PRESENT LAW AND BACKGROUND RELATING TO WORKER CLASSIFICATION FOR FEDERAL TAX PURPOSES

Scheduled for a Public Hearing
before the
SUBCOMMITTEE ON SELECT REVENUE MEASURES
and the
SUBCOMMITTEE ON INCOME SECURITY AND FAMILY SUPPORT
of the
HOUSE COMMITTEE ON WAYS AND MEANS
on May 8, 2007

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INTRODUCTION

The Subcommittee on Income Security and Family Support and the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means have scheduled a joint public hearing for Tuesday, May 8, 2007, on the effects of misclassifying workers as independent contractors. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of present law and background relating to worker classification for Federal tax purposes.

[1] This document may be cited as follows: Joint Committee on Taxation, *Present Law and Background Relating to Worker Classification for Federal Tax Purposes* (JCX-26-07), May 7, 2007. This publication is also available on the web at www.house.gov/jct.

I. WORKER CLASSIFICATION RULES

A. Present Law

In general

Significant tax consequences result from the classification of a worker as an employee or independent contractor. These consequences relate to withholding and employment tax requirements, as well as the ability to exclude certain types of compensation from income or take tax deductions for certain expenses. Some consequences favor employee status, while others favor independent contractor status. For example, an employee may exclude from gross income employer-provided benefits such as pension, health, and group-term life insurance benefits. On the other hand, an independent contractor can establish his or her own pension plan and deduct contributions to the plan. An independent contractor also has greater ability to deduct work-related expenses.

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. Under a special safe harbor rule (sec. 530 of the Revenue Act of 1978), a service recipient may treat a worker as an independent contractor for employment tax purposes even though the worker is in fact an employee if the service recipient has a reasonable basis for treating the worker as an independent contractor and certain other requirements are met. In some cases, the treatment of a worker as an employee or independent contractor is specified by statute.

Significant tax consequences also result if a worker was misclassified and is subsequently reclassified, e.g., as a result of an audit. For the service recipient, such consequences may include liability for withholding taxes for a number of years, interest and penalties, and potential disqualification of employee benefit plans. For the worker, such consequences may include liability for self-employment taxes and denial of certain business-related deductions.

Common-law test

In general, the determination of whether an employer-employee relationship exists for Federal tax purposes is made under a common-law test that has been incorporated into specific provisions of the Internal Revenue Code (the "Code") or that is required to be used pursuant to Treasury regulations or case law. For example, section 3121(d)(2)[2] (which defines terms for purposes of the Social Security taxes that apply to wages paid to an employee) generally defines the term "employee" to include any individual who, under the usual common law rules applicable in determining the employer-employee relationship, has the status of an employee. By contrast, section 3401 (which defines terms for purposes of an employer's Federal income tax withholding obligation with respect to wages paid to an employee) does not define the term "employee." However, regulations issued under section 3401 incorporate the common-law test.

[2] Except as otherwise indicated, all references to sections are to sections of the Code.

The regulations provide that an employer-employee relationship generally exists if the person contracting for services has the right to control not only the result of the services, but also the means by which that result is accomplished. In other words, an employer-employee relationship generally exists if the person providing the services "is subject to the will and control of the employer not only as to what shall be done but how it shall be done."[3] Under the regulations, it is not necessary that the employer actually control the manner in which the services are performed, rather it is sufficient that the employer have a right to control.[4] Whether the requisite control exists is determined based on all the relevant facts and circumstances.

Over the years courts have identified on a case-by-case basis various facts or factors that are relevant in determining whether an employer-employee relationship exists. In 1987, based on an examination of cases and rulings, the Internal Revenue Service ("IRS") developed a list of 20 factors that may be examined in determining whether an employer-employee relationship exists.[5] The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed; factors other than the listed 20 factors may also be relevant.

The 20 factors identified by the IRS are as follows:

1. **Instructions:** If the person for whom the services are performed has the right to require compliance with instructions, this indicates employee status.

