INTERNAL REVENUE SERVICE
ADVISORY COUNCIL

SMALL BUSINESS/SELF-EMPLOYED
SUBGROUP REPORT

DONNA L. RODRIGUEZ, SUBGROUP CHAIR
FRANK DEGEN
JAY E. FISHMAN
DEAN HEYL
DAVID A. LIFSON
CHARLES P. RETTIG
JOHN SATAGAJ

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INTRODUCTION/EXECUTIVE SUMMARY

The IRSAC Small Business/Self-Employed Subgroup (hereafter “Subgroup”) is made up of seven tax professionals. The members of the Subgroup offer the IRS Advisory Council a variety of experiences, ranging from the representation of individuals and small businesses to large corporations. The Subgroup is honored to use this depth and breadth of knowledge to assist the SB/SE Division of the IRS (hereafter “SB/SE”) in any way possible.

The Subgroup enjoys a close working relationship with the professionals within SB/SE. This relationship has granted the Subgroup the opportunity to consult with SB/SE on many issues outside of the regularly scheduled meetings. The Subgroup and SB/SE consulted both formally and informally on the issues contained in this report. The Subgroup respectfully recommends the following:

1. Extended Due Date of Partnerships, Real Estate Mortgage Investment Conduits (REMICS) and Certain Trusts that File Fiduciary Tax Returns. Pursuant to recently Proposed Regulations issued July 1, 2008, Proposed Regulations under 1.6081-2 and -6 etc., the partnership and trust extended due date has been reduced from the current six months to five months generally effective for years beginning in 2008. Moving the extended due date from October 15 to September 15 will help many recipients file accurate and timely tax returns, should enhance the efficiency of the tax system, and reduce overall taxpayer burden. These regulations should be supported and made final.

2. Mail Procedures in the AUR/CP2000 Correspondence Cycle. The Automated Under Reporter and Computer Paragraph 2000 (AUR/CP2000) Program is a vital part of the IRS’s

efforts to ensure accurate income reporting compliance and a valuable tool in helping to reduce the tax gap. However, more effective mail procedures are needed to avoid unnecessary correspondence with taxpayers. We recommend that upon receipt of taxpayer's response, the IRS should promptly notify the taxpayer that no further action will be taken until the response is processed. Concurrent with the sending of an acknowledgement letter a "hold" should be placed on the taxpayer's correspondence cycle ensuring that no further escalating letters will be sent until the "case is worked" by an examiner. Finally, since taxpayers have the option of responding to an AUR/CP2000 notice by either mail or fax, guidance needs to be given as to what constitutes a timely response in order to satisfy the requirement for the two previous recommendations. A fax is received by the Service on the transmission date. A mailed response may be timely based on the postmark date but will arrive at some time after that date. IRS procedures need to consider whether the language in an AUR/CP2000 notice needs to be modified in the section "you need to respond by …" to reflect the differences in dates of receipt given the two modes of possible response by the taxpayer.

3. <u>Improve Employment Tax Reporting and Worker Classification Compliance.</u> Currently, there is no definitive test to distinguish whether a worker is an employee or an independent contractor. The tests used to determine whether a worker is an independent contractor or an employee are complex and subjectively applied. Significant tax consequences result from the classification of a worker as an employee or independent contractor. The IRS has developed the Worker Classification Settlement Program (CSP) as equitable remedy to this situation. This program, however, is not widely publicized and thus few companies know about it and thus don't utilize it. We recommend that the IRS publicize the availability of the CSP to service recipients, whether under examination or not, allowing them to voluntarily apply for the

CSP even in the absence of an employment tax related examination. Additionally, the IRS should consider creating an informal voluntary disclosure program emphasizing employment tax and worker classification issues. IRS should also consider sending letters to service recipients in industries having a history of noncompliance offering a way to avoid penalties through the employment tax voluntary disclosure filing of amended returns and payment of the taxes and interest due. Finally, the IRS should accelerate the matching process for federal tax deposits and Forms 941 so that the Trust Fund Recovery Penalty (TFRP) Investigations can be started whenever there are employment tax delinquencies for two consecutive calendar quarters.

