



*Improvements to the SS-8 Program Are
Needed to Help Workers and Improve
Employment Tax Compliance*

September 19, 2018

Reference Number: 2018-30-077

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HIGHLIGHTS

IMPROVEMENTS TO THE SS-8 PROGRAM ARE NEEDED TO HELP WORKERS AND IMPROVE EMPLOYMENT TAX COMPLIANCE

Highlights

**Final Report issued on
September 19, 2018**

Highlights of Reference Number: 2018-30-077
to the Commissioner of Internal Revenue.

IMPACT ON TAXPAYERS

The determination of whether a worker is an employee or an independent contractor has significant tax implications for the worker, the business, and the IRS. The emergence of the gig economy has made worker classification more complex. The IRS addresses worker classification issues through the Small Business/Self-Employed Division's SS-8 Program and the Examination functions. In an April 2017 report, the Government Accountability Office determined that worker classification issues yielded the highest wage adjustments in employment tax examinations conducted by the Small Business/Self-Employed Division for Tax Years 2008 through 2010, with \$44.3 billion in wage adjustments associated with worker classification issues. Misclassification can cause harm to workers and create an unfair competitive business advantage for businesses that misclassify workers.

WHY TIGTA DID THE AUDIT

This audit was initiated to assess the efficiency and effectiveness of the IRS's SS-8 Program, including the effectiveness of referrals of businesses to the IRS's Employment Tax Examination function, and to determine whether the program has adopted a strategic approach for worker classification issues related to the gig economy.

WHAT TIGTA FOUND

While there are a large number of workers participating in the gig economy, the SS-8 Program does not track Form SS-8 submissions

from gig economy workers. The SS-8 Program has guidance for other types of workers but lacks guidance about workers in the gig economy. TIGTA identified 15 gig economy cases that were mishandled due to the lack of guidance. The cases were held without action for an average of 524 days, and then the SS-8 Program mistakenly determined no decision could be made on the cases because the gig economy businesses were given Section 530 relief, which prevents the IRS from addressing past and future worker misclassification. In addition, TIGTA found that the Employment Tax Examination function did not receive any referrals from the SS-8 Program for potential examination from October 2014 through April 2018. Furthermore, the SS-8 Program does not process SS-8 requests timely enough for the determinations to be useful to workers who file requests for assistance. TIGTA also found that the SS-8 Program did not render timely decisions for the worker in 129 of the 189 determinations reviewed and 26 of the 66 opinions reviewed.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS: create guidance and training for gig economy Form SS-8 requests; evaluate which function would be best to identify cases for referrals; evaluate whether businesses are complying with determinations and consider program changes and referrals to increase business compliance with worker classification determinations; evaluate the process used in making worker classification determinations and opinions and make necessary changes to improve the process; and work with the Department of the Treasury on legislation to amend Section 530 so that the IRS can address noncompliance with the law prospectively.

The IRS agreed with all of our recommendations and plans to create guidance and training for gig economy SS-8 requests. The IRS also plans to evaluate the proper function for referrals, whether businesses are complying with determinations, and the process used in making worker classification determinations. The IRS also agreed to work with the Treasury Office of Tax Policy to pursue a legislative change to Section 530.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 19, 2018

MEMORANDUM FOR COMMISSIONER OF INTERNAL REVENUE

FROM: Michael E. McKenney
Deputy Inspector General for Audit

SUBJECT: Final Audit Report – Improvements to the SS-8 Program Are
Needed to Help Workers and Improve Employment Tax Compliance
(Audit # 201730016)

This report presents the results of our review to assess the efficiency and effectiveness of the Internal Revenue Service's (IRS) SS-8 Program, including the effectiveness of referrals of businesses to the IRS's Employment Tax Examination function, and to determine whether the program has adopted a strategic approach for worker classification issues related to the gig economy. This review is included in our Fiscal Year 2018 Annual Audit Plan and addresses the major management challenge of Improving Tax Compliance.

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

If you have any questions, please contact me or Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations).



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Table of Contents

Background	Page 1
Results of Review	Page 6
The SS-8 Program Lacks Guidance on the Gig Economy	Page 6
Recommendation 1:	Page 7
Recommendation 2:	Page 8
The SS-8 Program Did Not Make Referrals to the Employment Tax Examination Function for Several Years	Page 8
Recommendations 3 and 4:	Page 10
SS-8 Requests Are Not Processed Timely Enough for the Determinations to Be Useful to Workers	Page 11
Recommendation 5:	Page 12
Appendices	
Appendix I – Detailed Objective, Scope, and Methodology	Page 14
Appendix II – Major Contributors to This Report	Page 16
Appendix III – Report Distribution List	Page 17
Appendix IV – Outcome Measure	Page 18
Appendix V – Management’s Response to the Draft Report	Page 20



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Abbreviations

GAO	Government Accountability Office
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed
TIGTA	Treasury Inspector General for Tax Administration
WSD	Workload Selection and Delivery



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Background

The determination of whether a worker is an employee or an independent contractor has significant tax implications for the worker, the business, and the Internal Revenue Service (IRS). How a worker is classified affects the tax obligations for both the worker and the business. For example, the classification will affect who is responsible for paying the Social Security tax, Medicare tax, and Federal unemployment taxes as well as whether or not Federal income tax withholding is needed. The IRS addresses worker classification issues through the SS-8 Program in the Small Business/Self-Employed (SB/SE) Division; the Campus Examination Function in Brookhaven, New York; and the SB/SE Examination function.¹

***How a worker is classified
affects the tax obligations
for both the worker and
the business.***

In addition to the harm misclassification can cause to workers, the misclassification of employees can create an unfair competitive business advantage when one business classifies a class of workers as employees, while a competitor misclassifies the same class of workers as independent contractors. For example, using an annual average income of \$48,642 per employee during Calendar Year 2016, a business that misclassifies a worker as an independent contractor reduces the amount of employment taxes it pays by \$4,141.²

The IRS's worker classification compliance efforts span all industries and include outreach, education, employment tax examinations, the Classification Settlement Program, and the Voluntary Classification Settlement Program.³ By filing Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, a business or a

¹ The IRS also addresses worker classification issues through the Tax Exempt & Government Entities Division; however, our review only looked at the SB/SE Division.

