

**U.S. Department of Labor
Office of Inspector General
Office of Audit**

BRIEFLY...

Highlights of Report Number: 03-05-005-03-315, to the Assistant Secretary for Employment and Training.

WHY READ THE REPORT

The Federal-state Unemployment Compensation (UC) program, created by the Social Security Act of 1935, offers the first economic line of defense against the effects of unemployment. The Employment and Training Administration's (ETA's) Office of Workforce Security (OWS) administers the program. The UC program is almost totally funded by employer taxes.

In a March 1999 Office of Inspector General (OIG) audit on best practices of State Workforce Agencies (SWA) UI field tax audits, we reported that the 1099-MISC Income Data, supplied by the Internal Revenue Service (IRS), can be used as a tool to identify misclassified employees. Employers who misclassify employees as independent contractors reduce tax liability by not paying state and Federal Unemployment Insurance, Social Security, and Medicare taxes. We recommended that OWS work with the IRS to develop an extract tape of the IRS Form 1099 tailored for use SWAs. The IRS first permitted SWAs to apply for the IRS 1099 data in October 2001

WHY OIG DID THE AUDIT

We conducted this audit to answer the following questions: (1) How many SWAs were using the 1099 data to identify potential employers misclassifying employees as independent contractors? (2) What were the obstacles that influenced the SWAs not to apply for and use the 1099 data? (3) What were the methods and strategies used by the SWAs that were successful in obtaining and using the 1099 data? and (4) What results were achieved by SWAs using the 1099 data since the IRS made it available in 2001?

READ THE FULL REPORT

To view the report, including the scope, methodology, and full agency response, go to: <http://www.oig.dol.gov/public/reports/oa/2005/03-05-005-03-315>.

September 2005

State Workforce Agencies Use of IRS Form 1099 Data To Identify Misclassified Workers

WHAT OIG FOUND

The OIG found that only nine SWAs were using the 1099 data to identify potential employers misclassifying employees as independent contractors.

Based on our contacts with the SWAs, we identified five common obstacles to the SWAs' application for and use of the 1099 data. (See page 9).

We found that communication with the IRS was the key to successfully obtaining and using the 1099 data. We also found that SWAs may be further ahead in meeting the IRS application and safeguard requirements if they are already receiving other IRS tax information. Representatives from SWAs using the 1099 data identified several extract criteria to make the 1099 data useful. Finally, we found that the age of the 1099 data was a perceived obstacle because the age of the data does not affect its usefulness in identifying potential employers who may be misclassifying employees.

As of December 2004, we found that 7 of the 9 SWAs reported that they identified misclassified employees. The seven SWAs started reporting results at staggered quarters beginning with the 4th quarter of calendar year 2002. As of December 2004, seven SWAs reported that they identified 7,118 misclassified employees, recovered \$1,492,521 in underreported UI tax contributions, and adjusted \$328,634 for overreported UI tax contributions associated with these workers

WHAT OIG RECOMMENDED

We recommended that the Assistant Secretary for Employment and Training: provide assistance and guidance to the SWAs applying for the 1099 data to increase the possibility that they are successful in obtaining and using the data; communicate to these SWAs how to overcome obstacles in obtaining and using the data; and encourage SWAs before the start of the 2006 IRS enrollment period to apply for and use the 1099 data in their UI field tax audit program.

ETA agreed with, and has already taken action to implement, our recommendations.