



*Employment Tax Compliance Could Be  
Improved With Better Coordination and  
Information Sharing*

**March 23, 2010**

**Reference Number: 2010-30-025**

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.

**Redaction Legend:**

2(f) = Risk Circumvention of Agency Regulation or Statute



TREASURY INSPECTOR GENERAL  
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

March 23, 2010

**MEMORANDUM FOR** COMMISSIONER, WAGE AND INVESTMENT DIVISION  
COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED  
DIVISION

*Michael R. Phillips*

**FROM:** Michael R. Phillips  
Deputy Inspector General for Audit

**SUBJECT:** Final Audit Report – Employment Tax Compliance Could Be  
Improved With Better Coordination and Information Sharing  
(Audit # 200930004)

This report presents the results of our review to evaluate the effectiveness of the Internal Revenue Service's (IRS) controls and procedures for ensuring taxpayer compliance with the determinations of worker status. This audit is part of the Treasury Inspector General for Tax Administration's risk-based audit coverage included in the Fiscal Year 2009 Annual Audit Plan under the major management challenge of Tax Compliance Initiatives.

*Impact on the Taxpayer*

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.<sup>1</sup> According to program documents, closing the tax gap remains one of the biggest challenges for the Small Business/Self-Employed Division. The 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.

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<sup>1</sup> See Appendix VII for a glossary of terms.





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Recommendations

We recommended the Commissioner, Wage and Investment Division, \*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
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\*\*\*\*\*2(f)\*\*\*. We also recommended the Commissioner, Small Business/Self-Employed  
Division, coordinate with the operating divisions to ensure that feedback is provided to the  
SS-8 program regarding its referrals, \*\*\*2(f)\*\*\*\*\*  
\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*.

Response

IRS management agreed with two recommendations, disagreed with one, and partially agreed  
with the remaining recommendation. \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*and to coordinate with the operating  
divisions to ensure that feedback is provided to the SS-8 program regarding its referrals. In  
addition, the IRS partially agreed with our recommendation to ensure that \*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. Based upon results of the pilot study, workload, staffing, and budget, they  
will consider expanding the compliance program to include Tax Year 2010 returns flagged  
during processing in Processing Year 2011.

However, the IRS disagreed with our recommendation to \*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*, stating that the potential increase in revenue does not justify the significant  
programming costs that would be incurred. \*\*\*2(f)\*\*\*\*\*  
\*\*\*2(f)\*\*\*\*\*  
\*\*\*2(f)\*\*\*\*\* U.S. Individual Income Tax Returns (Form 1040). \*\*\*2(f)\*\*\*\*\*  
\*\*\*2(f)\*\*\*\*\*.

Management also disagreed with our reported outcome measure of potential increased revenue of  
\$131.1 million over 5 years, citing that our computation did not account for situations where  
relief was granted to the employer under Section 530 of the Revenue Act of 1978.  
Management’s complete response to the draft report is included as Appendix VIII.



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*Office of Audit Comment*

Although IRS management agreed with the finding, they did not agree with our proposed recommendation due to significant programming costs. The IRS' response did not include any data to suggest what those costs might be and whether they outweigh the potential increase in revenue it would receive by identifying potentially noncompliant returns up front. We are encouraged that the IRS will perform a study to address noncompliance. However, we are concerned about its overall effectiveness and the Calendar Year 2012 completion date because the IRS, in response to our March 2007 report, agreed to perform a pilot study to ensure compliance with filing the Form 8919. The IRS only recently began to take action to address our prior concerns.

In addition, the IRS asserts that many of the taxpayers \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. We believe that this  
may indicate the need for additional educational and outreach efforts to ensure the Form SS-8 is  
filed in the future. \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*.

The IRS disagreed with our outcome measure, stating that our analysis did not account for situations where relief was granted to an employee based upon Section 530. However, we provided IRS management with detailed information that explained how we calculated the outcome measure. This included our analysis of IRS Master File data for Forms 8919 that identified 2.5 percent of taxpayers selected the Section 530 designation. We believe our reported outcome is valid because these taxpayers were excluded from our calculation.

Furthermore, the IRS stated it would consider the results of the pilot study, workload, staffing, and budget \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. We continue to believe that the issue of employment taxes and reducing the underreporting tax gap is a priority that warrants continued attention. These steps are critical because we estimate that the IRS could potentially lose an estimated \$131.1 million in taxes over 5 years if no additional actions are taken to address this matter.

Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Margaret E. Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations), at (202) 622-8510.



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*Abbreviations*

FY	Fiscal Year
IRS	Internal Revenue Service
SB/SE	Small Business/Self-Employed



## *Employment Tax Compliance Could Be Improved With Better Coordination and Information Sharing*

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### *Background*

The misclassification of employees as independent contractors is a nationwide issue affecting millions of workers that continues to grow and contribute to the tax gap.<sup>1</sup> Closing the tax gap remains one of the biggest challenges for the Internal Revenue Service (IRS), and employment tax compliance affects the underreporting portion of the tax gap. Two specific program areas within the Small Business/Self-Employed (SB/SE) Division contribute toward reducing the tax gap—the Campus Compliance Services and Specialty Programs functions. The Campus Compliance Services function oversees various activities (e.g., post-filing services such as the remote collection and examination programs) occurring at the campuses. The Specialty Programs function oversees tax matters relating to excise, estate and gift, and employment taxes.

The Determination of Worker Status Program (referred to as the SS-8 program) falls under the purview of the Specialty Programs function. The SS-8 program was established in 1994 to allow either a business or a worker to request a determination letter from the IRS regarding a worker's Federal employment tax status as an employee or independent contractor. To receive this determination, the worker, the employer, or both, must submit a Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding (Form SS-8). During the IRS' determination process, the program examiner considers three categories of evidence and various judicial, tax law, and legislative precedents, after which both the employer and taxpayer are notified of the results. The IRS' determination rulings are binding, but sometimes employers will continue to not withhold taxes even when a worker has received a determination letter from the IRS and was determined to be an employee.

In the Specialty Programs function's Fiscal Years (FY) 2008 and 2009 Program Letters, one of the challenges and commitments was to build on the improved productivity and efficiency of its programs by applying resources towards those areas with the most potential to impact the tax gap and compliance. Program success will be measured not only by traditional business measures (e.g., taxes assessed or collected), but also by the impact on subsequent taxpayer actions or taxpayer compliance.

This review was performed at the Brookhaven Campus in Holtsville, New York, during the period October 2008 through September 2009. We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our

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<sup>1</sup> See Appendix VII for a glossary of terms.



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audit objectives. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.





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Figure 1: Matching Results of Forms 8919 and SS-8 (Processing Year 2008)

Matching Results	Number of Taxpayers	Percentage of Taxpayers	Taxes Avoided
*****2(f)***** ***** *****	*2(f)*	**2(f)**	**2(f)**
*****2(f)***** ***** *****	*2(f)*	**2(f)**	**2(f)**
*****2(f)***** ***** ***** *****	*2(f)*	*2(f)**	**2(f)**
Total Forms 8919 Filed	82,447	100%	
Total Tax Avoided			\$26,210,308

Source: Our analysis of Forms 8919 and SS-8 data.

\*\*\*\*\*2(f)\*\*\*\*\*

- \*\*\*\*\*
- \*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\*

In response to our March 2007 report, \*\*\*\*\*2(f)\*\*\*\*\*  
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\*\*\*\*\* According to the FY 2009 Program Letter for the Employment Tax Program,<sup>4</sup> the Forms 8919 will be reviewed for audit potential and a pilot considered as part of its strategy to address the underreporting portion of the tax gap.

<sup>4</sup> The Employment Tax Program, whose mission is to develop and implement policies and strategies for employment tax compliance, falls under the purview of the Specialty Programs function.



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In January 2009, IRS management informed us that the Form 8919 pilot program had been delayed. The original due date of January 2009 to implement a compliance program was extended to enable the IRS to secure the necessary data that addresses areas of compliance risk without unnecessarily burdening taxpayers. As of November 2009, the IRS had identified the sample returns for the pilot program and it expects it will take about 6 months to complete the audits and obtain results.

We recently issued a report<sup>5</sup> that recommended the IRS develop and implement an agency-wide Employment Tax Program to address the issue of worker classification to improve coordination among the business divisions, improve compliance, and reduce the tax gap. We believe, as part of this program, \*\*\*\*\*2(f)\*\*\*\*\*. The IRS has other independent files (such as the Dependent Database) that it routinely uses while processing tax returns to help identify noncompliance among returns. The practice of identifying, stopping, and correcting potential erroneous or noncomplaint returns during initial processing is more cost efficient than identifying potential errors during an audit. \*\*\*\*\*2(f)\*\*\*\*\*.

