeated noncompliant behavior. Therefore, it is insufficient in helping the AUR program achieve the case selection goal of addressing repeated noncompliance. Our review identified taxpayers who were noncompliant from one to four prior years, with past potential discrepancy amounts ranging from less than \$1,000 to more than \$2 million, all labeled with the same repeater code. A taxpayer who has had potential discrepancies of \$1 million several years in a row is much more egregious than a taxpayer who had a potential discrepancy of \$100 in only one prior year, but the IRS's current repeater code profile does not make any distinctions between the two taxpayers. TIGTA believes revising the repeater codes to account for more taxpayer situations will allow for better case selection practices to address and improve taxpayer noncompliance.

The Automated Underreporter Program Removed Cases From Inventory Without Justification, and Examiners Made Errors on the Cases That Were Worked

After a potential discrepancy is identified to be included in the AUR program's inventory, AUR tax examiners manually review the associated return along with other information received by the IRS during what is called the case analysis phase. During this process, the tax examiner matches the information returns that were filed with the IRS to the information reported on the taxpayer's return. A determination is made as to whether the case can be closed without any further action (referred to as screening out a case), whether the case needs additional research, or



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

whether a notice needs to be generated to inform the taxpayer of a proposed tax change.³⁸ In response to the notice, the taxpayer may provide supporting documentation that fully resolves the discrepancy described in the notice. In this situation, the AUR tax examiner would close the AUR case with no changes to the taxpayer's account. However, if the taxpayer is unable to provide any support for their position, the IRS will, after allowing the taxpayer an opportunity to internally appeal the proposed deficiency, issue a Notice of Deficiency to assess additional taxes and penalties. Taxpayers are allowed to protest the matter in the U.S. Tax Court.³⁹

We interviewed AUR tax examiners at the Philadelphia and Ogden Campuses and analyzed cases that were selected to be worked by the AUR program, and determined that:

- AUR employees removed, or screened out, thousands of cases from inventory without justification or with justification that was not accurate.
- The AUR program should take steps to reduce errors. IRS notice reviews identified critical errors made by IRS examiners in 15 percent of all cases reviewed, and 9 percent of these errors involved self-employment taxes.
- *****2*****
*****2***** and employees rarely refer questionable deductions claimed by taxpayers on amended returns filed in response to a Computer Paragraph (CP) 2000 notice to the Examination function.

AUR employees removed thousands of cases from inventory

The AUR program uses a number of two-digit numeric codes to identify income types associated with the various fields on different information returns.⁴⁰ Two of the primary codes related to self-employment tax are nonemployee compensation (category 04; Form 1099-MISC) and merchant card and third-party network payments (category 72; Form 1099-K).⁴¹ When analyzing nonemployee compensation, internal IRS procedures direct AUR tax examiners to verify whether the income belongs to the primary or secondary taxpayer so that the AUR system computes self-employment tax correctly.⁴² The procedures also explain that underreported nonemployee compensation is considered self-employment income unless it meets one of the

³⁸ The notice most commonly used is the Computer Paragraph 2000 Notice, *Request for Verification of Unreported Income, Payments, or Credits*.

³⁹ IRM 4.19.3.2.1.1 (August 26, 2016) provides AUR tax examiners with information about the Notice of Deficiency.

⁴⁰ IRM Exhibit 1.4.19-10 (October 20, 2017).

⁴¹ Nonemployee compensation is fees, commissions, or any other compensation paid by a business to an individual who is not an employee and is usually reported on line 7 of Form 1099-MISC. Merchant card and third-party network payments are payments the taxpayer accepted from merchant cards (credit and debit cards) or received through a third-party network (such as one of the gig economy platforms).

⁴² IRM 4.19.3.8.6.2(1) (August 22, 2017).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

five listed circumstances.⁴³ The procedures provide guidance to the AUR tax examiners on assessing self-employment tax on reported nonemployee compensation for which the taxpayer should have paid self-employment tax but did not.⁴⁴ Nearly identical instructions as provided for cases that fall under the merchant card and third-party network payments income identity code classification.⁴⁵

AUR tax examiners additionally work cases in which the taxpayer has unidentified income of \$400 or more reported on line 21 and did not pay self-employment tax.⁴⁶ These cases are coded as income category 50 (self-employment tax).⁴⁷ The AUR tax examiners are supposed to propose self-employment tax for these cases unless they are able to determine that the income listed on line 21 is not subject to self-employment tax.⁴⁸

When AUR tax examiners are assigned a case and begin the case analysis phase, they can make the determination to screen out the case and close it without taking any further action. AUR tax examiners screen out cases by assigning one of nine process codes to the case. The process codes explain the reason that the case was screened out, such as when the examiner determined that:

- The discrepancy identified by the IRDM CISA system was already accounted for (process code 21).
- An identity theft indicator was on the case (process code 23).
- The paper copy of the return could not be secured by the tax examiner for review (process code 29).⁴⁹

Additionally, AUR tax examiners have the option of leaving a note on the AUR system to explain the reasoning behind their actions. For example, if an AUR tax examiner decides to screen a category 50 case because, during the course of their case analysis, it was discovered that the income reported on line 21 was gambling income and therefore not subject to the self-employment tax, it can be notated on the AUR system. These notes are beneficial because they remove any questions as to why certain actions were taken on a case if another tax examiner

⁴³ IRM 4.19.3.8.6.2(2) (August 22, 2017). These circumstances would generally not be applicable to taxpayers receiving payments from one of the nine gig economy payers in our population.

⁴⁴ IRM 4.19.3.8.6.2(3) (August 22, 2017).

⁴⁵ IRM 4.19.3.8.7.2 (September 30, 2014).

⁴⁶ IRM 4.19.3.5(9) (August 22, 2017).

⁴⁷ IRM Exhibit 1.4.19-10 (October 20, 2017).

⁴⁸ IRM 4.19.3.15.1 (August 22, 2017).

⁴⁹ IRM Exhibit 4.19.3-4 (August 26, 2016).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

accesses the case in the future or if the case is selected for either the Embedded Quality Review System (EQRS) or National Quality Review System (NQRS) quality review.⁵⁰

However, AUR tax examiners are not required to leave a note on the AUR system explaining why they made the determination to screen out a case. Tax examiners do not have to justify why they screen out a case, and managers do not have to approve these actions. Further, screened out cases are not subject to an additional review, whereas many cases that result in a notice being sent to the taxpayer are subject to the notice review.⁵¹

We completed an analysis of TY 2013 nonemployee compensation, merchant card and third-party network payments, and self-employment tax (category 50) cases that were closed as screened out.⁵² During TY 2013, 76,444 cases within these categories were screened out, and 62,381 cases (82 percent) were closed with process code 21 (indicating that the tax examiner did not find a discrepancy on the case).

- Of the 62,381 cases, we identified 39,393 taxpayers who did not pay self-employment tax with their original return, did not have a loss on their original Schedule C, and live in the United States.
- Of the 39,393 screened out cases, the tax examiner did not leave a note on the AUR system explaining why they screened out 24,771 cases.
- The majority (16,864) of the 24,771 screened out cases with no note on the AUR system were self-employment tax (category 50) cases.

Even though the tax examiners did not document the reasons for screening out most cases, we determined that when reasons were present, they did not always make sense. For example, we identified cases in which the examiner documented that the reason for screening out the case was that the taxpayers reported Form 1099-K and Form 1099-MISC income on line 21. However, the examiner did not compute the associated self-employment tax for this reported income, and from the note it appeared as if the tax examiner did not understand the requirements for assessing self-employment tax on income reported on line 21, when appropriate. Therefore, potentially productive self-employment tax cases were improperly screened out, and self-employment tax was not always assessed when appropriate.

⁵⁰ The EQRS is a system designed to assist managers in measuring employees' individual performance as it relates to case activities. Employee performance is evaluated against attributes that are designed to identify actions that move cases toward closure through appropriate and timely case activity. The NQRS allows national reviewers to evaluate closed audit files to determine whether examiners complied with quality attributes established by the IRS.

⁵¹ The notice review is a non-evaluative product review taken toward perfecting the quality of notices in the AUR program. The notice review is explained in more detail later in this report.

⁵² TY 2013 was selected for review because it is the last tax year that the AUR program completed working when this audit began.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

We expanded our analyses of the category 50 cases to include the three most recently completed tax years, and Figure 3 shows that self-employment tax cases were screened out at a high rate.

**Figure 3: Self-Employment Tax (Category 50)
Cases Screened Out by AUR Employees**

Self-Employment Tax Cases:	TY 2011	TY 2012	TY 2013	Three-Year Average
Selected by AUR	39,224	89,270	56,107	61,534
Screened Out	22,902	46,888	35,013	34,934
Screen-Out Rate	58%	53%	62%	57%
Not Screened Out	16,322	42,382	21,094	26,599
With Self-Employment Tax Assessments	7,359	18,970	9,537	11,955
Percentage With Self-Employment Tax Assessments	45%	45%	45%	45%
Total Self-Employment Tax Assessed	\$15,005,465	\$52,717,362	\$33,055,540	\$33,592,789
Average Self-Employment Tax Assessed Per Case	\$2,039	\$2,779	\$3,466	\$2,810

Source: TIGTA analysis of AUR program data provided by the IRCS program team.

Over the three-year period, 57 percent of all self-employment cases selected to be worked by the AUR program were screened out. When the cases were not screened out, only 45 percent were assessed self-employment tax; therefore, 55 percent were not assessed tax. In total, an average of 19 percent (11,955 of 61,534 cases) of all AUR self-employment tax cases were assessed additional self-employment tax, while 81 percent (49,579 of 61,534 cases) were not assessed self-employment tax.

The IRS does not have assurance that cases were screened only when appropriate. Even when cases are screened out, AUR employees must devote time and resources to make that determination. As described earlier in the report, many of the cases that are candidates for the AUR program are not worked due to limited resources. It is important that the cases selected and worked are the most productive cases. For perspective, we estimate that approximately \$44 million in additional self-employment taxes could have been assessed during TY 2013 if the 35,013 screened out taxpayer cases in category 50 had been worked and resolved similarly to those that were not screened out.