² This is the estimated national median income wage index for Calendar Year 2016 that the Social Security Administration uses to compute retirement benefits. The \$4,141 in employment tax benefit is calculated based upon the Social Security tax rate of 6.2 percent of wages (\$3,016), the Medicare tax rate of 1.45 percent of wages (\$705), and the Federal unemployment tax rate of 6 percent on the first \$7,000 of wages (\$420).

³ The Classification Settlement Program allows taxpayers and tax examiners to resolve worker classification cases as early in the administrative process as possible, reducing taxpayer burden. It also ensures that the taxpayer relief provisions under Section 530 are properly applied. Under this program, IRS examiners are able to offer taxpayers under examination a worker classification settlement using a standard closing agreement. The Voluntary Classification Settlement Program is a voluntary program that provides an opportunity for businesses to reclassify their workers as employees for employment tax purposes for future tax periods with partial relief from Federal employment taxes. To participate in this voluntary program, the business must meet certain eligibility requirements, apply to participate in the program by filing Form 8952, *Application for Voluntary Classification Settlement Program*, and enter into a closing agreement with the IRS.



Improvements to the SS-8 Program Are Needed to Help Workers and Improve Employment Tax Compliance

worker can request a determination letter from the IRS regarding a worker's Federal employment tax status as an employee or independent contractor.

Workers, whether classified as independent contractors or employees, who believe that their classification is incorrect can file Form SS-8. The SS-8 Program will issue a determination letter to the business and worker notifying them of the proper classification of the worker for purposes of Federal employment taxes and income tax withholding. For example, if the IRS determines that the worker is an employee, it issues a determination letter to the worker that allows the worker to stop paying self-employment tax required as an independent contractor.⁴ In that case, the worker would be responsible for paying only the employee's part of the employment taxes, and the employer would be responsible for the rest. The IRS also sends a letter to the employer stating that it is responsible for satisfying the employment tax reporting, filing, and payment obligations that result from the employee determination.⁵

Because SS-8 Program determinations are not examinations under the law, determination letters are binding only on the IRS based on the facts presented. This means that the IRS allows the worker to file according to the determination made; however, the IRS cannot compel a business to change a worker's classification unless it conducts an examination. Results from a prior Treasury Inspector General for Tax Administration (TIGTA) review showed that approximately 19 percent of businesses that were asked to change the way they classify their employees did not comply with the determination.⁶

The SS-8 Program may also use a streamlined process for worker classification requests for cases meeting the following criteria:

- The worker has earnings of \$2,500 or less and no longer works for the business.
- The business has a Classification Settlement Program or a Voluntary Classification Settlement Program agreement.
- The business is no longer in business.
- No contact was made with the business, or the business did not respond to the SS-8 Program.

Under this streamlined process, the SS-8 Program issues an opinion/courtesy letter to the worker in response to the streamlined case and provides an opinion on how the worker should file for purposes of Federal employment taxes and income tax withholding.⁷ The conclusion in an

⁴ Letter 4991, *SS-8 Employee Determination*.

⁵ Letter 4991-A, *Notice to Firm – Determination Employee*.

⁶ TIGTA, Ref. No. 2013-30-058, *Employers Do Not Always Follow Internal Revenue Service Worker Determination Rulings* (June 2013).

⁷ Letter 5081, *Form SS-8 Determination of Employment Status Courtesy Letter – Employee*; Letter 5082, *Form SS-8 Determination of Employment Status Courtesy Letter – Independent Contractor*.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

opinion/courtesy letter is binding on the IRS based on the facts presented. In addition to the determination and opinion letters, the SS-8 Program may also issue an information letter.⁸ The information letter is advisory only and has no binding effect on the IRS.⁹

During the process of rendering a determination or an opinion, the SS-8 Program may become aware of opportunities to address employment tax issues that arise where a referral to the Employment Tax Examination function would be appropriate. The Employment Tax Examination function is part of the Specialty Examination function under the SB/SE Division. Tax noncompliance associated with worker misclassification is significant. In an August 2009 report, the Government Accountability Office (GAO) reported that at the IRS's last estimate in 1984, the IRS estimated that 15 percent of United States businesses misclassified 3.4 million workers as independent contractors, causing a loss of approximately \$1.6 billion in tax revenue.¹⁰ In an April 2017 report, the GAO determined that worker classification issues yielded the highest wage adjustments in employment tax examinations conducted by the SB/SE Division for Tax Years 2008 through 2010, with \$44.3 billion in wage adjustments associated with worker classification issues.¹¹

Worker classification examinations generally start with consideration of Section 530 of the Revenue Act of 1978 and common law factors.¹² Section 530 is a safe harbor provision that prevents the IRS from retroactively and prospectively reclassifying workers who were treated as non-employees (*i.e.*, "independent contractors") as employees and subjecting the business to Federal employment taxes, penalties, and interest for such misclassification. To obtain

⁸ An information letter may be issued for worker classification requests that involve a three party arrangement that is requesting a determination of the worker's employment status only. A three party arrangement is when a worker performs services for a business but receives payment from another business. However, if the worker classification request is asking guidance from the IRS on who the employer is and not guidance on the worker status, no determination or information letter will be provided due to the issue being outside the scope of the SS-8 Program.