**The IRS did not \*\*\*\*\*2(f)\*\*\*\*\***

In response to our March 2007 report,<sup>6</sup> \*\*\*\*\*2(f)\*\*\*\*\*.

<sup>5</sup> *While Actions Have Been Taken to Address Worker Misclassification, an Agency-Wide Employment Tax Program and Better Data Are Needed* (Reference Number 2009-30-035, dated February 4, 2009).

<sup>6</sup> *Social Security and Medicare Taxes Are Not Being Properly Assessed on Some Tips and Certain Types of Wage Income* (Reference Number 2007-30-062, dated March 30, 2007).



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If the IRS plans to have a successful pilot program to determine compliance with the Forms 8919, and ultimately make inroads in reducing the underreporting portion of the tax gap,

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\*\*\*\*\*2(f)\*\*\*\*\* We believe this effort can be undertaken by the IRS' agency-wide Employment Tax Strategy. \*\*\*\*\*2(f)\*\*\*\*\*

\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\* , we believe about \$131 million in taxes could be avoided over the next 5 years. See Appendix IV for further information on the potential for increased revenue.

**Enhancements to the referral process are needed to improve compliance with employment taxes**

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\*\*\*\*\*2(f)\*\*\*\*\* the IRS also has the opportunity to enhance its referral process to improve compliance with worker status determinations. After the IRS makes a worker classification determination, cases meeting specific criteria are referred to the field and operating divisions for enforcement of the determination. The criteria consider factors such as the amount the worker earned, the number of workers in the same class as the worker under consideration, and other employment tax issues meeting a specific threshold. As stated in the SS-8 program's referral criteria, the operating divisions will classify the referrals for field potential and the SS-8 program will be notified when referrals are not selected and why. According to IRS management, 924 (12.8 percent) of the 7,236 closed Form SS-8 cases were referred to the field and operating divisions for enforcement. The referrals comprised 858 different employers of which 799 (93 percent) were accepted for examination.

Although almost all of the referred cases resulted in acceptance by the Examination function, results from the completed examinations were not always provided to the SS-8 program. In addition to sharing results of examinations, the operating divisions should provide feedback to the SS-8 program when referrals are either rejected or surveyed before and after assignment. We believe it is important that this information is shared to ensure that the IRS, as part of its Employment Tax Strategy, maximizes efficiency and results when addressing the underreporting



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portion of the tax gap. Implementing this practice will ensure that the burden of uncollected taxes is not shifted to compliant taxpayers.

\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*2(f)\*\*\*\*\* As part of an SS-8 program initiative, the Specialty Programs and Campus Compliance Services functions created an action plan to work toward implementing a pilot program to address these cases. The pilot program calls for detailing two tax compliance officers to review a sample of “tax gap” cases. The IRS will gather and monitor results throughout the pilot program to determine overall taxpayer compliance. The pilot program was not concluded at the time of our fieldwork; therefore, we cannot provide an assessment on the value of this program. However, we are encouraged by the IRS’ initiative to examine cases that do not meet referral criteria to ensure workers comply with their tax obligations.

***Recommendations***

The Commissioner, Wage and Investment Division, should:

**Recommendation 1:** \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*

**Management’s Response:** \*\*\*\*\*2(f)\*\*\*\*\*  
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**Recommendation 2:** \*\*\*\*\*2(f)\*\*\*\*\*  
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**Management’s Response:** IRS management disagreed with our recommendation to \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\* stating that the potential increase in revenue does not justify the significant programming costs that would be incurred. Additionally, \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*2(f)\*\*\*\*\*  
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\*\*\*\*\*2(f)\*\*\*\*\* (see Recommendation 4).

Management also disagreed with our reported outcome measure of potential increased revenue of \$131.1 million over 5 years, citing that our computation did not account for situations where relief was granted to the employer under Section 530 of the Revenue Act of 1978.





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**Management's Response:** \*\*\*\*\*2(f)\*\*\*\*\*  
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\*\*\*\*\*2(f)\*\*\*\*\*. Based upon

results of the pilot study, workload, staffing, and budget, they will consider expanding the compliance program to include Tax Year 2010 returns flagged during processing in Processing Year 2011.

