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Report to Rep. Al Ullman, Chairman, Joint Committee on Internal Revenue Taxation; Sen. Russell B. Long, Vice Chairman; by Elmer B. Staats, Comptroller General.

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Authority: Federal Insurance Contribution Act. Federal Unemployment Tax Act. Tax Reform Act of 1976. 26 U.S.C. 3121(d). 26 U.S.C. 3401(a). 26 U.S.C. 1402(b).

The definition of who is an employee and who is self-employed is not clear. The definition is generally based on common law in which the determining factor is the degree of control, or right of control, the employer has over the worker. If workers are employees, their employers must withhold and pay to the Government income and social security taxes, contribute to the social security fund, and, in most instances, pay an unemployment insurance tax. Findings/Conclusions: When the Internal Revenue Service (IRS) determines that persons have been misclassified as self-employed, the effects are that: employers can be retroactively assessed employment taxes for 3 current tax years, double taxation can occur when the employer and employee pay income and social security taxes on the same income, and self-employment retirement plans established by taxpayers can be declared invalid. Alternative proposals for Congress to develop statutory language to clarify definitions of employee and self-employed or to provide legislative relief from retroactive tax assessments were all found to be inadequate. A primary source of controversy has been the IRS interpretation of the common law definition of an employee in a way that considers persons operating separate businesses as employees of another business because one can exercise some control over the other. Recommendations: Congress should amend the Internal Revenue Code to exclude separate business entities from the common law definition of employee in instances where they: have a separate set of records which reflect items of income and expenses, have the risk of loss and the opportunity of profit, have a principal place of business other than that furnished by the persons for whom he or she performs services, and are self-employed in their

own home and/or make their services available to the public. If a worker cannot meet all of these criteria and there is evidence that he is self-employed, some type of common law criteria should be applied. (HTW)

REPORT TO THE JOINT COMMITTEE ON TAXATION CONGRESS OF THE UNITED STATES

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Tax Treatment of Employees And Self-Employed Persons By The Internal Revenue Service: Problems And Solutions

IRS, businessmen, accountants, and lawyers often have difficulty determining or agreeing, for income tax withholding and social security purposes, whether a person is an employee or self-employed.

Businesses often treat contractors as self-employed persons whom IRS later determines to be employees. IRS then assesses businesses for payroll taxes they should have withheld and/or paid. Frequently this results in taxes being collected twice on the same income--from the employee and from the employer.

The Congress should amend the Internal Revenue Code to provide more precise criteria to define employees and self-employed persons and ways to prevent the same income from being taxed twice.

GGD-77-88

NOVEMBER 21, 1977

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-137762

To the Chairman and Vice Chairman
Joint Committee on Taxation
Congress of the United States

In response to your Committee's request, this report addresses the problems affiliated with the administration of taxes on self-employment income, including the need to clarify the law defining who is an employee and who is self-employed. We would be pleased to provide the Congress additional assistance as it develops legislation to solve the problems noted in the report.

As arranged with the Committee, unless you publicly announce its contents earlier, we plan no further distribution until 30 days from the date of the report. At that time, we will send copies to interested parties and make copies available to others upon request.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT TO THE JOINT COMMITTEE ON TAXATION CONGRESS OF THE UNITED STATES

TAX TREATMENT OF EMPLOYEES AND SELF-EMPLOYED PERSONS BY THE INTERNAL REVENUE SERVICE: PROBLEMS AND SOLUTIONS

D I G E S T

Key elements of an efficient tax system are that the tax laws be clear, unambiguous and not subject to arbitrary interpretation, both for the taxpayer and the Government. Who may be classified an employee as opposed to a self-employed person presently is not clear and is subject to conflicting interpretations by the Internal Revenue Service. Clarification would benefit both the Government and taxpayers.

COMMON LAW DEFINITION OF EMPLOYEES DIFFICULT TO INTERPRET

With the exception of certain job classifications the current definition of who is an employee and who is self-employed is based on the common law. Under the common law the factor determining whether a worker is self-employed or an employee is the degree of control, or right of control, the employer has over the worker. (See pp. 5 to 10.)

Accurate determinations are important because they involve millions of tax dollars. If workers are employees, their employers must withhold and pay to the Government income and social security taxes from their wages. The employers must also contribute to the social security fund at the same rate as their employees and, in most instances, pay an unemployment insurance tax.

IRS frequently determines that persons have been misclassified as self-employed and should, instead, be considered employees. Such determinations by IRS are generally retroactive. When this happens:

--Employers can be retroactively assessed employment taxes for 3 current tax years. (The statute of limitations generally relieves them of responsibility for taxes due before that period.)

--Double taxation can occur when the employer and employee pay income and social security taxes on the same income.

--Self-employment (Keogh) retirement plans established by individual taxpayers can be declared invalid with all prior untaxed contributions and income earned thereon becoming taxable in the current year. (See pp. 12 to 16.)

Many businesses have asked the Congress to develop statutory language that would clarify the definition of employee and self-employed or provide legislative relief from retroactive tax assessments.

GAO reviewed some of the alternatives proposed by business and found all of them to be inadequate in some respect. However, there is a solution that would reduce the extent of uncertainty.

Many IRS decisions that workers are employees and not self-employed involve clear-cut cases as defined by the tax laws and/or in accordance with the common law criteria. However, IRS has interpreted the common law definition of an employee in such a way that persons operating separate businesses are often considered the employees of another business because one can exercise a certain amount of control over the other.

This interpretation has been one of the primary sources of controversy in this area and has an impact on many persons such as barbers, beauticians, real estate sales agents, insurance agents, and service station operators who claim to be self-employed independent contractors. (See pp. 18 to 34.)

RECOMMENDATIONS

Where separate business entities exist, some degree of control to protect the image of the manufacturer, supplier, or prime contractor should be allowed without necessarily creating an employer/employee relationship under the common law. On the other hand, there should be a clear-cut test to assure that only legitimately independent businesses are excluded from common law criteria and that the tax obligations of the employer-employee relationship are not being avoided by subterfuge.

Accordingly, the Congress should amend section 3121 of the Internal Revenue Code to exclude separate business entities from the common law definition of employee in those instances where they:

--Have a separate set of books and records which reflect items of income and expenses of the trade or business;

--Have the risk of suffering a loss and opportunity of making a profit;

--Have a principal place of business other than at a place of business furnished by the persons for whom he or she performs or furnishes services; and

--Hold themselves out in their own name as self-employed and/or make their services generally available to the public.

There may be some situations where a worker is able to meet some, but not all of the above criteria and still have a valid basis for being considered self-employed. In these circumstances some type of common law criteria should be applied, but not unless there is evidence that the worker's situation tends toward being one of a self-employed individual.

The Congress should amend section 3121 of the Internal Revenue Code to require separate business entities to meet three of the four criteria noted in the previous recommendation before using common law criteria to determine employment status. If the independent contractor cannot meet at least three of the criteria, GAO recommends that he be considered to be an employee.

To avoid unnecessary burdens on those businesses that elect to or must obtain the services of independent contractors, GAO also recommends that the Congress amend the Internal Revenue Code to provide that, absent fraud, IRS cannot make retroactive employee determinations in those cases where businesses (1) annually obtained a signed certificate from the persons they classify as self-employed stating that they meet all separate business entity criteria; and (2) annually provided IRS the name and the employer identification or social security number of all such certificate signers.

The certificate should be

--signed by the contractor under penalty of perjury, and

--in a form approved by the Secretary of the Treasury. (See pp. 45 and 46.)

TREASURY'S REACTION

The Department of the Treasury and IRS comments on GAO's report (see app. V) state that the report has made a contribution in emphasizing the need for certainty in the area. However, they do not agree that the GAO report provides an adequate basis for legislation. The Department objects to GAO's proposed solution but neither it nor IRS offers any alternative to solve the problem. It is unfortunate that this is the case since IRS has been studying this issue for at least three years.

IRS' primary concern is that any change in the law which increases the number of self-employed taxpayers will result in lost tax revenues. IRS views self-employed taxpayers as having a low compliance rate in reporting income earned.

Using a limited sample, GAO estimated that employees formerly classified as self-employed persons had reported between 89 and 92 percent of the income earned when they considered themselves to be self-employed.

IRS was concerned that GAO's compliance rate was not accurate and undertook a study of its own. This study showed an overall compliance rate of 74 percent. But even after its own study, IRS concluded that neither study was conclusive regarding the "true level of compliance."

GAO concedes that IRS' compliance problems could increase but it questions whether tax compliance rates should be the primary concern in deciding how to clarify the laws. Congress has already determined that there should be both employees and self-employed persons. The GAO recommendation only adds clarity to that distinction.

IRS has an array of administrative tools available to insure compliance. Only if those tools are inadequate should Congress consider eliminating or controlling the number of self-employed persons as a means of increasing compliance. Nowhere in Treasury's comments is there any indication that IRS is studying, or committed to identifying ways to more effectively administer the law as it applies to self-employed persons. (See pp. 35 to 42 for a detailed analysis of Treasury's comments.)

The Departments of Labor and Justice are also concerned that the GAO criteria will permit taxpayers to be considered self-employed when they have the form but not the substance of self-employment. (See pp. 42 to 44.)

RETROACTIVE ASSESSMENTS SHOULD BE APPLIED MORE ACCURATELY

Adoption of GAO's recommended criteria will help employers and IRS make more accurate and consistent employment status determinations. But there will still be cases in which businesses do not withhold the proper income and social security taxes from their employees.

This includes situations where (1) "self-employed" persons are reclassified as "employees," (2) nonwage payments to employees are reclassified as wages, and (3) employees (employees' status not disputed) are not included on a business' employment tax return. The IRS assessment practices in such instances, including those relating to computing interest and applying appropriate penalties, need to be improved to eliminate certain tax inequities.

If an employer can produce evidence indicating that its employees claim to have paid their proper tax, IRS will eliminate the assessment against the employer for nonwithheld income taxes. However, former employees cannot always be located nor do they always cooperate with their former employer. In these cases the assessed tax is not eliminated.

In many instances, IRS has information that would allow it to ascertain whether employees paid taxes on the income received from the employer. It does not, however, use this information to eliminate the assessment. By not using this information IRS can collect income taxes twice on the same income--once from the employer and once from the employee.

Also, GAO found that social security taxes are frequently collected twice on the same income. Unless the statute of limitations has expired, IRS is precluded by the Internal Revenue Code from reducing the social security tax assessed under the Federal Insurance Contribution Act

by any social security taxes the employees have paid under the Self-Employment Contributions Act. This is because the self-employment tax was technically paid in error and the employees could seek refunds of the tax payments. Generally, however, they do not seek to recover such payments. Consequently, social security taxes are being collected twice on the same income--once from the employer and once from employees. (See pp. 47 to 56.)

RECOMMENDATIONS

GAO recommends that the Congress:

--Amend section 6521 of the Internal Revenue Code to authorize IRS to reduce the employees' portion of social security taxes assessed against employers by an appropriate portion of the self-employment social security taxes paid by reclassified employees for the open statute years. (See p. 57.)

GAO also recommends that the Commissioner of IRS, through appropriate policy and procedural revisions:

--Require his auditors, in computing the initial tax assessment, to use information in IRS files on tax payments made by those employees for whom social security numbers are available but from whom tax payment certificates were not obtained by employers

--Automatically refund to the reclassified employees the balance of self-employment taxes paid over the employee's social security taxes due.

GAO also recommends that the Commissioner improve the way IRS computes interest and applies the appropriate penalties. (See pp. 57 and 58.)

Treasury and IRS agreed with GAO's recommendation that the Congress amend the Code to reduce the employees' portion of social security taxes assessed against employers by

the amount of self-employment taxes previously paid. They also agreed with the recommendations and plan to take corrective action regarding the way they compute interest and apply penalties.

Treasury and IRS opposed the recommendations that IRS (1) use information in its file to determine an initial correct tax assessment against employers and (2) automatically refund to reclassified employees the amount by which self-employment taxes paid exceed the employee's share of social security taxes due. This opposition was apparently the result of their misunderstanding our recommendation. GAO amended its recommendation to clarify its intent. (See pp. 58 and 59).

Contents

ABBREVIATIONS

ABA	American Bar Association
AICPA	American Institute of Certified Public Accountants
FICA	Federal Insurance Contribution Act
FUTA	Federal Unemployment Tax Act
GAO	General Accounting Office
IRS	Internal Revenue Service
SECA	Self-Employment Contribution Act

CHAPTER 1

INTRODUCTION

> "The tax which each individual is bound to pay ought to be certain, not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person. * * * The certainty of what each individual ought to pay is, in taxation, a matter of so great importance that a very considerable degree of inequality * * * is not near so great an evil as a very small degree of uncertainty."

This statement appeared in Adam Smith's "Wealth of Nations," as one of his canons of taxation. While the statement appeared over 200 years ago, it is still applicable today, especially as it relates to taxes which must be paid when an employer-employee relationship exists.

The laws defining who is an employee for tax purposes are uncertain, unclear, and subject to conflicting interpretations. Accurate interpretation is important because the withholding of Federal employment taxes (income and social security taxes) on wages applies only to employees. Other Federal taxes applicable to employee wages include the employers' share of social security taxes under the Federal Insurance Contribution Act (FICA), and unemployment taxes under the Federal Unemployment Tax Act (FUTA).

The Internal Revenue Service (IRS) is responsible for assessing and collecting these taxes.

EMPLOYEE VERSUS SELF-EMPLOYED DETERMINATIONS

IRS generally relies on the employers to initially determine whether their workers are employees or self-employed. IRS audits are the check on the validity of these determinations.

With certain specific exceptions, the Internal Revenue Code (26 U.S.C. 3121(d)) defines an employee as "any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee." Under the common law the determining factor is the degree of control, or right to control, the employer has over the worker. Little importance is attached to the

form of the relationship. Thus, a job contract, separate bookkeeping, and separate business locations appear to have little effect in determining whether the person is an employee or is self-employed.

In the past the Congress, industry representatives, and other affected parties have expressed concern over the use of the common law criteria to define "employee." Because of this concern and the difficulty in applying the common law to certain hard to define occupations, the Congress added several statutory exceptions to the common law definition of employee. This was accomplished in 1950 through amendments to the Internal Revenue Code when agent and commission drivers, full-time life insurance salesmen, homeworkers, and traveling and city salesmen were defined as employees. By adding the statutory categories, the Congress clarified the status of certain occupations in the "twilight zone" between employee and self-employed classifications. For this same reason, the Congress recently, under the Tax Reform Act of 1976, excluded certain fishermen from being considered employees for withholding and social security tax purposes.

Other industries with hard to define occupations now seek congressional relief from the IRS position that the relationship with their workers is within the common law definition of employer-employee. They claim that the common law definitions as administered by IRS are unclear and not uniformly applied. Many also complain that inequities occur because common law does not recognize the independent contractor status of many salespersons or distributors who sell their products. This includes certain "independent" insurance salesmen and gasoline station operators. Others, however, see no problem with the common law definition. Their complaint is the way IRS interprets it.

IRS, on the other hand, is greatly concerned that the degree of voluntary compliance with our tax laws will decline as more persons are classified as self-employed. Thus, the Service tends to classify as many persons as possible as employees, thereby subjecting their earnings to withholding.

REVIEW OBJECTIVES AND SCOPE

Because of these various concerns, the Joint Committee on Taxation asked us to review IRS administration of taxes on self-employment income, including the classification of persons as either self-employed or employees.

This report deals with the (1) difficulties employers and IRS face in determining who is an employee and who is self-employed and (2) retroactive assessments against employers who IRS believes have misclassified employees.

We examined IRS policies, procedures, and practices for reclassifying self-employed persons as employees; and for retroactively assessing the employer for taxes he should have withheld from wages paid to these employees.

As part of the review we also randomly sampled cases from the universe of all cases IRS closed during 19. in which there was an abatement of at least some of the ployment taxes assessed. We limited our study to those cases involving abatement because they were the ones most likely to have employee/self-employed issues involved. We assumed that the vast majority of employee/self-employed cases would have had at least one abatement for current "employees." Further, the sample was also designed to provide our base data for evaluating the adequacy of IRS' abatement procedures.

The universe was 1559 cases. Using random sampling techniques, we sampled 259 cases. This technique allowed us to make statistical projections to the universe at the 95 percent confidence level.

We classified the 259 cases into the following categories.

Category	Sample size
1. Self-employed reclassified as employee	92
2. Non-covered wages reclassified as covered for withholding or social security tax	13
3. Employer did not withhold income or social security taxes from employees (employee status not disputed)	35
4. Employment tax assessment abated for administrative reasons (e.g. to correct an error)	73
5. Unable to determine--insufficient file data or files could not be located	46
Total	259

To test the criteria we developed for determining self-employed persons we analyzed the 92 sample cases in which IRS had reclassified 1,070 workers as employees. These workers were in various types of industries and occupations where the problem of classification as employee or self-employed exists and were primarily used to develop the findings presented in Chapter 2.

To assess the adequacy of IRS abatement procedures, we used the sampled cases in the first three categories noted above. Chapter 3 discusses the findings as a result of our analysis of the 140 cases.

CHAPTER 2

IRS AND BUSINESS TAXPAYERS DISAGREE OVER WHO SHOULD BE CONSIDERED EMPLOYEES: WHY; RESULTS; SOLUTIONS

IRS and business taxpayers frequently disagree over whether various business relationships with individuals are that of employer-employee under the common law definitions. IRS interpretation of a common law employee is more strict--more likely to result in a finding of employee status--than that of business and, in many instances, the courts. This is particularly troublesome because IRS relies on business taxpayers to make the initial employment status determinations which may later be subjected to IRS audit.

The term "common law" is not defined in the statutes. It is a body of law and legal theory based on customs and usages that originated and developed in England. The common law definition of employee is based on a master-servant relationship where the master directs and controls the work performed by the servant.

Under the common law, a worker is an employee if the person for whom he works has the right to direct and control the way he works, both as to the final result and as to the details of when, where, and how the work is to be done. It is the IRS view that the employer need not actually exercise control. It is sufficient that he has the right to do so.

IRS has adopted 20 rules (see app. I) to determine whether workers are employees. In brief, these rules are directed at the following questions.

1. Is the person providing services required to comply with instructions about when, where, and how the work is to be done?