⁹ Letter 5007, *Firm – Advise on Future Workers*.

¹⁰ GAO, GAO-09-717, *EMPLOYEE MISCLASSIFICATION: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention* (August 2009).

¹¹ Worker classification issues yielded \$44.3 billion of all wage adjustments, with the next most significant issue being fringe benefits, which yielded \$34.4 billion of all adjustments, then payment re-characterization, which yielded \$26.3 billion of all adjustments. GAO, GAO-17-371, *EMPLOYMENT TAXES: Timely Use of National Research Program Results Would Help IRS Improve Compliance and Tax Gap Estimates* (April 2017).

¹² In order for a business to qualify for Section 530 relief, it must have: 1) consistently treated the workers (and similarly situated workers) as non-employees; 2) complied with information reporting requirements with respect to the remuneration paid to workers for the tax years at issue; and 3) had a reasonable basis for treating the workers as non-employees. Section 530 does not make or validate workers as independent contractors but it allows the business to continue treating them as non-employees for Federal employment tax purposes. Section 530 also does not apply to Federal agencies. Section 530 of Public Law 96-600, 92 Stat. 2885 (1978) as amended by Public Law 96-167, 93 Stat. 1278 (1979); Public Law 96-541, 95 Stat. 3204 (1980); Public Law 97-248, 96 Stat. 552 (1982); and Public Law 104-188, 110 Stat. 1766 (1996). Common law is a body of law that is based on custom and general principles and embodied in case law and that serves as precedent or is applied to situations not covered by statute.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Section 530 relief, it is not necessary that the classification of workers be legally correct. IRS procedures require that examiners close the examination if Section 530 relief is applicable.¹³

The emergence of the sharing economy, or the “gig economy,” which generally uses web-based platforms to bring people together who need services and other people who are willing to provide those services, has made worker classification more complex. These businesses provide workers temporary assignments. Although temporary, many of these assignments possess the traits of a traditional employer-employee relationship, further blurring the line between employee and independent contractor. A study by Intuit predicted that by Calendar Year 2020, more than 40 percent of American workers will be a flexible workforce, such as independent contractors, freelancers, or temporary workers hired by a staffing business.¹⁴

The gig economy allows individuals and groups to use technology advancements to arrange transactions to generate revenue from assets they possess (such as ride sharing and apartment or home rentals) or services they provide (such as on demand household chores or demand technology services). There are tax implications for the companies that provide the services and the individuals who perform them. This means that if income is received from a gig economy activity, it is generally taxable even if certain income reporting documents have not been issued, such as a Form 1099-MISC, *Miscellaneous Income*; Form 1099-K, *Payment Card and Third Party Network Transactions*; and Form W-2, *Wage and Tax Statement*. This is true even if the income is received as a side job or part-time business. Depending upon the circumstances, some or all of the business expenses may be deductible and subject to the normal tax limitations and rules.¹⁵

The IRS has taken some steps to provide information to workers and businesses regarding the gig economy. The IRS responded to the growth of the gig economy business model by collaborating with the Taxpayer Advocate Service and other stakeholders to create the Sharing Economy Tax Center. The Sharing Economy Tax Center includes information to help businesses determine the status of workers providing services. The site also includes links to additional information about Section 530, the common law factors, and meeting any employment tax filing and payment obligations. The IRS issued a news release and other communications to introduce the Sharing Economy Tax Center in August 2016. Additionally, the IRS Communications and Liaison function provides information regarding worker classification and the gig economy via Twitter and TUMBLR.

This review was performed at the SB/SE Division Campus Examination Function in Brookhaven, New York, during the period October 2017 through July 2018. We conducted this

¹³ Internal Revenue Manual 4.23.5.3.3 (Nov. 22, 2017).

¹⁴ The Intuit study is part of the Intuit 2020 Report that is a collaboration between Intuit and Emergent Research. Intuit is a provider of businesses and financial management solutions for small businesses, consumers, and accounting professionals. Emergent Research is a research and consulting firm focused on small businesses.

¹⁵ View the Sharing Economy Tax Center online at the following web page:

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



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

performance audit in accordance 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.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Results of Review

The SS-8 Program Lacks Guidance on the Gig Economy

A recent study conducted by the Pew Research Center in 2016, estimated that 8 percent of Americans earned money on some sort of digital platform by taking on some job or task, while nearly 18 percent of Americans earned money by selling something online.¹⁶ A survey conducted in March 2016 of members from the National Association of the Self-Employed found that of those earning income in the gig economy:

- 34 percent did not know they needed to file quarterly estimated tax payments.
- 36 percent did not understand what records they would need to maintain as a small business for tax purposes.
- 43 percent did not set aside money to meet their tax obligations or know how much they owed.
- 69 percent did not receive any tax information from the gig economy platform they used to earn their income.¹⁷

The SS-8 Program lacks guidance about workers in the gig economy. It is unknown how many participants in the gig economy have filed Forms SS-8 with the IRS to request a determination. The SS-8 Program has specific guidance with respect to home health care workers, couriers, corporate officers, and other workers but has no guidance for workers in the gig economy.¹⁸ SS-8 Program employees follow the standard common law for determining worker status in worker classification cases, including gig economy cases. While the SS-8 Program does not track gig economy cases, we were able to identify 15 gig economy cases that were mishandled due to lack of guidance and training. From March 2016 through February 2018, the IRS suspended 15 cases involving gig economy businesses pending ongoing examinations from the Employment Tax Examination function on worker classification issues, including considering Section 530 relief for the businesses. In all 15 cases, the businesses had treated the workers as independent contractors. The SS-8 Program held these 15 cases without action for an average of

¹⁶ Pew Research Center, *Gig Work, Online Selling and Home Sharing* (Nov. 2016).