**Office of Audit Comments:** The IRS stated it would consider the results of the pilot study, workload, staffing, and budget \*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*  
\*\*\*\*\*2(f)\*\*\*\*\*. We continue to believe that the issue of employment taxes and reducing the underreporting tax gap is a priority that warrants continued attention. These steps are critical because we estimate that the IRS could potentially lose an estimated \$131.1 million in taxes over 5 years if no additional actions are taken to address this matter.

***Taxpayers Were Not Always Receiving Timely Responses to Requests for Worker Determinations***

The SS-8 program's technical reference guide states that examiners should issue an acknowledgement letter (Letter 3891 or 3891-A) from the SS-8 unit within 30 calendar days of receipt of the Form SS-8. The acknowledgement letter advises the taxpayer that his or her request was received and indicates that it can take up to 180 calendar days to provide a ruling. If a case cannot be processed to closing within 180 calendar days, the IRS will send a followup letter (Letter 3740) to the taxpayer advising of the delay.

We reviewed a judgmental sample of 30 closed SS-8 cases and found that the IRS did not timely acknowledge receipt of the taxpayer's request in 8 (27 percent) cases. For these 8 cases, the elapsed days ranged from a minimum of 32 days to a high of 62 days. In addition, we identified 10 closed SS-8 cases that were not processed within 180 calendar days. In 4 of the 10 cases, there was evidence (e.g., copy of the followup letter and/or a notation in the history sheet) in the case files indicating that the IRS mailed the followup letter. For the remaining six cases, we were provided with a checksheet maintained by the SS-8 program indicating that the followup letters were sent. Management attributed the processing delays to the increased volume of Forms SS-8, without receiving a corresponding increase in staffing.

In addition to our judgmental sample, we obtained the Form SS-8 receipts, resources, and processing times for all SS-8 determinations for the last 3 fiscal years as reflected below.



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**Figure 2: Form SS-8 Receipts, Resources, and Processing Times  
FYs 2007–2009**

<b>Fiscal Year</b>	<b>Number of Form SS-8 Receipts</b>	<b>Number of Tax Examiners to Process Forms</b>	<b>Seasonal Tax Examiners</b>	<b>Detailed Tax Examiners<sup>7</sup></b>	<b>Average Number of Days to Process the Cases to Closure</b>
2007	5,935	29	0	0	128
2008	10,951	24	0	6	141
2009	11,361	26	10	2	239

*Source: Data provided by the IRS' SS-8 program management.*

In FY 2007, the SS-8 program received 5,935 Forms SS-8 for processing and had 29 tax examiners processing the workload. It took an average of 128 calendar days for the tax examiners to make an SS-8 determination. The workload increased substantially in FY 2008; almost doubling to 10,951 receipts, although the number of examiners decreased by 5. To process the increased workload, IRS management detailed tax examiners to improve its processes for closing cases rather than requesting permanent staffing because they did not know whether the increase in SS-8 filings was an anomaly. Even with the added seasonal employees and streamlined processes, the average days to close a case increased to 141 calendar days. In December 2008, the IRS submitted a proposed organization chart to increase staffing in the SS-8 program. The proposal was approved in October 2009. The proposed increase called for nine additional tax examiners, but the permanent staff only increased by two in FY 2009. The volume of Forms SS-8 receipts increased 3.7 percent in FY 2009, while the average days to make a determination increased to 239 calendar days, well above the IRS' 180 calendar day criteria for ruling on determination requests.

The SS-8 program also relies on feedback from the Quality Review staff to ensure cases are processed in accordance with stated procedures, including accuracy, professionalism, and timeliness. However, the SS-8 program did not receive feedback on timeliness concerns because the Quality Review staff's Internal Revenue Manual did not contain the criteria for timely processing a case. For the 10 closed cases we previously noted were not timely processed (within the 180 calendar days), the records provided to us by the Quality Review staff indicated these cases were timely.

**Management Actions:** Subsequent to completion of our fieldwork, we communicated our concern regarding the inaccurate feedback provided to the SS-8 program by the Quality Review staff. IRS management took prompt action to update the SS-8 procedures to include the

<sup>7</sup> A detailed tax examiner is one that is brought in from another IRS area to assist with the work.