The AUR program should take steps to reduce errors

Within the AUR program, all cases are subject to possible selection for EQRS and NQRS reviews, and most CP 2000 notices that are generated are subject to the notice review. Therefore, there are three different quality reviews that can be conducted on most AUR cases.⁵³ The CP 2000 notice is the notice that the AUR program sends to the taxpayer after the taxpayer's return has been analyzed by an AUR tax examiner. It includes a description of the discrepancies

⁵³ The notice review is only conducted on cases that result in a CP 2000 notice being sent to the taxpayer.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

that the tax examiner identified during screening and a proposed balance due. The notice review is conducted weekly on a statistically valid sample of the scheduled CP 2000 notice mail-out.⁵⁴ The notice review is intended to perfect the quality of the CP 2000 notices sent to taxpayers. Managers may also identify potential performance deficiencies or error trends and increase the evaluative quality reviews for an individual employee or team with higher error rates. The review can also be used to identify system problems, the need for procedural clarification or updates, and the need for additional training for AUR tax examiners.

During the notice review, the reviewer verifies the CP 2000 notice for correctness and overall quality by reworking the case. The case is reworked from the beginning, including the determination of the underreported amount. If no error is found, no action is necessary. If an error is found and the CP 2000 notice needs to be corrected, the reviewer must stop the original CP 2000 from being mailed to the taxpayer and ensure that the notice is revised.⁵⁵ There are two main types of errors: critical errors, which affect the total balance due, and noncritical errors, which do not affect the total balance due but could result in confusion for the taxpayer.

Each campus is required to conduct the notice review weekly and submit the results to AUR Headquarters. If the error rate exceeds 10 percent in any week, the campus should also include an action plan to correct the problem, and AUR Headquarters should provide its opinion as to whether or not the plan is appropriate for correcting the errors.⁵⁶

Upon reviewing the results of the three AUR quality reviews (EQRS, NQRS, and notice review) and interviewing AUR employees, we determined that quality reviews are finding errors, but there is little action to identify and correct the error trends. Additionally:

- Common reasons for errors identified by these reviews include lack of understanding of Form 1040 line 21, forgetting to determine if the self-employment income belonged to the primary or secondary taxpayer, and entering things incorrectly in the self-employment tax window of the AUR system. In addition, the AUR system does not always capture negative numbers correctly.
- AUR Headquarters did not provide oversight of the notice review or monitor the proposed action plans to reduce the number of errors, which allowed tax examiners to repeatedly make the same mistakes. At one campus, employees were correcting the errors identified during the notice review and not reporting them so that they could stay below the 10 percent threshold that would have required an action plan for improvement. We inspected the source documentation for all FY 2017 quality notice reviews at this campus and determined that this practice occurred in 26 of 51 weeks, and the number of

⁵⁴ The selection of sample notices is performed from all CP 2000 notice runs, with the exception of cases with sort codes, employee AUR cases, and CP 2000 notices posted after CP 2501 notices.

⁵⁵ IRM 4.19.3.22(6) (March 14, 2018).

⁵⁶ IRM 4.19.3.22(8) (March 14, 2018).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

errors not reported ranged from one error to 43 errors to keep them under the 10 percent threshold.

- Due to the lack of oversight by AUR Headquarters, every campus has been conducting and documenting the results of the notice review differently. For example, some campuses do not track the noncritical errors that are discovered and instead only track the critical errors. In addition, some campuses ensure that only high-performing tax examiners serve in the role of notice reviewer, whereas other campuses solicit volunteers or have one entire team perform the review without taking into consideration if the tax examiners on that team have a high accuracy rate in their own work.
- Notice reviewers are concerned that tax examiners are not always held accountable for the errors found during the notice review. In addition, it is not always verified that the tax examiners are actually correcting these errors, and the notice reviewers believe this responsibility should fall on managers. Managers who we spoke with acknowledged that they do not always check to ensure that the errors are corrected. Some reviewers told us there are times when they will get the same notice from the same tax examiner back in a subsequent sample selection, and the notice will still have the same error because the tax examiner never corrected it.
- There are several high-risk areas when it comes to the notice reviewers themselves. It is possible for a notice reviewer to review his or her own notice or a notice of a team member, and there is no oversight in these instances. Additionally, there is incentive for a notice reviewer to find no errors on a notice because those cases are not subject to a review. If a reviewer believes there is an error, but the tax examiner rebuts this claim and the reviewer is found to be incorrect, the reviewer's manager would be informed and the reviewer would receive feedback of the mistake. However, if the reviewer says there is no error on a notice and there actually is an error, the work is never checked and there are no repercussions.
- Some managers always conduct their EQRS reviews the same time every month, allowing tax examiners to know when they have to do their best work (and that they could potentially be less diligent the rest of the month).

After we brought the lack of oversight of the notice review to AUR Headquarters' attention, management informed us that they were taking corrective actions. Figure 4 shows the Fiscal Year (FY) 2017 results of the notice review for all AUR campuses.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Figure 4: Campus Notice Review Results (FY 2017)⁵⁷

	Overall Results
Notice Population for Sample Selection	2,594,437
Yearly Sample Size	80,761
Number of Notices With Critical Errors	8,410
Number of Notices With Noncritical Errors	3,458
Approximate Total Number of Notices With Any Error⁵⁸	11,868
Critical Error Rate	10.49%
Noncritical Error Rate	6.59%
Approximate Total Error Rate⁵⁹	16.33%
Potential Number of Notices With Critical Errors	272,147
Potential Number of Notices With Noncritical Errors	121,168
Potential Number of Notices With Any Error⁶⁰	423,695
Total Number of Notice Reviews That Occurred	315

⁵⁷ The chart reflects the sum total of errors reported by each campus except the campus that was correcting errors and not reporting them. TIGTA computed the error rates for this campus based on a 100 percent physical inspection of the original notice review files. The sample was stratified by campus, and the stratification affects the calculation of the error rates. The error rates and projections were computed by TIGTA’s contract statistician. The critical error point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 266,661 and 277,632 (where the 266,661 and 277,632 represent the lower and upper range, respectively). The noncritical error point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 117,228 and 125,108 (where the 117,228 and 125,108 represent the lower and upper range, respectively). The total error point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 415,580 and 431,811 (where the 415,580 and 431,811 represent the lower and upper range, respectively).

⁵⁸ It is possible that this number is lower because it may include overlap of the 8,410 critical and 3,458 noncritical errors (some notices could have both critical and noncritical errors). However, the IRS does not capture the total number of notices with any error, so it was not possible to accurately account for the overlap.

⁵⁹ It is possible that this percentage is lower because it may include overlap of the 8,410 critical and 3,458 noncritical errors (some notices could have both critical and noncritical errors). However, the IRS does not capture the total number of notices with any error, so it was not possible to accurately account for the overlap.

⁶⁰ It is possible that this number is lower because it may include overlap of the 8,410 critical and 3,458 noncritical errors (some notices could have both critical and noncritical errors). However, the IRS does not capture the total number of notices with any error, so it was not possible to accurately account for the overlap. Additionally, the potential number of critical errors and potential number of noncritical errors do not total to the potential number of any errors due to the stratification of the sample by campus, as well as the fact that not every campus reported noncritical errors. These calculations were computed by TIGTA’s contract statistician.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

	Overall Results
Number of Reviews for Which the Critical Error Rate Was Over 10 Percent	153
Percentage of Reviews for Which the Critical Error Rate Was Over 10 Percent	48.6%

Source: TIGTA analysis of notice review results and error rates and projections by TIGTA's contract statistician.

During FY 2017, the quality reviews identified an average of 15 percent error rates for all campuses, and nearly 50 percent of all weekly reviews exceeded the 10 percent threshold for critical errors. The percentage of weekly review results that exceeded the critical error threshold varied from 9 percent (the Ogden Campus) to 80 percent (the Austin Campus). Additionally, five of the seven AUR campuses had an overall yearly critical error rate that exceeded the 10 percent threshold. TIGTA estimates that during FY 2017, the AUR program sent 272,147 CP 2000 notices proposing an incorrect balance due and 121,168 notices that potentially caused taxpayer confusion.

When AUR tax examiners conduct the notice review and find an error, the error is captured using a numeric notice review error code that indicates what item on the notice is not correct.⁶¹ For example, if the self-employment tax amount on the notice is incorrect, the error is coded as 41; if the wage income amount is incorrect, it is coded as 01; and if the exemption amount is incorrect, it is coded as 34. We isolated the CP 2000 notices that had critical errors specific to self-employment taxes. Figure 5 shows that 9 percent of the critical errors were specific to self-employment taxes.

⁶¹ IRM Exhibit 4.19.3-11 (February 12, 2016).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

**Figure 5: Self-Employment Taxes
Notice Review Results (FY 2017)⁶²**

	Overall Results
Notice Population for Sample Selection	2,594,437
Yearly Sample Size	80,761
Number of Notices With Critical Errors	8,410
Number of Self-Employment Tax Critical Errors	719
Percentage of Critical Errors That Were Incorrect Self-Employment Tax	8.55%
Potential Number of Notices With Self-Employment Tax Errors	23,481

Source: TIGTA analysis of notice review results

TIGTA estimates that the AUR program sent taxpayers 23,481 inaccurate CP 2000 notices specific to self-employment taxes in FY 2017.⁶³ We further analyzed how the self-employment tax errors affected taxpayers and tax administration. As previously discussed, due to lack of AUR Headquarters oversight, every campus documents the results of the notice review differently. For example, some campuses track detailed reasons why the error was committed, whereas others only track the error code, which offers no further explanation to understand why these errors are occurring. For the 719 self-employment tax critical errors, the reviewer documented an explanation for 609 (85 percent) errors. Figure 6 shows the types of self-employment tax errors identified.