4. Seasonal Employees and Employees Working Limited Hours. There is no de minimis number of hours or minimum compensation which exempt an employer from the requirement to withhold income taxes and to pay and withhold employment taxes. IRS publications related to the employment taxes and employment classification have limited guidance on this topic. A possible solution would be to more prominently feature and more clearly state in plain language in all relevant publications and materials that there is no de minimis hours worked nor dollar amount earned threshold for employment tax status.

5. Requiring Appraisers to Include Their Social Security Number on Written Appraisal Reports and on IRS Form 8283. Treasury Regulation 1.170A-13(c) (3) (E) requires qualified appraisals to include "The name, address, and identifying number (i.e. social security number) of the qualified appraiser. Additionally, an appraiser’s SSN is required to be entered on Form 8283 in Part III, “Declaration of Appraiser.” These requirements invite identity theft. In order to remedy this situation we recommend that the IRS take immediate action to eliminate all existing requirements that appraisers include their SSNs on written appraisal reports, on IRS Form 8283 and on any other documents that could expose them to the threat of identity theft. Additionally,

the IRS should permit appraisers to apply for an expanded Preparer Tax Identification Number ("PTIN") or for an equivalent discreet number that will permit the service to identify their work without exposing them to the possibility of ID Theft. Should the above or its equivalent not be adopted the proposed regulations (REG-140029-07) need to be adopted permanently and be publicized.

ISSUES AND RECOMMENDATIONS

ISSUE ONE: EXTENDED DUE DATE OF PARTNERSHIPS, REAL ESTATE MORTGAGE INVESTMENT CONDUITS (REMICS) AND CERTAIN TRUSTS THAT FILE FIDUCIARY TAX RETURNS

Executive Summary:

Pursuant to recently Proposed Regulations issued July 1, 2008, Proposed Regulations under 1.6081-2 and -6 etc., the partnership and trust extended due date has been reduced from the current six months to five months generally effective for years beginning in 2008. Moving the extended due date from October 15 to September 15 will help many recipients file accurate and timely tax returns, should enhance the efficiency of the tax system and reduce overall taxpayer burden. These regulations should be supported and made final.

Background:

Pursuant to temporary regulations previously effective for tax returns due for tax year 2005 and later, the IRS allowed partnerships, real estate mortgage investment conduits (REMICs) and certain trusts that file fiduciary tax returns to file an automatic six-month extension of time to file their tax return on one application, Form 7004, *Application for Automatic 6-Month Extension of Time to File Certain Business Income Tax, Information, and Other Returns*. [See T.D. 9229, November 7, 2005] The six-month automatic extension of time to file set forth in the temporary regulations applies to returns of pass-through entities, e.g., Form 1065, *U.S. Return of Partnership Income*, and Form 1041, U.S. Income Tax Return for Estates and Trusts, filed by most trusts, beginning in 2006 (for tax years 2005 and later) for a three year period, i.e. tax years 2005, 2006 and 2007. Previously two extension requests were required to obtain a full six month extension.

When the Treasury Decision was released in late 2005 for that year's filing season it was rightly heralded for streamlining tax filing responsibilities and eliminating administrative procedures that no longer advanced the goal of efficient tax collection by eliminating the prior interim extension filling requirements. The preamble to the Treasury Decision left for another day, and cautioned the tax community about, the obvious anomaly that the filing due date for most pass-through entities coincided with the due date for their owners to file tax returns reporting the same data. It said, in relevant part, that:

> The Treasury Department and the IRS recognize that because the six-month automatic extension is available for returns of pass-through entities, some taxpayers may not receive information returns from the pass-through entities that they need in order to complete their own income tax returns before those returns are due. For example, an individual income taxpayer with a six-month extension of time to October 15 to file the Form 1040 may not receive a Schedule K-1, *Beneficiary's Share of Income, Deductions, Credits, etc*., from a partnership in which the taxpayer holds an interest until after the partnership files its Form 1065 on its extended due date of October 15. Similarly, a C-Corporation with a six-month extension to September 15 to file its Form 1120, *U.S. Corporation Income Tax Return*, may not receive a Schedule K-1 from a calendar year partnership in which it holds an interest until 30 days after its return is due if the partnership files its Form 1065 and sends out the Schedule K-1s on its extended due date of October 15. This filing anomaly existed under prior regulations when the pass-through entity received an extension of time to file to a date on or after the extended due date for the pass-through interest holder, but the automatic six-month extension in these regulations may cause this to happen with more frequency.
>
> Because of this filing anomaly, the availability of a six-month extension of time to file for pass-through entities may result in taxpayers filing an increased number of amended income tax returns. Therefore, it may be appropriate for pass-through entities to have a shorter extension period than their partners or shareholders.

At that time, the Treasury Department and the IRS requested comments on "whether a shorter extension of time to file for pass-through entities might reduce overall taxpayer burden." A request was also made that, "in order to minimize the burden that might be imposed as a result of this filing anomaly, the Treasury Department and the IRS encourage pass-through entities that request an extension of time to file to minimize the impact that such extension might have on their partners' or members' ability to timely file (with an extension) their own tax returns."

Comments were received and many of them recommended shortening the extension period to five months. Proposed Regulations modifying Treasury Decision 9229 to shorten the due date to September 15 were issued effective July 1, 2008. See IRS News Release 2008-84, June 30, 2008.

The anomaly presaged by Treasury Decision 9229 has become a self-fulfilling prophecy that is raising increasing concern among a growing group of owner/partner/members (and their representatives) of pass-through entities. Commercial pressures have not provided sufficient motivation. Too many partnerships, REMICs and trusts that have been granted automatic extensions to October 15 have not been mindful of the impact of utilizing the full extension period on the recipients of the K-1's having an October 15 filing date. There are several factors that have been identified as causing a significant number of K-1s to be released at the "last minute" in the final week or two before owners must also file their tax returns. These include:

- Underlying transactions are difficult and complex--- it is only human nature to put off difficult decisions to the last minute;

- “Tiered” partnerships or trusts have created information “bottlenecks.” For example, a trust may be awaiting a partnership K-1 before it may issue K-1s to its beneficiaries, while the partnership awaits a K-1 from several alternative investments;
- Many entities are more mindful of their own responsibility to the tax system than they are to the needs of their owners, particularly in later life businesses that no longer are actively involved with many of their original investors;
- Extraneous issues such as foreign tax credits, passive activities and multistate tax jurisdiction issues further complicate calculations and require time to gather data;
- Tax treatment of particular items is sometimes difficult to determine, and only the pressure of a filing deadline motivates the decision makers to act;
- The significant proliferation of the use of pass-through entities involves many more taxpayers now than were involved five and ten years ago.

Today, as a result, too many K-1s are often not available until shortly before or on the October 15 deadline.

The change to the partnership and trust extended due dates in the Temporary Regulation would reduce overall taxpayer burden. It would smooth out the workflow and improve the accuracy, efficiency and reliability of the administration of our tax laws. Having said this, we recognize the need to balance the requirements of the pass-through entities that need sufficient time to prepare their tax returns with the same needs of owners who desire to accurately comply with their filing obligations in a timely fashion. The new, Temporary Regulation balances those needs.

This change will induce partnerships and trusts to complete their work within 8 ½ months after the end of their year … September 15 for calendar year entities…which will give most individuals at least a month to complete their tax filings by October 15.

This should not be a hardship to the pass-through entities, and will simply hold partnerships and trusts to the same timetable as most similarly situated businesses conducted in corporate form. At the same time, this revision will resolve the anomaly that has arisen by giving pass-through entities as much time as possible to report their activity.

By changing the extended due date one month earlier, the filing system would be enhanced in several ways:

- Better, more accurate returns may be prepared in a timely manner;
- Fewer compliance issues might arise;
- Processing work flow will be streamlined for taxpayers, practitioners and the government;
- Simpler, less complex practices will be possible, reducing the current need to estimate and then amend tax filings.