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following, “should case inventory remain open up to 180 days from the date of receipt, support staff will notify the requester of the reason for the delay and the expected time frame for response by sending a followup letter.”

According to Quality Review staff management, establishing a timeliness criterion in the Internal Revenue Manual will allow the quality review staff to report cases that take more than 180 calendar days to process and where no followup letter was issued to the taxpayer as not meeting the timeliness criteria. In addition, the SS-8 program recently developed an automated program to identify aging cases. This program, referred to as the 3740 report, identifies cases that are 5 months old and have not yet been closed with a determination ruling. The program automatically generates a followup letter to be sent to the taxpayer on a monthly basis. While these added measures will help the SS-8 program ensure that taxpayers are notified when delays occur in processing worker status determination requests, the SS-8 program needs to have sufficient resources to process its workload and avoid backlogs.



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## **Appendix I**

### *Detailed Objective, Scope, and Methodology*

The objective of this review was to evaluate the effectiveness of the IRS' controls and procedures for ensuring taxpayer compliance with the determinations of worker status. To accomplish our objective, we:

- I. Determined the SB/SE Division's roles and responsibilities, including resource commitments, to the Determination of Worker Status Program (referred to as the SS-8 program).
  - A. Interviewed applicable SB/SE Division management and determined their roles and responsibilities in addressing noncompliance within the SS-8 program.
  - B. Reviewed the SB/SE Division's strategic plans, program letters, policies, and guidance and determined its goals and objectives.
  - C. Determined the SB/SE Division's resource commitment allocated to the SS-8 program.
- II. Evaluated how SS-8 program staff coordinates with field office staff to identify and examine cases involving worker status noncompliance.
  - A. Reviewed procedures developed by SB/SE Division management for identifying cases that should be referred to the field offices and to the Criminal Investigation Division.
  - B. Obtained information reports generated by the SS-8 database for FYs 2006 through 2008 that show the acceptance rates and outcomes of determination of worker status referrals.
- III. Evaluated the effectiveness of the quality review process to ensure consistency within the SS-8 program.
  - A. Reviewed quality review procedures and criteria and interviewed quality review staff to gain an understanding of the review process.
  - B. Reviewed a judgmental sample of 30 of the 101 cases quality reviewed at the Brookhaven IRS Campus<sup>1</sup> from July 2008 through December 2008. We used judgmental sampling because we did not intend to project the results.

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<sup>1</sup> See Appendix VII for a glossary of terms.



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- C. Evaluated any feedback provided to determine how the quality review process is used to enhance the SS-8 program.
- IV. Evaluated the results of the SS-8 program for the period October 1, 2005, through September 30, 2008.
  - A. Identified how the SS-8 program tracks cases in its database.
  - B. Reviewed information reports from the SS-8 database and SS-8 program reviews regarding worker classification trends, taxpayer compliance rates, and program accomplishments.
- V. Determined whether evaluating the Uncollected Social Security and Medicare Tax on Wages (Form 8919) that were filed could help improve overall program compliance.
  - A. Analyzed a Master File extract of 82,447 Forms 8919 filed by taxpayers during Processing Year 2008 to determine the reasons why taxpayers filed.
  - B. Obtained an extract of all 75,237 requests for Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding (Form SS-8) in a database maintained by the IRS as of September 2, 2009.
  - C. Matched the Master File extract of Processing Year 2008 Forms 8919 (see Step V.A.) against the database of Forms SS-8 (see Step V.B.) to identify the taxpayers who did not file the required Forms SS-8. We considered the reliability of the data to be valid because our review of the information on the Integrated Data Retrieval System was the same as the information reported on the forms.

**Internal controls methodology**

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. We determined the following internal controls were relevant to our audit objective: the SS-8 program's policies, procedures, and practices for quality review and referral of cases involving noncompliance. We evaluated these controls by interviewing management and reviewing case files and management information reports.