⁶² The chart reflects the sum total of errors reported by each campus except the campus that was correcting errors and not reporting them. TIGTA computed the error rates for this campus based on a 100 percent physical inspection of the paper file reviews. The self-employment tax error point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 21,755 and 25,207 (where the 21,755 and 25,207 represent the lower and upper range, respectively).

⁶³ The 23,481 notices are included in the 272,147 incorrect notices reported in Figure 4.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Figure 6: Self-Employment Errors Identified on CP 2000 Notices (FY 2017)⁶⁴

	Number of Cases	Percentage of Total
Total Number of Self-Employment Tax Critical Errors for Which the Notice Reviewer Documented an Explanation for the Error	609	
Summary of the Explanations Given:		
1. The tax examiner did not assess self-employment tax but should have. This includes the following instances: a. The taxpayer had reported nonemployee compensation income on line 21. b. The taxpayer had unknown income on line 21. c. The taxpayer had reported self-employment income on a Schedule C or elsewhere on the return but did not pay self-employment tax. d. The taxpayer had unreported self-employment income. These errors resulted in an underassessment of self-employment tax.	137	23%
2. The tax examiner either did not enter an income identity code or entered the incorrect income identity code. When the income identity code (stating whether the income belongs to the primary or secondary taxpayer) is not entered by the tax examiner, this results in an underassessment of self-employment tax (because the AUR system will not calculate self-employment tax when there is no code entered). If the wrong income identity code was entered, this could result in either an overassessment or underassessment of self-employment tax depending on each case.	77	13%
3. The tax examiner did not enter the negative amount from the Schedule C into the self-employment tax window. Currently, the programming in place within the AUR system does not automatically populate negative numbers; therefore, tax examiners have to manually enter negative amounts. This would result in an overassessment of self-employment tax.	186	31%
4. The tax examiner entered something incorrectly in the self-employment tax window on the AUR system. This could result in either an overassessment or underassessment of self-employment tax depending on what was entered incorrectly.	112	19%
5. The tax examiner calculated self-employment tax and included the self-employment tax proposal on the notice when the taxpayer did not owe self-employment tax. This would result in an overassessment of self-employment tax.	35	6%
6. The self-employment tax amount was off by \$1 due to rounding, and IRS procedures require that the tax examiner fix any rounding errors in order to avoid causing confusion to the taxpayer.	48	8%
7. We were unable to determine the reason for the error due to the notice reviewer not leaving a detailed enough description.	14	2%
Of all the reasons above, total instances for which the notice reviewer indicated that the error was a direct result of the tax examiner not handling the information on line 21 correctly (either assessing self-employment tax when it was not owed or not assessing self-employment tax when it was owed).	83	14%

Source: TIGTA analysis of notice review results.

⁶⁴ The chart reflects the sum total of errors reported by each campus except the campus that was correcting errors and not reporting them. TIGTA computed the error rates for this campus based on a 100 percent physical inspection of the paper file reviews.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

The errors included both overstatements and understatements of tax liabilities. We could not quantify the monetary impact of these mistakes because the IRS does not keep such records, but we estimate that over 23,000 taxpayers were burdened when they were sent inaccurate notices proposing an incorrect amount of self-employment taxes. Additionally, during our interviews of tax examiners and managers at two campuses, we asked what types of errors tax examiners make when working self-employment tax cases, and these same examples were given by many different AUR employees. Therefore, the notice review is finding common errors that are also being observed by tax examiners and managers at the campuses.

In addition to the notice review (completed by notice reviewers for the purpose of perfecting the quality of the CP 2000 notices sent to taxpayers), a small sample of the work performed by all AUR tax examiners is selected for the EQRS review (completed by leads and managers for the purpose of evaluating tax examiners' performance), and another small sample is selected for the NQRS review (completed by Headquarters for the purpose of evaluating the overall quality of the program). Unlike the notice review, EQRS and NQRS reviews can also include cases that were screened out (not issued a notice) in addition to cases for which a notice was issued in order to evaluate the tax examiner's actions on the case. However, the EQRS and the NQRS reviews are quality reviews and are not intended to reflect managerial approval of the actions taken on the case. We reviewed the EQRS and NQRS results that pertained to the tax computations completed by AUR tax examiners for the past five fiscal years. Figure 7 shows the results of the EQRS and NQRS reviews.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Figure 7: EQRS and NQRS Results for FYs 2013 Through 2017⁶⁵

		FY 2013	FY 2014	FY 2015	FY 2016	FY 2017	Average ⁶⁶
Notices and Screen-Outs Within AUR⁶⁷		6,947,983	6,688,700	6,067,214	5,765,059	5,471,676	6,188,126
EQRS Review Results							
All EQRS Reviews	Total Cases	42,044	37,295	26,457	25,499	26,177	31,494
	Percentage	0.6%	0.6%	0.4%	0.4%	0.5%	0.5%
Tax Computation Errors	Total Cases	1,014	722	389	468	756	670
	Percentage	2.41%	1.94%	1.47%	1.84%	2.89%	2.13%
Incorrect SE Tax	Total Cases	207	232	79	93	205	163
	Percentage	20%	32%	20%	20%	27%	24%
Incorrect Line 21 SE Tax	Total Cases	45	63	10	14	39	34
	Percentage	22%	27%	13%	15%	19%	21%
NQRS Review Results							
All NQRS Reviews	Total Cases	2,765	2,948	2,975	1,738	2,133	2,512
	Percentage	0.03%	0.03%	0.05%	0.05%	0.05%	0.04%
Tax Computation Errors	Total Cases	49	49	41	25	30	39
	Percentage	1.77%	1.66%	1.38%	1.44%	1.41%	1.54%
Incorrect SE Tax	Total Cases	12	8	3	6	4	7
	Percentage	24%	16%	7%	24%	13%	17%
Incorrect Line 21 SE Tax	Total Cases	2	3	1	2	0	2
	Percentage	17%	38%	33%	33%	0%	24%

Source: TIGTA analysis of EQRS and NQRS Paper Quality Review Results and the historical productivity rates within the AUR program. SE = Self-Employment.

⁶⁵ For each row under EQRS Review Results, the percentage is computed as a percentage of the category above it. So for All EQRS Reviews, the percentage is calculated using Notices and Screen-Outs Within AUR; for Tax Computation Errors, the percentage is calculated using All EQRS Reviews; for Incorrect SE Tax, the percentage is calculated using Tax Computation Errors; and for Incorrect Line 21 SE Tax, the percentage is calculated using Incorrect SE Tax. This same methodology is used for NQRS Review Results figures. The tax errors and incorrect calculations were made by IRS examiners when working the cases.

⁶⁶ This is a five-year average of the years presented. The percentages shown in this column were calculated using the actual (unrounded) averages, whereas the rounded figures are shown above. For example, the 1.54% Tax Computation Error percentage was calculated by taking the unrounded average of All NQRS Reviews (2,511.8 total cases) divided by the unrounded average of the Tax Computation Errors (38.8 total cases). $38.8/2,511.8 = 0.015447089736444$ or 1.54 percent.

⁶⁷ The “Notices and Screen-Outs Within AUR” for each fiscal year was determined by adding together the “Screen Outs” and “Notices Issued” from the AUR historical productivity rates captured on the AUR Work Plan. However, it is possible that there are other letters and case actions that an AUR tax examiner can take that would be subject to



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

The EQRS and NQRS results demonstrate that errors relating to self-employment tax are not new; AUR tax examiners have consistently been making errors relating to self-employment tax on cases. In addition, depending on the timing of the review and at what point in the AUR process the case is selected, the NQRS and EQRS may select cases that were already subject to the notice review. Therefore, it is possible that EQRS and NQRS cases may have included errors that were already corrected during the notice review. Also, as previously discussed, the EQRS has other limitations, such as some managers always conducting their EQRS reviews the same time every month (which allows tax examiners to know when they need to do their best work). This could skew the results of the EQRS to reflect higher quality than what actually exists. Given all of these limitations, we believe the notice review results are more reflective of the quality of the AUR program's work.

The IRS's mission is to provide top quality service and apply the tax law with integrity and fairness to all. Sending an accurate and complete notice to the taxpayer is important. Incorrect notices result in increased taxpayer burden and unnecessary delays in resolving issues, thus violating the rights of the taxpayer. Further, failure to correctly identify, calculate, and assess self-employment tax creates a system that is unfair to the taxpayers who voluntarily comply with the law. The AUR program sent thousands of incorrect CP 2000 notices to taxpayers. During FY 2017, we estimate that 423,695 incorrect CP 2000 notices were sent to taxpayers, of which 23,481 included an error in the amount of self-employment tax proposed.⁶⁸

Additionally, sending a correct CP 2000 notice to the taxpayer is important for revenue protection. If self-employment tax is omitted from the original CP 2000 notice that is sent to the taxpayer (or if any other type of noncompliance is not addressed on the notice), IRS policy does not permit the AUR program to go back and correct that notice to later assess the self-employment tax *unless the taxpayer raises the issue*.⁶⁹ The AUR employees we interviewed told us that if the tax examiner were to go back and attempt to assess the self-employment tax that is owed, it would be considered harassing the taxpayer. This makes the notice review and corrections that result from the review all that more important.

*****2*****
*****2*****, **and employees rarely refer questionable subsequent deductions to the Examination function**

According to the position description, AUR tax examiners are expected to determine the acceptability of the taxpayer's explanations and to make determinations using sound judgement concerning taxpayers' data. However, IRS procedures make it clear that AUR tax examiners are

the EQRS or NQRS reviews and are not reflected in this total. Therefore, we believe that the percentage reviewed is a low estimate, because not all situations were considered in our population.

⁶⁸ Notices sent during FY 2017 were for TYs 2014 and 2015.