2. Is the person provided training to enable him to perform a job in a particular method or manner?

3. Are the services provided integrated into the business' operations?

4. Must the services be rendered personally?

5. Does the business hire, supervise, or pay assistants to help the person performing services under contract?

6. Is the relationship between the individual and the person he performs services for a continuing relationship?

7. Who sets the hours of work?

8. Is the worker required to devote his full time to the person he performs services for?

9. Is the work performed at the place of the business of the potential employer?

10. Who directs the order or sequence in which the work must be done?

11. Are regular oral or written reports required?

12. What is the method of payment--hour, week, commission, or by the job?

13. Are business and/or traveling expenses reimbursed?

14. Who furnishes tools and materials used in providing services?

15. Does the person providing services have a significant investment in facilities used to perform services?

16. Can the person providing services realize both a profit or a loss?

17. Can the person providing service work for a number of firms at the same time?

18. Does the person make his services available to the general public?

19. Is the person providing services subject to dismissal for reasons other than nonperformance of contract specifications?

20. Can the person providing services terminate his relationship without incurring a liability for failure to complete a job?

If an employer-employee relationship exists under the common law rules, the parties involved cannot by contract or other means define the relationship otherwise for tax

purposes. Thus, it is of no consequence that the employee is designated as a partner, coadventurer, agent, independent contractor, or the like.

COMMON LAW RULES DIFFICULT TO APPLY

Why do IRS, employers, accountants, lawyers, and other advisors have difficulty determining whether a person is an employee or is self-employed? One reason is that the application of the common law rules to specific employee/self-employed situations is open to broad and inconsistent interpretation. For example, not all of these rules are always present in every employment situation. Some of the rules do not apply to certain occupations. Further, the rules vary as to applicability and importance in different situations. Evaluating the weight to be given various rules is often a subjective matter, even though IRS and employers make a strong and comprehensive effort to develop all relevant facts. As a result, many employers cannot, with any degree of certainty, determine who will be considered an employee until after IRS has audited the situation.

Another reason IRS, employers, and their advisors have difficulty in making employment status determinations is that contracts, past industry practice, and the incurring of business expenses do not make an individual self-employed where the common law elements of control exist. For example, many people operate businesses that are separate entities from those for whom they perform services. These people, in the course of running their business, may

--hire, direct, and pay assistants;

--provide their own office, equipment, materials and other work facilities;

--have continuing and recurring liabilities or obligations;

--perform certain jobs for prices agreed upon in advance and pay expenses incurred in connection with the work; and

--realize a profit or loss from the business based on his or her management of the business.

Even where these conditions are present, IRS may still determine the operator of the business to be an employee if

certain aspects of the job are controlled by the business which contracted for the job to be done.

Example:

--John Jones operates a service station.

--He rents the station from the same company he purchases gasoline from.

--The rent is included in the price he pays for the gasoline.

--John hires and pays employees to work in the station.

--John's income statement shows the following:

Gross sales receipts		$100,000
Less: rent and cost of goods sold		45,000
Gross profit		$ 55,000
Less: Other business expenses		
Wages paid to employees	$30,000	
Insurance	900	
Utilities	1,500	
Service truck expense	1,500	
Supplies, towels, uniforms	500	
Employment taxes (FICA & FUTA)	2,500	
Miscellaneous expense	100	37,000
Net profit		$18,000

--John pays his income and self-employment social security taxes on the $18,000 net income.

--IRS determines that the supplier has the right to direct and control John Jones in the way he works.

Under these circumstances IRS would rule that an employer-employee relationship exists. The supplier would be assessed for the income and employee social security taxes that should have been withheld. The assessment would be

based on $55,000 gross income, not the $18,000 net income. 1/ The employer would also be assessed for unemployment taxes and its matching share of social security taxes. Penalties and interest can also be added to the assessment. Such assessments can be applied retroactively for up to 3 years.

COMMON LAW RULES NOT UNIFORMLY APPLIED

The former director of the IRS Legislative Analysis Division told us that it is not uncommon for two knowledgeable individuals to disagree on an employee status determination given the same set of circumstances. He said that the employment tax law should have more certainty for the benefit of both the employer and employee and that guidelines should be provided to the taxpaying public which permit it to make its own determinations with certainty.

IRS has not provided such guidelines. The results are misclassifications of employees by employers and inconsistent and conflicting interpretations of the common law rules by IRS personnel in different geographic areas.

The problems associated with this latter point are illustrated by one large national manufacturing company which had contracted with independent franchise sales outlets to sell and service its products. Persons operating the sales outlets were treated by the manufacturer as self-employed persons. It was brought to the attention of IRS that the franchise sales outlets had received different employment status determinations by IRS agents in cases involving substantially similar facts. As a result, IRS stopped its agents from making employment determinations in this case until the national office could furnish them guidance.

The difficulty of conflicting interpretations of the common law rules is further highlighted by IRS audit contradictions. IRS individual tax audits sometimes treated individuals as self-employed while agents auditing the business the individuals worked for classified them as employees.

1/FICA tax and income tax withholding is assessed on "wages" which is defined by law (26 U.S.C. 3121(a) and 26 U.S.C. 3401(a)) as all remuneration for employment. SECA tax is assessed on "self-employment income" which is defined by law (26 U.S.C. 1402(b)) as net earnings from self-employment.

As discussed on page 3, we sampled 92 employers who had self-employed workers reclassified as employees. We were able to identify 59 of their "employees" who had their income tax returns audited by IRS--13 were audited as a result of their "employer's" audit and 46 were audited independent of their "employer's" audit. Of these 46 individual audits 11 (24 percent) had income on which IRS assessed self-employment social security tax. This income was subsequently reclassified as employee wages subject to employee social security tax under FICA when IRS audited the employers.

For example, one worker reported on his 1973 return "other" income of $4,652 which was received for driving a truck for a family owned company. IRS representatives, during a 1975 audit of his return classified the earnings as self-employment income and assessed him $372 in self-employment social security tax. At the same time, other IRS representatives were conducting an employment tax audit of the family-owned company, and the worker was subsequently classified as an employee. As a result the IRS officials assessed FICA social security taxes on the same income that SECA taxes had been paid on.

WHAT TYPE OF WORKER IS BEING RECLASSIFIED?

Some of the industries which are hit the hardest by IRS reclassification of worker status are those that rely on a direct sales organization to sell their products. This includes many oil product suppliers who market gasoline through contractual arrangements with individuals who operate service stations owned or leased by the supplier, and insurance companies who rely on "independent insurance agents" to sell their policies. IRS frequently determines other direct sales organizations to be employers of those persons who sell their products door-to-door or through home party plans.

IRS reclassifications are not limited to these large, well organized industries. Other workers IRS reclassified as employees included carpenters, painters, entertainers, truck drivers, store managers, nurses, security guards, and mechanics.

Many of the persons reclassified by IRS are small businesses--often one person--separate from, but under a certain degree of control of, other businesses whose product they sell or for whom they perform services. Reclassifications are made even though such persons can incur nonreimbursable costs; can suffer a loss, as well as make a profit; maintain

separate books and records; and have a principal place of business at locations other than on the premises of the supplier or the business to which the services are provided.

Other persons being reclassified perform their services on the premises and use the equipment and facilities of the contracting business. The service provided is supervised and directed in the same manner as an employee. The principal difference is that a service contract exists.

Often the difference between an employee and a self-employed independent contractor is difficult to distinguish. For example, what is the difference between a building guard supplied under contract by a large protective agency, an off-duty policeman who independently contracts his services as a building guard, and a building guard on the company payroll? The duties and hours worked by each are the same. The off-duty policeman has elements of being a one-man protective service agency as well as elements of being an employee. In his case, what is the difference between a fixed salary and a fixed contract fee? Questions such as these cause problems in defining employees. IRS interprets to the Government's advantage and the business interprets to its advantage.

EMPLOYEE VERSUS SELF-EMPLOYED DETERMINATIONS BENEFIT EMPLOYERS AND IRS DIFFERENTLY

IRS and employers often approach employee/self-employed determinations differently. IRS examines the employment relationship from the viewpoint of "can the worker be considered an employee?" Employers, on the other hand, view the relationship from the perspective of whether the worker can be considered self-employed. This difference in perspective may be due to the objectives each has in assessing the same situation. Benefits will accrue to either IRS or the employer depending on a worker's classification. At stake are millions of dollars in employment taxes.

Benefits to IRS

Classifying individuals as employees makes collecting taxes easier for IRS since the tax is collected from only one employer rather than from several self-employed individuals. Other reasons why IRS prefers the workers to be classified as employees include;

--withholding of employment taxes by the employer provides for an even flow of tax dollars into the treasury,

--increased compliance in payment of social security and income taxes since the employer withholds taxes at the source,

--worker being eligible for unemployment compensation if laid off by the employer, and

--increased dollars to the social security trust fund. The trust fund can receive up to $627 more per person if the worker is classified as an employee rather than self-employed. The combined employer-employee payment is 11.7 percent of the first $16,500 of gross wages. The self-employment payment is 7.9 percent of the first $16,500 of net earned income.

Benefits to employers

Benefits to employers by classifying workers as self-employed persons include;

--reduced insurance premiums (e.g. health and liability insurance),

--more aggressive workers as self-employed persons,

--reduced business expenses through elimination of contributions to social security and unemployment taxes, and

--reduced recordkeeping because employment taxes are not required to be withheld by the employer on compensation paid to self-employed persons.

EFFECT OF RECLASSIFYING SELF-EMPLOYED PERSONS AS EMPLOYEES

When IRS determines that persons treated as self-employed are, in fact, employees, it generally does so retroactively. When this occurs the following can happen.

--Employers can be retroactively assessed employment taxes for years not subject to statute of limitations--3 current tax years.

--Double taxation can occur when the employer and employee pay income and social security taxes on the same income.

--Self-employment (Keogh) retirement plans established by individual taxpayers can be declared invalid with all contributions and income earned thereon becoming taxable in the current year.

Retroactive assessments made

Based on our sample of 1975 closed employment tax cases we estimate that there were at least 554 cases in which IRS determined workers to be employees instead of self-employed. The employers involved in these cases were assessed about $3.6 million for taxes they should have withheld from employee wages. These cases involved retroactive assessments totaling an estimated $2.9 million in employee income taxes and $.7 million in social security taxes not withheld from the wages. An additional $1.7 million in the employer's share of social security taxes plus interest and penalties was also assessed. These amounts are apparently only the tip of the iceberg. The National Association of Independent Insurers reported in a letter to the Commissioner of Internal Revenue that IRS determinations that commissioned insurance agents are employees have resulted in tax deficiencies totaling tens of millions of dollars per company and hundreds of millions of dollars in the aggregate.

Another industry subject to large retroactive assessments is the direct sales industry which includes persons who sell from door-to-door and at home parties. Last year a Court of Claims trial judge ruled against IRS' determination that persons engaged in home party plans distributing and selling women's fashions were employees of Queen's-Way to Fashion, Inc. (Queen's Way to Fashion, Inc., vs. U.S. 37 AFTR 2d 76-1128). This ruling caused IRS to reverse its $2.4 million assessment against the company.

Such retroactive assessments, if upheld, can have a very serious impact on business. For example, one small employer stated that if a lump sum payment of the assessments had to be made, he would have been out of business. Fortunately, he was able to work out a monthly payment plan with IRS. Another employer told us that capital expansion plans were delayed because of the assessment, while a third employer stated that if the 3-year assessment must be paid, he will have to close his business.

Double taxation

IRS adjusts the withholding income tax assessments if the employer provides employee signed certificates stating

that they paid their proper income tax. But no adjustment is made to the assessment for non-withheld social security tax assessments even if the employee paid self-employment social security taxes.

Unfortunately, employers are not always able to locate or gain the cooperation of their former employees to sign the certificate. No adjustment is made for any taxes these persons may have paid. The result: IRS collects income tax on the same wages twice.

For example, we selected five of our employer sample cases for detailed analysis and reviewed the tax returns filed by their 37 "employees." The employers were assessed $41,400 in income taxes that should have been withheld from employee wages. Of this amount, $38,300 was identified by the employer as tax applicable to "employees" who certified they paid their proper income tax. IRS removed this amount from the tax assessment. However, the remaining $3,100 was not eliminated because signed statements were not obtained from some employees. Our review of the employees' tax returns indicated that an additional $1,900 could have been abated because some IRS records indicate some of these employees paid income tax on the money earned from the employer.

We also found that 24 of the 37 employees paid self-employment social security taxes on income earned while considered self-employed. The employers were assessed $6,913 for social security taxes that should have been withheld from wages paid to the 37 employees. Our analysis showed that $5,008 (72.4 percent) represented a double payment of social security taxes to the Government.

As long as the 3-year statute of limitations has not expired the employees can generally seek a refund of their self-employment social security taxes since, in IRS' eyes, they were not self-employed. However, IRS generally makes no attempt to tell the employees this. We also found that the employers generally do not advise employees of their right to a refund.

Retirement plans endangered

Self-employed persons can establish an IRS approved retirement plan known as Keogh or HR-10 plans. These plans, authorized by section 401 of the Internal Revenue Code, permit self-employed persons to set aside annually, tax free, up to $7,500 of their income in Keogh accounts. The contributions plus income earned by the account remain tax free until paid out after the taxpayer reaches at least the age of 59-1/2.

An IRS determination that someone presumed to be self-employed is actually an employee can have drastic adverse effects on the Keogh plan he or she has established. Two different situations can result. There are occasions when the employee has, independent of the employer audit, received written advice from IRS saying he or she is self-employed. If this advice is reversed by an IRS audit of the employer, then the plan is frozen. That is, the plan continues to exist but any future income contributed to the plan would not be tax-exempt.

If the individual has not received an IRS determination that he is self-employed, all proceeds (contribution plus income earned) of the plan become taxable. The individual would be required to file an amended return for the open years not covered by the statute of limitations and report the contributions for those years as ordinary income. The remainder of the plan's proceeds would become taxable as current year income. The end result is that these persons are left with less retirement income than they were counting on.

Employee/self-employed redeterminations can also affect the retirement income security of persons other than those whose employee status was in question. Employee pension plans (qualified under sections 401(a) and 410(b) of the Internal Revenue Code) provided by an employer for his employees must benefit either

> "(A) 70 percent or more of all employees, or 80 percent or more of all the employees who are eligible to benefit under the plan if 70 percent or more of all the employees are eligible to benefit under the plan, excluding in each case employees who have not satisfied the minimum age and service requirements, if any, prescribed by the plan as a condition of participation, or
>
> (B) such employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of employees who are officers, shareholders, or highly compensated."

Officials of one company said they established a "generous" retirement plan for their office employees. They said that after IRS determined the company's "independent contractors" to be employees, the office employees' pension plan was terminated because the company could not afford to extend the plan to the reclassified employees. In this case,

the persons reclassified as employees lost their eligibility to establish Keogh plans and the undisputed office employees lost their retirement benefits.

CHANGES NEEDED BUT BUSINESS-PROPOSED ALTERNATIVES ARE INADEQUATE

Many businesses have found the common law criteria, as administered by IRS, to be so subjective that they have turned to IRS and the Congress for precise criteria.

Short of obtaining more precise criteria, some businesses have asked for relief from the retroactive tax assessments which result when IRS disagrees with their interpretation of the law. They propose that all IRS redeterminations be applied prospectively only. Even after IRS gives its interpretation of the law, others disagree with the decision and seek to be excluded from the common law criteria. Still others believe the common law is clear but that IRS needs to be restrained from trying to expand or "liberalize" its interpretation to classify as employees those it formerly accepted as self-employed.

Prospective application of IRS reclassifications

One way to reduce the impact of reclassifying the self-employed to employee status is to make the reclassification apply only prospectively. If this were done, IRS would continue to impose its interpretation of common law criteria but the businesses would not be assessed taxes retroactively. The workers would maintain their self-employment status until IRS notifies the business that an employer/employee relationship exists.

Advantages

Such prospective treatment would eliminate the possibility that retirement plans could retroactively lose their qualified status. Workers and employers would still have to restructure their retirement plans to comply with the new employer-employee status. This would mean that self-employment Keogh plans would become frozen and the reclassified worker would either become eligible for a qualified company plan or for establishing an individual retirement account authorized by section 408 of the Code.

Prospective application of employee/self-employed redeterminations would also eliminate retroactive tax

assessments and the possibility of IRS collecting income and social security taxes twice--once from the employee who paid taxes as a self-employed person and once from the employer based on the retroactive assessments.

Disadvantages

A serious disadvantage with this proposal is that there is no incentive for businesses to properly classify workers as employees. Businesses could take the attitude that their workers are self-employed contractors until IRS catches up with them. Such bad faith actions of the employer would be difficult to prove. The end result could be unpaid taxes which IRS has little hope of collecting.

As payroll taxes and the associated processing costs increase, the financial incentive for making bad faith decisions also increases. Also, it would be unfair to competing businesses to let one have a cost advantage over another simply because IRS had audited one company and not the other.

Penalties for bad faith employee status determinations would probably be ineffective since bad faith intent would be difficult to prove. They would also be administratively burdensome because they would force IRS into the position of proving guilt instead of the taxpayer proving his innocence.

Excluding certain occupations from common law criteria

In the past, one method used to clarify whether certain persons were employees was to exclude certain occupations from common law criteria, and define by law whether they were employees or self-employed. There are several occupations so defined.

Corporate officers, certain agent- or commission-drivers, full-time life insurance salesmen, home workers performing specified work on materials provided by and delivered to other persons, and certain traveling or city salesmen are defined as employees (26 U.S.C. 3121(d)). The Tax Reform Act of 1976 excluded certain fishermen from being considered employees for income tax and social security purposes. Some businesses would like the law to be further amended to provide that certain other occupations are not to be subject to an employer-employee relationship.

In other attempts to eliminate use of the common law criteria, some industry representatives have proposed that special criteria be established for their industries. The National Association of Independent Insurers has proposed a series of eight factors to determine whether independent insurance agents were employees or self-employed. A representative of gasoline marketing companies proposed a series of 10 factors which would be used to determine whether a contract gasoline station operator is self-employed or an employee of the marketing company.

Each of these proposals was an attempt to gain Federal recognition that the usual way these industries do business does not involve an employer-employee relationship between those that supply the product and those who sell it to the public.

Advantage

Exclusions of specific occupations from common law criteria is an effective way to eliminate some disagreements between businesses and IRS. Employee status determinations for these occupations would be more uniformly applied and it would be easier for businesses to make the initial determinations.

Disadvantages

Special exclusions and special criteria are essentially stopgap measures for a few large industries. It would be very cumbersome and impractical to have special criteria for all industries. Therefore, it becomes discriminatory treatment in favor of a few industries.

To the extent workers in those occupations are defined to be employees, the benefits of federally sponsored programs (e.g., unemployment compensation, minimum wage, and workmen's compensation) are extended to more workers. However, the pressure from industry is to define those employed in specific occupations as being self-employed. Such action could take away these benefits from many who now consider themselves employees.