2. **Training:** Worker training (e.g., by requiring attendance at training sessions) indicates that the person for whom services are performed wants the services performed in a particular manner (which indicates employee status).

3. **Integration:** Integration of the worker's services into the business operations of the person for whom services are performed is an indication of employee status.

4. **Services rendered personally:** If the services are required to be performed personally, this is an indication that the person for whom services are performed is interested in the methods used to accomplish the work (which indicates employee status).

5. **Hiring, supervision, and paying assistants:** If the person for whom services are performed hires, supervises or pays assistants, this generally indicates employee

[3] Treas. Reg. sec. 31.3401(c)-(1)(b).

[4] *Id.* See also, *Gierek v. Commissioner*, 66 T.C.M. 1866 (1993) (involving the classification of a stockbroker and stating that the key inquiry is whether the brokerage firm had a right to control the worker regardless of the extent to which such control was actually exercised). See also, IRS Publication 1779 (Rev. 1-2005).

[5] Rev. Rul. 87-41, 1987-1 C.B. 296 (providing guidance with respect to section 530 of the Revenue Act of 1978).

status. However, if the worker hires and supervises others under a contract pursuant to which the worker agrees to provide material and labor and is only responsible for the result, this indicates independent contractor status.

6. **Continuing relationship:** A continuing relationship between the worker and the person for whom the services are performed indicates employee status.

7. **Set hours of work:** The establishment of set hours for the worker indicates employee status.

8. **Full time required:** If the worker must devote substantially full time to the business of the person for whom services are performed, this indicates employee status. An independent contractor is free to work when and for whom he or she chooses.

9. **Doing work on employer's premises:** If the work is performed on the premises of the person for whom the services are performed, this indicates employee status, especially if the work could be done elsewhere.

10. **Order or sequence test:** If a worker must perform services in the order or sequence set by the person for whom services are performed, that shows the worker is not free to follow his or her own pattern of work, and indicates employee status.

11. **Oral or written reports:** A requirement that the worker submit regular reports indicates employee status.

12. **Payment by the hour, week, or month:** Payment by the hour, week, or month generally points to employment status; payment by the job or a commission indicates independent contractor status.

13. **Payment of business and/or traveling expenses.** If the person for whom the services are performed pays expenses, this indicates employee status. An employer, to control expenses, generally retains the right to direct the worker.

14. **Furnishing tools and materials:** The provision of significant tools and materials to the worker indicates employee status.

15. **Significant investment:** Investment in facilities used by the worker indicates independent contractor status.

16. **Realization of profit or loss:** A worker who can realize a profit or suffer a loss as a result of the services (in addition to profit or loss ordinarily realized by employees) is generally an independent contractor.

17. **Working for more than one firm at a time:** If a worker performs more than de minimis services for multiple firms at the same time, that generally indicates independent contractor status.

18. **Making service available to the general public:** If a worker makes his or her services available to the public on a regular and consistent basis, that indicates independent contractor status.

19. **Right to discharge:** The right to discharge a worker is a factor indicating that the worker is an employee.

20. **Right to terminate:** If a worker has the right to terminate the relationship with the person for whom services are performed at any time he or she wishes without incurring liability, that indicates employee status.

More recently, the IRS has identified three categories of evidence that may be relevant in determining whether the requisite control exists under the common-law test and has grouped illustrative factors under these three categories: (1) behavioral control; (2) financial control; and (3) relationship of the parties.[6] The IRS emphasizes that factors in addition to the 20 factors identified in 1987 may be relevant, that the weight of the factors may vary based on the circumstances, that relevant factors may change over time, and that all facts must be examined.[7]

Generally, individuals who follow an independent trade, business, or profession in which they offer services to the public are not employees. Courts have recognized that a highly educated or skilled worker does not require close supervision; therefore, the degree of day-to-day control over the worker's performance of services is not particularly helpful in determining the worker's status. Courts have considered other factors in these cases, tending to focus on the individual's ability to realize a profit or suffer a loss as evidenced by business investments and expenses.