More specifically, the IRS may anticipate the following improvements to the reporting and tax compliance system, should it enact this proposal:

1. Tax reporting would be improved because the tax preparer community would have completed the entity returns by September 15, thus allowing substantially more time to be devoted to the accurate preparation of individual returns due October 15.

2. Unarguably, the proposed change would be revenue positive because personal returns would be completed sooner (as many balances due from taxpayers would be paid weeks before October 15 rather than exactly on October 15).
3. More tax returns may be filed before October 15 thereby saving the IRS the extra costs incurred by the late "rush" of filings.
4. Taxpayers would be spared the cost of preparing amended tax returns that resulted from not receiving their K-1s early enough to be included in their tax returns. (Traditionally when this situation occurs, taxpayers estimated the amounts anticipated on their K-1s, and tax preparers were engaged to prepare amended returns well after October 15.)
5. The vast majority of corporate partners will receive K-1's on a timely basis in advance of the filing of the partner's corporate tax return and the situation where K-1's arrive after the Form 1120 was required to be filed should become rare.

Recommendation

The new, Temporary Regulation should be supported and made final.

ISSUE TWO: MAIL PROCEDURES IN THE AUR/CP2000 CORRESPONDENCE CYCLE

Executive Summary:

The Automated UnderReporter and Computer Paragraph 2000 (AUR/CP2000) Program is a vital part of the IRS's efforts to ensure accurate income reporting compliance. The program is a valuable tool in helping to reduce the tax gap but more effective mail procedures are needed to avoid unnecessary and often, escalating correspondence with taxpayers. It is important that the IRS allow sufficient time to process taxpayer correspondence and equally important that the taxpayer know that the IRS has received the response. When the taxpayer response is received, they should be promptly notified by the IRS that no further action will be taken until the response is processed. It should be noted that similar problems can exist with campus examination letters 566, *Initial Contact Letter,* and all references to AUR/CP2000 problems should be construed to include the 566 letter process as applicable.

Background:

AUR/CP2000 notices are sent to taxpayers when "income and payment information that the IRS has on file does not match entries" that the taxpayer has submitted via a filed Form 1040 return, *U.S. Individual Income Tax Return*. These notices typically give taxpayers a 30-day period in which to respond with documentation to support their entries on the filed Form 1040 or, in the event of a taxpayer omission or error, the opportunity to agree with the proposed adjustment in AUR/CP2000 notice. This process is reasonable and appropriate given the IRS's mission to collect the correct amount of tax from each taxpayer. But, the next steps in the mail procedures are often frustrating and counter-productive to both taxpayers and tax practitioners assisting the taxpayers. The AUR notice steam is a CP2000 followed by a Statutory Notice of Deficiency Letter 3219 (For Campus Examination, the notice stream begins with letter 566, followed by letter 525 and lastly letter 3219). Far too frequently, a 90-day letter (letter 3219, Statutory Notice of Deficiency) is mailed to the taxpayer before any documentation submitted within the original 30-day response period provided by the AUR/CP2000 can "be worked by the Service". Certainly, taxpayers may be left wondering – is anyone acting on my correspondence?

To be fair, many of these issues do get resolved before the end of the 90-day period in which a taxpayer can file a petition with the Tax Court but that begs the question. Current procedures in the IRS mail cycle response process are creating unnecessary anxiety and often duplicative efforts for both taxpayers and tax practitioners. During this intervening time period the taxpayer and the practitioner are forced to begin preparation of the petition and may actually prepare and file the petition with the Tax Court in order to not lose the ability to resolve the issue through the prepayment process afforded by the Tax Court procedures. The potential costs and efforts create an unnecessary burden on taxpayers who complied in a timely manner with the IRS request.

If the IRS research indicates that a case involving an AUR/CP2000 notice requires "x" days to be worked after a taxpayer submits a response and/or the requested documentation, it is absolutely foolish to send further escalating notices to the taxpayer anytime prior to the expiration of "x" days. If a taxpayer has responded in a timely manner to an IRS request, then the concept of good customer service requires that the IRS evaluate the response and the accompanying information before <u>any</u> further escalating correspondence is sent.