A SOLUTION: SEPARATE BUSINESS ENTITIES SHOULD BE EXCLUDED FROM COMMON LAW CRITERIA

Each of the proposals made by business representatives has serious deficiencies. Prospective determination does not solve the problem, only its effects. Also, wholesale

legalization of self-employment status for given occupations removes from certain businesses their responsibilities in tax administration (withholding tax at source of income) and in financing various social programs (social security and unemployment insurance).

We do not view the IRS interpretation of the common law in defining an employee to be unfair or inequitable in cases where the workers are under the direct control of those for whom they are performing services. This would include situations where working hours are specified, equipment for performing the job is supplied to the worker, the worker has no opportunity for a business loss, and all aspects of the job are subject to the control of the business paying for the service being provided. Such a situation should be that of employer-employee with the employer bearing its responsibility for withholding employee taxes and paying those taxes and wage-related employer taxes to IRS. Most of the IRS employment status redeterminations covered by our sample fell into this category.

Our study lead us to the conclusion that a major cause of the employee/self-employed controversy involves those cases in which the reclassified workers operate a business separate from the one IRS considers to be the employer. We do not believe such relationships should, in all instances, be considered one of employer-employee and, therefore, should, in some cases, be excluded from the common law definition.

Such businesses would include those who (1) provide and are paid for an end product, such as blueprints, (2) sell a supplier's product at a markup over cost, (3) install, under contract or subcontract a product such as carpeting and air-conditioning units which are sold by another business, (4) subcontract work from a prime contractor such as painting new homes in a housing development, and (5) sell through their independent agency another party's products, such as insurance, on a commission basis. In such situations some degree of quality control to protect the image of the manufacturer, supplier, or prime contractor should be allowed without creating an employer-employee relationship under common law.

On the other hand, there should be a clear cut test to limit the exclusion from common law criteria to legitimate businesses. To this end we proposed in a draft of this report that four basic tests be used to determine whether

a true separate business entity exists. An independent contractor engaged in a trade or business should be considered self-employed if the contractor has

--a separate set of books and records which reflect items of income and expenses of his or her trade or business;

--the risk of suffering a loss and opportunity of making a profit;

--a principal place of business other than that furnished by the persons for whom he or she performs or furnishes services; and

--acquired an employer identification number required under 26 U.S.C. 6109.

If a worker could not meet all four requirements we proposed that the following situations be used to govern how his or her employment status would be determined.

To even be considered as possibly self-employed the worker would have had to obtain an employer identification number. In addition, he or she must have met the conditions described in two of the three remaining criteria to warrant use of common law criteria to determine his or her employment status.

Thus, a worker would have been considered an employee if he or she did not meet at least three of the four criteria, including the acquisition of an employer identification number. Only in those cases where all four criteria were met would workers have been automatically considered self-employed.

The requirement that the independent contractor obtain an employer identification number was relatively simple but important. First, it was a means, if IRS chose to use it, to identify persons who consider themselves to be self-employed. Secondly, obtaining the identification number would have been a positive step taken by the persons who consider themselves self-employed to prove that they intended to consider themselves self-employed and did not fall into that status by accident.

The other requirements were intended to insure that persons performing services in connection with another business were truly in business for themselves. However, there might be some situations in which a worker would be able to meet some, but not all of these requirements and

still have a valid basis for considering that his or her relationship with another business was one of a self-employed businessman. Thus, we did not think it was appropriate to make a hard and fast rule that all persons not meeting all four criteria would automatically be considered employees.

In these circumstances some type of common law criteria should be applied. Nevertheless, we did not believe it was appropriate to consider applying these criteria unless there was evidence that the worker's situation tended toward being one of a self-employed individual. There should be some evidence that there is a probability of the worker being considered self-employed before using the common law criteria. The best way to judge whether such a probability exists is to apply the rule that at least two of the three criteria, other than obtaining an employer identification number, must be met before using the common law factors.

We believed these criteria were more precise, easier to understand, and can be applied more accurately and consistently than the common law rules. However, some clarification is needed.

--Separate books and records should be for the purpose of determining profit and loss of a business. They should reflect all items of income and expense. Books and records are not intended to include those records maintained for the purpose of determining costs to be reimbursed. Reimbursed costs or costs allocated from another business should not be included in determining business expenses.

--A building rented from a supplier or wholesaler should qualify as a separate principal place of business if the rent is comparable to rents normally paid between nonrelated businesses. Also, if a person uses his or her residence as a principal place of business and also uses office facilities of the business for which services are provided, the residence should not be considered as meeting the separate place of business criteria.

--A risk of suffering a loss must be a real one. That is, there is a real possibility that expenses directly related to the business will exceed business income. Education and conference expenses should not be considered to be expenses directly related to the business.

Some of these clarifications are necessary to guard against giving self-employed status to those who are not truly separate business entities. It is a normal practice for many employees to keep records of business expenses to be reimbursed by their employers. Also, it is not unusual for employees to work at their residence in addition to an employer-provided office. Further, it would be easy for a part-time salesperson to claim the possibility of business loss by attending a professional conference in a distant city and deduct the cost as a business expense. The clarifications are intended to prevent someone from constructing an unintended self-employment situation.

Our proposed criteria were not intended to replace the common law definition of employee. They were only to exempt certain people for which the IRS interpretation of the common law is inappropriate. To drop the common law criteria entirely would have the effect of arbitrarily reclassifying many recognized self employed as employees. We did not identify who these persons are or whether such arbitrary reclassification would be justified--they were not the ones that were adversly affected by the current law.

The number of persons meeting the four-point test plus others who fail to meet the statutory self-employment tests would have reduced the number of cases IRS must question. Consequently, IRS retroactive employment status determinations would decline.

However, the proposed criteria would not eliminate all retroactive employment status determinations since some businesses and workers who did not meet the criteria would continue to assert--in some cases justifiably--self-employment status under common law criteria. When retroactive assessments occur in these situations, there are ways to limit the chance of double taxation by using IRS records to determine how much of the tax has already been paid by the employees. This point is fully discussed in chapter 3 of this report.

Prospective determination when employer believed separate business entities were involved

It would be difficult for a business to verify in all cases that a contractor truly meets all of the self-employment criteria. Situations could arise where IRS finds that a business, in good faith, treats someone as self-employed when he did not meet all four criteria.

As a result, retroactive assessments would be made against employers who relied upon the contractor's word that he met the self-employment criteria.

One solution to this situation is to permit the business to obtain annually a certificate--signed under penalty of perjury--from a contractor certifying that he or she meets all of the required criteria for being considered self-employed. Businesses should be required to inform IRS annually of the identities of all parties from whom they receive such certificates. The business could hold this certificate as evidence that its decision to treat the contractor as self-employed was made in good faith. On this basis IRS should not assess taxes retroactively. However, the business would be alerted to consider the contractor as an employee in the future.

The certificate has the benefits of the prospective determination proposal while at the same time tying the action to specific documents as evidence of good faith. The annual identification to IRS of persons from whom self-employment certificates have been obtained would permit IRS to check (1) the validity of the certificates and (2) the overall compliance of this category of self-employed taxpayers.

We discussed extensively the proposed criteria with executive branch officials.

IRS CONCERN WITH PROPOSED CRITERIA

In August and September 1977 meetings with us, IRS officials expressed the following concerns with using the four tests as criteria to define self-employed persons.

--Taxpayers would be able to easily change their employment status to that of self-employed at will. As such, many who are now employees may opt to be self-employed.

--If more taxpayers became self-employed, it would lead to higher noncompliance with the tax laws through unreported income.

--The proposed criteria would still leave too many situations open to interpretation under common law criteria.

Our analysis indicated that most of the taxpayers who are now employees would remain employees if the proposed

criteria were used to define self-employed persons. They could not change their employment status. This statement is also true for those employees who had their self-employment status changed by IRS.

We examined the files of 92 businesses where IRS changed the status of self-employed contractors to that of employees. Twenty-five of the files contained enough information to permit us to apply the proposed criteria. Of these, only four of the businesses had reclassified employees who might meet the self-employment criteria. Employees of the remaining 21 businesses could not satisfy the four tests and would not be considered self-employed.

Although a number of businesses subjected to IRS worker status reclassifications would not be affected by our criteria, the industries suffering the most from retroactive determinations would, to a large extent, have their business/independent contractor status recognized for tax purposes. For example, an employer/employee relationship would not be imposed on those industries which have set up a network of distributors to sell their products, as long as the distributors meet the four criteria.

IRS officials were also concerned that any change which results in more taxpayers being classified as self-employed would result in lower compliance with the tax laws. Their concern was two-fold. First, they were concerned that self-employed taxpayers may not file income tax returns. Secondly, if they do file, IRS believes there is a greater chance that some of the income may not be reported.

IRS officials had no statistically valid information available to support these concerns. However, they believe taxpayers are more likely to file a return if IRS has some money that was withheld from their income. IRS also believes that when a taxpayer has to attach a wage statement (Form W-2) to the tax return, there is less opportunity to have unreported income.

On the basis of our sample, we have concluded that those taxpayers involved in employee/self-employed redeterminations had generally paid their income and social security taxes.

Specifically, based on our sample of employment tax cases closed in 1975 (see p. 3) there were at least 554 cases where IRS reclassified workers from self-employed to employee status. IRS assessed these employers about $3.6 million in taxes they should have withheld from employee wages.

--$2.9 million for income tax not withheld and $0.7 million for social security tax not withheld. Of the income tax not withheld, between 89 and 92 percent was eventually eliminated because evidence satisfactory to IRS was provided which showed that the "employees" had paid their income taxes.

We found that taxpayer compliance may be better than the 89 to 92 percent. We selected five employer cases for detailed analysis and reviewed the tax returns filed by their 37 employees. The analysis showed that 60 percent of the income tax not eliminated by IRS had been paid by the employees.

As a further test of compliance, we reviewed 126 audit case files of 82 persons (26 reviewed but not audited and 56 audited) who were reclassified as employees as a result of IRS auditing their employers. Our review showed that 14 of the 82 taxpayers (16 percent) did not report all of the income they earned from their self-employment position. Of $297,000 in self-employment income earned, $39,000 (13 percent) was not reported on tax returns. 1/ IRS may consider 13 percent to be a rather high percentage of unreported income. However, since IRS generally selects for audit those returns which have the highest potential for tax change, the 13 percent under reporting of income may not be indicative of all persons whose self-employment status is questioned by IRS.

IRS officials also were not convinced that using our proposed criteria would greatly reduce the number of situations subject to common law interpretation. They were also concerned that perhaps too many occupations would be classified as self-employed.

As we noted earlier, we believe that where the circumstances legitimately warrant it, persons should be considered self-employed. Our primary concern in developing criteria was not to try to place as many workers as possible in one status or the other. Rather, we wanted to reduce the uncertainty of determining whether workers are self-employed or employees. In several meetings with IRS officials, they gave the impression that one of the reasons they objected to our criteria was that it tended to legitimize the self-employed status of several occupations that were now subject to common law interpretation and for which, in some circumstances, IRS could rule that the workers were employees.

1/The 82 workers were included in the 92 cases sampled to arrive at findings for the chapter. These were the only workers that IRS audited independently.

Being responsible for insuring the greatest possible compliance with our tax laws, the IRS concern is understandable. But we believe equity factors and the public's will, as expressed by the Congress, are also very important considerations.

In this case the Congress has given no indication that it believes the distinction between self-employed workers and employees should be eliminated. To do so would, in our opinion, be unfair to those persons legitimately working for themselves. On the other hand, if there is evidence that self-employed persons are much more likely to cheat on their income taxes than employees, then perhaps stronger measures than now exist need to be taken to insure proper payment. This could include using information provided by businesses which identify those taxpayers who certified they met the self-employment criteria. But our sample results, as noted earlier, provided some evidence that self-employed workers tend to declare income earned as self-employed.

In September 1977, we advised IRS that we believe the results of our study are sufficient for the Congress to legislate a solution, but additional valid information can always be useful for making legislative decisions. To that end, the public purpose would be served if IRS could provide timely additional information on the extent of compliance by self-employed workers and employees in reporting income earned. Our concern is that there not be any lengthy delay in clearing up this major problem which causes great uncertainty for many taxpayers.

The extent to which our criteria would reduce the amount of uncertainty is illustrated below. At our request, IRS provided us a list of several occupations whose employment status is uncertain as well as some of the factors IRS considers in determining employment status. Among the 14 occupations listed were barbers and beauticians, direct sales persons, opinion poll takers, insurance salespersons, real estate salespersons, and service station operators. Among the factors IRS would use in the occupations to assess employment status are the following.

Barbers and beauticians

Factors indicating an employee

1. Sharing of income between worker and shop owner/operator on a percentage basis under the terms of so-called "lease agreements." The worker shares the

income he derives from services to his own customers, or the shop's customers, either by

(a) making a periodic accounting to the owner/operator of his income, paying the owner/operator his agreed upon percentage, and retaining the balance, or

(b) depositing all of his receipts in the cash register and receiving his agreed upon percentage periodically from the owner/operator.

2. Requiring the worker to follow shop rules concerning

(a) observance of days and hours of work,
(b) personal appearance and conduct,
(c) wearing of uniforms,
(d) courtesy to patrons, and
(e) observance of no smoking rule.

3. Right of owner/operator to discharge worker for

(a) failure to conform fully with shop rules,
(b) misconduct or discourtesy to customers, or
(c) working while under the influence of intoxicants.

4. Furnishing to the worker by the owner/operator of

(a) necessary licenses and permits,
(b) equipment,
(c) tools of the trade, and
(d) necessary supplies.

Factors indicating an independent contractor

1. Worker leases a chair or space from the owner/operator of the shop for a regular fixed weekly or daily fee. Owner/operator usually furnishes heat, light, water, and the usual supplies necessary for the worker to provide services to his customers.

2. Worker furnishes his own tools of the trade and licenses.

3. Worker determines his own work routine and is not required to work a minimum number of hours per day or week.

4. Worker collects all fees for his services, retains the full amount thereof (except for the daily or weekly fee), and makes no accounting of his income to t e owner/operator.

Direct salespersons

Factors indicating employee

1. Instructions
2. Training
3. Integration
4. Order or sequence set
5. Customer leads and follow-up
6. Oral or written reports
7. Materials furnished by company
8. Lack of investment
9. Right to discharge
10. No risk of loss
11. Attend meetings

Factors indicating independent contractor

1. No set hours
2. No continuing relationship
3. Pay own expenses
4. Investment
5. Full time not required

Interviewers (opinion poll takers)

Factors indicating employee

1. Instructions
2. Training (minor)
3. Integration
4. Services performed personally
5. Order or sequence set
6. Oral or written reports
7. Payment by hour
8. Expenses paid
9. Materials furnished
10. No risk of loss

Factors indicating independent contractor

1. No integration
2. May hire assistants
3. No set hours

4. No continuing relationship
5. Method of payment
6. Investment (transportation)
7. Work for more than one firm
8. Professional status

Insurance Agent

Factors supporting employee status

1. Training--required at company expense
2. Furnishing of office facilities, supplies, secretary and clerical help
3. Required meetings
4. Production quotas
5. Unilateral right to terminate agents contract
6. Assigned territory--can be enlarged or reduced by company
7. Agents required to learn sales presentations
8. Advertising paid for by company
9. Set hours of work--routine established by company
10. Required to canvass territory at periodic intervals
11. Fringe benefits--retirement--vacations
12. Company pays for agents
13. Personal services--performed exclusively
14. Salary plus commission
15. Supervision of agent's activities--reports--regular
16. Leads furnished by company--required to follow-up

Factors supporting independent contractor status

1. No training required
2. Salesman has quasi-property right in the agency which he can sell, assign or transfer (i.e. business generated)
3. Salesman supplies his own office facilities, supplies, secretary, and clerical help
4. Salesmen not required to attend meetings
5. Salesmen not required to meet production quotas
6. Company cannot unilaterally terminate agent's contract
7. Company cannot assign to specific territory (enlarge or reduce it)
8. Salesmen not required to learn any sales presentations.
9. Salesmen pay for their advertising
10. No set hours required of salesmen, no set routine is established by the company
11. No fringe benefits given to salesmen
12. Agent pays for his own expenses
13. Agent assigns some of the work, as the contract of service does not contemplate personal performance on the part of the agent
14. No set salary is paid the agent by the company

15. No supervision of agent's activities--no reporting required
16. No leads are furnished by the company

Real estate agents

Factors supporting employee status

1. Office facilities, etc. furnished by company
2. Furnishing business cards, forms, stationery, etc.
3. Right to discharge
4. Company pays for license and membership dues in local real estate
5. Mandatory sales meetings
6. Daily reporting to the company office
7. Company assigns floor time on weekends
8. Fixed hours
9. Full time
10. Advertising paid for by company
11. Agents required to comply with instructions in manual
12. Advance
13. Company can place listings exclusively in certain agencies
14. Broker may determine listings upon which agent may work--assign and reassign listings
15. Call on particular prospect at a given time
16. Pursue prescribed sales technique
17. Fixed office procedures
18. Agents furnished leads and expected to follow-up
19. Salary and commission
20. Training
21. Fringe benefits
22. Quota of minimum
23. Agents can buy and sell own property only through broker
24. Close or continued supervision in order to comply with state regulatory requirements

Factors indicating independent contractor status

1. Salesmen furnish their own office facilities
2. Salesmen furnish their own cards, forms, stationery, etc.
3. Salesmen cannot be discharged by company
4. Salesmen pay for own license and membership dues in local real estate exchange
5. No mandatory sales meetings
6. No daily reporting to the company's office
7. No company assignment to floor time on weekends or otherwise
8. No fixed hours (no full time employment necessary)
9. Advertising paid for by salesmen

10. Salesmen not required to comply with instructions in manual
11. No advances given to salesmen
12. Company does not place listings exclusively with certain salesmen
13. Broker may not determine listings upon which agent may work--cannot assign or reassign listings
14. Salesmen don't have to call on a particular prospect at a given time
15. Salesmen must not pursue any prescribed techniques
16. Salesmen have no prescribed office procedures
17. Salesmen not furnished leads
18. Salesmen not given a set salary or set commissions
19. Salesmen not given any training
20. Salesmen not given any fringe benefits
21. Salesmen not required to meet a minimum quota
22. Salesmen do have to go through broker to buy and sell property
23. No close or continued supervision in order to comply with State regulatory requirements--for Independent Contractors-no supervision must be present.

Service station operators:

Factors indicating employee

1. Instructions
2. Training
3. Integration
4. Helpers hired with implied consent
5. Set hours
6. Oral or written reports
7. Method of payment
8. Payment of operating expense
9. No significant investment
10. Right to discharge
11. No risk of loss
12. Not handle competitive products

Factors indicating independent contractor

1. No personal performance
2. Hiring, supervising, and paying assistants
3. Method of payment
4. Payment of operating expense
5. Furnish tools and materials
6. Significant investment
7. Risk of loss
8. Handle competitive products

IRS officials noted that all the factors may not be the same in each case in the same occupational area, further complicating the task of determining employment status.