Section 530 of the Revenue Act of 1978

Section 530 of the Revenue Act of 1978 ("section 530") generally allows a taxpayer to treat a worker as not being an employee for employment tax purposes (but not income tax purposes), regardless of the worker's actual status under the common-law test, unless the taxpayer has no reasonable basis for such treatment or fails to meet certain requirements. The relief provided to an employer under section 530 was initially scheduled to terminate at the end of 1979 to give Congress time to resolve the many complex issues regarding worker classification. It was extended through the end of 1980 by P.L. 96-167 and through June 30, 1982, by P.L. 96-541. The provision was extended permanently by the Tax Equity and Fiscal Responsibility Act of 1982. A number of changes to section 530 were made by the Tax Reform Act of 1986, the Small Business Job Protection Act of 1996, and the Pension Protection Act of 2006.

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[6] Department of the Treasury, Internal Revenue Service, *Independent Contractor or Employee? Training Materials*, Training 3320-102 (10-96) TPDS 84238I, at 2-7. This document is publicly available through the IRS website.

[7] *Id*. at 2-3 through 2-7.

Under section 530, a reasonable basis for treating a worker as an independent contractor is considered to exist if the taxpayer reasonably relied on (1) past IRS audit practice with respect to the taxpayer, (2) published rulings or judicial precedent, (3) long-standing recognized practice in the industry of which the taxpayer is a member, or (4) if the taxpayer has any "other reasonable basis" for treating a worker as an independent contractor. The legislative history states that section 530 is to be "construed liberally in favor of taxpayers."

The relief under section 530 is available with respect to a worker only if certain additional requirements are satisfied. The taxpayer must not have treated the worker as an employee for any period, and for periods after 1978 all Federal tax returns, including information returns, must have been filed on a basis consistent with treating such worker as an independent contractor. Further, the taxpayer (or a predecessor) must not have treated any worker holding a substantially similar position as an employee for purposes of employment taxes for any period beginning after 1977 (the "similar worker consistency requirement").

Under section 1706 of the Tax Reform Act of 1986, section 530 does not apply in the case of a worker who, pursuant to an arrangement between the taxpayer and another person, provides services for such other person as an engineer, designer, drafter, computer programmer, systems analyst, or other similarly skilled worker engaged in a similar line of work. Thus, the determination of whether such workers are employees or independent contractors is made in accordance with the common-law test.

Under section 864 of the Pension Protection Act of 2006, the similar worker consistency requirement does not apply with respect to services performed after December 31, 2006, by an individual who provides services as a test proctor or room supervisor by assisting in the administration of college entrance or placement examinations. This exception only applies if the service recipient is an organization that is described in section 501(c) and the service provider is not otherwise treated as an employee of the organization for employment tax purposes.

Section 530 also prohibits the Department of Treasury and the IRS from publishing regulations and revenue rulings with respect to the employment status of any individual for purposes of the employment taxes.[8] However, a taxpayer may generally obtain a written determination from the IRS regarding the status of a particular worker as an employee or independent contractor for purposes of Federal employment taxes and income tax withholding.[9]

Statutory employees or independent contractors

The Code contains various provisions that prescribe treatment of a specific category or type of worker as an employee or an independent contractor. Some of these provisions apply for

[8] Rev. Rul. 87-41 (described above) provides guidance with respect to section 530 of the Revenue Act of 1978.

[9] IRS Form SS-8 (Rev. 11-2006). A written determination with regard to prior employment status may be issued by the IRS. The IRS will not issue a written determination with respect to prospective employment status. Rev. Proc. 2007-3, 2007-1 I.R.B. 108.

