Coalition to Promote Independent Entrepreneurs

·ICCoalition.org · (202) 659-0878

October 1, 2018

CC:PA:LPD:PR (REG-107892-18)
Room 5203
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, D.C., 20044

Re: Proposed Regulations Governing the Qualified Business Income Deduction
Internal Revenue Code section 199A
REG-107892-18
RIN 1545-BO71

Dear Sir or Madam:

The Coalition to Promote Independent Entrepreneurs[1] (the "Coalition") appreciates the opportunity to submit comments concerning the above-referenced proposed regulations that address the recently enacted section 199A of the Internal Revenue Code of 1986, as amended (the "Code").[2]

The Coalition applauds the clear and extensive guidance the proposed regulations provide with respect to Code section 199A. These comments pertain to only one aspect of the proposed regulations, namely, Prop. Treas. Reg. §1.199A-5(d)(3), which provides:

> Solely for purposes of section 199A(d)(1)(B) ..., an individual that was properly treated as an employee for Federal employment tax purposes by the person to which he or she provided services and who is subsequently treated as other than an employee by such person with regard to the provision of substantially the same services directly or indirectly to the person (or a related person), is presumed to be in the trade or business of performing services as an employee with regard to such services.

The Coalition respectfully submits that this presumption should be removed.

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[1] The Coalition to Promote Independent Entrepreneurs, http://iecoalition.org/, is an organization dedicated to informing the public and elected representatives about the importance of an individual's right to work as a self-employed individual, and to defend an individual's right to contract in this capacity.

[2] 83 Fed. Reg. 40884 (Aug. 16, 2018).

I. Code Section 199A Generally

By way of background, Code section 199A(a) allows a tax deduction for a taxpayer other than a corporation in an amount equal to the taxpayer's combined "qualified business income" amount, subject to a specified limitation. Code section 199A(c)(1), in turn, defines "qualified business income" to mean, for any taxable year, the net amount of qualified items of income, gain, deduction, and loss with respect to any "qualified trade or business" of the taxpayer. A "qualified trade or business" is defined in Code section 199A(d) to mean any trade or business other than, among other things, the trade or business of performing services as an employee.

It follows that an individual is eligible to claim the deduction based on the individual's own independent services only if the individual does not perform the services as an employee. This means that if an individual performs services independently for a company, the individual can claim a Code section 199A deduction with respect to those services only if the individual performs the services as an independent contractor, and not as an employee. Prop. Treas. Reg. §1.199A-5(d)(3) provides in this regard that if an employer misclassifies an employee as an independent contractor, the misclassified employee will be treated for purposes of Code section 199A as being an employee notwithstanding the employer's misclassification.

As noted, Prop. Treas. Reg. §1.199A-5(d)(3) provides that an individual who performs substantially the same services for a former employer, as the individual performed for that employer while an employee, will be presumed to remain an employee. The Preamble provides that the presumption may be rebutted:

> only upon a showing by the individual that, under Federal tax rules, regulations, and principles (including common-law employee classification rules), the individual is performing services in a capacity other than as an employee. This presumption applies regardless of whether the individual provides services directly or indirectly through an entity or entities.[3]

The just-quoted language affirms that the common-law test generally will govern a determination of an individual's status, as an employee or independent contractor, for purposes of Code section 199A.

II. The Presumption of Employee Status Should be Removed

The Coalition respectfully submits that the presumption contained in Prop. Treas. Reg. §1.199A-5(d)(3) should be removed.

The Coalition believes this presumption should be removed because it (i) would impede a stated objective set forth in the Preamble accompanying the proposed regulations, that two similarly situated individuals who provide services for a company should be treated the same,

[3] 83 Fed. Reg. 40884, 40901.

regardless of whether one of these individuals had previously performed services for the company as an employee, (ii) is unnecessary, and (iii) would create uncertainty for taxpayers.

A. The Presumption Would Impede a Stated Objective that Two Similarly Situated Individuals be Treated the Same

The presumption contained in Prop. Treas. Reg. §1.199A-5(d)(3) would almost certainly affect the analysis of whether an individual covered by the presumption is recognized as an employee or independent contractor for purposes of Code section 199A. The presumption would likely create a more demanding standard for a former employee of a company who provides services for the company to qualify as an independent contractor, relative to a similarly situated individual who provides services for the company but is not a former employee.[4]

Applying a more demanding standard to individuals covered by the presumption would conflict with the stated purpose of the presumption contained in the Preamble accompanying the proposed regulations, which states:

> it would not be appropriate to provide that someone who formerly was an employee of an employer is now "less likely" to be respected as an independent contractor. Such a rule would not treat similarly-situated taxpayers similarly: two individuals who have a similar relationship with a company and each claim to be treated as independent contractors would be treated differently depending on any prior employment history with the company. Therefore, proposed § 1.199A–5(d)(3) does not provide any new or different standards to be properly classified as an independent contractor or owner of a business. Instead, proposed § 1.199A–5(d)(3) contains a presumption that applies in certain situations to ensure that individuals properly substantiate their status.[5]

The Coalition submits that the stated objective of ensuring similar treatment of similarly situated taxpayers is in all respects salutary and appropriate. In order for two similarly situated taxpayers who provide services for the same company to be treated the same, however, where one is a former employee of the company and the other is not, the presumption could not affect the analysis. But if the presumption does not affect the analysis, the presumption serves no purpose. It follows that the presumption should be removed.