¹⁷ Caroline Bruckner, *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy* (May 2016) available at <https://www.american.edu/kogod/research/upload/shortchanged>.

¹⁸ Internal Revenue Manual (IRM) 7.50.1.5.8.2 (Aug. 19, 2016); IRM 7.50.1.5.8.1 (Aug. 19, 2016); IRM 7.50.1.5.10 (Aug. 19, 2016); IRM 7.50.1.5.8 (Aug. 19, 2016).



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

524 days. In March 2018, the SS-8 Program sent rejection letters to 11 of the 15 workers informing them that the IRS does not currently issue determination letters regarding the status of workers performing services as drivers for companies in the gig economy.¹⁹ The letter directed them to either call an IRS Customer Service Representative for assistance or visit the Shared Economy Tax Center website for additional information.

The reason that these cases were mishandled is that the SS-8 Program was under the incorrect belief that because Section 530 relief was given to these businesses by the Examination function, it could not review worker classification complaints from workers who believed those same companies incorrectly characterized them as independent contractors. Section 530 has the extraordinary result of providing a safe harbor for businesses that may have incorrectly treated workers as independent contractors instead of employees both retroactively and prospectively. In other words, the IRS cannot assess taxes against the gig economy businesses identified in this report for past underpayment of taxes and cannot reclassify independent contractors as employees going-forward. In the past, legislation has been proposed to repeal Section 530; however, the efforts were unsuccessful.²⁰ However, workers can still request a determination from the SS-8 Program even if the businesses were provided Section 530 relief.

There is no legal or regulatory provision that prohibits an individual worker's classification determination after Section 530 relief has been granted to his or her employer. This misunderstanding resulted in the mishandling of the 15 gig economy cases that were mentioned above. When we brought this issue to IRS management's attention, they agreed that rejecting the cases based on Section 530 relief was erroneous and rescinded all 11 rejection letters. The IRS agreed with us that Section 530 relief for a business does not necessarily preclude a favorable determination for the worker as an employee. IRS management informed us that they would process the cases and make determinations based on the facts of each case.

Training for SS-8 Program employees and guidance on gig economy workers would relieve unnecessary burden for workers and allow the IRS to more effectively make worker classification determinations.

Recommendation

Recommendation 1: The Commissioner, SB/SE Division, should create guidance and training for the responsible functions to ensure the accurate processing and determinations of worker classification requests, including gig economy worker classification requests.

Management's Response: The IRS agreed with the recommendation and will create additional guidance and training for the responsible functions to ensure the accurate

¹⁹ The remaining four gig economy cases are not drivers.

²⁰ For example, the Taxpayer Responsibility, Accountability, and Consistency Act of 2009, H.R. 3408, 111th Cong. (July 2009) would have repealed Section 530 but was not enacted into law.



Improvements to the SS-8 Program Are Needed to Help Workers and Improve Employment Tax Compliance

processing and determinations of worker classification requests, including the gig economy worker classification requests.

Recommendation 2: The Deputy Commissioner Services and Enforcement should work with the Treasury Office of Tax Policy to pursue a legislative change to Section 530 so that, at a minimum, the IRS can take prospective action to enforce the law on employers who incorrectly treat workers as independent contractors.

Management's Response: The IRS agreed with the recommendation and will provide a copy of TIGTA's final report to the Assistant Secretary for Tax Policy to pursue a legislative change to Section 530.

The SS-8 Program Did Not Make Referrals to the Employment Tax Examination Function for Several Years

In April 2017, the GAO reviewed the IRS National Research Program study on employment tax returns from Tax Years 2008 through 2010 and found that worker classification issues tended to yield the highest adjustments in examinations.²¹ Additionally, as described above, determinations by the SS-8 Program are binding on the IRS only. In order for the IRS to compel a business to change its classification of a worker, the IRS must conduct an examination. When SS-8 Program determinations are not followed by businesses, it is essential that employees make referrals to the Examination function so that the noncompliance can be considered for an examination. Referrals from the SS-8 Program to the Examination function are a source of leads for potential examinations that can help ensure compliance with employment tax requirements. However, there are no referral criteria for businesses that the SS-8 Program determined to have erroneously treated workers as independent contractors but who do not follow the IRS's SS-8 determination. Pursuant to Internal Revenue Manual (IRM) criteria, in order for a case to be referred, it must meet guidelines, such as:

- The business has not filed information returns, but Form SS-8 data reveal one worker earning at least \$25,000 or, if less than this amount, there are multiple Forms SS-8 received.
- Indicators of fraud.
- A payer is found to be in violation of the Classification Settlement Program or the Voluntary Classification Settlement Program.
- Issues involving officer compensation.