Federal tax purposes generally; for example, certain real estate agents and direct sellers are treated for all tax purposes as not being employees.[10] Others apply only for specific purposes; for example, full-time life insurance salesmen are treated as employees for social security tax and employee benefit purposes,[11] and certain salesmen are treated as employees for social security tax purposes.[12]

[10] Sec. 3508.

[11] Sec. 3121(d)(3)(B) and 7701(a)(20).

[12] Sec. 3121(d)(3)(D).

B. Reasons for Misclassification of Workers

Need to make factual determinations

A major source of the confusion regarding classification of a worker as an employee or an independent contractor is that present law requires an examination of a variety of factors that often do not result in a clear answer. Although the proper classification of a worker often will be clear, in close cases the law creates a significant gray area that leads to complexity, with the potential for inadvertent errors and abuse.

Under the common-law test, some of the relevant factors may support employee status, while some may indicate independent contractor status, and there are no rules for the weight that any particular factor is given. In addition, some of the relevant factors involve an examination of objective facts, while others involve an examination of subjective facts or an examination of a combination of objective and subjective facts. Because the determination of proper classification is factual, reasonable people may differ as to the correct result given a certain set of facts. Thus, for example, even though a taxpayer in good faith determines that a worker is an independent contractor, an IRS agent may reach a different conclusion by weighing some of the relevant factors differently than the taxpayer. Similarly, a worker and a service recipient may reach different conclusions as to the proper classification of the worker.

Misclassification of workers also may be deliberate. In some cases, workers and service recipients may prefer to classify workers as independent contractors, both for tax and nontax reasons. For example, the worker may wish to take advantage of the ability to contribute on a deductible basis to a pension plan or to deduct significant work-related expenses. A service recipient may wish to avoid administrative problems associated with withholding income and employment taxes. The service recipient also may wish to avoid coverage and nondiscrimination requirements applicable to qualified retirement plans by classifying lower-paid workers as independent contractors. The IRS may have an interest in classifying workers as employees, in order to obtain the compliance benefits of mandatory withholding.

Workers sometimes argue that they prefer independent contractor status because it gives them more control over their own lives. To the extent such reasons exist in particular cases, service recipients may feel compelled to classify workers as independent contractors rather than employees. In many instances, it may be very difficult to distinguish whether a misclassification was deliberate or inadvertent.

Lack of published guidance

As discussed above, since the enactment of the Revenue Act of 1978, the Department of Treasury and the IRS have been prohibited from publishing regulations and revenue rulings with respect to the employment status of any individual for purposes of employment taxes. The resulting lack of current guidance contributes to the lack of clarity in the law and increases the likelihood of inadvertent misclassification of workers. Previously issued guidance may not reflect current case law, statutory changes, or changes in workplace situations. Without appropriate guidance, not only are differences between taxpayers and the IRS more likely, but

different IRS agents may reach different conclusions on the law as well as the relevant facts, resulting in increased inconsistent enforcement.

The IRS has made publicly available its training guide for agents on worker classification issues. Department of the Treasury, Internal Revenue Service, *Independent Contractor or Employee? Training Materials*, Training 3320-102 (10-96) TPDS 84238I. The guide may aid consistent enforcement by different agents and provide a guide to taxpayers regarding the state of the law; however, the guidelines leave substantial discretion to individual agents and do not resolve all issues. Further, the guidelines do not carry the same force of law as revenue rulings or regulations.

Section 530 of the Revenue Act of 1978

Although section 530 was intended to reduce disputes between the IRS and taxpayers regarding classification issues, it also has been a source of disputes. Like the common-law test, some aspects of section 530 depend on the facts and circumstances and reasonable people may differ as to the correct result given a certain set of facts, i.e., whether section 530 properly is available to the taxpayer.

Another source of confusion regarding worker classification stemming from section 530 is that it applies only to the service recipient and only for employment tax purposes. As a result of these limitations, if a worker is treated by the service recipient as an independent contractor under section 530, the worker may mistakenly believe he or she is in fact an independent contractor for Federal income tax purposes. However, because section 530 does not apply for Federal income tax purposes, the worker is still required to determine whether he or she is an independent contractor or employee under the common-law test without regard to section 530.