⁶⁹ IRM 4.19.3.21(2) (September 30, 2014).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

not auditors.⁷⁰ Therefore, they are not permitted to audit a taxpayer’s return, conduct audit-related research, or use their judgement when assessing the acceptability of taxpayer explanations or referring the case to other IRS functions such as the Examination function. Instead, AUR employees believe the role of the AUR program is to educate taxpayers of their filing requirements. However, in our interviews with AUR tax examiners, some expressed frustration that taxpayers often use questionable explanations during the response and reconsideration phases to avoid additional assessments. For example:

- Taxpayers can claim that the Form 1099-K (or Form 1099-MISC) they received was fake or erroneous and that they did not earn that income. They can ask the AUR program to contact the payer on their behalf. In these instances, the tax examiner will send a letter to the payer asking them to verify the information on the Form 1099. *****2*****
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*****71 *****2*****
*****2*****
*****2***** However, AUR Headquarters does not track how often this occurs or how many of these letters are mailed to payers.
- Taxpayers often do not report the Form 1099-K or Form 1099-MISC income on their original returns, but after receiving the CP 2000 notice, they file an amended return on which they add new expenses that result in a refund. *****2*****
*****2*****
*****2***** AUR procedures advise tax examiners to “Avoid ‘auditing’ returns.”⁷² Further, referrals pertaining to these amended returns are only made to the Examination function when certain thresholds, referred to as “Category A” criteria, are met.⁷³ These thresholds are relatively high, which limits the number of referrals made. For example, a referral cannot be made for self-employment taxes if the amount of questionable income is less than \$15,000 and no self-employment taxes were paid.⁷⁴ AUR management advised us that they do not keep track of how many Category A referrals were made to the Examination function.
- Taxpayers may claim that someone else was using their online payment account (such as PayPal or other TPSOs) and, therefore, the other person needs to pay the tax (or may have already reported the Form 1099-K income on his or her own return). ****2***
*****2*****

⁷⁰ IRM 4.19.3.2(2) (December 15, 2017).
⁷¹ IRM 4.19.3.21.7.5 (July 17, 2017).
⁷² IRM 4.19.3.2(2) (December 15, 2017).
⁷³ IRM 4.19.3.21.1.19 (May 7, 2018).
⁷⁴ IRM 21.5.3-2 (February 8, 2018).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

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*****2***** Additionally, they generally do not refer these cases to the Examination function.

Tax administration is negatively affected when AUR examiners are unable to use sound judgement when assessing the acceptability of taxpayers' responses or referring suspicious cases to the Examination function. If taxpayers are able to make egregious claims that are not addressed by the IRS, they may continue to commit the same type of noncompliance in future years.

Recommendations

The Commissioner, SB/SE Division, should:

Recommendation 3: Revise Internal Revenue Manual (IRM) procedures with additional information and examples to clarify when tax examiners should enter a note on the AUR system justifying the reason why they are screening out cases.

Management's Response: The IRS agreed with the recommendation and will update IRM 4.19.3 with additional information and examples to clarify when tax examiners should enter a note on the AUR system justifying the reason cases are screened out.

Recommendation 4: Evaluate case selection practices for Category 50 cases, such as the feasibility of systemically determining whether the income on line 21 is subject to self-employment tax, to reduce the current screen-out rate.

Management's Response: The IRS agreed with the recommendation and has already implemented changes to Category 50 case selection.

The IRS did not agree with the measurable impact (outcome measure) that our recommended corrective action will have on tax administration. IRS management stated that due to system limitations, not all tax return and/or information return data are available for AUR case selection, and they select AUR inventory based on historical results of individual category types. The IRS clarified that screen-out does not necessarily mean that the case was improperly selected, and there are many factors that lead to a screen-out, such as the following: the tax examiner verified that the unreported income was reported elsewhere on the return, the IRS received an amended return after

⁷⁵ IRM 4.19.3.21.4.1 (September 4, 2015).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

the original return was selected, or conditions are present which prevent the IRS from taking action on the return.

Office of Audit Comment: Taking steps during case selection to ensure that the most productive cases are selected and to reduce the screen-out rate will result in an increase in revenue because selected cases that are ultimately screened out cannot result in any revenue for the IRS; whereas, a selected case that results in a notice being sent to the taxpayer can result in revenue.

Recommendation 5: Consider programming changes in the AUR system to automatically populate the self-employment tax window (including situations in which taxpayers have negative numbers on their return) for electronically filed returns as well as add additional prompts and reminders concerning line 21 and the need to fill out the income identity code.

Management's Response: The IRS partially agreed with the recommendation and will request a systemic message on cases when an amount is present on Form 1040, line 21: "CAUTION: Income reported on line 21 - SE Tax may be required - See IRM 4.19.3." However, the IRS does not agree to more resource-intensive programming changes.

Office of Audit Comment: Many of the errors pertaining to self-employment tax that were identified by the AUR quality reviews were caused by AUR employees either forgetting to enter information or entering incorrect information in the self-employment tax window of the AUR system. These errors can lead to the IRS not assessing self-employment tax when it is owed or proposing that the taxpayer owes the incorrect amount of self-employment tax on the CP 2000 notice. Therefore, additional programming changes to mitigate the risk of human error would be beneficial to improve taxpayer compliance and the accuracy of the notices the AUR program sends to taxpayers.

Recommendation 6: Adopt more uniform processes for the notice review that include capturing additional details beyond the error code, a revised process for selecting and ensuring that the notice reviewers are qualified tax examiners, and oversight of the notice review cases when no error is identified.

Management's Response: The IRS agreed with the recommendation and will review existing guidance and strengthen it where necessary.

Recommendation 7: Begin overseeing the notice review process to ensure that campuses are creating and implementing corrective actions to address notice errors and monitoring whether those corrective actions reduce each campus's error rate.

Management's Response: The IRS agreed with the recommendation and has made changes to achieve more uniform reporting of notice review data. Each week, an AUR Headquarters Policy analyst is now evaluating the results of the reviews and action plans,



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

and if concerns are noted, the analyst is to contact the campus sites. Each AUR campus is to engage in quality improvement initiatives based on the results of the reviews.

The IRS did not agree with the measurable impact (outcome measure) that our recommended corrective action will have, stating that it was unable to validate the calculation of the 26 quality review results that were changed to reflect a lower error rate.

Office of Audit Comment: In order to make this determination, we inspected the source documentation for all FY 2017 quality notice reviews at one AUR campus where employees were correcting the errors identified during the notice review so that they could stay below the 10 percent threshold that would have required an action plan for improvement. A campus official acknowledged this practice, and the evidence clearly shows the practice occurred during 26 quality reviews.

Recommendation 8: Require managers and leads to vary when they select cases for the EQRS review so that the employees they are evaluating cannot anticipate when the review will occur.

Management's Response: The IRS agreed with the recommendation and will review current guidance and update it, if necessary. Management will also remind personnel of the proper approach to reviews.

Recommendation 9: Using the tax examiner's existing authority as described in the position description to determine the acceptability of taxpayers' explanations, change guidance that currently requires examiners to accept many taxpayer explanations and allow tax examiners to assess the credibility of taxpayer responses, especially in the cases of suspicious expenses or taxpayers claiming information returns are fake or that the income belongs to another taxpayer.

Management's Response: The IRS agreed with the recommendation and will use continuing professional education and an AUR System Message of the Day to emphasize the ability of AUR employees to exercise their discretion and make referrals of suspicious information to the Examination function for an in-depth review.

The Emergence and Expansion of the Gig Economy Has Expanded the Information Reporting Gap

As was described in the Background section of this report, when there is substantial information reporting, income reporting compliance is 93 percent, and when there is little or no information reporting, tax compliance is 37 percent. Thus, enhanced information reporting reduces the Tax Gap, and shrinking information reporting increases the Tax Gap.

Prior to the emergence of the gig economy, most workers who engaged in independent, contingent work received a Form 1099-MISC reporting their income. I.R.C. § 6041(a) generally requires persons engaged in a trade or business and paying rents, salaries, compensations, and other gains, profits, and income of \$600 or more to report the payment (to the IRS and the



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

recipient) on Form 1099-MISC.⁷⁶ For tax years before Calendar Year 2011, Form 1099-MISC was used to report amounts paid to all independent contractors. However, as subsequently described further, the enactment of I.R.C. § 6050W and the related Treasury Regulations resulted in certain types of businesses sending Forms 1099-K to independent contractors (and to the IRS), but only if they received in excess of \$20,000 and engaged in more than 200 transactions during the year.

I.R.C. § 6050W was intended to increase information reporting and tax compliance by providing the IRS with payment card information on businesses. With this information, the IRS could compare amounts reported by business taxpayers on their tax returns with amounts those business taxpayers earned through payment card transactions. In a FY 2017 report, TIGTA reported that the IRS was underutilizing the payment card information to select cases for audit.⁷⁷

I.R.C. § 6050W established two different information reporting standards. Under I.R.C. § 6050W, merchant acquiring entities are required to report the gross amount of all reportable payment transactions on Form 1099-K. The most common example of a merchant acquiring entity is a bank with a contractual obligation to pay businesses for sales of goods or services, *i.e.*, a bank that pays merchants for the goods or services bought by consumers with a credit card.⁷⁸ A different information reporting standard was established for businesses that are considered to be TPSOs. A TPSO has to report to the IRS payments to a taxpayer only if it paid the taxpayer more than \$20,000 and the taxpayer has more than 200 transactions in a year. The TPSO thresholds are referred to as *de minimis* payments. The most common example of a TPSO (at the time I.R.C. § 6050W was enacted) was an online auction payment facilitator, which operates merely as an intermediary between buyer and seller by transferring funds between accounts in settlement of an auction or purchase.⁷⁹

Businesses that would have had an information reporting obligation under I.R.C. § 6041(a) do not have that obligation if they are covered under the I.R.C. § 6050W reporting standards. A “tie-breaker” rule was provided in the Treasury Regulations to provide that if both I.R.C. § 6041 and I.R.C. § 6050W apply, then payees are to follow I.R.C. § 6050W. For TPSOs, the tie-breaker rule is determined without regard to the *de minimis* thresholds, meaning that even though a TPSO may have had an information reporting obligation at the \$600 threshold, it only has that obligation at the \$20,000 and 200 transaction threshold under I.R.C. § 6050W.