Our proposed criteria would discard almost all factors relating to one party's control over another and thereby simplify the employee/self-employed determination process. For example, factors such as mandatory attendance at sales meetings, fixed hours, pursuing prescribed sales techniques, and following fixed office procedures would not be considered unless the salesperson had an employer identification number and met two of the other three recommended criteria. Under that situation common law definition of an employer would prevail. However, by meeting all three of the other criteria the person would be self-employed. By meeting fewer than two of the other criteria the person would be an employee.

The extent to which use of our proposed criteria could reduce the degree of uncertainty for the problem occupations identified by IRS is shown in the following table.

	Employee identification number	Profit and loss	Separate books and records	Separate place of business	Work status
Barbers and beautician					
Pays fixed fees for chair and supplies own tools	Yes	Yes	Yes	No	Common law
No fee or only token fee paid for chair; receives percentages	Yes	No	No	No	Employee
Direct sales					
Incurs non-reimbursed business expenses (office, travel, liability insurance, employee wages, etc.); does not operate out of an office supplied by business whose product he or she sells	Yes	Yes	Yes	Yes	Self-employed
All but minor business expenses reimbursed; provided office space by business whose product he or she sells; and a home office is not necessary to business	Yes	No	No	No	Employee

	Employee identification number	Profit and loss	Separate books and records	Separate place of business	Work status
Interviewers (opinion polls taken) No office; name on list of available interviewers in area; paid by job, time spent or number of persons interviewed: expenses reimbursed	Yes	No	No	Yes	Employee
Same as above except interviewer hires others to help him, this means there is a chance to sustain a loss	Yes	Yes	Yes	Yes	Self-employed
Insurance Agent: Pays majority of own business expenses; does not operate out of insurance company provided space	Yes	Yes	Yes	Yes	Self-employed
Pays majority of own business expenses; operates out of personal residence but uses insurance company telephone and secretary for taking and sending messages	Yes	Yes	Yes	No	Common Law
Real Estate Agent: Uses office facilities furnished by company; also operates out of personal residence; expenses not reimbursed; paid commission only	Yes	Yes	Yes	No	Common Law
Same as above but paid salary or fixed amount which would cover direct business expense (Note: Conference or education expense should not be included as direct business expenses)	Yes	No	Yes	No	Employee

	Employee identification number	Profit and loss	Separate books and records	Separate place of business	Work status
Service station operators					
Rents station from supplier; expenses paid or reimbursed by supplier	Yes	No	No	Yes	Employee
Rents station from supplier; hires own employees; operates garage for automobile repair and maintenance using parts and materials not purchased from gasoline supplier	Yes	Yes	Yes	Yes	Self-Employed
Sells gasoline provided in connection with the business (e.g. grocery store with gas pumps outside in parking area)	Yes	Yes	Yes	Yes	Self-Employed

DEPARTMENT OF THE TREASURY COMMENTS

In an October 18, 1977, letter, the Assistant Secretary of the Treasury for Tax Policy submitted the Treasury and IRS final comments on a draft of this report. (See app. V.) The Department's comments state that our report makes a contribution in emphasizing the need for certainty in the area. However, it does not agree that the report provides an adequate basis for legislation. The Department objects to our proposed solution but does not offer any alternative to solve the problem. It is unfortunate that this is the case since IRS has been studying this issue for at least 3 years.

We believe the legislative process would have been better served had IRS and the Treasury addressed possible alternative solutions or recommendations to the criteria we developed. The Service's primary concern appears to be to make its administrative requirements as easy as possible rather than to make the law clear and equitable to the taxpayers. We believe that in deciding this issue there is a need to balance the tax equity concerns of taxpayers with the administrative concerns of the IRS. This balance is not evident in the comments provided to us by the Treasury Department.

IRS is concerned that any change in the law which increases the number of self-employed taxpayers will result in lost tax revenue. This is because it views self-employed taxpayers as having a low compliance rate in reporting income earned. It appears that the IRS approach to solve such noncompliance problems is to limit the number of self-employed persons instead of using the array of administrative mechanisms available to it, such as using information documents available and increased audits.

The Congress has recognized in the various tax laws that there is a distinction between self-employed persons and employees and we see no indication that it is considering eliminating this distinction. However, there is a concern that this distinction be clarified. Thus, we have recommended what we believe to be reasonable and clear criteria.

We hope that during further legislative deliberation both IRS and the Treasury Department will offer constructive suggestions to the Congress on how to improve on our recommendations, recognizing that a distinction will continue to be made between self-employed and employed individuals.

A detailed analysis of the Treasury's comments follows.

Statistical concerns

The Treasury and IRS questioned the statistical validity of our study for the following reasons.

--The study was confined to closed audit cases involving abatements.

--The compliance rate used in the study was based on the assumption that taxpayers who signed employee wage statements (IRS Form 4669) had reported the income on their tax returns. (The signed wage statements are used by IRS as a basis for abating tax assessments against employers.)

Before discussing specifically some of IRS' concerns, it is important to point out that during the 3 years that IRS has been studying this issue the Service never developed any statistical information on its own regarding the compliance rate of such individuals. It was only after GAO presented its results to the Service that it decided to do its own limited study.

In its study, IRS used our results and expanded on them by reviewing 411 open audit cases which involved independent contractor (self-employed)/employee issues. But IRS did not rely on the undocumented employee tax payment certifications that are daily relied on by its district offices as evidence that income had been reported. Instead it examined the "employee's" tax returns. The IRS study showed a compliance rate of 74 percent for the open cases and 82 percent for the employees involved in our sample cases. We estimated a compliance rate of 89 to 92 percent for all the closed cases from which we randomly sampled our cases. The IRS study also showed that only 6 percent of the income included in the tax payment certifications by individuals was not included in their tax returns.

As noted earlier, IRS was concerned that our sample results relative to the compliance rate were questionable. We stated that we believed the public purpose would be served if IRS could come forward with additional information. But the Treasury and IRS have concluded, after completing their own study, that neither their study nor ours is conclusive regarding the "true level of compliance."

Although the IRS study of open cases shows a lower compliance level than our study, we do not believe the difference is great enough to delay legislation which would clarify who is an employee and who is self-employed. We even question whether compliance rates should be the primary concern in deciding this issue. The Congress has already determined that for tax purposes there should be both employees and self-employed persons. Our recommendation is to add clarity to that distinction. It is the IRS job to use whatever administrative tools are available to it to insure compliance. Only if those tools are sufficiently inadequate should the Congress consider eliminating or controlling a given classification of taxpayers. Whether compliance is 89 percent, 82 percent, or 74 percent we believe IRS should exhaust the compliance mechanisms available for use against self-employed persons before it opposes clarifying the law for fear of increasing their numbers.

That its administrative procedures for insuring compliance need improving, regardless of whether any legislative action is taken, is evident by IRS' own findings. As noted earlier, we relied on the form IRS uses as a basis for abating tax assessments against employers as the basis for concluding that workers had reported all their income. During the compliance study, IRS determined that its form and procedure were not reliable. IRS is to be commended for its willingness to identify shortcomings in its procedures but what is somewhat disconcerting is that IRS offered no indication that it is going to take action to improve its procedures. Rather it stated it uses the form for reasons of "administrative expediency." How important is the tradeoff between administrative expediency and compliance? No more so than the trade-off between some administrative inconvenience and fairer, more certain treatment of taxpayers.

Treasury and IRS were concerned that, even on the basis of our results, the Social Security Trust Fund could be adversely affected. They state that if the number of self-employed persons is increased the trust fund would run a "clearly higher" risk of shortfall in collection of tax on self-employment income.

We have been concerned since 1973 with the need to increase efforts to assure that self-employed persons pay their self-employment tax. In 1973 and again in 1977, we recommended that the Congress amend the Social Security Act to make the receipt of self-employment social security benefits conditional on payment of the self-employment social

security tax. 1/ If the Congress enacted our recommendation, we believe this particular concern of Treasury would be mitigated greatly.

Concern that criteria can be manipulated

The Treasury and IRS expressed concern that our recommended criteria will permit many workers to choose self-employment status by structuring their affairs to meet the four criteria.

We agree that persons could plan their affairs knowing the specific tax impact that decision will have. That is one of the reasons for giving the taxpayer as precise a definition as possible. Indeed, taxpayers are constantly arranging their affairs to take advantage of numerous sections of the Internal Revenue Code. The Government should not keep secret the criteria for determining when self-employed status occurs and then later use them with the consequences of large assessments and penalties for taxes not withheld as well as possible loss of retirement plans.

We welcome any suggestions which would improve, or even limit, the application of our recommended criteria. But, taxpayers should be able to plan their affairs with knowledge of the tax consequences.

The criteria we recommend do preclude most taxpayers from electing self-employment. The vast majority of employees cannot sustain a monetary loss in their jobs nor do they maintain a place of business apart from those they perform services for. Restrictions and regulations to prevent abuse of the criteria would be helpful. Since IRS and the Treasury continue to express concern about this problem, we believe it should be discussed further during any legislative deliberations on our recommendations.

1/Report to the Joint Committee on Taxation: Collection of Taxpayers' Delinquent Accounts by the Internal Revenue Service, B-137762, August 9, 1973; Follow-up Report to the Joint Committee on Taxation on 1973 Recommendation To Change The Social Security Law Relative To Self-Employment Income Tax, GGD-77-78, August 8, 1977.

Concerns with the specific criteria

In commenting on the specific criteria, The Treasury and IRS believed the requirement for obtaining an employment identification number was meaningless since anyone could obtain one. They also said that the identification would have no useful tax compliance purpose for IRS. They said that a more meaningful way of insuring that persons consider themselves self-employed and do not fall into that status by accident would be to "consider whether an individual holds himself out in his own name as self-employed and/or make his services generally available to the public."

This alternative criteria is a constructive substitute and would serve to prevent persons from unknowingly being considered self-employed. We have therefore amended our final recommendations accordingly.

The Treasury and IRS do not view the maintenance of separate books and records as a necessary requirement for being selfemployed. They believe

> "* * * it would be unfair to deny independent contractor status merely because he or she keeps inadequate books and records. It also seems unwise to 'reward' employees for keeping careful records by including this as a factor in determining independent contractor status."

They further believe this criteria could be manipulated and would cause administrative problems for business and IRS. As an example, they said

> "The determination of a putative employer's obligation to withhold on his payees would turn on examining whether his payees in fact kept books and records and making judgments as to whether particular record systems--ranging from the back of a matchbook to a scribble in a notebook--should pass muster."

We did not intend that scraps of paper be considered as appropriate books and records. The privilege of being considered self-employed should carry with it the responsibility of keeping proper records for determining profit or loss of the business. This includes the cost of purchases, business expenses, and receipts of income. IRS is capable

of providing instructions describing what type of books and records will meet its administrative requirements.

With regard to the risk of loss and opportunity for profit criterion, The Treasury and IRS

> "* * * suggest that if Congress enacts a risk-of-loss test, care be taken to make the test as objective as possible. For example, the test could incorporate a specified minimum level of investment, or a specified minimum level of expenses tantamount to investment. Without an objective standard of some type, a risk-of-loss test would be complex and uncertain."

As we noted earlier in the report, some of our recommended criteria should be further clarified, either in the law, by Committee reports, or regulations. One of the most difficult criteria to deal with is the one relating to suffering a loss or making a profit. The Treasury and IRS offer a reasonable clarification when they suggest that in defining a risk-of-loss test, minimum levels of investment or expenses be specified. The difficulty with their suggested clarifiction is one of defining what the specified levels should be. All parties affected by such a change should have the opportunity to comment during the legislative deliberations on any proposed levels.

The Treasury and IRS suggested that to improve our criterion on separate place of business a worker's home should not qualify as a separate place of business unless it meets the tests for allowing certain expenses in connection with business use of the home as provided by section 280A of the Internal Revenue Code.

We agree with this suggested change and have amended our final recommendation accordingly.

Continued use of common law rules

The Treasury and IRS expressed concern that in many cases IRS and taxpayers may still have to base their employment status determinations on the common law.

As carefully as we worked in developing our criteria there was no way we were able to set forth criteria which would result in a clear determination in every situation.

We believed, therefore, that there was a need to continue use of the common laws in those cases where there was some evidence that a worker not meeting all four of our criteria should be considered self-employed. That evidence, we determined, should be that he meet three of the criteria.

Administrative problems foreseen with use of self-employment certificate

With regard to our recommendation on the use of self-employment certifications as a means of limiting retroactive tax assessments against employers, Treasury and IRS said:

> "Audits are the basic tool of tax enforcement. All audits are retroactive; by definition, none cover current or future periods. The GAO proposal could emasculate the audit process in determinations of employment status."
>
> * * * * *
>
> "The proposal could also create substantial administrative problems. For example, examining agents could be required to examine the circumstances under which each worker performs services in order to invalidate the certificates. Apparently nothing would prevent employers from obtaining new certificates following reclassification. * * *"

We think IRS overreacted when it noted that our proposal "could emasculate" the audit process in determining employment status. We strongly agree that audits are a vital tool of tax enforcement and that all audits are retroactive. What concerns us in this situation is the reluctance on IRS' part to recognize the tax equity issue in many retroactive assessments made when IRS determines that workers should be classified as employees.

Who is to be classified as an employee as opposed to a self-employed person is not clear and subject to conflicting interpretations by the IRS. Employes following past practices and interpreting complex and unclear tax laws and inconsistent IRS applications of the law should not be penalized when they have acted in good faith. Our recommended use of certificates is intended to provide tangible proof of that good faith. It thus provides a balance between the sometimes conflicting principles of insuring equity and efficient tax administration.

We agree use of the certificates will force IRS agents to view each contractor individually instead of allowing them the administrative convenience of grouping them together in one all encompassing determination. However, this is necessary to give appropriate tax treatment to individuals with different circumstances.

IRS suggests employers may obtain new certificates after IRS invalidates the old certificates. Under our recommendation, anyone who filed a false certificate would be subject to penalties and IRS should take appropriate action against them. This should deter them from filing another false certificate. The administrative procedures here would appear to be similar to those associated with employees who file false withholding exemption certificates statements with employers claiming more exemptions than allowed. The filing of false withholding exemption certificate information with an employer is subject to penalties under section 7205 of the Code which provides for fines up to $500, or imprisonment of not more than 1 year, or both. This penalty appears to be light compared to the potential for tax noncompliance of self-employed persons. Therefore, we believe the perjury penalty provisions of section 7206 of the Code would be more appropriate. The maximum fines under this section are $5000 and/or 3-year imprisonment together with the cost of prosecution.

OTHER AGENCY COMMENTS

In an October 19, 1977, letter the Assistant Secretary for Administration and Management, Department of Labor, provided comments on our proposals for defining employee and self-employed (see app. VI). Although Labor is in general agreement with the desirability to make the criteria for defining an employee more definite, it also echoes the Tresury and IRS concerns that the criteria would enable taxpayers to rearrange their affairs so that many who are now employees could be relcassified as self-employed.

The Assistant Attorney General for Administration also commented on our recommendation in a letter dated October 21, 1977. The letter was hand delivered to us on October 25, 1977, too late for detailed analysis without delaying the issurance of this report. However, their full comments are included as appendix VII of this report.

The Department agreed that our proposal "is sound in drawing a line which in general terms specifies that if one does not meet certain criteria, he is to be treated as an employee." However, Justice does not agree with the proposal

that "those who automatically meet certain criteria should be classified as independent contractors." Justice concerns were similar to those of Treasury and IRS. It fears that persons now considered employees under the common law could be considered self-employed under specific criteria. It also fears there will be significant noncompliance among those newly recognized as self-employed.

Justice also considered the criteria that self-employed persons should have an employer identification number and separate books and records as meaningless. It was suggested that a checkbook would probably meet this requirement. As mentioned previously, the criteria concerning the employer identification number has been deleted from our final recommendation. Also, in responding to the Treasury and IRS comments we noted that the requirement for separate books and records should involve more than scrap pieces of paper. Also, we do not intend that a checkbook suffice as separate books and records.

Justice also suggested that another useful criteria would be whether the worker had a substantial investment in property used in connection with the performance of services. Unlike the similar Treasury and IRS recommendation, Justice would specifically disallow trucks and cars from the definition of investment. As we observed earlier, the difficulty with this suggestion is one of defining what constitutes "substantial investment" or as IRS put it "minimum level of investment."

The Department of Health, Education, and Welfare was also requested to comment on a draft of this report. Their comments were not received in time to be included in this report. However, based on discussions with Department representatives they agree that the common law definition of an employee is subjective. However, they have concerns with our proposed criteria. They, too, are concerned that taxpayer compliance with the tax law will be lower if more people are considered self-employed. To the extent that employees become self-employed the Department is also concerned there could be an adverse impact upon receipts to the Social Security Trust Funds, since SECA contributions paid by a self-employed person are substantially less than the combined employer/employee FICA contributions on the same income. The Department could provide no figures as to what this impact on receipts would be.

We agree that self-employed taxpayers contribute less to the trust funds. However, this is a condition that was recognized when the tax rates were established. We believe the desirability of clarifying the law in defining employee and self-employed should be decided independent of whether self-employed persons share their full burden of social security costs. Moreover, as we noted earlier, passage by the Congress of our 1973 recommendation that the payment of self-employment social security benefits be tied to the payment of the self-employment social security tax should help reduce any additional adverse impact on the trust fund.

CONCLUSION

Many IRS decisions that workers are employees and not self-employed involve clear-cut cases as defined by statute or are in accordance with the classic master-servant interpretation of common law. However, IRS has interpreted the common law definition of an employee in such a manner that persons operating separate businesses are sometimes considered the employees of another business. This is because IRS believes sufficient common law elements of control exist.

Such an interpretation results in many hardships and inequities on unsuspecting businesses and those with whom they have contractual arrangements. Large assessments are made for employment taxes IRS believes that the business owes or that the business should have withheld from payments made to those contractors IRS considers to be employees. Besides the financial hardship created, taxes are frequently collected twice and self-employment retirement plans can be subject to termination.

IRS interpretation of who is an employee under the common law has been inconsistent.

--IRS has accepted independent contractor status during prior audits.

--Separate IRS audits of contractors having similar arrangements with the same company have resulted in conflicting employment status determinations.

--Separate IRS audits of businesses and their contractors have resulted in different employment status treatment.

To eliminate many of the hardships, inequities, and instances of general confusion, separate business entities should be excluded from the common law definition of employee for tax purposes.