<u>Recommendations:</u>

1. Upon receipt of a taxpayer's timely response to an AUR/CP2000 notice, the Service should send an acknowledgement letter to the taxpayer indicating the correspondence has been received and stating that the taxpayer's next notice will not be sent until after the response and/or documentation has been reviewed.
2. Concurrent with the sending of an acknowledgement letter, a "hold" should be placed on the taxpayer's correspondence cycle ensuring that no further escalating letters will be sent until the "case is worked" by an examiner.

3. Since taxpayers have the option of responding to an AUR/CP2000 notice by either mail or fax, guidance needs to be given as to what constitutes a timely response in order to satisfy the requirement for the two previous recommendations. A fax is received by the Service on the transmission date. A mailed response may be timely based on the postmark date but will arrive at some time after that date. IRS procedures need to consider whether the language in an AUR/CP2000 notice needs to be modified in the section "you need to respond by …" to reflect the differences in dates of receipt given the two modes of possible response by the taxpayer.

ISSUE THREE: IMPROVE EMPLOYMENT TAX REPORTING AND WORKER CLASSIFICATION COMPLIANCE

Executive Summary:

IRS procedures should be reviewed to increase the awareness of various programs and initiatives designed to enhance compliance. Worker classification is dependent upon a complex, difficult factual analysis. A reclassification as a result of an examination for prior tax years often results in a liability that effectively renders the employer/service recipient insolvent. Compliance may be enhanced by providing reclassification incentives to employers.

Background:

No definitive test exists to distinguish whether a worker is an employee or an independent contractor. The tests used to determine whether a worker is an independent contractor or an employee are complex and subjectively applied. Significant tax consequences result from the classification of a worker as an employee or independent contractor.

Under the Worker Classification Settlement Program (CSP), the examiner must first determine whether the employer is entitled to relief under the guidelines for determining the employment status of a worker as set forth in Section 530 (a) of the 1978 Act, as amended by Section 269(c) of the Tax Equity and Fiscal Responsibility Act of 1982 ("Section 530"). Section 530 generally allows a service recipient to treat a worker as not being an employee for employment tax purposes, regardless of the worker's actual status under the common-law test, unless the service recipient has no reasonable basis for such treatment or fails to meet certain requirements. Section 530 was permanently extended by the Tax Equity and Fiscal Responsibility Act of 1982.

If the service recipient is entitled to Section 530 relief, under CSP there is no assessment and the service recipient can continue to treat the workers in question as independent contractors. If the service recipient desires to begin treating the workers as employees, it can agree to do so in the future (no later than the beginning of the next year) without giving up its claim to Section 530 relief for earlier periods.

If the examiner determines that the service recipient is erroneously treating employees as independent contractors, a series of two graduated CSP settlement offers can occur. If the service recipient has met the reporting consistency requirement of Section 530 but clearly has no reasonable basis for its treatment of the workers as independent contractors or has been inconsistent in its treatment of the workers, the offer will be a full employment tax assessment under IRC §3509 for one taxable year (with the employer agreeing to reclassify the workers as employees on a prospective basis, ensuring future compliance). If the service recipient has met the reporting consistency requirement and can reasonably argue that it met the reasonable basis and consistency of treatment tests, the offer will be an assessment of 25% of the employment tax liability for the audit year under IRC §3509 (with the employer agreeing to reclassify the workers as employees on a prospective basis, ensuring future compliance).

In the event of a recharacterization of workers as employees from independent contractors under CSP or otherwise, no interest will be due on the additional liability arising as a result of the recharacterization if: (i) the employer agrees to the recharacterization with either the Examination Division or the Appellate Division of the IRS (following a timely Protest), and (ii) the additional FICA tax is paid in full before the date the current Form 941 would be due for the quarter within which there is an agreement with the IRS as to the recharacterization. See Revenue Ruling 75-464 and IRC § 6205. The foregoing represents a significant economic incentive for the employer to promptly agree to the recharacterization and satisfy the resulting liability.