The legislative history of I.R.C. § 6050W does not make clear why Congress established *de minimis* thresholds for TPSOs but not for merchant card acquiring entities. However, given that the main purpose of the law was to give the IRS merchant card data on businesses and that (at the time the law was enacted) TPSOs were thought most commonly to be online auction

⁷⁶ I.R.C. § 6041(a).

⁷⁷ TIGTA, Ref. No. 2017-30-083, *The IRS Is Underutilizing Form 1099-K Data to Identify Tax Returns for Audit* (Sept. 2017).

⁷⁸ Treas. Reg. § 1.6050W-1(e), Example 1 pertaining to merchant entities.

⁷⁹ IRS Frequently Asked Questions, I.R.C. § 6050W, p. 1.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

facilitators, information pertaining to *de minimis* auction sales may have been deemed of lesser value to tax administration (since sales of goods online would not necessarily be taxable to the seller) than information pertaining to all payments to merchants via credit card.⁸⁰

With the emergence of the gig economy in recent years, a more common example of a TPSO may be an online platform business. Many gig economy platforms consider themselves to fall within the definition of a TPSO and therefore only issue Forms 1099-K to taxpayers who earn more than \$20,000 and have more than 200 transactions in a year. In this way, the expanding gig economy has expanded the information return gap because more workers are earning income that is not subject to information reporting.

To put this into the context of the gig economy, if a taxpayer is earning income as a driver through a ride-sharing platform, the taxpayer would have to both earn at least \$20,000 in payment for services and provide a minimum of 200 rides in a year before the online platform business, *i.e.*, TPSO, would have an information reporting obligation. In such cases, the TPSO is required to send both the taxpayer and the IRS a Form 1099-K listing the total amount of payments made during the year. An IRS official confirmed the IRS's view that many of the gig economy online platform businesses fall under the definition of a TPSO. This means that it is possible for taxpayers who participate in these platforms to receive income in excess of the \$20,000 threshold that will not be reported to the IRS on an information return as long as they have less than 200 transactions during that year. Additionally, taxpayers can work for multiple online platform businesses, thus remaining under the \$20,000/200 transaction thresholds for each of them and earning significantly above \$20,000 in total while avoiding information reporting on their income.

Some confusion exists regarding I.R.C. § 6050W reporting obligations

The gig economy had not fully emerged at the time of the enactment of I.R.C. § 6050W or the promulgation of the accompanying Treasury Regulations. Generally, examples in the Treasury Regulations are helpful to taxpayers and practitioners because they use hypothetical taxpayer situations in somewhat less complicated language to illustrate the application of the law to different facts. However, none of the examples in the regulations pertaining to I.R.C. § 6050W address the online platform business model.

Commentators have noted that there is confusion about how gig economy platforms should report payments to both the IRS and to taxpayers, and some gig economy platforms may be taking advantage of the confusion by asserting erroneously that they satisfy the definition of a TPSO with a \$20,000 reporting threshold. This confusion is partly reflected in the fact that some companies in the gig economy ridesharing business had staked out different positions about

⁸⁰ Under I.R.C. § 1001, sales of property are taxable at the sale price less adjusted basis. See Maricel P. Montaro, *Can Widening the Scope of Information Reporting to Include Income Derived from Online Sales Help to Narrow the Expanding Tax Gap?*, 83 S. Cal. L. Rev. 379, 393 (2010), discussing the limited usefulness of these information returns because the adjusted basis can only be determined by audit.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

whether to be treated as a TPSO even though the business models were the same.⁸¹ The Information Reporting Program Advisory Committee, an independent Federal advisory committee that provides an organized public forum for discussion of information reporting issues, has recommended such clarification in their past few reports, including in 2017. This committee recommends further guidance for I.R.C. § 6050W because various terms such as “third-party payment network” are ambiguous and need to be further defined. Much of the confusion to taxpayers comes from the fact that currently there are not many resources available to answer the question of how a payer (such as one of the gig economy online platform businesses) should report payments under I.R.C. § 6050W.

Some of the confusion about how to report under I.R.C. § 6050W may arise from the inclusion in the statute of these special intermediary reporting rules. In particular, there is significant overlap between the definition of aggregated payee and the definition of TPSO in the statute. This overlap in definitions may be significant to taxpayers, because aggregated payees report without regard to a reporting threshold (meaning they must report any income earned, no matter how small of a dollar amount), and TPSOs report only when their payments to a payee for the year exceed \$20,000 and 200 transactions. Therefore, taxpayers are burdened by having to first interpret the overlap in the statute before determining how they should report under I.R.C. § 6050W.

The IRS Office of Chief Counsel is aware of this confusion and overlap between the definitions, and it believes that published guidance could clarify the definitions of the different groups of payers who are subject to the different thresholds (*i.e.*, aggregated payee versus TPSO) so long as the clarification is consistent with the statutory language. However, currently no guidance has been issued. The office has issued Private Letter Rulings to a number of taxpayers who have requested a ruling that they are a TPSO; however, these rulings are binding only with respect to the taxpayers who requested them. Information specific to the taxpayers is frequently redacted. Each Private Letter Ruling is limited to the facts of the taxpayer’s specific situation on which IRS Counsel was asked to opine and does not go beyond that to provide additional clarity. As such, Private Letter Rulings are not binding guidance for others to cite for authority, and they do not provide the necessary legal clarification. It is also unrealistic to expect all taxpayers to request a Private Letter Ruling as they are burdensome in terms of cost and the time they must wait in order to receive the ruling.

The impact on taxpayer compliance of the difference between these varying reporting thresholds and how a payer classifies themselves under I.R.C. § 6050W is significant. Taxpayers who earn income in the gig economy may not understand the tax obligations of their activities or that they may owe self-employment tax. This misunderstanding or unawareness of tax liabilities is further compounded if the taxpayer does not receive a tax form, such as any Form 1099-K, from the online platform company.

⁸¹ For example, see Shu-Yi Oei and Diane M. Ring, *Can Sharing Be Taxed?*, 93 Wash. U. L. Rev. 989, 1042 (2016).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

As we previously described, income reporting compliance is much higher when there is information reporting. Therefore, taxpayers who do not receive a Form 1099-K due to not meeting the high thresholds are much more likely to misreport their income on their tax return than those taxpayers who do receive a Form 1099-K. Misreporting of income greatly contributes to the underreporting portion of the Tax Gap.

To illustrate the effect of the \$20,000 reporting threshold and how a payer classifies themselves under I.R.C. § 6050W, we compared the Form 1099-K issuance history of three gig economy platform companies that do not strictly follow the \$20,000 reporting threshold established in I.R.C. § 6050W. Figure 8 demonstrates how many Forms 1099-K would have been issued for TY 2016 if the companies followed varying reporting thresholds.

Figure 8: Forms 1099-K Issuances Using Various Reporting Requirements for Three Gig Economy Platforms⁸²

	Number of Forms 1099-K	Total Amount
Actual Forms 1099-K Issued	2,401,813	\$10,738,487,079
\$20,000 Reporting Threshold	130,682	\$4,898,548,602
\$600 Reporting Threshold	1,471,289	\$10,547,421,534

Source: TIGTA analysis of data obtained from the Information Returns Master File.

In TY 2016, these three gig economy platform companies (not following the strict TPSO thresholds in I.R.C. § 6050W) filed 2.4 million Forms 1099-K involving \$10.7 billion of income. Conversely, if these platforms had reported as TPSOs as most other technology-based platforms are, they would have reported 130,682 Forms 1099-K involving \$4.9 billion of income. If these platforms had elected to report in this manner, the IRS would not have been provided income information for 2.3 million (95 percent) taxpayers earning income in the gig economy from these platforms, involving \$5.8 billion of income (54 percent). IRS Tax Gap studies estimate that when third parties do not provide information to the IRS, 63 percent of income is misreported. Projecting that figure to this example would have resulted in an estimated \$3.7 billion of misreported Form 1099-K payments for these three companies alone.

Considering these three companies represent only a fraction of the larger gig economy and that the expansion of online service providers will likely continue, the importance of providing these taxpayers with guidance on how to classify themselves under I.R.C. § 6050W is clear. Further, the information reporting gaps created by the emergence of the gig economy may require regulatory or legislative action.

⁸² Includes only Forms 1099-K issued to a valid Social Security Number or Employer Identification Number.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

The SB/SE Division Examination function's Field Case Selection management informed us that without information reporting (such as instances in which a Form 1099-K is not issued because of the thresholds), they have no way of identifying taxpayer noncompliance for case selection unless they receive a referral from one of various sources such as from States or information referrals that may include self-employment income not reported on a Form 1099-MISC or Form 1099-K. In addition, the AUR program can identify and work cases of self-employment tax noncompliance when the taxpayer did not receive a Form 1099-K if the taxpayer actually reported the income they earned.

The IRS is beginning to assess the impact of the Forms 1099-K reporting threshold. A Joint Statistical Research Program project recently began analyzing the contingent workforce.⁸³ One of the objectives of this study is to determine the size of the Form 1099-K reporting gap. An excerpt from the proposal for this project states:

The 1099-K 'Gap': A growing form of alternative work is online platform-based 'gig' work. Online intermediaries often report a 1099-K. Introduced in 2011, the 1099-K is subject to a higher minimum reporting threshold (\$20,000) compared with the 1099-MISC (\$600). We wish to test whether this reporting gap may lead to systematic nonfiling of 'gig' income on Schedule C. To estimate the size of the gap, we will exploit two features: (1) before the introduction of the 1099-K, a 1099-MISC would be issued; and (2) several platforms issue the 1099-K to individuals even if they are earning below the statutory threshold. We will calculate the probability of Schedule C reporting across 2010 and 2011, and across different EIN-minimum reporting thresholds.

These projects typically take two years to complete, and currently no updates are available on any findings.