The criteria we recommend accomplish this. The four basic tests are more precise and easier to understand, and therefore, can be more accurately applied than the common law rules.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress:

1. Amend section 3121 of the Internal Revenue Code to exclude separate business entities from the common law definition of employee in instances where they

   --have a separate set of books and records reflecting items of income and expenses of the trade or business;

   --have the risk of suffering a loss and opportunity of making a profit;

   --have a principal place of business other than at a place of business furnished by the persons for whom he or she performs or furnishes services; and

   --hold themselves out in their own name as self-employed and/or make their services generally available to the public.

   Further, a worker's home should not qualify as a separate place of business unless it qualifies under section 280A of the Internal Revenue Code for certain deductible expenses in connection with business use of the home.

2. Amend section 3121 of the Internal Revenue Code to require that (a) unless specifically excluded by law an employer-employee relationship exists if an individual meets fewer than three of the criteria noted in 1 above, and (b) the common law criteria will be used to determine the employment status if the individual meets three of the four criteria.

3. Amend the Internal Revenue Code to provide that, absent fraud, IRS cannot make retroactive employee determinations in those cases where businesses: (a) obtained annually from the persons they classify as self-employed a signed certificate stating that they meet all separate business entity criteria,

and (b) annually provided IRS the name and employer identification number or social security number of all such certificate signers.

The certificates should be signed by the contractor under penalty of perjury and the employer should not have reason to know that the certificate was false. Also, the certificate should be in a form approved by the Secretary of the Treasury.

CHAPTER 3

RETROACTIVE ASSESSMENT PROCEDURES NEED IMPROVEMENT

The improved criteria recommended in chapter 2 should help employers make more accurate determinations concerning employment status of individuals. We recognize, however, that even with improved criteria people will still be considered as independent contractors, when they should have been classified as employees. As a result, improvements are needed in IRS assessment practices to eliminate certain tax inequities. IRS should

--use information in its files to assist employers in determining the actual employment tax due, thus eliminating duplicate payments;

--be permitted by law to offset any social security taxes paid by employees while considered self-employed against the social security taxes now due as employees; and

--improve its assessment practices concerning interest and penalties to eliminate overcharges to employers.

INFORMATION IN IRS FILES SHOULD BE USED TO DETERMINE EMPLOYERS' INCOME TAX ASSESSMENTS

When IRS determines that employers have not withheld taxes from employee wages, it assesses the employer for such taxes. A great part of these assessments duplicate Federal income taxes that the employee has already paid.

IRS has in its files information needed to adjust these assessments so that they reflect only unpaid taxes. Using names and social security numbers provided by the "employer" IRS could review its own records for information needed to make the adjustment. However, IRS generally requires the employer to obtain the needed information from current and former employees. To obtain this reduction in the tax assessment, the employer must locate these employees and have them sign an employee wage statement. (See app. II.) These statements are personal certifications from each employee that he has filed and paid taxes on the income shown on the statement. Employee wage statements must be

furnished for each tax year in order to obtain a reduction in the tax assessment for that year.

After obtaining as many statements as possible, the employer must complete and sign a Request for Relief from Income Tax Withholding. (See app. III.) This form, along with the employee wage statements, are sent to an IRS Service center. On receipt of these forms, service center representatives reduce the tax assessment by the amount of taxes paid on wages shown on the statements.

To determine how effective this procedure is we randomly sampled 259 of 1,559 audit cases closed in 1975 in which employment tax assessments had been abated. (See p. 3). Abatement took place in 140 of these cases because employers were able to satisfy IRS that the employees paid income tax received from the employer. For the remaining 119 cases either (1) we did not obtain enough information to use them in our analysis or (2) abatement was made for administrative reasons not related to our study. As shown by the following table, the problem of obtaining accurate abatement figures is not limited to cases in which self-employed persons have been reclassified as employees.

Category		Sample size
1	Self employed persons reclassified as employees	92
2	Nonwage payments to employees reclassified as wages	13
3	Employee not included on employment tax return (employee status not disputed)	35
	Total	140

Based on our sample results, we estimated that at least 843 employers whose audit cases were closed in 1975 fell into the 3 categories listed above. They were assessed at most $6.6 million in income taxes that should have been withheld from employees' wages. Of this amount, $4.1 million (62.1 percent) represented taxes which IRS later eliminated when the employers provided signed employee wage statements.

The remaining $2.5 million was not eliminated because either the employer was unable to locate the employees or the employees would not sign the required statement.

Employers have difficulty in obtaining signed statements from employees

Employers often spend considerable time trying to locate previous employees and convincing them to sign the statement. IRS assessed the 140 employers in our sample $718,000 in income taxes that should have been withheld from employee wages. Of this amount, $508,000 was identified as a duplicate income tax assessment through employers being able to obtain signed wage statements. IRS subsequently eliminated this amount from its original tax assessments. However, $210,000 of the assessment was not eliminated because the employers were unable to obtain signed statements from 1,720 (72 percent) of the 2,374 employees involved.

As noted in chapter 2, our review of the 92 cases where self-employed persons were reclassified as employees (category 1 of our sample) showed that these employers had a higher success rate in obtaining the required documentation --89 to 92 percent of the tax was abated. For the 92 cases in our sample, $338,709 of $371,256 (91 percent) in nonwithheld income taxes assessed, was identified as assessments on income for which the employee had paid taxes. These assessments were subsequently abated.

An indepth examination of five cases sampled revealed that IRS could use information in its files to further adjust the employment tax assessments to reflect the true tax due and eliminate instances of double taxation.

The tax assessments against these 5 employers involved 37 employees and 6 tax returns. Some employers were assessed for 2 years. The initial $41,379 in assessments against the employers was reduced by $38,274 because signed statements were obtained. However, $3,105 was not eliminated because 9 of the 46 wage statements needed were not obtained. Analysis of the 9 returns involving 7 individuals who did not sign statements showed that 5 of the individuals had filed 7 of the returns and paid the income tax due. Had IRS used information in its files, an additional $1,869 in duplicate tax payments would have been identified and the initial assessments to the employers reduced by this amount.

A considerable amount of time was frequently required to locate employees and have them sign the wage statements. We estimate that at least 3 months were required by the employers in our sample to obtain and turn over to IRS 28 percent of the wage statements needed. For example, one employer said that it took about a month of constant effort to obtain only 12 of 35 statements needed. Because of the poor success rate, no further effort was made to obtain additional statements.

Employers face contingent liability for several months

IRS current practice of assessing the employer the full amount of income taxes that should have been withheld and requiring signed statements to be provided before the assessment is reduced, results in the employer incurring a contingent tax liability for several months. Based on our sample results (140 cases), the contingent liability to employers exceeds the adjusted amount of tax due by 167 percent.

IRS required an average of 11 months to audit and close our sample cases. The initial audit and assessments took only 2.8 months. The remaining 8.2 months was needed to permit

--the employer to obtain the signed employee statements; and

--IRS Service Center representatives to become familiar with the case, to process any reduction in the employer's tax assessment, and to collect the tax due.

The 8.2 months also represents the period of time employers had a contingent tax liability--a potential obligation for the payment of the initial tax assessment. A sizable contingent liability can adversely affect a business' credit rating which can financially strangle an otherwise healthy business. Although less serious, such a liability can also delay various other decisions such as expansion of the business.

IRS recognizes the problem

IRS is aware that employers often have difficulty in getting wage statements from former employees and that this can result in double taxation. Various IRS studies have examined alternate ways to support the abatements. One method explored was to statistically sample the employees for whom wage statements were not received and

examine their income tax returns to see if they paid taxes on the income in question. The final report on this study recommended that statistical sampling not be adopted because of the cost involved. In addition, the study group believed that sampling would not be accurate enough for employers having less than 401 employees.

Another study focused on abatement based on "fact of filing." That is, if the employee filed a tax return it would be assumed that all proper income items were included. IRS decided that the mere fact of filing was not adequate to support relief from payment.

IRS' Southeast region, in February 1977, issued instructions to its auditors that authorized them, in agreed upon cases to obtain copies of tax returns for those employees from whom the employer was unable to obtain wage statements. Based on an examination of these returns the auditor can, if justified, abate an additional portion of the employer tax assessent. Southeast regional officials consider these procedures to be successful in reducing the amount of double taxation.

IRS is considering using similar instructions nationally.

IRS IS NOT PERMITTED TO USE SOCIAL SECURITY TAXES PAID UNDER SECA TO REDUCE SOCIAL SECURITY TAXES DUE UNDER FICA

Social Security coverage is given to both employees and the self-employed. Employees' Social Security is authorized by the Federal Insurance Contribution Act (FICA) and paid for by a tax on the employer and the employee. Social security coverage for self-employed persons is authorized by the Self-Employment Contribution ACT (SECA) and is paid for by the self-employed person.

We found that social security taxes are often collected twice for persons IRS reclassifies from self-employed to employee--once under SECA and once under FICA. This happens because (1) IRS cannot now offset the self-employment payments against the employee payment that should have been made and (2) neither IRS nor the employer advise the worker that he can file for a refund of the self-employment payment he made in error.

The law prevents a FICA-SECA offset

Unlike the income tax withholding portion of employment tax assessments against employers, IRS cannot--unless the 3-year statute of limitations period has expired-offset the employee share of FICA with the amount of SECA tax he may have paid on the same income. The law (26 U.S.C. 6521(a)) authorizes such a FICA-SECA offset only if the employee is prevented by law or rule of law from filing for refund of the SECA tax paid in error.

This restriction, however, can result in the employee portion of social security taxes being collected twice--once from the employer as the FICA tax he failed to withhold and once from the employee as SECA tax paid in error. This happens because the employees are not advised that they can file for a refund of SECA tax paid.

The employer's portion of the FICA tax assessment does not represent a double payment because the tax is paid for the first time when the employer pays the tax assessment.

Based on our sample of cases closed in 1975, we estimate that at least 667 employers receiving employment tax abatement were assessed about $2 million in FICA taxes. Of this amount, $1 million represented the employers' portion of the tax. The remaining $1 million represented the employees' portion of the tax which the employer must pay. To the extent that the employees paid their SECA taxes while considered self-employed, a double payment of social security taxes will occur.

For example, we analyzed 5 of the employer cases in our sample involving 37 employees. Our analysis showed that 24 of the 37 employees paid social security (SECA) tax on the income earned while considered self-employed. IRS assessed the five employers $6,913 for the employees' portion of the FICA taxes due on wages paid to the 37 employees. Of this amount $5,008 (72.4 percent) represented a double payment of social security taxes to the Government. The amount of the social security taxes actually due the Government was $1,905.

Such double taxation could be prevented if the law (26 U.S.C. 6521) was changed to permit IRS to offset SECA tax payments made against the employee's share of FICA that should have been withheld. Such a change should also prevent the employee from seeking a SECA tax refund for that portion applied against his FICA tax. Any excess SECA should be refunded to the employee.

Employees are not advised to file for their social security (SECA) tax refund

Double payment of social security taxes, can be prevented only if the reclassified employees file for a refund of the SECA taxes paid; only a few of these employees have filed.

Based on our sample results, we estimate that 6,828 employees had a SECA tax refund due from the Government during 1975. Representatives at 7 of 10 IRS Service Centers we visited estimated that they had received only 355 claims for SECA refunds during 1975. If their estimate is accurate, only 1 in 13 reclassified employees filed a claim for their tax refund.

Of the 37 individuals whose case files we reviewed, 24 were entitled to a SECA tax refund. We found no indication in IRS files that any of the 24 employees had filed for their refund.

In talking with employers, we learned that many employees were not even aware that they could file a claim for their SECA refund--IRS did not explain to employers the rights of their employees. IRS district officials, as well as service center representatives, stated that auditors may not be doing a good job of informing employees of their right to file for refunds. The officials said that one reason may be due to IRS lack of a procedure requiring auditors to so notify the employees. It is obvious that IRS is not doing a good job of advising employees of their right to recover SECA payments made.

EMPLOYERS OVERCHARGED INTEREST AND PENALTIES BECAUSE OF IRS ASSESSMENT PRACTICES

Interest payment is mandatory on underpayments of any income or employment tax unless specifically prohibited by law or a mutual agreement. Generally, interest is collected for the time the taxpayer had use of the Government's money.

When an employer fails to withhold taxes from employee wages, IRS charges employers interest on the taxes that should have been withheld. Some employers were overcharged interest on these taxes because IRS did not use the actual payment date of the tax.

The law also authorized IRS to assess taxpayers penalties for failing to perform certain actions on time. In certain

situations, IRS may assess a taxpayer with a failure-to-deposit and a failure-to-pay penalty when taxes are not deposited or paid to the Government on time. In many instances, IRS has not properly applied these penalties resulting in overassessments to employers who have had workers reclassified as employees.

IRS interest computations can result in overassessments to employers

IRS is authorized to assess an interest charge on taxes that should have been withheld from employees' wages. By law the interest assessed should be computed from the due date of the tax to the date the tax is paid. However, IRS computes interest from the date the tax was due until the following April 15--not the date it was paid by the employee.

The interest charge may be computed by the IRS agent performing the audit, or by an IRS service center representative where the agent's workpapers are sent for processing. If an employer receives a reduction in the initial tax assessment because the employee paid his income tax, the interest charged is recomputed. The computation may be performed manually by the service center representative or automatically by the center's computer.

In most of our sample cases, IRS did not compute interest correctly because service center representatives used April 15 instead of the actual date the employee paid his tax. In fact, the actual tax payment date is not available in IRS computer files unless a taxpayer submits a late return or sends a payment separate from his return. If the taxpayer submits his return with payments early, April 15 is recorded in the computer as the payment filing date.

IRS assessed the employer interest in 116 (83 percent) of the 140 sample cases where employment taxes were not withheld on employees' wages. The interest assessed these employers amounted to about $118,600. We estimate that about 700 employers were charged $1.1 million in interest during 1975.

Because the correct payment date is not recorded in IRS files, we could not compute the amount of interest erroneously charged employers without reviewing every reclassified employees tax return for the years being audited. These returns are kept at Federal Record Centers located around the country.

To determine the impact of using the April 15 date as it related to five small employers in our sample, we reviewed 46 income tax returns submitted by employees who worked for them. Thirty-nine of the returns were filed prior to April 15. The five employers were charged $5,043 in interest. About $935 or 18.5 percent of the amount was an overcharge because IRS used the April 15 date.

The overassessment of interest to some employers can be substantial. For example, the employer in one employment tax audit was overcharged $3,850. This represented a 46 percent interest overcharge. When the employer protested, IRS recomputed the interest using the correct payment dates, thus eliminating the interest overcharge.

Representatives at six of seven IRS service centers we visited said that the April 15 date is used as a substitute date because they are not required to research individual income tax returns to determine the actual tax payment dates.

To compute interest correctly, IRS must determine the amount of tax that should have been withheld from each employee's wages and the date the tax was paid. IRS can obtain the tax payment date by entering the actual payment date into its files, instead of the April 15 date; and requiring the agent to request the employee's transcript. With this information, IRS can make an accurate interest computation for each employee.

Misapplication of penalties by IRS results in overassessments to employers

The law specifies that any person who, without reasonable cause, fails to deposit taxes on time in an authorized depository should be charged with a failure-to-deposit penalty of 5 percent of the underpayment. IRS Chief Counsel advised us that this penalty is applicable only if an employer actually withholds and fails to deposit taxes.

Our sample of employers included 105 who either had self-employed workers reclassified as employees (92) or had made payments to workers which the employer believed were noncovered wages for withholding or social security tax purposes (13). In each case the employer did not withhold taxes for which it was later assessed.

We found that IRS incorrectly assessed $3,902 in failure to deposit penalty against 22 of the 105 employers. Since none of the 22 employers had withheld employment taxes, all of the

$3,902 was an overcharge by IRS. Based on these sample results, we estimate that about 163 employers were overcharged $42,300 in failure-to-deposit penalties in cases closed during 1975.

To determine why IRS was not properly applying the failure-to-deposit penalty, we reviewed training manuals for the IRS' Revenue Agent Training Program and the Employment Taxes Course. Although both manuals made reference to the penalty, neither one discussed the conditions under which the penalty should be applied.

An IRS official attributed the improper application of the penalty to shortcomings in IRS training which does not specify the conditions under which the penalty can be applied.

IRS provided technical advice to its auditors on this problem with the issuance of Revenue Ruling 75-191 on May 27, 1975. The revenue ruling specified that the failure-to-deposit penalty should only be applied when employment taxes are actually withheld from employees' wages, but are not deposited in an authorized depository.

The revenue ruling has not alleviated the misapplication of the failure-to-deposit penalty. Of the 105 cases in our sample 67 were completed after the revenue ruling was issued. IRS improperly applied the failure-to-deposit penalty in 14 of the 67 cases (21 percent), the same rate as before the ruling was issued. An IRS service center representative in May 1977 told us employment tax cases were still being processed through the service center with failure-to-deposit penalties assessed when it was apparent that employers had not withheld taxes from their workers.

CONCLUSION

Each tax assessment IRS makes should reflect as closely as possible the amount of tax due. The current practice of assessing the gross amount of the deficiency knowing that it is overstated is unfair to the taxpayer. This contingent liability hangs over his head until he has supplied proof that his employees and former employees have paid their taxes. We believe IRS should strive to identify all of the proper adjustments before the assessment is made. This could be done through combined efforts of both IRS and the employer.

IRS can make its employment tax assessments more accurate and avoid the problem of double taxation if it will use information available in its own files. The IRS southeast region

has implemented workable procedures to reduce the level of double taxation. Similar procedures being considered for national use should be implemented.

Concerning double payment of social security taxes, legislation is needed to permit SECA tax payments made to be applied against the employee's share of FICA tax due. This would correct the obvious problem of double payments of social security taxes caused when persons are reclassified as employees.

If the amount of SECA tax paid exceeds the employees' portion of FICA tax assessed the employer, IRS should automatically refund the difference to the employees or at least notify them to file for their refunds.

To accomplish this, Section 6521 of the Internal Revenue Code should be amended to provide IRS authority to offset the employee's SECA tax payments against the FICA taxes now due. The code should also be revised to permit employees to file only for a refund of the SECA tax not used to offset FICA.

IRS representatives are aware that using the April 15 date in computations results in an overassessment of interest in those cases where employees pay their income taxes before April 15. Their use of the April 15 date appears to be due to a lack of data in IRS files and to a shortcoming in operating instructions that allow the representatives to compute interest without determining the actual tax payment date.

Also, IRS representatives do not universally understand when the failure-to-deposit penalty should be applied in employment tax audits because a clear discussion is lacking in IRS manuals of the conditions under which the penalties should be applied.

