Oppose Section 530 Repeal

- We urge a "no vote" on S. 2882 and H.R. 3408
    - *Taxpayer Responsibility, Accountability and Consistency Act of 2009*
- Seek no change to Section 530
    - Section 530 was a compromise

Independent Contractors Need Clients, Too

- Section 530 provides the certainty that enables the 9 million self-declared independent contractors to survive and grow
    - Like any other business, independent contractors need clients for their business to survive and grow
    - If Section 530 is repealed and companies become overly fearful of doing business with independent contractors, self-employed service providers could find it increasingly difficult to survive
- The unfortunate victims will be the legitimate independent contractors who pay their taxes, but find fewer and fewer companies willing to do business with them
- During the current economic conditions, the government policy should encourage entrepreneurs to pursue their dreams and start their own business; a repeal of Section 530 would scare away independent contractors' potential clients by increasing the regulatory risks and uncertainties associated with doing business with sole proprietors

Section 530 Is No Loophole

- Section 530 has rigorous eligibility requirements that are not easily satisfied
- IRS rulings and reported court decisions are replete with decisions denying Section 530 protection to companies that mistakenly believed Section 530 was a loophole

Repealing Section 530 Will Not Reduce the Tax Gap

- Repealing Section 530 will not reduce the tax gap, but could increase it …
- Section 530 enhances tax compliance by demanding compliance with Form 1099 reporting requirements as a condition to eligibility

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- IRS data[1] show (i) 97% compliance rate for recipients of Forms 1099, relative to 99% for recipients of Forms W-2, and (ii) the tax gap for the self-employed is attributable principally to those whose income is not reported on Forms 1099, *i.e.,* the cash economy

- Repealing Section 530 would completely miss the cash economy, because those service providers do not receive Forms 1099

- Companies seeking Section 530 protection commonly report amounts on Forms 1099 – even in cases where it is unclear that reporting is required, to eliminate that risk

  - Without Section 530, such companies would likely cease reporting in those cases

The *Prospective* Certainty that Section 530 Provides Is Essential

- The elimination of Section 530's *prospective* certainty would be lethal to businesses that operate with legitimate independent contractors
- The belief that the *retroactive* protection in the pending bills is good enough reflects a fundamental misunderstanding of how independent-contractor-based businesses operate
- Businesses need the *prospective* certainty that Section 530 provides:
  - to know that the business model is viable
  - to justify capital investments that require several years to become profitable
  - to justify leasing office space for multiple years
  - to obtain essential outside capital to fund their operations
  - to ultimately sell the business at a fair price

New Contracting Arrangements in a Post-Section 530 Era Would Be Less Efficient

- A repeal of Section 530 could cause companies to insist that independent contractors work through third-party firms that function as their "employer of record"

  - Increasing costs to companies that do business with independent contractors

  - Reducing income to the independent contractors

- Third-party firms would become a new structural cost to companies that outsource projects to U.S.-based independent contractors

- US-based companies that currently use independent contractors would become less competitive if they elect to bring those functions in-house

[1] *E.g., TAX COMPLIANCE Opportunities Exist to Reduce the Tax Gap Using a Variety of Approaches*, GAO-06-1000T, at 11 (July 26, 2006) GAO, *Tax Gap: Making Significant Progress in Improving Tax Compliance Rests on Enhancing Current IRS Techniques and Adopting New Legislative Actions,* GAO-06-453T, at 17, (Feb. 15, 2006); GAO, *Tax Compliance: Reducing the Tax Gap Can Contribute to Fiscal Sustainability but Will Require a Variety of Strategies*, GAO-05-527T, at 18 (Apr. 14, 2005); GAO, *Tax Administration: Improving Independent Contractor Compliance*, GAO/T-GGD-92-63, at 7 (Jul. 23, 1992); GAO, *Tax Administration: Approaches for Improving Independent Contractor Compliance*, GAO/GGD-92-108, at 5 (Jul. 1992).

