



Treasury Inspector General for Tax Administration Office of Audit

EMPLOYMENT TAX COMPLIANCE COULD BE IMPROVED WITH BETTER COORDINATION AND INFORMATION SHARING

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Highlights

Highlights of Report Number: 2010-30-025 to the Internal Revenue Service Commissioners for the Small Business/Self-Employed Division and the Wage and Investment Division.

IMPACT ON TAXPAYERS

The misclassification of employees as independent contractors is a nationwide issue affecting millions of employees that continues to grow and contribute to the tax gap. According to program documents, closing the tax gap remains one of the biggest challenges for the Small Business/Self-Employed Division. The Internal Revenue Service (IRS) has several opportunities to enhance compliance in its Employment Tax Program by taking measures to ensure that employment tax forms are not misused to avoid paying proper tax and by regularly sharing results of examinations from worker classification leads to ensure it is maximizing its resources efficiently when addressing the underreporting tax gap. Implementing these enhancements will help ensure that the burden of uncollected taxes is not shifted to compliant taxpayers.

WHY TIGTA DID THE AUDIT

The objective of this audit was to evaluate the effectiveness of the IRS' controls and procedures for ensuring taxpayer compliance with the determinations of worker status. This audit is part of TIGTA's risk-based audit coverage included in the Fiscal Year 2009 Annual Audit Plan under the major management challenge of Tax Compliance Initiatives.

WHAT TIGTA FOUND

The IRS created the Uncollected Social Security and Medicare Tax on Wages (Form 8919) for taxpayers to use when reporting only the worker's share of Social Security and Medicare wages. TIGTA identified 74,068 taxpayers who may have avoided paying \$26.2 million in Social Security and Medicare taxes because they improperly used the Form 8919.

TIGTA believes the improper use of Forms 8919 occurred because the IRS did not ensure that only qualifying taxpayers used it to report their wages. If IRS

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management does not take steps to correct the weaknesses and ensure taxpayers do not continue to improperly claim to be employees, TIGTA believes \$131 million in taxes could be avoided over the next 5 years.

The IRS has the opportunity to enhance its referral process to address compliance with worker status determinations. Almost all of the referred cases were accepted by the Examination function, but results from examinations were not always provided to the SS-8 program. TIGTA believes it is important that results are shared to ensure that the IRS, as part of its Employment Tax Strategy, maximizes efficiency when addressing the underreporting portion of the tax gap.

WHAT TIGTA RECOMMENDED

TIGTA made three recommendations for the IRS to take measures that will ensure that employment tax forms are not misused. In addition, TIGTA recommended that the operating divisions take steps to ensure that feedback is provided to the SS-8 program regarding its referrals.

IRS management agreed with two recommendations, disagreed with one, and partially agreed with the remaining recommendation. The IRS cited costs as the basis for its disagreement with one of TIGTA's recommendations, and offered an alternative corrective action to conduct a pilot study. Although TIGTA is encouraged by this, it is also concerned about the overall effectiveness of the alternative corrective action and the Calendar Year 2012 completion date because the IRS previously agreed to perform a similar pilot study in response to a prior report and only recently began to take action to address these concerns. Furthermore, the IRS stated it plans to consider the results of the pilot study, workload, staffing, and budget before committing to any expansion.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

<http://www.treas.gov/tigta/auditreports/2010reports/201030025fr.pdf>.

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