Under present law, the determination of whether a worker is an employee or an independent contractor is generally made under a facts and circumstances test that seeks to determine whether the worker is subject to the control of the service recipient, not only as to the nature of the work performed, but the circumstances under which it is performed.

Before a service recipient can know how to treat payments made to workers for services, they must first know the business relationship that exists between the service recipient and the person performing the services. The person performing the services may be: (a) A common-law employee, (b) A statutory employee, (c) A statutory nonemployee, or (d) An independent contractor.

Under common-law rules, a worker may generally be subject to classification as an employee if the service recipient can control what will be done and how it will be done. An individual is generally treated as an independent contractor if the person for whom the services are performed has the right to control or direct only the result of the work and not the means and methods of accomplishing the result. In Rev. Rul. 87-41, the IRS developed a list of 20 factors that may be examined in determining whether an employer-employee relationship exists. The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed. In 1996, the IRS published a training manual for examiners, entitled “Independent Contractor or Employee? Training Materials” which grouped the common factors in three categories: (1) behavioral control; (2) financial control, and (3) relationship of the parties.

On May 7, 2007, the U.S. Joint Committee on Taxation (JCT) released a report, entitled “The Report”, describing the present law and background relating to worker classification for federal tax purposes.[1] The Report analyzed alternative methods of classifying workers, including: (1) adopting a "check-the-box" approach whereby the parties decide by contract whether the worker is to be treated for all federal tax purposes as an employee or independent contractor; (2) limiting the number of relevant factors to be considered either by way of an additional safe harbor or by replacing the present-law rules; or (3) providing similar treatment of workers for all federal tax purposes with the result that worker classification would become irrelevant. We reference the JCT Report without comment on its recommendations.

Recommendations:

1. **Increased Application and Awareness of the CSP.** Under the CSP, the IRS allows examiners and employers to resolve worker classification cases as early in the enforcement process as possible. IRS should publicize the availability of the CSP to service recipients, whether under examination or not, allowing them to voluntarily apply for the CSP even in the absence of an employment tax related examination.

2. **Employment Tax Voluntary Disclosure Program.** IRS should consider creating an informal voluntary disclosure program emphasizing employment tax and worker classification issues. The employment tax / worker classification voluntary disclosure program could provide for graduated CSP treatment for employers who voluntarily contact the IRS before:

   A. The IRS has initiated an examination or investigation of the service recipient, or has notified the service recipient that it intends to commence such an examination or investigation;

   B. The IRS has received information from a third party (e.g., informant, other governmental agency, or the media) alerting the IRS to the specific service recipient's potential noncompliance; or

[1] Joint Committee on Taxation, "Present Law and Background Relating to Worker Classification for Federal Tax Purposes" (JCX-26-07), May 7, 2007). For the text of the report, see http://www.house.gov/jct/x-26-07.pdf.

C. The IRS has initiated a civil examination or investigation that is directly related to the specific liability of the service recipient.

3. Provide Incentives to Improve Compliance. IRS should consider sending letters to service recipients in industries having a history of noncompliance offering a way to avoid penalties through the employment tax voluntary disclosure filing of amended returns and payment of the taxes and interest due. Service recipients may self-comply if they receive educational information regarding worker status and an opportunity to correct any filing errors rather than be subjected to a traditional examination.

4. Publish "Top 10" Employment Tax Audit Priorities. IRS should increase the publication and clarification of worker status and employment tax priorities with meaningful examples setting forth potential liabilities for taxes and penalties. Examples could include seasonal (such as retail help at holidays) and long-term substitutes (such a person who answers phone only one day a week) being subject to employee status.

5. Improve IRS Oversight and Enforcement. In employee concentrated industries such as professional employer organizations (PEOs), manufacturing, etc. IRS should improve oversight such that it can promptly intercede following the first significant quarterly liability. Often, quarterly liabilities are several quarters delinquent before IRS first contacts the employer. Pyramiding of employment tax liabilities frequently makes it difficult for both the IRS and the employer to achieve any realistic resolution in a timely manner.