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[4] The presumption also could lead to an individual being treated differently for purposes of services the individual provides for a former employer and services the individual provides for another company for which the individual has not previously worked. This is because the presumption would not appear to apply with respect to the services the individual performs for the other company.

[5] 83 Fed. Reg. 40884, 40901.

B. The Presumption is Not Necessary

Another reason why the presumption contained in Prop. Treas. Reg. §1.199A-5(d)(3) should be removed is that a presumption is not necessary for the Internal Revenue Service to properly determine the status, as an employee or independent contractor, of a former employee of a company. Rather, IRS has demonstrated that the common-law test under current law is well equipped for distinguishing between former employees of a company who are properly classified as independent contractors and those whose classification as independent contractors is incorrect.

For example, in Priv. Ltr. Rul. 9345002 (Jul. 13, 1993), the IRS considered whether six retired workers who were rehired as consultants by their former employer qualified as independent contractors under the common-law test. The ruling indicates that the firm was in the business of producing, manufacturing, and distributing automotive and allied products. Prior to retirement, all six of these individuals worked full-time for the company or a subsidiary. The ruling states that individuals #s 1, 2, 3 formerly worked for a subsidiary: one served as Chairman; one served as Chief Executive Officer; and one served as a principal sales and marketing executive. Individual #4 formerly worked for the firm as an account manager, project manager, operations manager, and director of one of the firm's foreign marketing and engineering divisions. Individual #5 formerly worked for the firm as supervisor of manufacturing at a facility, where the individual supervised more than 500 subordinates. Individual #6 formerly worked for the firm as an engineer and was involved with the firm's design and development of a new facility. After an extensive factual discussion of each relationship between these individuals and their former employer, IRS analyzed the relationships under the common-law test and concluded that individuals #s 1, 2, 3 and 5 qualified as independent contractors, and that individuals #s 4 and 6 were employees.

Furthermore, the fact that a former employee establishes an entity out of which the individual provides services to a former employer has not impeded the IRS's ability to find an employment relationship. In this regard, Priv. Ltr. Rul. 8949013 (Sept. 7, 1989), considered a firm in the business of design and process engineering. The ruling involved a former employee of the firm who had entered into a consulting agreement with the firm after a termination of employment. The firm entered into a written agreement with an entity, of which the individual served as president. The ruling states that although the agreement for services was entered into between the firm and the entity, it was understood that the individual was to perform the services personally. The individual was determined to be an employee of the firm for purposes of federal employment taxes under the common-law test. Accord, Priv. Ltr. Rul. 8951308 (Feb. 21, 1989).

The foregoing private letter rulings illustrate the efficacy of the common-law test for distinguishing between former employees of a company who qualify as independent contractors from those who do not. It follows that a new presumption is not necessary.

C. The Presumption Would Create Uncertainty for Taxpayers

Finally, the presumption contained in Prop. Treas. Reg. §1.199A-5(d)(3) would likely create significant uncertainty for affected taxpayers seeking to determine their eligibility for a Code section 199A deduction. To be sure, the specific language of proposed regulation provision

creating the presumption does not contain the objective expressed in the Preamble that two similarly situated individuals who provide services to a company should be treated the same, regardless of whether one is a former employee of the company. Consequently, the presumption would create a very real risk that its practical effect would be to affirmatively modify the analysis of an affected individual's status relative to a company, by creating a more demanding standard for such an individual to be recognized as an independent contractor for purposes of Code section 199A.

This uncertainty, in turn, could create a chilling effect with respect to former employees of a company and lead to certain individuals who, in fact, are eligible for a Code section 199A deduction not claiming the deduction, in order to avoid a dispute with the IRS over whether the presumption could be effectively rebutted.

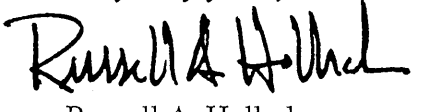
III. Conclusion

Inasmuch as a presumption of employee status would likely affect the analysis of an individual's status relative to a former employer, which could result in two substantially similar individuals who perform services for the same company being treated differently for purposes of Code section 199A, the Coalition respectfully submits that the presumption should be eliminated.

The Coalition believes the elimination of the presumption would be especially appropriate in light of the fact that IRS has had no difficulty under current law in applying the common-law test to differentiate between former employees of a company, whom the company engages as independent contractors, who are classified correctly and those who are misclassified.

Thank you very much for your consideration. If you have any questions or would like additional information concerning these comments, please let us know.

Very truly yours,



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