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**Appendix II**

*Major Contributors to This Report*

Margaret Begg, Assistant Inspector General for Audit (Compliance and Enforcement Operations)  
Marybeth Schumann, Director  
Diana Tengesdal, Audit Manager  
Michael Hillenbrand, Acting Audit Manager  
John Chiappino, Lead Auditor  
Marge Filippelli, Senior Auditor  
Janis Zuika, Senior Auditor



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**Appendix III**

*Report Distribution List*

Commissioner C  
Office of the Commissioner – Attn: Chief of Staff C  
Deputy Commissioner for Operations Support OS  
Deputy Commissioner for Services and Enforcement SE  
Deputy Chief Information Officer for Operations OS:CTO  
Deputy Commissioner, Wage and Investment Division SE:W  
Deputy Commissioner, Small Business/Self-Employed Division SE:S  
Director, Specialty Programs, Small Business/Self-Employed Division SE:S:SP  
Chief, Employment Tax, Small Business/Self-Employed Division SE:S:SP:ET:C  
Program Manager, Employment Tax Policy, Small Business/Self-Employed Division  
SE:S:SP:ET:TP  
Chief Counsel CC  
National Taxpayer Advocate TA  
Director, Office of Legislative Affairs CL:LA  
Director, Office of Program Evaluation and Risk Analysis RAS:O  
Office of Internal Control OS:CFO:CPIC:IC  
Audit Liaisons:  
    Deputy Commissioner for Services and Enforcement SE  
    Commissioner, Small Business/Self-Employed Division SE:S





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**Methodology Used to Measure the Reported Benefit:**

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\*\*\*\*\*2(f)\*\*\* and avoided paying \$26.2 million in Social Security and Medicare taxes.

**Type and Value of Outcome Measure:**

- Taxpayer Burden – Actual; eight taxpayer accounts impacted because the IRS did not timely acknowledge receipt of the worker status determination request (see page 7).

**Methodology Used to Measure the Reported Benefit:**

We selected a judgmental sample of 30 of 101 worker status determinations closed between July and December 2008. We identified 8 cases where the IRS did not acknowledge receipt of the individual’s worker status determination within the required 30 calendar days.



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**Appendix V**

*Form 8919*

<b>Form 8919</b> <small>Department of the Treasury Internal Revenue Service</small>	<b>Uncollected Social Security and Medicare Tax on Wages</b> <small>▶ See instructions on back. ▶ Attach to Form 1040, Form 1040NR, Form 1040NR-EZ, Form 1040-SS, or Form 1040-PR.</small>	<small>OMB No. 1545-0074</small> <b>2008</b> <small>Attachment Sequence No. 72</small>
<small>Name of person who must file this form. If married, complete a separate Form 8919 for each spouse who must file this form.</small>		<small>Social security number</small>

**Who must file.** You must file Form 8919 if all of the following apply.

- You performed services for a firm.
- The firm did not withhold your share of social security and Medicare taxes from your pay.
- Your pay from the firm was not for services as an independent contractor.
- One or more of the reasons listed below under Reason codes apply to you.

**Reason codes:** For each firm listed below, enter the applicable reason code(s) for filing this form in column (c). If none of the reason codes apply to you, but you believe you should have been treated as an employee, enter reason code G, and file Form SS-8 on or before the date you file your tax return.

**A** I filed Form SS-8 and received a determination letter stating that I am an employee of this firm.

**B** I was designated as a "section 530 employee" by my employer or by the IRS prior to January 1, 1997.

**C** I received other correspondence from the IRS that states I am an employee.

**D** I was previously treated as an employee by this firm and am performing services in a substantially similar capacity and under substantially similar direction and control. (You must also enter reason code G.)

**E** My co-workers, performing substantially similar services under substantially similar direction and control, are treated as employees. (You must also enter reason code G.)

**F** My co-workers, performing substantially similar services under substantially similar direction and control, filed Form SS-8 for this firm and received a determination that they were employees. (You must also enter reason code G.)