A Post-Section 530 Era Could Exacerbate Off-Shoring of Services

- In today's global economy with pervasive internet access, companies could respond to their loss of Section 530 protection by shifting outsourced work offshore

Repealing Section 530 Would Drive Certain Types of Firms out of Business

- Firms that function as brokers that facilitate discrete, project-based transactions between companies and independent contractors throughout the country could vanish
    - These firms have experienced inconsistent results under the common-law test and if Section 530 were repealed, they gradually would be converted to an employee-based model, which is not a viable business model for these industries

Section 530 Repeal Would Restore the Acrimony Between IRS and Business

- Section 530 was enacted in response to an unpredictable and overzealous IRS approach to worker classification
- A repeal of Section 530 would re-create the undesirable environment that resulted in (i) IRS coercing reclassification settlements from small businesses that cannot afford to litigate, and (ii) IRS appeals offices and courts becoming clogged with larger companies that can afford to litigate and will resist IRS efforts to reclassify their vendors to employee status
    - The cost to the government – and to businesses – of litigating these cases would be staggering, resulting in….
        - Diminished net revenues to government
        - Reduced competiveness of U.S. business

GAO Found an Institutional Antipathy at IRS Toward Independent-Contractor Status

- Without Section 530, taxpayers doing business with legitimate independent contractors would be adversely affected
    - A 1977 GAO report[2] – predating the enactment of Section 530 – observed that
        - "the Service tends to classify as many persons as possible as employees, thereby subjecting their earnings to withholding"
        - "It appears that the IRS approach to solve such noncompliance problems is to limit the number of self-employed persons"

[2] *Tax Treatment of Employees and Self-Employed Persons by the Internal Revenue Service: Problems and Solutions,* Nov. 21, 1977 (GGD-77-88)

- A 1992 GAO report[3] found that since 1989, IRS data show that an astounding 90 percent of ETEP audits found misclassified workers
    - The ETEP is the IRS's Employment Tax Examination Program, which targets for audit small businesses with assets of $3 million or less (*i.e.,* those businesses least able to defend themselves against IRS challenges)

[3] TAX ADMINISTRATION: Approaches for Improving Independent Contractor Compliance, at 4, July 1992 (GAO/GGD-92-108).

GAO's Views on IRS Enforcement of Worker Classification Prior to Section 530

The following excerpts from a General Accounting Office[4] report, *Tax Treatment of Employees and Self-Employed Persons by the Internal Revenue Service: Problems and Solutions,* Nov. 21, 1977 (GGD-77-88), describe the IRS's approach to worker-classification audits prior to the enactment of Section 530.

IRS Is Not Objective on Worker-Classification Matters

IRS … 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**. GGD-77-88 at 2.

IRS … 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. GGD-77-88 at 35.

IRS Is Inconsistent in its Worker Classification Determinations

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 [same] 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. GGD-77-88 at 10.

Massive Reclassifications of Workers Can Wreak Havoc for Retirement Plans

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.** GGD-77-88 at 15.

[4] Predecessor to the Government Accountability Office

Courts' Views on IRS' Enforcement of Worker Classification

Prior to Section 530's Enactment: In *Henry v. United States,* 793 F.2d 289, 1986 U.S. App. LEXIS 20095, 86-2 U.S. Tax Cas. ¶9512, 58 A.F.T.R.2d 5144 (Fed. Cir. App. 1986), the court found:

In April 1974, IRS informed the taxpayer that it need not pay FICA or FUTA payroll taxes on the workers it brokered, because they were independent contractors. Relying on that IRS advice, the taxpayer continued treating the workers as independent contractors and reporting their compensation on Forms 1099.

In mid-1975, the IRS conducted a payroll-tax audit of that same taxpayer, and this time reclassified the workers as employees and assessed FICA and FUTA taxes against the taxpayer. The taxpayer paid the taxes, ceased doing business and sold its assets.

* * *

Even after Section 530's Enactment: the court in *In re Compass Marine Corporation* 146 B.R. 138, 1992 Bankr. LEXIS 1290 (Bankr. E.D. Pa. 1992), expressed concern about the doctrinaire zeal with which IRS continued to pursue reclassifications of workers treated as independent contractors. In that case, the court offered the following observation:

> It is somewhat disturbing to us to observe the selective enforcement of the IRC requirements for classification of employees, which [an IRS Agent] himself conceded in his admission that his own wife was probably improperly classified by her employer. We also were disturbed by the suggestion that [the IRS Agent] prides himself as somewhat of a *crusader on this issue*. It is perhaps in recognition of the harshness of enforcement of these IRC requirements on the unfortunate targets of IRS enforcement that Congress has enacted Section 530 as an "out" for certain employers.

146 B.R. at 155. (Emphasis added).