A. Accelerate Trust Fund Recovery Penalty (TFRP) Investigations. IRC §6672 authorizes the imposition of the TFRP against the individual responsible persons within a corporate entity who fail to take appropriate steps to assure payment of certain employment tax related amounts to the government. The amount of the penalty is equal to the unpaid balance of the trust fund tax and is based on the unpaid income taxes withheld, plus the employee's portion of the withheld FICA taxes. IRS should accelerate investigation of TFRPs by maintaining an informal policy providing for the commencement of the TFRP investigation whenever there are employment tax delinquencies for two consecutive calendar quarters.

B. Federal Tax Deposits. IRS should review the required timing for federal tax deposits to determine if deposits should be accelerated in certain types of situations of historically noncompliant industries.

C. Employment Tax NRP. IRS should commence a National Research Program (NRP) focused on employment tax and independent contractor issues. Historical data seems to be out of date with the current Internet economy. The employment tax NRP would increase the ability of the IRS to focus limited resources within employment tax compliance challenged industries.

D. Form SS-4, *Application for Employer Identification Number*, Revisions. IRS should add employment tax /worker classification information to the Form SS-4, which would provide an additional tool since taxpayers could not realistically assert that they lack sufficient knowledge of the relevant withholding obligations and determination of worker status as an independent contractor. For example, provide links to relevant publications and sites on www.irs.gov.

E. Employment Tax Web Site. We applaud the launch of the employment tax site on www.irs.gov. We would recommend that a search of "employee" or "contractor" be linked to the employment tax site. The site should continue to be highly publicized through www.irs.gov, business associations and professional organizations.

ISSUE FOUR: SEASONAL EMPLOYEES AND EMPLOYEES WORKING LIMITED HOURS

Executive Summary:

There is no de minimis number of hours or minimum compensation which exempt an employer from the requirement to withhold income taxes and to pay and withhold employment taxes. IRS publications related to the employment taxes and employment classification have limited guidance on this topic. Our recommendation would be to more prominently feature and more clearly state in plain language in all relevant publications and materials that there is no de minimis hours worked nor dollar amount earned threshold for employment tax status.

<u>Background</u>:

Some businesses believe that an individual can be considered an independent contractor based solely on the number of hours worked or the short period of time that the individual is performing services. The number of hours worked may be a factor in the determination of whether the individual is an independent contractor or employee, however, an individual can be an employee even if only one hour is worked.

IRS Publications related to the employment taxes and employment classification have limited guidance on this topic.

IRS Publication 15, *Employer's Tax Guide*, has two references to this issue:

1) In Section 2, "Who Are Employees?" there is the following paragraph:

> "If an employer-employee relationship exists, it does not matter what it is called. The employee may be called an agent or independent contractor. It also does not matter how payments are measured or paid, what they are called, or if the employee works full or part time."

2) Section 9 has a paragraph entitled "Part-Time Workers," which states:

> "For federal income tax withholding and social security, Medicare and federal unemployment (FUTA) tax purposes, there are no differences between full-time employees, part-time employees and employees hired for short periods."

Regarding classification as employees or independent contractors, Publication 15-A, *Employer's Supplemental Tax Guide*, in a paragraph entitled "Common-Law Employees," it states:

> "If you have an employer-employee relationship it makes no difference how it labeled. The substance of the relationship, not the label, governs the worker's status. Nor does it matter whether the individual is employed full-time or part-time."

There is one publication that has a clear statement. Fact sheet FS-2007-27, December 2007, "Employment Taxes and Classifying Workers" states:

> "It is a common misconception that someone working part time or earnings less than $600 per year should be classified as an independent contractor. But in fact, part time status and the number of hours worked are generally not factors that determine whether a worker is an employee or independent contractor."