**G** I filed Form SS-8 with the IRS and have not received a reply.

(a) Name of firm	(b) Firm's federal identification number <small>(see instructions)</small>	(c) Enter reason code(s) from above	(d) Date IRS determination or correspondence was received <small>(MM/DD/YYYY) (see instructions)</small>	(e) Check if Form 1099-MISC was received	(f) Total wages received with no social security or Medicare tax withholding and not reported on Form W-2
1				<input type="checkbox"/>	
2				<input type="checkbox"/>	
3				<input type="checkbox"/>	
4				<input type="checkbox"/>	
5				<input type="checkbox"/>	
<b>6</b> Total wages. Combine lines 1 through 5 in column (f). Enter here and include on Form 1040, line 7, Form 1040NR, line 8, or Form 1040NR-EZ, line 3				<b>6</b>	
<b>7</b> Maximum amount of wages subject to social security tax		<b>7</b>	102,000 00		
<b>8</b> Total social security wages and tips (total of boxes 3 and 7 on Form(s) W-2) or railroad retirement (tier 1) compensation, and unreported tips subject to social security tax from Form 4137, line 10		<b>8</b>			
<b>9</b> Subtract line 8 from line 7. If line 8 is more than line 7, enter -0- here and on line 10				<b>9</b>	
<b>10</b> Wages subject to social security tax. Enter the smaller of line 6 or line 9				<b>10</b>	
<b>11</b> Multiply line 10 by .062 (social security tax rate)				<b>11</b>	
<b>12</b> Multiply line 6 by .0145 (Medicare tax rate)				<b>12</b>	
<b>13</b> Add lines 11 and 12. Enter here and on Form 1040, line 58, Form 1040NR, line 53, or Form 1040NR-EZ, line 16				<b>13</b>	

For Paperwork Reduction Act Notice, see Instructions.

Cat. No. 37730B

Form 8919 2008









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## Appendix VII

### *Glossary of Terms*

**Business Measures** – At a strategic level, business measures are used to assess the overall progress in delivering the mission and goals of the organization. At the operational level, business measures are used to assess the effectiveness of a specific program (e.g., Examination).

**Campus** – The data processing arm of the IRS. The campuses process paper and electronic submissions, correct errors, and forward data to the Computing Centers for analysis and posting to taxpayer accounts.

**Dependent Database** – A system that identifies and selects for examination taxpayer returns that may have possible erroneous Earned Income Tax Credit claims. During initial processing, the Dependent Database Scoring Program analyzes tax returns that have claimed at least one Earned Income Tax Credit (qualifying or dependent child). Using data from several sources, it analyzes each tax return for criteria indicating that the taxpayer might not be eligible for the Earned Income Tax Credit and assigns a numeric value to each criterion which provides for an overall score for the return. Based on the resources available to conduct examinations, the IRS selects certain types and quantities of returns for pre-refund examinations to verify the taxpayers' eligibility for the Earned Income Tax Credit.

**Employment Taxes** – Taxes (e.g., Federal income, Social Security, and Medicare) withheld by an employer from an employee's wages.

**Form 4137 – Social Security and Medicare Tax on Unreported Tip Income** – Used by taxpayers to figure the Social Security and Medicare taxes owed on tips the taxpayer did not report to an employer, including any allocated tips shown Wage and Tax Statements (Form W-2).

**Form 8919 – Uncollected Social Security and Medicare Tax on Wages** – Used by taxpayers for uncollected Social Security and Medicare taxes on wages that have neither been collected nor submitted by the employer to the IRS.

**Form SS-8 – Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding** – Used by taxpayers to request a determination of worker status for purposes of Federal employment taxes and income tax withholding.

**Form W-2 – Wage and Tax Statement** – Used by employers to report wages and other compensation paid to employees. The form also captures the amounts of income and Social Security taxes withheld.



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**Integrated Data Retrieval System** – IRS computer system capable of retrieving or updating stored information; it works in conjunction with a taxpayer’s account records.

**Letter 3740** – Letter sent to the Form SS-8 requester concerning the status of his/her request. This letter is only warranted if the case has not been processed within the 180 calendar day time limit.

**Letter 3891/3891-A** – Acknowledgment letter to a worker/payer, who requested a determination that indicates the IRS received his or her request.

**Master File** – The IRS database that stores various types of taxpayer account information. This database includes individual, business, and employee plans and exempt organizations data.

**Operating Divisions** – The IRS divisions which include the Small Business/Self-Employed, Wage and Investment, Tax Exempt and Government Entities, and Large and Mid-Size Business Divisions. Each operating division is responsible for planning and managing nationwide programs that meet the needs of particular groups of taxpayers.

**Processing Year** – The year in which tax returns and other tax data are processed.

**Section 530** – Section 530 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. 2763, 2885-86 (current version at Internal Revenue Code Section 3401 note). This section permits a taxpayer to treat workers as other than employees for employment tax purposes when certain requirements are met. It also prohibits the IRS from issuing guidance clarifying the employment status of individuals for purposes of employment taxes.