The gig economy has grown considerably since the IRS last estimated the self-employment portion of the Tax Gap at \$69 billion, and each year thousands of new taxpayers will be responsible for self-employment taxes for income earned in the gig economy. Due to the various reporting requirements in the law and the varying voluntary reporting of income within the different gig economy companies, the risk of taxpayers underreporting income earned in the gig economy is high. Ultimately, third-party reporting of the income a taxpayer earns significantly affects whether or not the IRS can identify and address the noncompliance.

⁸³ The Joint Statistical Research Program within the Statistics of Income Division of the Office of Research, Applied Analytics, and Statistics organization seeks to increase use of its tax microdata by researchers outside the Federal government. Researchers who are selected into the program will partner with IRS staff on projects that advance the understanding of how existing taxes affect people, businesses, and the economy and provide new understanding of taxpayer behavior that can aid in the administration of the tax system.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Recommendations

The IRS Chief Counsel should:

Recommendation 10: Develop and issue guidance on how taxpayers should classify themselves under I.R.C. § 6050W.

Management's Response: The IRS disagreed with the recommendation, stating that clarifying how taxpayers should classify themselves under I.R.C. § 6050W must be done through a Treasury Regulation, which cannot be accomplished by IRS Chief Counsel alone. The IRS indicated that they have already opened a guidance project on this issue intended to clarify the definitions of third-party network and aggregated payee; however, the Department of the Treasury and Chief Counsel resources are focused on guidance in response to the Tax Cuts and Jobs Act⁸⁴ and identifying and reducing regulatory burdens in response to Executive Order 13789. The IRS further clarified that each year, the Department of the Treasury and Chief Counsel develop a priority guidance plan that has not yet included guidance under I.R.C. § 6050W, and until there is agreement to prioritize I.R.C. § 6050W guidance over other guidance projects, the IRS cannot provide an implementation date for when guidance might be issued under I.R.C. § 6050W.

Office of Audit Comment: The IRS does not appear to disagree with the substance of the recommendation, but rather indicates that it is the Department of the Treasury's responsibility to address. We believe that the IRS should work with Treasury officials on this recommendation at the same time they address the recommendation below.

Recommendation 11: Work with the Treasury Office of Tax Policy to pursue regulatory or legislative change relating to the third-party reporting thresholds established in I.R.C. § 6050W.

Management's Response: The IRS agreed with the recommendation and will discuss with the Treasury Office of Tax Policy the need for legislative action on this point.

⁸⁴ Pub. L. No. 115-97. Officially known as "An act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for Fiscal Year 2018."



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Appendix I

Detailed Objective, Scope, and Methodology

Our overall objective was to evaluate the compliance of taxpayers who earn income in the gig economy with their self-employment tax requirements and assess the AUR program's processes and controls that identify and address noncompliance with self-employment tax requirements.¹ To accomplish this objective, we:

- I. Identified IRS procedures, processes, reports, and studies relating to the AUR program's identification of self-employment tax noncompliance and the gig economy.
 - A. Researched and reviewed applicable IRM sections.
 - B. Interviewed SB/SE Division Examination function employees.
 - C. Researched current and pending legislation related to third-party reporting requirements.
 - D. Reviewed the IRS's "Sharing Economy Tax Center" web page and related information.
- II. Assessed the compliance rate of gig economy taxpayers and the AUR program's ability to successfully identify and address self-employment tax noncompliance relating to the gig economy.
 - A. Completed data analysis on the population of Forms 1099-K, *Payment Card and Third Party Network Transactions*, issued by gig economy companies for the past few years and determined if taxpayers reported the income and payed self-employment tax.
 - B. Determined if any taxpayers in the population identified in Step II.A. were identified or selected by the AUR program due to noncompliance related to the Form 1099-K.
 - C. Evaluated the case selection procedures for the AUR program and determined if they are sufficient to identify gig economy self-employment tax noncompliance and enable such cases to be selected and worked.

¹ See Appendix V for a glossary of terms.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

- III. Assessed the AUR program's manual work process and determined if AUR tax examiners are assessing self-employment taxes on cases when appropriate.
- A. Conducted site visits to the AUR program offices in Philadelphia, Pennsylvania, and Ogden, Utah, and interviewed employees.
 - B. Completed data analysis on a population of screened-out AUR self-employment tax, merchant card and third-party network payments, and nonemployee compensation cases from TY 2013 in order to assess the tax examiner's actions.
 - C. Reviewed results of the three AUR quality reviews currently in place and evaluated if they are sufficient in ensuring that AUR examiners are assessing self-employment taxes on cases when appropriate.
 - D. TIGTA's contracted statistician assisted in projecting the results of the AUR notice review. Critical error projections were based on a 10.49 percent estimated population exception rate, a ± 0.21 percent weighted strata precision, and a 95 percent confidence interval. Noncritical error projections were based on a 6.59 percent estimated population exception rate, a ± 0.21 percent weighted strata precision, and a 95 percent confidence interval. Total error projections were based on a 16.33 percent estimated population exception rate, a ± 0.31 percent weighted strata precision, and a 95 percent confidence interval. Self-employment tax projections were based on a 0.91 percent estimated population exception rate, a ± 0.07 percent weighted strata precision, and a 95 percent confidence interval.
- IV. Validated all data obtained to complete Steps II. and III. by running queries on the population to ensure that the data met our criteria and no information was missing or incomplete. We also matched to the information found on the Integrated Data Retrieval System (*e.g.*, the number of Forms 1099-K issued by a company, the total Forms 1099-K dollar amount). Our validation supported that the data were sufficiently reliable and could be used to meet the objective of this audit.

Internal controls methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined that the following internal controls were relevant to our audit objective: the SB/SE Division Examination function's policies, procedures, and practices related to determining a taxpayer's compliance with their self-employment tax obligations. We evaluated these controls by interviewing IRS management and Examination function employees as well as conducting data analysis.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Appendix II

Major Contributors to This Report

Mathew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Carl Aley, Director
Phyllis Heald London, Acting Director
Richard Viscusi, Audit Manager
Nicole DeBernardi, Lead Auditor
Joshua Perry, Auditor
Amy Coleman, Data Liaison (Data Analytics)



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Appendix III

Report Distribution List

Deputy Commissioner for Services and Enforcement
Commissioner, Small Business/Self-Employed Division
Director, Examination, Small Business/Self-Employed Division
Director, Headquarters Exam, Small Business/Self-Employed Division
Director, Office of Audit Coordination



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to Congress.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$480,959,289 that could have potentially been assessed if the IRS had a strategic plan to address gig economy taxpayer noncompliance (see page 6).

Methodology Used to Measure the Reported Benefit:

Neither the AUR program¹ nor the Examination function addressed 134,089 individual taxpayers with a potential Form 1099-K, *Payment Card and Third Party Network Transactions*, discrepancy; all of these taxpayers received at least one Form 1099-K from one of nine gig economy payers in TYs 2012 through 2015. These cases involved potential discrepancies amounting to \$11,855,047,806 of merchant card and third-party network payments. For these individual taxpayers, we assume that the Form 1099-K income should have been reported on the taxpayer’s Schedule C, *Profit or Loss from Business (Sole Proprietorship)*. We calculated the average percentage of self-employment tax that taxpayers paid on their Schedule C gross income in TYs 2012 through 2015, shown in Figure 1.

Figure 1: Self-Employment Tax Paid on Schedule C Gross Income

	TY 2012	TY 2013	TY 2014	TY 2015
Schedule C Gross Income	\$1,299,759,131,000	\$1,339,489,379,000	\$1,397,510,585,000	\$1,451,530,524,000
Total Reported Self-Employment Tax	\$48,773,186,000	\$55,533,464,000	\$58,467,503,000	\$60,173,787,000
Average Percentage of Self-Employment Tax on Schedule C Gross Income	3.752%	4.146%	4.184%	4.146%
Four-Year Average Percentage of Self-Employment Tax on Schedule C Gross Income: 4.057%				

Source: TIGTA analysis of Publication 4801, *Individual Income Tax Returns Line Item Estimates*.

We applied the four-year average of self-employment tax reported on Schedule C gross income (4.057 percent) to the \$11,855,047,806 in potentially discrepant Form 1099-K payments. We

¹ See Appendix V for a glossary of terms.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

estimate that if the IRS had addressed these discrepancies and assessed self-employment tax on those payments, \$480,959,289 in self-employment tax could have potentially been assessed. Additionally, we would also expect to see an increase in Federal income tax revenue as a result of these discrepancies being addressed; however, this was not accounted for because this report is focused on underreporting of self-employment tax due. We also recognize that IRS resources would have to be shifted from other types of work in order to address gig economy taxpayer noncompliance, but the IRS does not have data available to accurately estimate the opportunity cost.

Type and Value of Outcome Measure:

- Increased Revenue – Potential; \$44,119,214 that could have potentially been assessed if more productive category 50 self-employment tax cases were selected to be worked by AUR tax examiners (see page 14).

Methodology Used to Measure the Reported Benefit:

From TY 2011 through TY 2013, 57 percent of all self-employment cases selected to be worked by the AUR program were screened out. When the cases were not screened out, only 45 percent were assessed self-employment tax; therefore, 55 percent were not assessed tax. In total, an average of 19 percent of all AUR program self-employment tax cases were assessed additional self-employment tax (11,955 of 61,534), while 81 percent (49,578 of 61,534) were not assessed self-employment tax. Figure 2 shows that self-employment tax cases were screened out at a high rate. It also shows the average amount of self-employment tax assessed per case for those that were not screened out (and for which the tax examiner made an assessment).