²¹ GAO, GAO-17-371, *EMPLOYMENT TAXES: Timely Use of National Research Program Results Would Help IRS Improve Compliance and Tax Gap Estimates* (April 2017). The IRS's National Research Program conducts audits to determine filing, payment, and reporting compliance by taxpayers for different types of taxes.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

- Instances in which the business treated workers as employees then converted them to independent contractors.²²

The Employment Tax Examination function did not receive any referrals from the SS-8 Program for potential examination from October 2014 through April 2018. In Calendar Year 2014, the SS-8 Program began providing a referral report quarterly to the Employment Tax Workload Selection and Delivery (WSD) function, which performs case selections for the Employment Tax Examination function. The Employment Tax WSD function analyzed the report to determine if cases had examination potential for case selection. However, this process stopped when the database used to create the referral report was moved from an older server to a new server. When the database was moved, the ability to access the data and create the referral report was lost. Employment Tax WSD management explained that they had not received any referrals since October 2014.

We brought this unresolved issue to SS-8 Program management's attention in November 2017. They explained that in April 2016, the process was changed to have an analyst from the Employment Tax WSD function gain access to the system to pull referrals internally instead of having the SS-8 Program provide the referrals. The Employment Tax WSD analyst was to use the referral criteria found in IRM 7.50.1-9, *Field Referral Criteria*, against the SS-8 Program data to identify cases for classification. Cases that meet the criteria will be sent for additional screening to identify worker classification and other employment tax issues to be considered during an employment tax examination. However, as of November 2017, SS-8 Program management informed us that no one was currently pulling referrals from the database because the Employment Tax WSD analyst did not have access to the system. They stated that they would provide access to an analyst whose duties would include reviewing the new SS-8 E-Trak system to identify cases that meet the referral criteria.²³ In March 2018, a senior tax analyst from the Employment Tax WSD function was provided access to the new system to identify referrals. Prior to identifying referrals from the SS-8 Program, the analyst was tasked with reviewing the SS-8 E-Trak database and determining an efficient process on how to select referrals. In April 2018, after the analyst was granted access to the system, three leads for potential referral to the Employment Tax Examination function were identified.

The IRS is changing IRM 7.50.1 to state that referrals to the Employment Tax Examination function are not required (unless a case has indicators of fraud or unusual circumstances) because it has access to the SS-8 E-Trak database. However, discouraging referrals from SS-8 Program employees who have first-hand knowledge of the facts of the very cases needing to be referred is highly problematic because it will likely result in worthy cases not being referred to the Employment Tax Examination function. As of April 13, 2018, the revised IRM 7.50.1 was in the clearance phase of the IRM approval process, with an anticipated publish date of

²² IRM 7.50.1 (Aug. 19, 2016).

²³ The E-Trak system is a web-based, Service-wide document tracking system that assists the IRS with its ability to timely and effectively manage its responses to issues raised by stakeholders.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

September 30, 2018. During the years in which no referrals were made, SS-8 Program management said there was no workaround for providing referrals from the SS-8 Program to the Employment Tax Examination function even after they realized that referrals had stopped. However, the fix to the problem only involved effective communication between the Employment Tax function and the SS-8 Program function.

The SS-8 Program has the responsibility of making determinations to assist businesses in classifying workers, which also includes the responsibility to notify businesses if they misclassify workers. The criteria for referrals to the Employment Tax Examination function should take into consideration the harm to workers who are misclassified as independent contractors. The most significant referrals are more likely to be identified by the employees making the SS-8 Program determinations rather than having an analyst from a different function use its case management database for the purpose of obtaining examination leads. Additionally, the IRS should treat noncompliance with its determinations as a serious matter worthy of a referral and IRS employees should be required to evaluate whether businesses are complying with their determinations and refer noncompliance to the Employment Tax Examination function. During the time that no referrals were made to the Employment Tax Examination function (October 2014 through April 2018), the IRS missed a source for potential productive employment tax examinations that could have made an impact on improving compliance.

Recommendations

Recommendation 3: The Commissioner, SB/SE Division, should evaluate whether SB/SE's Employment Tax WSD or the Campus SS-8 Program is the best function to identify potential cases and consider utilizing the experience of the SS-8 Program employees who have first-hand knowledge of the cases to encourage referrals to the Employment Tax Examination function.

Management's Response: The IRS agreed with the recommendation and will evaluate the process for identifying referrals from the SS-8 Program and determine whether modifications to existing processes are appropriate.

Recommendation 4: The Commissioner, SB/SE Division, should require employees to evaluate whether businesses are complying with determinations. Consider program changes and referrals to the Employment Tax Examination function as appropriate to increase business compliance with worker classification determinations.

Management's Response: The IRS agreed with the recommendation and will consider methods to identify businesses that may not be complying with worker classification determinations.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

SS-8 Requests Are Not Processed Timely Enough for the Determinations to Be Useful to Workers

The SS-8 Program's guidelines state that SS-8 Program clerical staff will issue Letter 3891, *Acknowledgement Letter*, notifying the worker that the IRS received Form SS-8 and that it has 180 calendar days in which to provide a determination.²⁴ If the business sends the Form SS-8, clerical staff will issue Letter 3891-A, *Acknowledgement Letter*, notifying the business that the IRS received the Form SS-8. Letter 3891 or Letter 3891-A is sent to the worker or business once the case is considered ready to process. A case is considered ready to process if the first submission of the Form SS-8 is complete or upon the second submission of Form SS-8.²⁵

We conducted a review of determinations and opinions made by the SS-8 Program during Fiscal Years 2015 through 2017.²⁶ The determination population consisted of 4,829 cases for which the IRS issued a worker classification determination. We reviewed a statistically valid random sample of 189 determination cases and found that 148 (78 percent) cases were for workers who appeared to no longer work for the business named on the SS-8 request after the determination was made. The businesses did not issue a Form 1099-MISC or a Form W-2 to the workers after the IRS's determination was rendered.²⁷ Only 24 (13 percent) workers were still employed by the business named on the SS-8 request. These businesses issued either a Form 1099-MISC or Form W-2 for the worker after the determination was rendered by the SS-8 Program. There are a number of reasons a worker may no longer be employed by a business, but confusion in reporting and paying taxes may be a factor.