**Specialty Programs** – A function reporting to the Commissioner of the Small Business/Self-Employed Division. They are responsible for providing leadership and direction in the design, development, and delivery of excise, employment, estate, and gift tax and supporting a comprehensive tax administration program designed to enhance taxpayer compliance.

**Tax Gap** – The difference between the annual Federal tax obligation and the amount of tax the taxpayer pays voluntarily and timely.



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Appendix VIII

**Management's Response to the Draft Report**



COMMISSIONER  
SMALL BUSINESS/SELF-EMPLOYED DIVISION

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

**RECEIVED**  
FEB 16 2010  
BY: *DAS*

February 16, 2010

MEMORANDUM FOR MICHAEL R. PHILLIPS  
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Christopher Wagner  
Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Audit Report – Employment Tax Compliance Could Be  
Improved With Better Coordination and Information Sharing  
(Audit # 200930004)

We have reviewed your draft report, "Employment Tax Compliance Could Be Improved With Better Coordination and Information Sharing." We appreciate the opportunity to respond to this report.

Closing the tax gap, including the portion attributable to unpaid employment taxes, is a major priority for the IRS. We have taken significant steps to improve employment tax compliance including those based on recommendations in the prior Treasury Inspector General for Tax Administration (TIGTA) report, "Social Security and Medicare Taxes Are Not Being Properly Assessed on Some Tips and Certain Types of Wage Income (Reference Number 2007-30-062, dated March 30, 2007)." 2(f)

2(f)

2(f)

2(f)

In the current audit, TIGTA estimates only 82,447 Forms 8919 were filed in processing year 2008. This reduction of 295,373 forms filed to report self employment income as wages is validation of the impact of our prior actions revising Form 4137 and creating Form 8919. We believe our comprehensive actions resulted in a significant



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improvement in compliance. The changes resulted in potential increased revenue of \$62 million per year, or \$310 million over five years, as measured from the TIGTA estimate in 2005 to the estimates in the current audit.

Although this shows significant improvement, we agree to take additional actions relating to recommendations in this report. 2(f)

2(f)

2(f) Based on the pilot results, we will make decisions on the future of this compliance program. In addition, we will develop a Servicewide process to provide feedback to the SS-8 unit on the results of their referrals.

However, we are not in agreement with the recommendation 2(f)

2(f)

2(f) Instead, we feel the compliance program, which we are agreeing to pilot, will address this issue.

In addition, we do not concur with the described benefits of potential increase in revenue of \$131.1 million over five years, for two reasons. 2(f)

2(f)

Attached is a detailed response outlining our corrective actions. If you have any questions, please contact me at (202) 622-0600 or members of your staff may contact John H. Imhoff, Jr., Director, Specialty Programs, at (215) 861-1176.

Attachment



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Attachment

**RECOMMENDATION 1:**

2(f)

**CORRECTIVE ACTION:**

We agree with this recommendation. 2(f)

2(f)

**IMPLEMENTATION DATE:**

January 15, 2011

**RESPONSIBLE OFFICIAL:**

Director, Submission Processing, Wage and Investment Division

**CORRECTIVE ACTION(S) MONITORING PLAN:**

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

**RECOMMENDATION 2:**

2(f)

**CORRECTIVE ACTION:**

We disagree with this recommendation. 2(f)

2(f)

2(f)

**IMPLEMENTATION DATE:**

N/A

**RESPONSIBLE OFFICIAL:**

N/A



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**CORRECTIVE ACTION MONITORING PLAN:**

N/A

**RECOMMENDATION 3:**

Coordinate with the operating divisions to ensure that feedback is provided to the SS-8 program regarding its referrals.

**CORRECTIVE ACTION:**

We agree with this recommendation. SB/SE Employment Tax will develop a process to be used by SB/SE, TE/GE, and LMSB to provide feedback on a quarterly basis to the SS-8 program on the results of the referrals received from the SS-8 program.

**IMPLEMENTATION DATE:**

July 15, 2010

**RESPONSIBLE OFFICIAL:**

Director, Specialty Programs, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

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

**RECOMMENDATION 4:**

2(f)

**CORRECTIVE ACTION:**

We partially agree with this recommendation. 2(f)

2(f)

**IMPLEMENTATION DATE:**

January 15, 2012



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**RESPONSIBLE OFFICIAL:**

Director, Specialty Programs, Small Business/Self-Employed Division

**CORRECTIVE ACTION MONITORING PLAN:**

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