RECOMMENDATION TO THE CONGRESS

We recommend that the Congress amend Section 6521 of the Internal Revenue Code to authorize IRS to reduce the employees' portion of FICA taxes assessed against employers by an appropriate portion of the amount of SECA taxes paid by reclassified employees for the open statute years.

RECOMMENDATIONS TO THE COMMISSIONER OF INTERNAL REVENUE

We recommend that IRS, through appropriate policy and procedural revisions:

--Require its auditors, in computing the initial tax assessment, to use information in IRS files on tax payments made by those employees for whom social security numbers are available and from whom tax payment certificates were not obtained by employers.

--Automatically refund to the reclassified employees the balance of SECA taxes paid over FICA taxes due, when the Congress permits an offset of SECA tax paid to FICA tax liability due.

To assure that IRS auditors properly compute interest and assess penalties in accordance with the code, we recommend that IRS:

--Revise the computerized individual master file records to include employees' actual income tax payment date, and that IRS auditors be required to use this data in making interest calculations.

--Revise current auditor training manuals to include a complete explanation of the correct application of the failure-to-deposit penalty. Instructions should also be devised which require adequate review of the use of this penalty to assure its correct application.

AGENCY COMMENTS

The Treasury and IRS agreed with our recommendation that the Congress amend the Code to reduce the employees' portion of FICA taxes assessed against employers by the amount of SECA taxes previously paid. They also agreed with our recommendations and plan to take corrective action regarding

--the present method of computing interest in connection with employment tax assessments and abatements and

--the misapplication of the 5-percent penalty for failure to deposit taxes actually withheld.

The Treasury and IRS opposed our recommendations that IRS use information in its files to determine an initial correct tax assessment against employers and automatically refund to reclassified employees the amount by which SECA taxes paid exceed the employee's share of FICA taxes due.

This opposition was apparently the result of their misunderstanding our recommendation. In their response they said

> "Where an employer provides the IRS with certain identifying information about his employees, it is possible for the IRS to make limited checks as to the taxes paid by these employees. However, the GAO proposal would go far beyond requiring the IRS to do this. The GAO proposal would shift from the employer to the IRS the whole burden of proving which employees had paid SECA and income taxes, and in what amount--even where the employer's records lacked (as they often do) the information necessary to locate the employee's return."

Our intent was not to shift to IRS the whole burden of proving which employees paid SECA and income tax. As stated in our conclusion (see p. 56) this can be done through the combined efforts of both IRS and the employer. We intended that the abatement procedures currently in use in the IRS Southeast region (see p. 51) be adopted for national use and expanded to cover abatement for SECA taxes paid when the Congress amends the law. The procedures used in the Southeast region provide that in agreed upon cases the IRS agent is authorized to obtain copies of tax returns for those employees from whom the employer was unable to obtain wage statements. Based on an examination of those returns the auditor can, if justified, abate an additional portion of the employer tax assessment. We believe such procedures should be required instead of just permitted.

We amended this recommendation to clarify our intent.

APPENDIX I

The Common Law Rules--Factors

1. Instructions. A person who is required to comply with instructions about when, where, and how he is to work is ordinarily an employee. Some employees may work without receiving instructions because they are highly proficient in their line of work and can be trusted to work to the best of their abilities; however, the control factor is present if the employer has the right to instruct. The instructions may be oral or may be in the form of manuals or written procedures which show how the desired result is to be accomplished.

2. Training. Training of a person by an experienced employee working with him, by correspondence, by required attendance at meetings and by other methods is a factor of control because it is an indication that the employer wants the services performed in a particular method or manner. This is especially true if the training is given periodically or at frequent intervals. An independent contractor ordinarily uses his own methods and receives no training from the purchaser of his services.

3. Integration. Integration of the person's services into the business operations generally shows that he is subject to direction and control. In applying the integration test, first determine the scope and function of the business and then whether the services of the individual are merged into it. When the success or continuation of a business depends to an appreciable degree upon the performance of certain services, the people who perform those services must necessarily be subject to a certain amount of control by the owner of the business.

4. Services Rendered Personally. If the services must be rendered personally it indicates that the employer is interested in the methods as well as the results. He is interested not only in getting a desired result, but also in who does the job. Lack of control may be indicated when an individual has the right to hire a substitute without the employer's knowledge.

5. Hiring, Supervising, and Payment of Assistants. Hiring, supervising, and payment of assistants by the employer generally shows control over all the men on the job. Sometimes one worker may hire, supervise, and pay the other workmen. He may do so as the result of a contract in which he agrees to provide materials and labor and under which he is responsible only for the attainment of a result, in which case he is an independent contractor. On the other hand, if he does so at the direction of the employer, he may be acting as an employee in the capacity of foreman for or representative of the employer.

6. Continuing Relationship. The existence of a continuing relationship between an

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individual and the person for whom he performs services is a factor tending to indicate the existence of an employer-employee relationship. Continuing services may include work performed at frequently recurring though somewhat irregular intervals either on call of the employer or whenever the work is available. If the arrangement contemplates continuing or recurring work, the relationship is considered permanent, even if the services are rendered on a part-time basis, they are seasonal in nature, or the person actually works only a short time.

7. Set Hours of Work. The establishment of set hours of work by the employer is a factor indicative of control. This condition bars the worker from being master of his own time, which is a right of the independent contractor. Where fixed hours are not practical because of the nature of the occupation, a requirement that the worker work at certain times is an element of control.

8. Full Time Required. If the worker must devote his full time to the business of the employer, the employer has control over the amount of time the worker spends working and impliedly restricts him from doing other gainful work. An independent contractor, on the other hand, is free to work when, and for whom, he chooses.

Full time does not necessarily mean an 8-hour day or a 5- or 6-day week. Its meaning may vary with the intent of the parties, the nature of the occupation, and customs in the locality. These conditions should be considered in defining "full time."

Full-time services may be required even though not specified in writing or orally. For example, a person may be required to produce a minimum volume of business which compels him to devote all of his working time to that business, or he may not be permitted to work for anyone else and to earn a living he necessarily must work full time.

9. Doing Work on Employer's Premises. Doing the work on the employer's premises is not control in itself; however, it does imply that the employer has control especially where the work is of such a nature that it could be done elsewhere. A person working in the employer's place of business is physically within the employer's direction and supervision. The use of desk space and of telephone and stenographic services provided by an employer places the worker within the employer's direction and supervision unless the worker has the option as to whether he wants to to use these facilities.

The fact that work is done off the premises does indicate some freedom from control. However, it does not by itself mean that the worker is not an employee. In some occupations the services are necessarily performed away from the premises of the employer. This is true, for example, of employees of construction contractors.

10. Order or Sequence Set. If a person must perform services in the order or sequence set for him by the employer, it shows that the worker may be subject to control as he is not free to follow his own pattern of work, but must follow the established routines and schedules of the employer.

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Often, because of the nature of an occupation, the employer does not set the order of the services or sets them infrequently. It is sufficient to show control, however, if he retains the right to do so.

11. Oral or Written Reports. If regular oral or written reports must be submitted to the employer, it indicates control, in that the worker is compelled to account for his actions.

12. Payment by Hour, Week, Month. An employee is usually paid by the hour, week, or month; whereas, payment on a commission or job basis is customary where the worker is an independent contractor. Payment by the job includes a lump sum which is computed by the number of hours required to do the job at a fixed rate per hour; it may also include weekly or monthly payments if this method of payment is a convenient way of paying a lump sum agreed upon as the cost of doing a job.

The guarantee of a minimum salary or the granting of a drawing account at stated intervals with no requirement for repayment of the excess over earnings tends to indicate the existence of an employer-employee relationship.

13. Payment of Business and/or Traveling Expense. Payment by the employer of the worker's business and/or traveling expenses is a factor indicating control over the worker. Conversely, a lack of control is indicated where the worker is paid on a job basis and has to take care of all incidental expenses.

14. Furnishing of Tools, Materials. The furnishing of tools, materials, etc., by the employer is indicative of control over the worker. Where the worker furnishes the tools, materials, etc., it indicates a lack of control but consideration must be given to the fact that in some occupational fields it is customary for employees to use their own hand tools.

15. Significant Investment. A significant investment by a person in facilities used by him in performing services for another tends to show an independent status. On the other hand, the furnishing of all necessary facilities by the employer tends to indicate the absence of an independent status on the part of the worker.

Facilities include, generally, equipment or premises necessary for the work but not tools, instruments, clothing, etc., that are provided by employees as a common practice in their particular trade.

16. Realization of Profit or Loss. A person who is in a position to realize a profit or suffer a loss as a result of his services is generally an independent contractor, while the individual who is an employee is not in such a position. Opportunity for profit or loss may be established by one or more of a variety of circumstances, e.g.:

A. The individual hires, directs, and pays assistants.

B. He has his own office, equipment, materials, or other facilities for doing the work.

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C. He has continuing and recurring liabilities or obligations and his success or failure depends on the relation of his receipts to his expenditures.

D. He agrees to perform specific jobs for prices agreed upon in advance and pays expenses incurred in connection with the work.

17. Working for More Than One Firm At a Time. If a person works for a number of firms at the same time, it usually indicates an independent status because in such cases the worker is usually free from control by any of the firms. It is possible, however, that a person may work for a number of people or firms and still be an employee of one or all of them.

18. Making Service Available to General Public. The fact that a person makes his services available to the general public is usually indicative of an independent contractual relationship. An individual may hold his services out to the public in a number of ways. He may have his own office and assistants, he may hang out a "shingle" in front of his home or office, he may hold business licenses, he may be listed in business directories, or he may advertise in newspapers, trade journals, magazines, etc.

19. Right to Discharge. The right to discharge is an important factor in indicating that the person possessing the right is an employer. He exercises control through the ever-present threat of dismissal which causes the worker to obey his instructions. An independent contractor, on the other hand, cannot be fired as long as he produces a result which measures up to his contract specifications.

Sometimes an employer's right to discharge is restricted because of his contract with a labor union. Such a restriction does not detract from the existence of an employment relationship.

20. Right to Terminate. An employee has the right to end his relationship with his employer at any time he wishes without incurring liability. An independent contractor usually agrees to complete a specific job and he is responsible for its satisfactory completion or is legally obligated to make good for failure to complete the job.

APPENDIX II

FORM **4669**
(Rev. Sept. 1974)

DEPARTMENT OF THE TREASURY · INTERNAL REVENUE SERVICE

EMPLOYEE WAGE STATEMENT

1. NAME AND ADDRESS OF EMPLOYEE

2. SOCIAL SECURITY NUMBER

3. NAME AND ADDRESS OF EMPLOYER

4. CALENDAR YEAR

5. AMOUNT OF WAGES (INCLUDING COMMISSIONS, BONUSES, PRIZES, ETC.) ON WHICH INCOME TAX AND SOCIAL SECURITY TAX WERE NOT WITHHELD
$

THE ABOVE WAGES, ON WHICH THERE WAS NO WITHHOLDING OF FEDERAL INCOME OR SOCIAL SECURITY TAX, WERE REPORTED ON MY TAX RETURN DESCRIBED BELOW. THE TAXES DUE ON THAT RETURN HAVE BEEN PAID IN FULL.

6. NAME AND ADDRESS SHOWN ON RETURN

7. SPOUSE'S SOCIAL SECURITY NUMBER IF A JOINT RETURN WAS FILED

8. RETURN FORM NUMBER

9. SERVICE CENTER WHERE FILED

10. THE WAGES SHOWN IN ITEM 5, ABOVE, ARE REPORTED ON

a. LINE_____, PAGE_____, OF MY RETURN.

b. SCHEDULE_____OF MY RETURN. IF REPORTED ON SCHEDULE C, F, OR SE, SELF-EMPLOYMENT TAX OF $_____WAS PAID.

UNDER PENALTIES OF PERJURY, I DECLARE THAT TO THE BEST OF MY KNOWLEDGE AND BELIEF THE ABOVE INFORMATION IS TRUE, CORRECT, AND COMPLETE.

11. SIGNATURE OF EMPLOYEE

12. DATE

Form **4669** (Rev. 9-74) GPO 1976 O - 202-077 Department of the Treasury - Internal Revenue Service

APPENDIX III

Form 4670 (Rev. Jul · 1976)	DEPARTMENT OF THE TREASURY · INTERNAL REVENUE SERVICE **REQUEST FOR RELIEF FROM PAYMENT OF INCOME TAX WITHHOLDING**	
NAME AND ADDRESS OF EMPLOYER	EMPLOYER IDENTIFICATION NUMBER	RETURN FORM NO. 941
	TAX PERIOD COVERED BY EXAMINATION From: To:	

As provided by Internal Revenue Code section 3402(d), explained on the back of this form, please relieve me from the payment of income tax required to be withheld from wages covered by the attached Forms 4669, Employee Wage Statements, listed below.

Year	Number of Statements

Total Statements Attached ⟶

I certify that either (1) the statements were signed in my presence, or (2) to the best of my knowledge and belief the signatures on the statements are valid and legal.

Signatures			
		DATE	*(The Internal Revenue Service does not require a seal on this form, but if one is used, please place it here)*
		DATE	
BY	TITLE	DATE	

(Over)

Form 4670 (Rev. ·-76)

APPENDIX III

INSTRUCTIONS FOR EMPLOYER

Section 3402(d) of the Internal Revenue Code provides that you can be relieved of payment of income tax not withheld from an employee, provided you can show that the employee has reported the wages and paid the tax. You should obtain a separate Form 4669, Employee Wage Statement, from each employee for each year relief is requested. After you get all Employee Wage Statements, please summarize them by year on the front of this form, and send them with this form to the Internal Revenue Service Center address shown below for the district in which your principal place of business, office, or agency is located.

New Jersey, New York City, and Counties of Nassau, Rockland, Suffolk, and Westchester	Internal Revenue Service Center 1040 Waverly Avenue Holtsville, N.Y. 11799
New York (all other counties) Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, Vermont	Internal Revenue Service Center 310 Lowell Street Andover, Mass. 01812
Delaware, District of Columbia, Maryland, Pennsylvania	Internal Revenue Service Center 11601 Roosevelt Boulevard Philadelphia, Pennsylvania 19155
Alabama, Florida, Georgia Mississippi South Carolina	Internal Revenue Service Center 4800 Buford Highway Chamblee, Georgia 30006
Michigan, Ohio	Internal Revenue Service Center Cincinnati, Ohio 45298
Arkansas, Kansas, Louisiana, New Mexico, Oklahoma, Texas	Internal Revenue Service Center 3651 South Interregional Highway Austin, Texas 78740
Alaska, Arizona, Colorado, Idaho, Minnesota, Montana, Nebraska, Nevada, North Dakota, Oregon, South Dakota, Utah, Washington, Wyoming	Internal Revenue Service Center 1160 West 1200 South Street Ogden, Utah 84201
Illinois, Iowa, Missouri, Wisconsin	Internal Revenue Service Center 2306 East Bannister Road Kansas City, Missouri 64170
California, Hawaii	Internal Revenue Service Center 5045 East Butler Avenue Fresno, California 93888
Indiana, Kentucky, North Carolina, Tennessee, Virginia, West Virginia	Internal Revenue Service Center 3131 Democrat Road Memphis, Tenn. 38110

If you have no legal residence or principal place of business in any Internal Revenue district, file with the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pa. 19155.

IMPORTANT: It is to your advantage to file this form and the required attachments at the earliest possible date, so as to avoid collection action.

Form **4670** (Rev. 7-76)

GPO 804-818

PRINCIPAL OFFICIALS RESPONSIBLE FOR ADMINISTERING ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of Office	
	From	To
Secretary of the Treasury:		
W. Michael Blumenthal	Jan. 1977	Present
William E. Simon	Apr. 1974	Jan 1977
George P. Shultz	June 1972	Apr. 1974
John B. Connally	Feb. 1971	June 1972
Commissioner of Internal Revenue:		
Jerome Kurtz	May 1977	Present
William E. Williams (acting)	Feb. 1977	May 1977
Donald C. Alexander	May 1973	Feb 1973
Raymond F. Harless (acting)	May 1973	May 1973
Johnnie M. Walters	Aug. 1971	Apr. 1973

THE DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

OCT 18 1977

Dear Mr. Lowe:

This letter summarizes the comments of the Treasury Department and the Internal Revenue Service on the report prepared by the General Accounting Office entitled "Tax Treatment of Employees and Self-Employed Persons by the IRS: Problems and Solutions." These comments are explained more fully in the attached memorandum entitled "Joint Comments by IRS and Treasury," to which is appended an Internal Revenue Service study of cases involving the reclassification of independent contractors as employees.

The Treasury Department and the Internal Revenue Service concur with the GAO in its recognition that a serious problem exists with respect to classification of independent contractors and employees. The GAO report has made a major contribution in emphasizing the need for certainty in this area so that employers can plan their tax liability. We believe that the proposed GAO solution will be helpful in suggesting new criteria which we shall propose in a separate report, although for the reasons described below, we do not believe the GAO report provides an adequate basis for legislation.

We agree with the GAO report that legislation is needed to enable a taxpayer to determine with certainty who, among the individuals involved in his business, are his employees and who are independent contractors. However, in addition to providing certainty, we believe it is of paramount importance that any legislative solution to the problem of determining employment status also consider the need to protect the general revenues and the Social Security Trust Fund, and the need to minimize complexity and expense for taxpayers and the government.

Currently there is a significant difference between the tax treatment of independent contractors and that of employees. A person who performs services as an independent contractor does not have income or employment taxes withheld

from his remuneration. Similarly, a person who obtains services from an independent contractor rather than from an employee is not liable for FUTA taxes or the employer's share of FICA taxes, and also avoids the administrative burden of withholding. In short, the tax law provides incentives for both the person performing the services and the person for whom the services are performed to seek classification of their relationship as payer-independent contractor rather than employer-employee.

The primary recommendation of the GAO report is to define independent contractor status by reference to four fixed criteria--acquisition of an employer identification number, maintenance of a separate set of books, existence of a separate place of business, and opportunity for profit or loss. We object to this proposed definition principally on the grounds that taxpayers could manipulate the specified criteria simply by changing the form of business relationships, without changing the substance of these relationships. In effect, the proposal would allow many workers to elect independent contractor status merely by reordering their affairs.

In light of the strong tax incentives for obtaining independent contractor status, enactment of an elective procedure of the type recommended in the GAO report could have a significant and adverse effect on the general level of income tax compliance. While the GAO report found a high level of compliance among independent contractors who were reclassified by the IRS as employees, a more complete IRS study found that such persons reported no more than 74 percent of the amounts received by them as remuneration for services In addition, permitting a large number of employees to elect to be treated as independent contractors could reduce substantially participation in both the Federal unemployment insurance system and the social security system.