In the sample of 189 determination cases, we identified 129 (68 percent) cases for which the IRS did not timely render a decision within the 180 days since the Letter 3891 or Letter 3891-A was issued and the case was ready to be processed. Based on our sample results, from a population of 4,829 determination cases, we projected that there were approximately 3,296 taxpayers who did not receive a timely rendered determination on the worker classification status.²⁸ We found that the SS-8 Program took, on average, 419 days to render a determination, with the longest taking 1,062 days to process. The substantial length of time it takes for the SS-8 Program to render a determination can make the determination useless for the workers. Not receiving a

²⁴ If the case cannot be closed within the 180-calendar day time frame, the SS-8 Program must issue to the worker an interim letter that contains the new closing date.

²⁵ Some cases are returned to the originator because information is missing on Form SS-8 or the proper documentation, such as payment documents, were not included. Even if these items are still missing after the second submission, the SS-8 Program considers the case ready to process.

²⁶ A fiscal year is 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.

²⁷ The employment status could not be determined on 17 (9 percent) of the 189 cases.

²⁸ The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 2,958 and 3,607 taxpayers who did not receive a timely rendered determination by the IRS. See Appendix IV for additional details.



Improvements to the SS-8 Program Are Needed to Help Workers and Improve Employment Tax Compliance

timely determination on his or her worker status can place burdens on the worker for tax filing purposes, as well as the additional economic impact of being treated as an independent contractor.

In addition to the determination cases, we also reviewed opinion cases for timeliness. The opinion population consisted of 7,942 cases for which the IRS issued an opinion to a worker rather than a determination. We reviewed a statistically valid random sample of 66 opinion cases and found 26 (39 percent) cases for which the IRS did not timely render a decision within the 180 days since the Letter 3891 or Letter 3891-A was issued and the case was ready to be processed. On average, opinion cases took 268 days to work. Based on our sample results, from a population of 7,942 opinion cases, we projected that there were approximately 3,129 taxpayers who did not receive a timely rendered opinion on their worker classification status.²⁹

According to SS-8 Program management, the SS-8 Program received an influx of Forms SS-8 in the years prior to Fiscal Year 2012, which increased its inventory. In order to improve efficiency, in Fiscal Year 2012 the SS-8 Program clarified guidance for acceptable determination requests and made program improvements such as increased customer service and a screening process for new receipts of Forms SS-8. However, our review indicates that the SS-8 Program is still not processing worker classification requests timely.

Untimely determinations and opinions can create significant taxpayer burden for workers asking for clarity on their classification and filing requirements, increasing the workers' frustration and potentially leading to further noncompliance.

Recommendation

Recommendation 5: The Commissioner, SB/SE Division, should evaluate the process used in making worker classification determinations and opinions in the SS-8 Program and make necessary changes to improve processing.

Management's Response: The IRS agreed with the recommendation and will evaluate the process used in making worker classification determinations and opinions in the SS-8 Program and determine whether changes are needed to improve processing.

However, the IRS did not agree with the measurable impact (outcome measure) that our recommended corrective action will have on tax administration. IRS management disagrees that there is an increased burden for 6,425 taxpayers. The IRS asserts that there is no requirement to respond to SS-8 determination requests within 180 days and states that this is an internally established time frame which is adjusted as inventory levels fluctuate. The IRS also states that during the time period that we reviewed, the high

²⁹ The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 2,195 and 4,141 taxpayers who did not receive a timely rendered opinion by the IRS. See Appendix IV for additional details.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

volume of SS-8 receipts prevented the IRS from making determinations as quickly as planned and states the data for Fiscal Year 2018 indicate that determinations are being made in an average of 110 days and believes our calculation may be overstated.

Office of Audit Comment: We maintain our position that the outcome measure is valid and reasonable as presented. Our outcome measure is based on the 180-day time frame for completion, as it is stated in IRM 7.50.1, *Form SS-8 Worker Classification Determinations, Form SS-8 Processing Handbook*. The IRM sets forth policies, procedures, instructions, and guidelines to IRS employees that aide in the operation of the IRS and must be accurate, accessible, and easy to follow to ensure employees provide consistent and fair treatment to the public. This manual, in particular, provides procedures to employees responsible for dealing with the Form SS-8. Moreover, these guidelines do not specify that the 180-day time frame is a requirement that may be adjusted. In addition, since Fiscal Year 2018 is still ongoing, the SS-8 Program's calculation is incomplete. The SS-8 Program's data used in their calculation for issued determinations, ended on July 20, 2018, with more than two months of data missing to the end of Fiscal Year 2018.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the efficiency and effectiveness of the IRS's SS-8 Program, including the effectiveness of referrals of businesses to the IRS's Employment Tax Examination function, and to determine whether the program has adopted a strategic approach for worker classification issues related to the gig economy. To accomplish this objective, we:

- I. Determined the applicable policies, procedures, and controls in place to process Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, cases.
- II. Obtained the SS-8 Program data for Fiscal Years 2015 through 2017.¹
 - A. Performed validation testing on data to ensure reliability.
 - B. Conducted analysis on data for timeliness.
- III. Determined whether the IRS has a strategy in place to address the gig economy and determined if the SS-8 Program works these cases differently. Reviewed all 15 suspended SS-8 Program gig economy cases and determined the timeliness on each case.
- IV. Determined whether the SB/SE Division effectively administered the SS-8 Program and whether established procedures were followed and were sufficient to effectively make worker classification determinations.
 - A. Visited the Brookhaven, New York, SS-8 Program office and performed a walkthrough of how worker classification determinations are made.
 - B. Interviewed management about the Form SS-8 processing operation and any concerns they had about Form SS-8 processing, including emerging economic issues and referrals.
 - C. From the data obtained in Objective II, we identified a population of 4,829 cases for which the IRS issued worker classification determinations and selected and reviewed a statistically valid random sample of 189 determination cases to determine the time from when the Letter 3891 or 3891-A, *Acknowledgement Letter*, was issued and the case was ready to be processed to when the determination was rendered and to

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*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

determine if businesses complied with the SS-8 Program determinations. We initially had a sample size of 66 cases based on the following criteria: 95 percent confidence level, 18 percent expected error rate, and ± 10 percent precision rate, and then we decided to oversample and increase the sample size to 189 cases.² From the data obtained in Objective II, we identified a population of 7,942 cases for which the IRS issued worker classification opinions and selected and reviewed a statistically valid random sample of 66 opinion cases to determine the time from when the Letter 3891 or Letter 3891-A was issued and the case was ready to be processed to the when the opinion was rendered. We used the following criteria to select our sample: 95 percent confidence level, 18 percent expected error rate, and ± 10 percent precision rate. We selected a statistically valid random sample so we could project our results across the population of both determination and opinion cases. For the determination sample, we also determined if businesses complied with the SS-8 Program determinations.

- V. Interviewed IRS officials to determine if cases were referred to the SB/SE Division's Employment Tax Examination function for examination.

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: IRS policies and procedures for receiving and processing Form SS-8 requests to make a determination of the worker classification status. We evaluated the controls by reviewing written policies and procedures of the SS-8 Program and the Employment Tax Examination function and holding discussions with relevant IRS officials.

² We worked with a contract statistician to help develop the sampling plan and the projections.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Appendix II

Major Contributors to This Report

Matthew A. Weir, Assistant Inspector General for Audit (Compliance and Enforcement Operations)
Glen Rhoades, Director
Michele Jahn, Audit Manager
David Guerra, Lead Auditor



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Appendix III

Report Distribution List

Deputy Commissioner for Operations Support
Deputy Commissioner for Services and Enforcement
Commissioner, Small Business/Self-Employed
Director, Examination, Small Business/Self-Employed Division
Director, Exam Case Selection, Small Business/Self-Employed Division
Director, Exam Policy, Small Business/Self-Employed Division
Director, Headquarters Exam, Small Business/Self-Employed Division
Director, Specialty Exam, Small Business/Self-Employed Division
Director, Office of Audit Coordination



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Appendix IV

Outcome Measure

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

Type and Value of Outcome Measure:

- Taxpayer Burden – Potential; 6,425 taxpayer accounts affected (see page 11). We projected that there were approximately 3,296 taxpayers who did not receive a timely determination and approximately 3,129 taxpayers who did not receive a timely opinion on their worker classification status.

Methodology Used to Measure the Reported Benefit:

The SS-8 Program's guidelines state that SS-8 Program clerical staff will issue Letter 3891, *Acknowledgement Letter*, notifying the worker that the IRS received Form SS-8 and that it has 180 calendar days in which to provide a determination. If the business sends the Form SS-8, clerical staff will issue Letter 3891-A, *Acknowledgement Letter*, notifying the business the IRS received the Form SS-8. Letter 3891 or Letter 3891-A is sent to the worker or business once the case is considered ready to process. A case is considered ready to process if first submission of the Form SS-8 is complete or upon the second submission of Form SS-8.

We conducted a review of samples of determinations and opinions made by the SS-8 Program during Fiscal Years 2015 through 2017.¹ The determination case population consisted of 4,829 cases for which the IRS issued a worker classification determination. Based on our review of a statistically valid random sample of 189 determination cases, we identified 129 (68 percent) cases for which the IRS did not timely render a decision (within 180 days since the Letter 3891 or Letter 3891-A was issued and the case was ready to be processed). Based on these results, from a population of 4,829 determination cases, we projected that there were approximately 3,296 taxpayers who did not receive a timely rendered determination on their worker classification status.² The substantial length of time it takes for the SS-8 Program to render a determination can make the determination useless for the worker. Not receiving a timely

¹ A fiscal year is 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.

² The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 2,958 and 3,607 taxpayers who did not receive a timely rendered determination by the IRS.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

determination on his or her worker status can burden the worker due to the confusion of not knowing how to file correctly.

In addition to the determination cases, we also reviewed opinion cases for timeliness. The opinion case population consisted of 7,942 cases for which the IRS issued an opinion to a worker rather than a determination. Based on our review of a statistically valid random sample of 66 opinion cases, we identified 26 (39 percent) cases for which the IRS did not timely render a decision (within 180 days since the Letter 3891 or Letter 3891-A was issued and the case was ready to be processed). Based on our sample results, from a population of 7,942 opinion cases, we projected that there were approximately 3,129 taxpayers who did not receive a timely rendered opinion on their worker classification status.³

³ The point estimate projection is based on a two-sided 95 percent confidence interval. We are 95 percent confident that the point estimate is between 2,195 and 4,141 taxpayers who did not receive a timely rendered opinion by the IRS.