**Figure 2: Self-Employment Tax (Category 50)
Cases Screened Out by AUR Employees**

	TY 2011	TY 2012	TY 2013	Three-Year Average
SE Tax Cases Selected to Be Worked	39,224	89,270	56,107	61,534
SE Tax Cases Screened Out	22,902	46,888	35,013	34,934
Screen-Out Rate	58%	53%	62%	57%
SE Tax Cases Not Screened Out	16,322	42,382	21,094	26,599
SE Tax Cases With Assessed SE Tax	7,359	18,970	9,537	11,955
Percentage of Worked Cases With SE Tax Assessed	45%	45%	45%	45%
Total SE Tax Assessed	\$15,005,465	\$52,717,362	\$33,055,540	\$33,592,789
Average Amount of SE Tax Assessed Per Case	\$2,039	\$2,779	\$3,466	\$2,810

Source: TIGTA analysis of AUR program data provided by the IRCS program team. SE = Self-Employment.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

To calculate the average amount of self-employment tax assessed per case, we took the total amount assessed divided by the number of cases for which self-employment tax was assessed. For example, for TY 2013, \$33,055,540 divided by 9,537 equals \$3,466. The average amount per case for the three-year time frame was then calculated (\$2,810). We estimate that if the three-year average of 34,934 category 50 cases that were screened out had been more productive (better selected) cases that did not need to be screened out, 45 percent (the three-year average of the number of cases that were not screened out that were assessed self-employment tax; *i.e.*, 15,702 cases) would have been assessed self-employment tax. If those 15,702 cases were assessed \$2,810 in self-employment tax each (the three-year average of self-employment tax assessed per case), the AUR program could have potentially assessed \$44,119,214 more in self-employment taxes on TY 2013 category 50 cases.²

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 272,147 taxpayers who may have been sent a CP 2000 notice from the AUR program with incorrect balances due (see page 14).

Methodology Used to Measure the Reported Benefit:

Each AUR campus conducts a weekly notice review on a statistically valid sample of the scheduled CP 2000 notice mail-out.³ In FY 2017, the total yearly sample size for the entire AUR program was 80,761 CP 2000 taxpayer notices, of which 8,410 were found to have critical errors (meaning the total balance due on the notice was incorrect). We projected the error rate (8,410 of 80,761 notices = 10.49 percent⁴) to the total population (provided by the IRS) of 2,594,437 CP 2000 notices mailed out in FY 2017 to arrive at 272,147 CP 2000 notices with incorrect balances due sent to taxpayers from the AUR program. Based on a precision rate of ± 0.21 percent, we are 95 percent confident that the range of potential incorrect notices is between 266,661 and 277,632.

Type and Value of Outcome Measure:

- Reliability of Information – Potential; 26 quality review results that were changed to reflect a lower error rate (see page 14).

² The actual math for this calculation is $\$2,809.857999219320 \times 15,701.58148491610$ cases = \$44,119,214. Rounded figures are shown above.

³ The CP 2000 notice includes a description of the discrepancies that the tax examiner identified and a proposed tax change. The selection of sample notices is performed from all CP 2000 notice runs, with the exception of cases with sort codes, employee AUR cases, and CP 2000 notices posted after CP 2501 notices.

⁴ The sample was stratified by campus, and the stratification affects the calculation of the error rate due to the different populations, sample sizes, and error rates at each campus. TIGTA's contract statistician computed all the error rates and projections pertaining to the notice review.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Methodology Used to Measure the Reported Benefit:

Each campus is required to conduct the notice review weekly and submit the results to AUR Headquarters. If the error rate exceeds 10 percent in any week, the campus should also include an action plan to correct the behavior, and AUR Headquarters should provide its opinion as to whether or not the plan is appropriate for correcting the errors.⁵ At one AUR campus, employees were correcting the errors identified during the notice review and not reporting them so that they could stay below the 10 percent threshold that would have required an action plan for improvement. We inspected the source documentation for all FY 2017 quality notice reviews at this campus and determined that this practice occurred in 26 of 51 weeks for which a notice review took place; the number of errors not reported ranged from one error to 43 errors each week. Therefore, inaccurate notice review results were reported to both AUR Headquarters and TIGTA for this review.

⁵ IRM 4.19.3.22(8) (March 14, 2018).



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Appendix V

Glossary of Terms

Term	Definition
Assessment	A determination by the IRS that an amount of tax (including penalty, interest, <i>etc.</i> , if applicable) is owed by the taxpayer.
Automated Underreporter (AUR) Program	The AUR program matches items reported on an individual's income tax return to information supplied to the IRS from outside sources (<i>e.g.</i> , employers, banks, credit unions) to determine if the taxpayer's tax return reflected the correct amounts, ensuring that the tax amount is correct.
Automated Underreporter (AUR) System	Software that consists of various screens and windows that tax examiners use to perform an in-depth analysis of each case selected for the AUR program to work.
Calendar Year	The period of time from January 1 to December 31.
Campus	The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.
Computer Paragraph (CP)	Computer-generated notices and letters of inquiry that are mailed to taxpayers in connection with tax returns for the Business Master File and Individual Master File. CP numbers are located in the upper right corner of the notices and letters.
Embedded Quality Review System (EQRS)	A system designed to assist managers in measuring employees' individual performance as it relates to case activities. Employee performance is evaluated against attributes that are designed to identify actions which move cases toward closure through appropriate and timely case activity.
Employer Identification Number	A unique nine-digit number used to identify a taxpayer's business account.
Examiners	IRS employees who examine tax returns to determine whether taxpayers accurately reported their tax liabilities.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Term	Definition
Fiscal Year (FY)	Any yearly accounting period, regardless of its relationship to a calendar year. The Federal Government's fiscal year begins on October 1 and ends on September 30.
Individual Income Tax Returns	Form 1040, <i>U.S. Individual Income Tax Return</i> , series are annual income tax returns filed by citizens or residents of the United States.
Individual Return Transaction File	An IRS database that maintains data transcribed from initial input of the original individual tax returns during return processing.
Information Reporting and Document Matching Case Inventory Selection and Analytics (IRDM CISA) System	An SB/SE Division Compliance function application used to identify discrepancies in tax return money amounts and create a universe of potential underreported cases. The IRCS program team is the group within SB/SE Division's Examination function that handles case selection for the AUR program.
Information Returns Master File	Contains information return data for the current year and prior six tax years.
Integrated Data Retrieval System	IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer's account records. This system shows historical information (original account balances, adjustments, payments, abatements) and current account status (fully paid, collections, suspended, etc.).
Internal Revenue Code (I.R.C.)	The codified collection of U.S. laws on income, estate and gift, employment, and excise taxes plus administrative and procedural provisions.
Internal Revenue Manual (IRM)	The primary, official source of instructions to staff relating to the organization, administration, and operation of the IRS.
National Quality Review System (NQRS)	A part of an integrated IRS-wide system of balanced performance measures. Performance is evaluated using attributes that identify actions which move cases toward closure through appropriate and timely case activity.
National Research Program	This program supports measurement of taxpayer compliance with Federal tax laws that require accurate reporting of tax liabilities, timely filing of returns, and timely and complete payment of taxes owed.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Term	Definition
National Taxpayer Advocate	An independent organization within the IRS to help taxpayers resolve problems with the IRS and recommend changes that will prevent the problems.
Notice	Computer-generated messages resulting from an analysis of the taxpayer's account on the Master File. These include notices of assessments of tax, adjustments, balances due, or overpayments that are refunded to taxpayers.
Small Business/Self-Employed Division	The IRS organization that services self-employed taxpayers and small businesses by educating and informing them of their tax obligations, developing educational products and services, and helping them understand and comply with applicable tax laws.
Social Security Number	The identifying number required on tax returns and other documents submitted to the IRS by an individual. A Social Security Number is composed of nine digits separated by two hyphens; for example, 123-45-6789.
Tax Forum	IRS-held event with seminars discussing Federal and State tax issues from top IRS subject matter experts and leading industry experts.
Taxpayer Identification Number (TIN)	A nine-digit number assigned to taxpayers for identification purposes. Depending upon the nature of the taxpayer, the TIN is an Employer Identification Number, a Social Security Number, or an Individual TIN.
Tax Year (TY)	A 12-month accounting period for keeping records on income and expenses used as the basis for calculating the annual taxes due. For most individual taxpayers, the tax year is synonymous with the calendar year.
Twitter	A social networking website that allows a user to share short messages or "tweets" that are visible to other users and can be only 280 characters or less in length.
YouTube	A popular video sharing website that allows users to upload videos for private or public viewing.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Appendix VI

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

December 21, 2018

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM:

Mary Beth Murphy 
Commissioner, Small Business/Self-Employed Division

SUBJECT:

Draft Audit Report –Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance (Audit #
201730014)

Thank you for the opportunity to review and comment on the subject draft report. In recent years, the gig economy has changed how people commute, travel, and perform many activities. The gig economy, also referred to as the sharing economy, allows people to utilize technology to facilitate transactions and generate income from items they own or services they provide. This rapidly evolving area of economy has tax implications for individuals who engage in these activities.

To help taxpayers meet their tax responsibilities, we launched the "Sharing Economy Tax Center" web page on irs.gov in August 2016. This page offers tips and resources on a variety of topics ranging from filing requirements and making quarterly estimated tax payments to self-employment taxes. During our 2016 and 2017 IRS Nationwide Tax Forums, tax experts discussed the implication of the gig economy for taxpayers. We also leveraged Twitter, Tumbler, and our IRS YouTube channel to increase communication and outreach with taxpayers on topics relevant to the gig economy.

Your report suggests that we could benefit from the development of a comprehensive strategic plan to address the gig economy as well as any potential noncompliance resulting from it. In November 2018, the Small Business/Self-Employed Division initiated an effort to develop and implement such a compliance strategy. As part of this endeavor, we plan to establish a single definition for the gig economy, perform demographic research on the population, and use internal and external data to identify significant compliance risk associated with this expanding economic sector. The strategy will address many of the issues identified in this report, including, but not limited to, information return reporting, non-filing of income tax returns, self-employment taxes, and worker classification issues. In addition, our communication plan and guidance plan will be assessed to determine what additional outreach is necessary.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

2

Your report includes several additional recommendations and outcome measures. We agree with most of your recommendations and have already begun to take corrective actions on several. However, we do not agree with your potential revenue increases.

Attached is a document detailing our responses to your recommendations and outcome measures. If you have any questions, please contact me or Brenda Dial, Director, Examination, Small Business/Self-Employed Division.