Recommendation:

1. More prominently feature and clearly state in plain language in all relevant publications and materials that there is no de minimis hours worked nor dollar amount earned threshold for employment tax status. This can be included in Web site materials as well as publications (e.g. , Publication 15, *Employer's Tax Guide; Publication* 15-A, *Employer's Supplemental Tax Guide*; Publication 334, *Tax Guide for Small Businesses*), Industry-Specific Audit Technique Guides; Section 7 of the Businesses with Employees area on the IRS web site; etc).

The statement in the fact sheet is one option. An alternative example is: "For federal income tax withholding, social security, Medicare, and federal unemployment (FUTA) tax purposes, neither the number of hours worked nor amount earned alone determines the status of an individual as independent contractor or employee. For example, an individual can be an employee even though the individual works one hour a week or one day a year."

ISSUE FIVE: REQUIRING APPRAISERS TO INCLUDE THEIR SOCIAL SECURITY NUMBER ON WRITTEN APPRAISAL REPORTS AND ON IRS FORM 8283

Executive Summary:

Treasury Regulation 1.170A-13(c) (3) (E) requires that, in order for an appraisal report to be considered a "qualified appraisal", it must include "The name, address, and... the identifying number of the qualified appraiser; and, if the qualified appraiser is acting in his or her capacity as a partner in a partnership [or] an employee of any person (whether an individual, corporation, or partnerships)... the name, address and taxpayer identification number...of the partnership or the person who employs or engages the qualified appraiser."

This has been interpreted by taxpayers and/or their agents to require the appraiser's signature and Social Security Number (SSN) on their appraisal reports in order for those reports to be considered as "qualified appraisals". Additionally, an appraiser's SSN is required to be entered on Form 8283 in Part III, "Declaration of Appraiser". These requirements invite identity theft.

Background:

It has been interpreted by many taxpayers and/or their agents that current IRS Regulations(Treasury Regulation 1.170A-13(c)(3)(E) require that, in order for an appraisal for any tax purpose to be considered a "qualified" appraisal, the appraisers must include his or her signature and Social Security Number on the appraisal reports. IRS is aware of the tax-related identity theft issues and, in fact, recently took action to address this issue for tax practitioners, but not for appraisers preparing reports to be used in connection with tax returns. This is an issue of great concern to many appraisers who work for companies offering appraisal services. Unlike sole practitioners, appraisers employed by others have not been eligible for a separate Tax ID Number. Accordingly, to meet service requirements for a "qualified appraisal", they are being asked to include their personal social security Number on written appraisal reports.

The IRS has recently attempted to remedy this problem. A provision in regulations (REG-140029-07) on "Substantiation and Reporting Requirements for Cash and Non-Cash Charitable Contribution Deductions" states "if an appraiser is employed by a firm, the firm's employer identification number should be used", thereby eliminating the need for an appraiser performing the work to include his or her personal social security number. The proposed rules also clarify that appraisers who are sole practitioners may obtain an employer identification (EIN) even if they do not have any employees.

Unfortunately this solution carries with it a host of different problems. The purpose for including the "identifying number of the Qualified Appraiser" is to identify the person responsible for the appraisal, not his or her employer. While the proposed provisions may solve the immediate identity theft problem it may create an identification problem. Appraiser employees who use their firm’s employer identification number may not be identifiable once they leave the firm, and a single appraiser who works for several firms could be submitting appraisals under several different identification numbers.

In lieu of using their firm’s Employer Identification Number, appraiser/employees might avail themselves of the ability to apply for their own EIN. Appraiser employees who have their own (EIN) blur the distinction between employee and independent contractor. This could encourage a bad business practice.

Recommendations:

1. IRS should take immediate action to eliminate all existing requirements that appraisers include their social security numbers on written appraisal reports, on IRS Form 8283, and on any other documents that could expose them to the threat of identity theft.
2. IRS should permit appraisers to apply for an expanded Preparer Tax Identification Number (“PTIN”) or for an equivalent discreet number that will permit the service to identify their work without exposing them to the possibility of identity theft.
3. The proposed regulations (REG-140029-07) should be modified to include providing an expanded PTIN or an equivalent discreet number to identify appraisers, and then be adopted.