We also object to the GAO proposal because of its administrative implications. In many respects, the four proposed criteria are unclear and difficult to administer. Moreover, the proposal would allow continued widespread application of the common law rules, with all of their attendant confusion and uncertainty.

These and additional comments are discussed in detail in the attachments to this letter. Thank you for giving us this opportunity to comment.

Sincerely,

Laurence N. Woodworth
Assistant Secretary for Tax Policy

Mr. Victor L. Lowe
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Attachments (See GAO note)

GAO note: The joint comments of IRS and Treasury are included as part of this appendix. The 32-page IRS study referred to in these comments is not included.

APPENDIX V

JOINT COMMENTS BY IRS AND TREASURY
ON GAO REPORT ENTITLED "TAX TREATMENT OF
EMPLOYEES AND SELF-EMPLOYED PERSONS BY THE
IRS: PROBLEMS AND SOLUTIONS"

There is a clear need for a legislative solution to the problem of determining whether an individual is an employee or an independent contractor. Considerations in choosing the proper solution include the need for certainty in determinations of employment status, the need to protect the general revenues and the Social Security Trust Fund, and the need to minimize complexity and expense for both taxpayers and the government.

Our primary concern with the GAO report is that GAO's study is based on unsound statistical assumptions which may lead to erroneous legislative conclusions. In addition, we object to the GAO proposal to define independent contractor status by reference to standards that tax planners can manipulate by changing the form of business relationships, without changing their substance.

GAO STATISTICAL STUDY

The GAO statistical study of independent contractors reclassified by the IRS as employees, found that such persons paid up to 96 percent of the taxes owed by them on the remuneration received by them for their services.* The GAO study was confined to closed cases involving abatements. In order to get a broader and more representative picture of compliance in this area, the IRS conducted a study of its own, more fully described in the Appendix. The more complete IRS study shows that independent contractors reclassified by the IRS as employees reported, at a maximum, only 74 percent of the amounts received by them as remuneration for services.** While neither study is definitive, the IRS figures suggest that compliance is significantly lower than estimated by GAO.

With a few unscientifically selected exceptions, GAO did not even review tax returns of reclassified employees to determine compliance. The IRS study, however, attempted

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* See page 38 of GAO's draft report. 96 percent is derived as follows: $\frac{(89 + .6 \times 11) + (92 + .6 \times 8)}{2}$

** See Table 7 of the IRS study.

to review all identifiable employee income tax returns to determine compliance and found that 32 percent of the workers who could be identified from their payors' records either should have, but did not, file income tax returns, or filed but omitted all or part of their reclassified wages from their returns. The omitted income was 15 percent of the reclassified income of these taxpayers. In other words, only 68 percent of the identified sample population filed timely and correct income tax returns showing 85 percent of the reclassified income.*

Since an actual audit examination of the reclassified employees' tax returns is the best and most reliable technique for determining whether they paid their taxes, neither the GAO nor the IRS study contains sufficient information to warrant conclusive judgments as to the true level of compliance.**

Approximately one-half of the taxes in the IRS sample of open cases were assessed to cover payments to workers who could not be identified with sufficient specificity from the payors' records even to obtain their tax returns. Over 50 percent of the reclassified employees in the GAO sample could not be the subjects of individual study because they were insufficiently identified. This demonstrates both the risks of drawing conclusions from such incomplete statistical data and the impracticability of GAO's recommendation that IRS use its files to determine an initial correct tax assessment to employers.

GAO's statistical study assumed compliance rates among independent contractors because the IRS had "abated" between 89 and 92 percent of the income tax assessments against employers since "evidence to IRS' satisfaction was provided showing that the workers had already paid their taxes." GAO's conclusion based on the IRS' abatement practice is unsound. For reasons of administrative expediency, the IRS accepts a Form 4669 signed by the worker certifying payment of his tax as providing a sufficient basis to abate the assessment against his employer.

*See Table 8 of the IRS study. For purposes of determining whether an income tax return was due, IRS assumed that if a person received reclassified wages of $2,800 or more (the filing requirements for a joint 1974 individual income tax return) he should have filed a timely return.

**Audit examinations would allow consideration of whether taxpayers had offsetting business deductions not taken into account in the IRS study.

The IRS study showed that many of these Forms 4669 contained inaccurate representations not squaring with income information disclosed on the actual income tax returns filed by the workers. The IRS study found that 21 percent of the employees (with 6 percent of the reclassified income) filing Forms 4669, and for whom tax returns were secured, did not report on their individual income tax returns any of the reclassified wages they certified as having been included in their income on the Forms 4669.*

The risk to the Social Security Trust Fund is substantial even on the basis of GAO's findings. GAO found on the basis of reviewing 126 audit case files of 82 persons, that 16 percent did not report all their self-employment income and that 13 percent of self-employment income was not reported. GAO also analyzed the tax returns of 37 employees from 5 of the 92 cases sampled. Of these 37 employees, just 24 (slightly under two-thirds) paid Social Security (SECA) tax on their income earned while considered self-employed.

From an analysis of its TCMP data, the IRS found that the gap between gross receipts reported by self-employed businessmen who file Schedule C (which would include, but not be limited to independent contractors) and the amount which they should have reported exceeds $8.5 billion per annum.** The amount of the gap is higher because unreported income cannot always be detected by IRS. Total wages reported on which withholding applies ($685 billion) are about 2.8 times gross receipts reported by the self-employed Schedule C filers ($248 billion). According to these data, the net underreporting of wages ($1.1 billion) is 0.2 percent, whereas the net underreporting of the self-employeds' Schedule C gross receipts ($8.5 billion) is 3.3 percent.

Self-employed persons underreport over $525 million per annum of self-employment tax. Again, the gap is undoubtedly higher in view of the difficulties of detecting unreported self-employment income. If the class of self-employed persons is increased, as under the GAO proposal, the Social Security Trust Fund would run a clearly higher, although not quantifiable, risk of shortfall in collection of tax on self-employment income.

*See Table 9 of the IRS study.

**IRS Taxpayer Compliance Measurement Program, Phase III, Cycle 5.

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GAO DEFINITIONAL SOLUTION

The GAO proposal for clarifying the definition of employee for employment tax purposes would define a class of independent contractors by four criteria. Under the proposal, a person engaged in a trade or business would be considered self-employed if he or she met each of the following criteria:

1. Has acquired an employer identification number required under Code section 6109.*

2. Has a separate set of books and records which reflect items of income and expenses of his trade or business.

3. Has a principal place of business other than at a place of business furnished by the persons for whom he performs or furnishes services.

4. Has the risk of suffering a loss and opportunity of making a profit.

If an individual met only three of these criteria, including that of obtaining an employer identification number (EIN), his status would be determined under the common law. If the individual did not have an EIN, or if he satisfied less than three of the four criteria, he would be considered an employee.

We object to this proposal on the ground that the four criteria on which independent contractor status would depend could be manipulated by changing the form of business relationships, without changing their substance. An employer might well prefer to obtain services from an independent contractor rather than an employee in order to avoid liability for FUTA taxes and the employer's share of FICA taxes, as well as the burden of withholding. Similarly, a person who provided services might prefer to be classified as an independent

*The word "required" should be dropped from this criterion, since individuals without employees are not "required" by section 6109 to obtain EINs and thus under a literal reading such individuals could never qualify as independent contractors.

contractor rather than an employee in order to avoid withholding or for some other reason. In effect, the GAO proposal would allow many workers to "choose" independent contractor status by structuring their affairs so as to meet the four criteria.

In some respects, the proposed criteria are not only manipulatable, but also unclear, difficult to administer, and not meaningful for determining employment tax or withholding obligations. Moreover, the GAO proposal would allow continued widespread application of the common law rules, with all of their attendant confusion and uncertainty.

The Criterion of an EIN

Anyone can obtain an EIN. Permitting tax consequences to turn on an essentially meaningless act would set up no standard of substance to differentiate employees from independent contractors and would set a trap for the unadvised or forgetful independent contractor. Disqualification as an independent contractor where independent contractor status is otherwise appropriate, merely for not obtaining the number, would be an unfortunate consequence.

The EIN would serve no useful tax compliance purpose for IRS. In fact, the Service intends to limit the use of the EIN to artificial persons after 1979 and to use Social Security numbers for people as a cost saving measure.

According to the GAO report, the criterion of acquiring an EIN is intended to show that persons "consider themselves self-employed and did not fall into that status by accident." (p. 30) A more meaningful way of achieving this result might be to consider whether an individual holds himself out in his own name as self-employed and/or makes his services generally available to the public.

The Criterion of a Set of Books and Records

Both employees and independent contractors may or may not keep books and records. Books and records do not necessarily signify the existence of a separate business. Nor does the absence of adequate books and records necessarily signify the nonexistence of a separate business. While in some cases it might be appropriate to impose a penalty on an independent contractor for failure to keep adequate books and records, it would be unfair to deny independent contractor status merely because he or she keeps inadequate books and records. It also seems unwise to "reward" employees for

keeping careful records by including this as a factor in determining independent contractor status.

The criterion of books and records appears to be manipulatable. Many employees could set up their own books and records if they wished to obtain independent contractor status, and employers might encourage this. For example, an employer might seek to reimburse an employee's record keeping expenses or, in fact, have the employee's record keeping requirements satisfied by the employer's record keeping system or accountant.

The criterion of books and records could also cause administrative problems. The determination of a putative employer's obligation to withhold on his payees would turn on examining whether his payees in fact kept books and records and making judgments as to whether particular record systems--ranging from the back of a matchbook to a scribble in a notebook--should pass muster. This would require locating the employees and making subjective judgments about their books and records--necessarily a time-consuming, expensive process, and all for the purpose of verifying a criterion that is less than meaningful.

The Criterion of Loss and Opportunity for Profit

Since both employees and independent contractors have an opportunity to make a profit, this is not a meaningful basis on which to distinguish one from another. Risk of loss, however, is a more meaningful basis for distinction.

We suggest that if Congress enacts a risk-of-loss test, care be taken to make the test as objective as possible. For example, the test could incorporate a specified minimum level of investment, or a specified minimum level of expenses tantamount to investment. Without an objective standard of some type, a risk-of-loss test would be complex and uncertain.

Even with an objective standard, a risk-of-loss test would raise difficult questions. For example, what types of expenses should be considered to contribute to a risk of loss? (Transportation expenses not related to the conduct of a transportation business?) Should an expenditure of time, as opposed to money, be considered to produce a risk of loss? If an expenditure of time is to be considered, how should it be measured?

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In addition, in many cases it would be difficult to prevent manipulation of a risk-of-loss test. Employers could simply raise wages and have employees use the extra remuneration for advertising and other business expenses, thus ostensibly transferring to the employee a risk of loss.

The Criterion of a Separate Principal Place of Business

The criterion of a separate place of business would be easily manipulatable. It would also be difficult to apply.

The difficulty of applying the test may be illustrated by two examples from the GAO report. GAO concludes that a service station operator "renting" a station from his supplier (possibly with the "rent" included in the price of gas and no obligation to pay for the consigned gas unless sold) has a separate place of business. (p. 50) Conversely, GAO concludes that a barber paying a fixed fee for his chair does not have a separate place of business. (p. 48) There are reasonable grounds for disagreeing with both of these conclusions.

The test would create many additional uncertainties. For example, would a cab driver's taxi or a truck driver's truck be considered a separate place of business? What about renting a portion of a warehouse or an office from a traditional employer? We would have further difficulty in applying GAO's requirement that rent paid to a supplier or wholesaler be comparable to rent normally paid between nonrelated businesses.

The administrative difficulties of interpreting and enforcing the principal-place-of-business rule would be substantial. The use of limited audit resources should not be extended to checking out alleged places of business that may be merely mailing addresses and phone answering services, for this limited and unproductive purpose. If Congress adopts GAO's criterion, we suggest as a minimum that a worker's home should not qualify as a separate place of business unless it meets the tests recently enacted in Code section 280A.

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The Fallacy of Judging Whether GAO's Standards Can Be Manipulated By Applying Them to Closed Cases

In response to our concern that the criteria to be applied must not be easily manipulatable by persons whose employment situation does not indicate self-employment, the GAO draft report notes that of 25 files examined "only four of the businesses had reclassified employees who might meet the self-employed criteria."

We believe that it is misleading to judge the manipulatability of the GAO criteria by applying them to closed cases where the taxpayers had no knowledge of the proposed rules when they arranged their transactions. If the Code is amended as suggested by GAO, it is likely that many taxpayers would attempt to order their affairs in such a way as to satisfy the new criteria for obtaining independent contractor status. In fact, employers in a strong bargaining position might insist that persons they pay to provide services order their affairs in such a way as to eliminate the employer's liability for FICA, FUTA and income tax withholding.

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The Continued Widespread Application of the Common Law Rules

In cases where a worker met three of the criteria, including that of obtaining an EIN, the GAO proposal would apply the common law to determine the individual's status. We believe that under the GAO proposal, the continued application of the common law rules would be widespread.

The draft GAO report lists six occupations and concludes that of these, 50 percent would require application of the common law to determine an individual's status. In our judgment, the continued application of the common law would be considerably greater than this analysis suggests. We have attempted to apply the GAO criteria to other occupations, with the following results:

Lawyer

A lawyer would be self-employed if he had obtained an EIN, had the opportunity for profit and loss, had separate books and records, and had a separate place of business. However, if a lawyer in private practice failed to obtain an EIN either because he did not need one or through inadvertence, he would be an employee of his clients.

Applicator, Roofer, Carpetlayer

These individuals often work in conjunction with a single retail seller installing or servicing a product at the request of the seller. An individual performing these types of services with no risk of loss could obtain an EIN and maintain separate books and records. If he had a separate place of business, his status would be determined under the common law. If he had a risk of loss but no separate place of business, his status would also be determined under the common law.

Crew Leader

A crew leader supplies workers in industries such as agriculture and construction. Such an individual with no risk of loss could obtain an EIN, maintain separate books and records, and have a separate place of business, and thus have his status determined under the common law.

Cab Driver

An independent cab driver (i.e. one who owned his own cab) could meet the requirements of obtaining an EIN, having the opportunity for profit and loss, and maintaining separate books and records. If the driver's taxi were viewed as a place of business, he would be considered self-employed. Otherwise, his status would be determined under the common law. If he failed to obtain an EIN, apparently the driver would be treated as the employee of his passengers.

A cab driver who did not own his cab and worked for only one cab company could obtain an EIN, have the opportunity for profit and loss, and maintain separate books and records, and thereby have his status determined under the common law. If the cab were regarded as the driver's separate place of business, the driver could be considered self-employed. In our opinion, this would be the wrong result in some circumstances (such as where the company leases the cab to the driver, directs him to his passengers by radio, and generally controls his activities).

Truck Driver

The status of truck drivers would be as unclear as that of cab drivers.

Subcontractor

A subcontractor probably would meet all of the criteria and be considered self-employed. If the subcontractor did not have an EIN, he would be considered an employee.

Artisan in Construction Industry

An artisan could have an EIN, maintain separate books and records, have a separate place of business, and thus have his status determined under common law. An artisan may or may not have a substantial risk of loss. Of course, he also may or may not have a separate place of business.

In short, many of the occupations examined would appear to continue to be subject to the common law tests under the GAO proposal.

In addition, the GAO proposal does not address the problem of determining the status of an individual who has two jobs--one where he is clearly an employee and another where he might meet the self-employment criteria. Since the proposed test looks to the facts of the worker's trade or business, it should be made clear which of his activities is to be examined. We believe, for example, that a grocer who also pumps gas outside the store should have his two businesses judged separately, not merged as GAO suggests. (p. 50)

CERTIFICATION TO AVOID TAX ENFORCEMENT
FOR PAST PERIODS

GAO proposes that IRS reclassifications of workers not be applied retroactively in situations where employers obtain certificates from their workers stating that the criteria of self-employment status are met.

Audits are the basic tool of tax enforcement. All audits are retroactive; by definition, none cover current or future periods. The GAO proposal could emasculate the audit process in determinations of employment status.

Limited audit resources would not allow the verification of a meaningful number of certificates, and taxpayers would soon know this. Permitting taxpayers to rely on the protection of a certificate by an alleged independent contractor would create the risk that economic pressure would induce filing such certificates in doubtful cases. Marginal employers would be willing to rely on certificates in circumstances where their more law-observing competitors would not. This would create a dilemma for conscientious taxpayers, who would be penalized for their honesty.

The proposal could also create substantial administrative problems. For example, examining agents could be required to examine the circumstances under which each worker performs services in order to invalidate the certificates. Apparently nothing would prevent employers from obtaining new certificates following reclassification. Moreover, confusion could arise if employers were unable to secure certificates from all workers.

By way of analogy, significant problems were encountered with certification to obtain relief from the manufacturer's excise tax. In order to support tax free purchases, buyers were required to furnish an exemption certificate. In part because of certain abuses, Rev. Proc. 73-21, 1973-2 C.B. 471 revoked all certificates issued prior to January 23, 1970. Reregistration under tighter controls was thereafter instituted. No practical controls are apparent in the GAO suggestion of certification for independent contractors, since the proposed standards defining independent contractors are so loose, vague and manipulatable.

DETERMINATION OF TAXES
DUE UPON RECLASSIFICATION

When the IRS determines that employers have not withheld taxes from employee wages, the IRS assesses the employer for the total amount of the taxes. The employer then receives a credit for Federal income taxes which employees certify they have paid. Present law does not allow SECA taxes paid by employees to be offset against FICA taxes due, unless the employee is not eligible for a refund of SECA taxes.

GAO recommends that Congress amend the Code to authorize IRS to reduce the employees' portion of FICA taxes assessed against employers by the amount of the SECA taxes previously paid. We agree with this recommendation.

In addition, GAO proposes that the IRS use information in its files to determine "an initial correct tax assessment to employers" and automatically refund to reclassified employees the amount by which SECA taxes paid exceed the employee's share of FICA taxes due. Where an employer provides the IRS with certain identifying information about his employees, it is possible for the IRS to make limited checks as to the taxes paid by these employees. However, the GAO proposal would go far beyond requiring the IRS to do this. The GAO proposal would shift from the employer to the IRS the whole burden of proving which employees had paid SECA and income taxes, and in what amount--even where the employer's records lacked (as they often do) the information necessary to locate the employee's return.

We strongly oppose this proposal. Our current resources could not absorb the costs involved in determining an initial correct assessment to employers and in determining the balance of SECA taxes to be refunded to employees. We estimate that it would cost $7.9 million in direct costs and $30.2 million in opportunity costs each year to make "initial correct assessments" in all the employment tax cases we handle during the year. Moreover, our computer system capabilities are inadequate to perform the function at present. Most importantly, we could not solve the substantial problem of checking employee returns where the employer's records lacked the necessary information to locate the employee's return. (At present, employers are permitted to avoid this problem by obtaining statements from employees certifying that taxes were paid.)