Attachment



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

Attachment

RECOMMENDATION 1:

The Deputy Commissioner for Services and Enforcement should develop a strategic plan to address tax administration for the gig economy, including the assessment and collection of self-employment tax, and consider developing initiatives such as pilots or soft notice programs geared towards gig economy workers with repeated noncompliance.

CORRECTIVE ACTION:

We agree with this recommendation. In November 2018, SB/SE initiated an effort to develop and implement a compliance strategy. As part of this effort, we will determine SB/SE examination and outreach opportunities to address non-compliance in the gig economy.

IMPLEMENTATION DATE:

April 15, 2020

RESPONSIBLE OFFICIAL:

Director, Exam Case Selection

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:

The Commissioner, SB/SE Division, should revise the repeater codes used in Automated Underreporter (AUR) case selection to account for more taxpayer situations, such as taxpayers who have a long history of high-dollar discrepancies and taxpayers who have the same type of discrepancy every year but have never been selected to be worked by the AUR program.

CORRECTIVE ACTION:

We do not agree with this recommendation. The IRS already has a repeater profile built into our current process. Adding additional repeater codes would add minimal value to our existing process. Additionally, Information Technology has advised it would be extremely difficult, timely, and costly to implement additional repeater codes.

IMPLEMENTATION DATE:

n/a

RESPONSIBLE OFFICIAL:

n/a



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

2

CORRECTIVE ACTION MONITORING PLAN:

n/a

RECOMMENDATION 3:

The Commissioner, SB/SE Division, should revise Internal Revenue Manual (IRM) procedures with additional information and examples to clarify when tax examiners should enter a note on the AUR system justifying the reason why they are screening out cases.

CORRECTIVE ACTION:

We agree with this recommendation. SB/SE will update IRM 4.19.3 with additional information and examples to clarify when tax examiners should enter a note on the AUR system justifying the reason cases are screened out.

IMPLEMENTATION DATE:

October 15, 2019

RESPONSIBLE OFFICIAL:

Director, Exam Field and Campus Policy

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 4:

The Commissioner, SB/SE Division, should evaluate case selection practices for Category 50 cases, such as the feasibility of systemically determining whether the income on line 21 is subject to self-employment tax, to reduce the current screen-out rate.

CORRECTIVE ACTION:

We have implemented this recommendation. Information Return Case Selection (IRCS) implemented changes to Category 50 (Self-Employment Tax) case selection in TY15.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

n/a



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

3

CORRECTIVE ACTION MONITORING PLAN:

n/a

RECOMMENDATION 5:

The Commissioner, SB/SE Division, should consider programming changes in the AUR system to automatically populate the self-employment tax window (including situations in which taxpayers have negative numbers on their return) for electronically filed returns as well as add additional prompts and reminders concerning line 21 and the need to fill out the income identity code.

CORRECTIVE ACTION:

We partially agree with this recommendation. SB/SE will request a systemic message on cases when an amount is present on Form 1040, line 21: "CAUTION: Income reported on line 21 – SE Tax may be required – See IRM 4.19.3." However, we do not agree to more resource-intensive programming changes.

IMPLEMENTATION DATE:

December 15, 2019

RESPONSIBLE OFFICIAL:

Director, Exam Field and Campus Policy

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 6:

The Commissioner, SB/SE Division, should adopt more uniform processes for the notice review that include capturing additional details beyond the error code, a revised process for selecting and ensuring that the notice reviewers are qualified tax examiners, and oversight of the notice review cases when no error is identified.

CORRECTIVE ACTION:

We agree with this recommendation. We will review existing guidance and strengthen, where necessary.

IMPLEMENTATION DATE:

February 15, 2019



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

4

RESPONSIBLE OFFICIALS:

Director, Exam Field and Campus Policy
Director, Exam Campus/AUR

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 7:

The Commissioner, SB/SE Division, should begin overseeing the notice review process to ensure that campuses are creating and implementing corrective actions to address notice errors and monitoring whether those corrective actions reduce each campus's error rate.

CORRECTIVE ACTION:

We agree with this recommendation. We have updated the FY 18 notice review tracker spreadsheet to achieve more uniform reporting of notice review data from AUR campuses. Each week, an AUR Headquarters Policy analyst evaluates the CP2000 Notice Review tracker, the results of reviews, and action plans. If concerns are noted, the analyst contacts the campus sites (see IRM 4.19.3.22, CP 2000 Notice Review). Each AUR campus engages in quality improvement initiatives based on the results of reviews.

IMPLEMENTATION DATE:

Implemented

RESPONSIBLE OFFICIAL:

Director, Exam Field and Campus Policy

CORRECTIVE ACTION MONITORING PLAN:

n/a

RECOMMENDATION 8:

The Commissioner, SB/SE Division, should require managers and leads to vary when they select cases for the Embedded Quality Review System review so that the employees they are evaluating cannot anticipate when the review will occur.

CORRECTIVE ACTION:

We agree with this recommendation. We already have guidance stating this recommendation approach is the preferred approach. We will review current guidance



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

5

and update, if necessary. We will also remind personnel of the proper approach to reviews.

IMPLEMENTATION DATE:

April 15, 2019

RESPONSIBLE OFFICIAL:

Director, Campus Examination/AUR

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 9:

The Commissioner, SB/SE Division, should, using the tax examiner's existing authority as described in the position description to determine the acceptability of taxpayers' explanations, change guidance that currently requires examiners to accept many taxpayer explanations and allow tax examiners to assess the credibility of taxpayer responses, especially in the cases of suspicious expenses or taxpayers claiming information returns are fake or that the income belongs to another taxpayer.

CORRECTIVE ACTION:

We agree with this recommendation. As your report notes, AUR tax examiners are expected to determine the acceptability of the taxpayers' explanations and to make determinations using sound judgement concerning taxpayers' data. However, AUR tax examiners are not auditors and are not permitted to audit a taxpayer's return. We will use continuing professional education (CPE) and an AUR System Message of the Day (MOD) to emphasize the ability of AUR employees to exercise their discretion and make referrals of suspicious information to Exam for an in-depth review.

IMPLEMENTATION DATE:

July 15, 2019

RESPONSIBLE OFFICIAL:

Director, Exam Field and Campus Policy

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

6

RECOMMENDATION 10:

The IRS Chief Counsel should develop and issue guidance on how taxpayers should classify themselves under Internal Revenue Code (I.R.C.) § 6050W.

CORRECTIVE ACTION:

Clarifying how taxpayers should classify themselves under I.R.C. § 6050W must be done through a Treasury regulation, which cannot be accomplished by IRS Chief Counsel alone. We have already opened a guidance project on this issue intended to clarify the definitions of third party network and aggregated payee. This guidance project is listed as a "Long-Term Action" on the Spring 2018 Unified Agenda of Federal Regulatory and Deregulatory Actions, under RIN 1545-BL34. Currently, Treasury and Counsel resources are focused on guidance in response to the Tax Cuts and Jobs Act, Pub. L. 115-97, and identifying and reducing regulatory burdens in response to Executive Order 13789. Each year Treasury and Chief Counsel develop a priority guidance plan that has not yet included guidance under section 6050W. Until there is agreement to prioritize section 6050W guidance over other guidance projects, we cannot provide an implementation date for when guidance might be issued under I.R.C. § 6050W. As a result, we must disagree with the recommendation.

IMPLEMENTATION DATE:

n/a

RESPONSIBLE OFFICIAL:

n/a

CORRECTIVE ACTION MONITORING PLAN:

n/a

RECOMMENDATION 11:

The IRS Chief Counsel should work with the Treasury Office of Tax Policy to pursue regulatory or legislative change relating to the third-party reporting thresholds established in I.R.C. § 6050W.

CORRECTIVE ACTION:

We agree with this recommendation. A change to third party reporting thresholds established in I.R.C. § 6050W requires Congressional action. The threshold cannot be changed by regulation. We will discuss with the Treasury Office of Tax Policy the need for legislative action on this point.

IMPLEMENTATION DATE:

October 15, 2019



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

7

RESPONSIBLE OFFICIAL:

Associate Chief Counsel (Procedure & Administration)

CORRECTIVE ACTION MONITORING PLAN:

IRS will monitor this corrective action as part of our internal management system of controls.

OUTCOME MEASURES

OUTCOME MEASURE 1:

Potential Increased Revenue - \$480,959,289 that could have potentially been assessed if the IRS had a strategic plan to address gig economy taxpayer noncompliance

IRS RESPONSE:

We disagree with this figure. We have been unable to replicate this calculation. Further, the presence and extent of non-compliance cannot be confirmed without taking compliance actions. This increased revenue protection estimate also fails to account for the opportunity costs to work these cases.

OUTCOME MEASURE 2:

Potential Increased Revenue - \$44,119,214 that could have potentially been assessed if more productive self-employment tax cases were selected to be worked by AUR tax examiners

IRS RESPONSE:

We disagree with this figure. Due to system limitations, not all tax return and/or information return data is available for AUR case selection. We select AUR inventory based on historical results of individual category types. Screen-out does not necessarily mean that the case was improperly selected. There are many factors that lead to a screen-out, such as, the tax examiner verified that the unreported income was reported elsewhere on the return, we received an amended return after the original return was selected, or conditions are present which prevent us from taking action on the return.

OUTCOME MEASURE 3:

Potential Reduced Taxpayer Burden - 272,147 taxpayers who may have been sent a CP 2000 notice with incorrect balances due from the AUR program

IRS RESPONSE:

We agree with this outcome measure. Notices were issued to taxpayers with incorrect balances and this had the possibility of increasing taxpayer burden. Some notice discrepancies, however, were due to rounding and the impact to taxpayer burden would



*Expansion of the Gig Economy Warrants
Focus on Improving Self-Employment Tax Compliance*

8

have been minimal. We will be acting on the recommendations included in this report and believe our actions will improve the quality of all AUR notices.

OUTCOME MEASURE 4:

Potential Increased Reliability of Information - 26 quality review results that were changed to reflect a lower error rate

IRS RESPONSE:

We disagree with this measure. We are unable to validate this calculation.