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Appendix V

Management's Response to the Draft Report



COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

September 6, 2018

MEMORANDUM FOR MICHAEL E. MCKENNEY
DEPUTY INSPECTOR GENERAL FOR AUDIT

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

SUBJECT: Draft Audit Report – Improvements to the SS-8 Program Are
Needed to Help Workers and Improve Employment Tax
Compliance (Audit # 201730016)

Thank you for the opportunity to review and comment on the above subject draft report. The proper classification of workers as employees or independent contractors is important and has significant tax implications for the worker, the business, and the IRS. We provide extensive general information on our website (irs.gov) on worker classification issues for employers and workers in the form of flyers, IRS forms, fact sheets, a webcast, and a training manual providing in-depth information on how IRS examiners determine a worker's correct classification. We undertake outreach and education efforts across industries. In addition to the SS-8 Program, we also address compliance with worker classification issues through examinations of employers and settlement programs.

The SS-8 Program was established to allow either a business or a worker to request a determination letter from the IRS regarding a worker's Federal employment tax status as an employee or independent contractor. If an employer classifies a worker as an independent contractor or employee and the worker believes the classification is incorrect, the worker can file a Form SS-8, Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding. In making a determination, we consider common law rules, or factors, on whether the worker is an employee or an independent contractor. Determination letters are not binding on the worker or employer/business. An examination of the employer/business must be conducted for any determination to be considered binding.

We are faced with a number of challenges in making SS-8 determinations in light of our limited resources, as the determinations are labor-intensive and involve complex law. We have taken actions in the past to gain efficiencies in our processes and appreciate your acknowledgement of those efforts. We plan to conduct a thorough assessment of



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

2

our processes, identify areas where additional efficiencies can be gained, and take actions to implement those changes. We also intend to develop guidance and training for our SS-8 employees to ensure the correct processing of worker classification requests irrespective of the industry involved.

We do not agree with your outcome measure of increased burden for 6,425 taxpayers. There is no requirement to respond to SS-8 determination requests within 180 days. This is an internally established timeframe which is adjusted when our inventory levels fluctuate. During the time period you reviewed, the high volume of SS-8 receipts prevented us from making determinations as quickly as planned. However, the data we provided shows in Fiscal Year 2018 we issued determinations in an average of 110 days. Thus, we believe your calculation may be overstated.

Attached is a detailed response outlining our corrective actions to address your recommendations. If you have any questions, please contact me or Brenda Dial, Director, Examination Operations, Small Business/Self Employed (SB/SE) Division.

Attachment



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

Attachment

RECOMMENDATION 1:

The Commissioner, SB/SE Division, should create guidance and training for the responsible functions to ensure the accurate processing and determinations of worker classification requests, including gig economy worker classification requests.

CORRECTIVE ACTION:

We agree with the recommendation. We will create additional guidance and training for the responsible functions to ensure the accurate processing and determinations of worker classification requests, including gig economy worker classification requests.

IMPLEMENTATION DATE:

December 15, 2019

RESPONSIBLE OFFICIAL:

Director, Examination-Field and Campus Policy, Small Business/Self-Employed Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

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

RECOMMENDATION 2:

The Deputy Commissioner Services and Enforcement should work with the Treasury Office of Tax Policy to pursue a legislative change to Section 530 so that, at a minimum, the IRS can take prospective action to enforce the law on employers who incorrectly treat workers as independent contractors.

CORRECTIVE ACTION:

We agree with the recommendation. Upon receipt of the final TIGTA report, we will provide a copy to the Assistant Secretary for Tax Policy.

IMPLEMENTATION DATE:

January 15, 2019

RESPONSIBLE OFFICIAL:

Director, Examination-Field and Campus Policy, Small Business/Self-Employed Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

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



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

2

RECOMMENDATION 3:

The Commissioner, SB/SE Division, should evaluate whether SB/SE's Employment Tax Workload Selection and Delivery or Campus SS-8 Program is the best function to identify potential cases and consider utilizing the experience of the SS-8 Program employees who have first-hand knowledge of the cases to encourage referrals to the Employment Tax Examination function.

CORRECTIVE ACTION:

We agree with the recommendation. We will evaluate the process for identifying referrals from the SS-8 program and determine whether modifications to existing processes are appropriate.

IMPLEMENTATION DATE:

August 15, 2019

RESPONSIBLE OFFICIAL:

Director, Field and Campus Policy, Small Business/Self-Employed Division (SB/SE)

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 require employees to evaluate whether businesses are complying with determinations. Consider program changes and referrals to the Employment Tax Examination function as appropriate to increase business compliance with worker classification determinations.

CORRECTIVE ACTION:

We agree with the recommendation. We will consider methods to identify businesses that may not be complying with worker classification determinations.

IMPLEMENTATION DATE:

October 15, 2019

RESPONSIBLE OFFICIAL:

Director, Examination Case Selection, Small Business/Self-Employed Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

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



*Improvements to the SS-8 Program Are Needed
to Help Workers and Improve Employment Tax Compliance*

3

RECOMMENDATION 5:

The Commissioner, SB/SE Division, should evaluate the process used in making worker classification determinations and opinions in the SS 8 Program and make necessary changes to improve processing.

CORRECTIVE ACTION:

We agree with the recommendation. We will evaluate the process used in making worker classification determinations and opinions in the SS 8 Program and determine whether changes are needed to improve processing.

IMPLEMENTATION DATE:

October 15, 2019

RESPONSIBLE OFFICIAL:

Director, Examination-Field and Campus Policy, Small Business/Self-Employed Division (SB/SE)

CORRECTIVE ACTION MONITORING PLAN:

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