The direct cost estimate reflects the limited amount of information available in our files and on individual returns. While the filing record for individuals for whom a name and Social Security number are available can be obtained from the individual master file, this file does not contain information needed to determine whether or not adjustments are allowable against the employer's liability for withholding and FICA taxes. Manual processing of the individual records and returns would be necessary to determine an "initial correct assessment." Our present resources would allow such processing if 10 employees were involved, but not if 10,000 were to be the subject of the exercise.

It would also be necessary to follow up on individuals for whom we had no record of filing to ascertain if a return was actually filed or required to be filed. In addition, it would be necessary to follow up on questionable returns where the income in question could not be identified as having been reported. The estimated direct costs of these follow-ups are $2.0 million for delinquency investigations and $5.9 million for questionable returns. The latter follow-up would include a determination of whether or not the individual worker was entitled to a refund of the balance of SECA taxes paid over FICA taxes due.

The opportunity cost of $30.2 million represents the additional income tax that could be expected to be lost from the diversion of our resources from the examination of individual returns to the determination of "initial correct assessments" of employment taxes. The cost breaks down to $8.7 million for revenue agents and $21.5 million for tax auditors.

IRS METHOD OF CALCULATING INTEREST AND PENALTIES

We agree with GAO's comments regarding our present method of computing interest in connection with employment tax assessments and abatements. This method results in overcharges in some instances.

We intend to correct the problem by using information in the master file for purposes of computing the interest. The date of payment is captured in the DLN (Document Locater Number) on the individual income tax return and can be retrieved

from the master file. Of course, this will require the service organization computing the interest assessment to require transcript information for all individuals reclassified as employees.

We also agree with GAO's suggestion that steps be taken to prevent misapplication of the 5 percent penalty for failure to deposit taxes actually withheld. We intend to take such steps.

CONCLUSION

The primary recommendation of the GAO report is to define independent contractor status by reference to four fixed criteria--acquisition of an employer identification number, maintenance of a separate set of books, existence of a separate place of business, and opportunity for profit or loss. We object to this proposed definition principally on the grounds that taxpayers could manipulate the specified criteria simply by changing the form of business relationships, without changing the substance of these relationships. In effect, the proposal would allow many workers to elect independent contractor status merely by reordering their affairs.

In light of the strong tax incentives for obtaining independent contractor status, enactment of an elective procedure of the type recommended in the GAO report could have a significant and adverse effect on the general level of income tax compliance. While the GAO report found a high level of compliance among independent contractors who were reclassified by the IRS as employees, the more complete IRS study found that such persons reported no more than 74 percent of the amounts received by them as remuneration for services. In addition, permitting a large number of employees to elect to be treated as independent contractors could reduce substantially participation in both the Federal unemployment insurance system and the Social Security system.

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We also object to the GAO proposal because of its administrative implications. In many respects, the four proposed criteria are unclear and difficult to administer. Moreover, the proposal would allow continued widespread application of the common law rules, with all of their attendant confusion and uncertainty.

For these reasons, we suggest that Congress give careful consideration to alternative proposals.

APPENDIX VI

U.S. DEPARTMENT OF LABOR
OFFICE OF THE ASSISTANT SECRETARY
WASHINGTON

OCT 19 1977

Mr. Gregory J. Ahart
Director
Human Resources Division
United States General Accounting
Office
Washington, D. C. 20548

Dear Mr. Ahart:

Thank you for the opportunity to review the draft report entitled "Tax Treatment of Employees and Self-Employed Persons by the IRS: Problems and Solutions."

The Department of Labor is in general agreement with the concerns of the Department of the Treasury/Internal Revenue Service. Although we do not question the desirability of making the criteria for defining employee more definite, the Department of Labor shares the concern of the Internal Revenue Service that the adoption of the GAO recommendations would enable taxpayers to rearrange their affairs so that many who are now employees could be reclassified as self-employed.

As it is the mission of the Department to protect the interests of workers, we are concerned that such reclassifications would not be in the interest of workers who should be classified as employees but could, under the GAO recommendations, be classified as independent contractors.

If we can be of further assistance to you, please let me know.

Sincerely,

ALFRED M. ZUCK
Assistant Secretary for
Administration and Management

APPENDIX VII

UNITED STATES DEPARTMENT OF JUSTICE

WASHINGTON, D.C. 20530

Address Reply to the Division Indicated and Refer to Initials and Number

OCT 21 1977

Mr. Victor L. Lowe
Director
General Government Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Lowe:

Pursuant to your letter of October 3, 1977, addressed to the Attorney General, we are submitting the following comments on the proposed draft report to the Congress entitled "Tax Treatment of Employees and Self-Employed Persons by the IRS: Problems and Solutions."

A basic premise of the GAO report is that the people whose status as employees or independent contractors is in dispute are reporting the income in question. This conclusion was based on a sampling of closed cases in which there had been some Section 3402(d) abatement. Ninety-two cases involving 1,070 workers were analyzed, of which 5 cases involving 37 workers were analyzed in depth, to establish that (in the 5 cases surveyed) 92% of the income on which the income tax withholding assessments were based had been reported by workers. 1/

To the contrary, we are convinced that because there is no withholding there is substantial nonreporting of income. The proportion of nonreporting varies from industry to industry and also within each industry. However, on the basis of our experience over the years and a current survey of our trial attorneys, we believe in many cases 50% or less of the income is actually being reported on income tax returns.

1/ We have some difficulty in following the analysis of these 5 cases. Thus, at pp. 19-20 it is said that the employers were assessed $39,700 in income taxes that should have been withheld, of which $35,300 was abated under Section 3402(d) after the employer obtained the necessary certification and (the survey established) an additional $1,600 could have been abated based on analysis of the workers' income tax returns. At page 60 it is stated that the assessments against these 5 employers totalled $41,379, of which $38,274 was abated under Section 3402(d) and an additional $1,869 could have been abated based on analysis of the returns. We also had other difficulties in following precisely what was done, but do not want to lengthen this response unduly.

That there should be a difference in perception with respect to the matter of reporting is explicable in part because the likelihood of a businessman agreeing to a determination that he is an employer increases as the cost of such determination decreases--and this cost decreases to the extent that the workers are reporting the compensation as income. Similarly, workers who are reporting compensation as income anyway would not be likely to object to withholding. We note also that the 5 cases sampled involved relatively small businesses, inasmuch as each case involved on the average fewer than 8 workers. To be meaningful, we think that any sampling would have to be far more extensive, and also would have to be done separately as to each industry, because the variations are so great.

The problem of reporting with respect to self-employment taxes is greater than with respect to reporting for income taxes generally. Even those who report the compensation in question as income often do not file the requisite Schedule C (Profit or (Loss) from Business or Profession) and Schedule SE (Computation of Social Security Self-Employment Tax). Furthermore, the self-employment tax is imposed on earnings from self-employment of $400 or more per year, even though people having such earnings may owe no income taxes and not be required to file an income tax return. It seems doubtful that many people in this situation would file the required self-employment tax returns. The result is that those who are not treated as employees are (overall) not making the same contribution to the social security system as others similarly situated, who are treated as employees. Equally as significant, these individuals do not acquire coverage, or as much coverage as they should, under social security.

Quite apart from the problems of compliance presented is the very substantial difference in cost to the businessman for whom services are performed in having the person performing such services classified as self-employed rather than as an employee. The S.E.C.A. rate is 7.9%, whereas the total F.I.C.A. taxes (both the employer's and employee's share) are now 11.7% of wages, and the F.U.T.A. tax represents an additional charge.

It is the benefit-detriment of classification, as well as the difficulty in application of the common law criteria, which contributes to conflict in this area.

These considerations may be illustrated by the fishermen's exclusion enacted by Section 1207(e) of the Tax Reform Act of 1976, which the GAO report suggests (p. 3) was enacted to clarify the employment status of crewmen. However, as a result of United States v. Webb, 397 U.S. 179 (1970), further proceedings on remand, 424 F. 2d 1070 (C.A. 5, 1970), the vessel owners benefited by the exclusion would have been treated as employers, and the crewmen as employees, in almost all cases. See also Bishop v. United States, 476 F. 2d 977 (C.A. 5, 1973), cert. denied,

414 U.S. 911 (1973); and Anderson v. United States, 450 F. 2d 567 (C.A. 5, 1971), cert. denied, 406 U.S. 906 (1972). Indeed, the Committee Reports do not discuss the law, but rather the burden on the boat operators of keeping the necessary records to calculate their tax obligations. 2/ There was no discussion, however, of the additional burden that would be imposed on those who would otherwise be employees--Schedules C and SE are far more complex than Form 941, on which wages subject to withholding and/or F.I.C.A. are computed. It has been estimated that the fisherman exclusion will result in a revenue loss of $13 million annually beginning in Fiscal 1977. Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1976, p. 383. Presumably this loss is attributable primarily to nonreporting.

Coming then to the specific proposal under consideration, we agree with the GAO draft report that the existing common law test set out in Section 3121 should be supplemented. However, we have problems with the solution proposed.

The GAO recommendation is to set up four criteria for distinguishing between employees and independent contractors. These criteria are that the person involved:

(1) have a separate set of books and records which reflect items of income and expenses of the trade or business;

(2) have the risk of suffering a loss and opportunity of making a profit;

(3) have a principal place of business other than at the place of business furnished by the person for whom services are performed;

(4) have acquired an employer identification number required under 26 U.S.C., Sec. 6109.

If the person whose status is in question meets all four of these criteria, he would automatically be deemed to be self-employed.

In those cases where the individual had an employer identification number, and met two of the other three criteria, the common law criteria of employee vs. independent contractor would be applicable.

A person would automatically be considered as an employee if he did not meet at least three of these four criteria, including the acquisition of an employer identification number.

In our view, the GAO proposal is sound in drawing a line which in general terms specifies that if one does not meet certain criteria, he is to be treated as an employee. Although Congress in 1950 eliminated

2/ Note, however, the reporting requirements imposed under Section 6050A.

considerable litigation by specifying that designated categories of workers were employees, such a solution is unsatisfactory to the extent that it depends on existence or continuance of a specific pattern. For example, since 1950, a full-time life insurance salesman has been treated as a statutory employee; however, this may not resolve the problem of classification of an insurance salesman who works full-time for a related group of companies (sometimes a parent company will have different subsidiaries, as, for example, one for life, one for casualty and one for accident and health).

Thus, it is obviously desirable to have a general category of people to be treated as employees when they lack the common indicia and economic situation of the self-employed. Although we have some problems with and suggestions concerning the particular criteria adopted, we do think that the concept is a useful one.

We do not agree, however, with the proposal that those who automatically meet certain criteria should be classified as independent contractors. One problem is that these criteria (however defined) will oftentimes automatically be met in the case of those individuals in occupations which are traditionally followed by independent contractors, who are in fact and in every common law sense employees of a particular employer, even though they are also independent contractors vis-a-vis others.

A second problem is that, while certainty is desirable, the structuring of transactions so as to minimize tax impact has obvious disadvantages in terms of revenue loss. Quite apart from the problems engendered by lack of compliance, it seems inadvisable for Congress to be considering increasing the impact of employment taxes [through increasing the rate and wage base] and at the same time to be offering an avenue for mitigating that impact both because of the differential in the tax rate between S.E.C.A. and F.I.C.A. and because of noncompliance.

Coming then to the particular criteria suggested for determining whether the individual is an employee or independent contractor, we believe that two of them are not meaningful. Thus, everyone can acquire an employer identification number, regardless of whether or not he has employees. Similarly, the requirement of a separate set of books and records can probably be met as easily; a checkbook would probably suffice. Neither of these criteria is necessarily within the knowledge of the payor, and both from the point of view of the payor and of the IRS in auditing the payor, it is necessary that one can determine whether an employment relationship exists by just looking to information available to the payor.

Thus, in lieu of the GAO proposal to treat individuals as employees if they did not have an employer identification number, or if they did not meet at least two of the other three criteria, we would suggest the following: that individuals receiving remuneration primarily for personal services integral to the payor's trade or business should be treated as employees if they neither

(1) have a substantial investment in property (other than facilities for transportation) used in connection with the performance of such services; nor

(2) have a substantial risk of loss; nor

(3) have a principal place of business used in connection with the performance of such services other than one furnished by the person for whom services are performed.

Preliminarily, providing that before people can be classified as employees their services must be integral to the payor's business offers an additional safeguard for the payor. To illustrate, if a small businessman hired someone to drive a car as an isolated occurrence, that would not be integral to the business. However, if the hiring of drivers was as recurrent a phenomenon in the business as in the case of Avis Rent-a-Car System, Inc. v. United States, 503 F. 2d 423 (C.A. 2, 1974), the services rendered would be integral to the payor's business.

The "risk of loss" is essentially equivalent to the GAO test concerning risk of loss or opportunity for profit; it is believed, however, that the risk of loss is the more significant and should be looked to. Many employees have opportunities for profit through bonuses or other incentive compensation.

The principal place of business test is similar to that of GAO, except that it is believed that the principal place of business should be one used in connection with performance of the service in question; this is something which (like risk of loss) would be within the knowledge of the person for whom services are performed.

Lastly, an indicium similar to (but not necessarily the same as) risk of loss and principal place of business is a substantial investment in property used in connection with the performance of the services in question. 3/

3/ With respect to substantial investment, the family car should be eliminated from consideration. Whether a taxi cab or truck should be treated as a substantial investment is a far closer question; probably they should be, except in some circumstances where the driver was purchasing the vehicle from the person for whom services were being rendered, over a period coterminous with the life of the vehicle.

The reason that these three tests are used is that if none of these is met, it is very likely that the compensation paid for services will be the economic equivalent of wages. This is not to say that there may not be incidental expenses (such as the cost of hand tools or uniforms) incurred by the people performing such services, but they are the same kind of expenses that have to be borne by many employees whose wages are subject to F.I.C.A. Accordingly, this proposal (like the equivalent portion of the GAO proposal) would have the advantage of treating similarly people similarly situated.

The GAO report (p. 4) is also concerned with "retroactive assessments against employers who IRS believes have misclassified employees," and about possible double taxation caused by both the employer and employee paying taxes on the same income.

With respect to the latter point, we agree with GAO that the law should be amended to prevent double taxation of the same income under F.I.C.A. and S.E.C.A. As the GAO report recognizes (p. 65), this would require (1) permitting IRS to offset S.E.C.A. tax payments made against the employee's share of F.I.C.A. that should have been withheld, and (2) preventing the "employee" from obtaining a S.E.C.A. refund of the tax so applied. Note, however, that the refund of the balance of S.E.C.A. tax paid to the employee (recommended by GAO) will result in a double loss of revenue if the employer successfully contests the F.I.C.A. assessment, or does not pay it.

With respect to the S.E.C.A. tax in excess of the employer's share of F.I.C.A., we suggest that the Internal Revenue Code be amended to utilize in this situation a procedure similar to that utilized with respect to refunds or credits of certain excise taxes under Sections 6415 and 6416. Under this amendment, the amount by which S.E.C.A. payments made by a reclassified employee exceeded the employee's share of F.I.C.A. would be credited against the employer's share of F.I.C.A., provided that [paraphrasing the language of Section 6415(a)] the employer establishes, under such regulations as the Secretary may prescribe, that he has repaid the amount of S.E.C.A. tax [in excess of the employee's share of F.I.C.A.] to such employee, or obtains the consent of the employee to the allowance of such credit.

We also agree with the GAO report that it is advisable that the IRS use information in its files to determine the appropriate Section 3402(d) credit. On the other hand, the cost of such analysis can be prohibitive. This is not the sort of cross-check that a computer can perform, and even physical scanning of the returns will generally not disclose whether the total of income reported includes the income in question.

We suggest that the problem of the Section 3402(d) credit be handled by giving the businessman the option of himself obtaining statements from workers (as he may under existing law) or abiding by an IRS determination

of the amount of the credit. In determining the amount of the credit the IRS would be obliged to use all return information at its disposal in the case of a determination involving less than a given number of workers (possibly 20), and would be obliged to sample at least a specified percentage of workers above that number, the percentage to decline as the number of workers increased. The businessman would have to choose which route to follow; he could not, for example, ask the IRS to sample and then procure statements from workers outside the sample. Furthermore, in order for the sampling procedure to be available, the employer would have to furnish the amount of compensation paid to each payee and name, address and social security number both of the payee and the payee's spouse. Also, to obviate any problem of privacy, the IRS should be specifically authorized to disclose to the employer the names of the employees selected for sampling, and the conclusions reached as to each such employee's reporting for both income tax and S.E.C.A. purposes.

These changes should substantially alleviate some of the horrors of retroactive assessments. To the extent that income is being properly reported by those performing the services there will be no assessments for income tax withholding or the employees' portion of F.I.C.A., and employers may obtain credit even for the balance of the S.E.C.A. payments. With respect to the implied criticism of retroactive assessments, it is important to realize that all assessments of taxes are based on what has happened, and in that sense are retroactive. Unless employers are subject to retroactive assessments, there is no incentive to compliance. Furthermore, a businessman who treats his workers as employees while his competitors do not would be severely disadvantaged.

The GAO report proposes (p. 34) that IRS can make no retroactive assessments where a business obtains from an individual that it compensates for services a signed certificate certifying that he or she meets the four GAO criteria for being self-employed. Inasmuch as we believe that the GAO criteria are insufficient, we necessarily disagree with this proposal. As stated earlier, we think that two of the four GAO criteria are not meaningful, and the remaining two are not sufficiently narrow. Furthermore, we think that to the extent the employer has or should have knowledge of circumstances such as risk of loss, he should not be able to shield himself by obtaining certification from the employee. If certification is used at all, we think it should be limited to certification each year that the payments are being or will be reported for income tax and S.E.C.A. purposes, coupled with the provision of the individual's social security number (and, if married, the name and social security number of his or her spouse), and identification of the Service Center where the prior year's return was filed.

APPENDIX VII

We recognize that the problems confronted in the GAO report are exceedingly difficult, and that it is far easier to criticize than to propose feasible solutions.

Additionally, the suggestions made here (like the recommendations in the GAO report) would provide only a partial answer. We also believe that, as the Commissioner of Internal Revenue has recommended, a comprehensive solution to the problem should include extension of withholding requirements (modified appropriately) to payments made to independent contractors.

We hope that these comments may be of some assistance. If you have any further questions, please feel free to contact us.

Sincerely,

Kevin D. Rooney
Assistant Attorney General
for Administration