Section 530 also causes confusion because it is not available to all taxpayers. In particular, section 530 does not apply with respect to certain services provided by technical services personnel and test proctors. Section 530 also causes confusion because it is not codified in the Code. Thus, it may be difficult for taxpayers and tax practitioners to locate the provision and subsequent changes made to it by other laws.

II. EFFECT OF MISCLASSIFICATION ON FEDERAL REVENUES

Under present law, there is revenue loss associated with lower compliance rates of independent contractors and service recipients compared to the compliance rates of employees and their employers. This revenue loss, however, is not necessarily the result of misclassification of a worker's status, but is largely due to differences in the rules, such as reporting and withholding requirements, that apply as a result of worker classification, regardless of whether that classification was legally correct.

Tax data indicate that service recipients often fail to file requisite Forms 1099 for payments made to independent contractors, and that independent contractors often fail to report the unreported payments as income. In addition, employers must file information reports on all wages paid to employees; the requirement with respect to service recipients is not as comprehensive. Even when Forms 1099 are issued, compliance is somewhat less than when workers are classified as employees and withholding is required.

The IRS has prepared several surveys from audits of employment tax returns. Two of the most widely utilized in the analysis of employment tax issues are the 1984 Strategic Initiative to Establish a Research Project on Withholding Noncompliance[13] (the "1984 Strategic Initiative") and the Employment Tax Examination Program.

The 1984 Strategic Initiative examined 3,331 employers for tax year 1984 and found that nearly 15 percent of employers misclassified employees as independent contractors. According to the IRS, the section 530 safe harbor protected nine percent of misclassified employees from being reclassified as employees.[14] Of those returns using the section 530 safe harbor protections, nearly half relied on the prior audit provision. The 1984 Strategic Initiative survey also found that when employers classified workers as employees, more than 99 percent of wage and salary income was reported. However, when workers were classified as independent contractors, 77 percent of gross income was reported when a Form 1099 was filed, and only 29 percent of gross income was reported when no Form 1099 was filed.

The IRS performed 11,380 audits in the Employment Tax Examination Program from fiscal years 1988 through 1994. Employers were audited to determine employment status of personnel who often were not classified as employees for employment tax purposes. The Government Accountability Office has conducted a study of audits from the program and has reported that these audits resulted in proposed tax assessments of $751 million and reclassification of 483,000 workers as employees.[15]

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[13] This survey is often referred to as SVC-1.

[14] Several changes have been made to the section 530 safe harbor since this survey that could affect the number of workers subject to the safe harbor.

[15] General Accounting Office (now the Government Accountability Office), *Tax Administration: Issues Involving Worker Classification*, GGD-95-224 (Aug. 2, 1995).

In addition to these data sources, the Taxpayer Compliance Measurement Program provides information on the overall level of tax compliance of sole proprietorships. This program consists of approximately 54,000 individual income tax returns that are extensively audited. The most recent year of the Taxpayer Compliance Measurement Program is for tax year 1988. The 1988 data indicated that gross income reporting for Schedule C filers improved when a Form 1099 was issued. This data also indicated that overall compliance for gross income reporting averaged 94 percent, while net income reporting averaged only 75 percent for Schedule C (Profit or Loss from Sole Proprietorship) filers. (The voluntary compliance percentage varies by employment sector and with income.) The successor to the Taxpayer Compliance Measurement Program is the National Research Program, which for tax year 2001, indicated that net income reporting averaged only 73 percent for Schedule C filers.

III. ALTERNATIVE METHODS OF CLASSIFYING WORKERS

A. General Issues

Introduction

A variety of different proposals have been suggested to modify the rules relating to the determination of worker status. A concern with proposals that seek to add safe harbors or other modifications to the existing rules is that such approaches increase the complexity of an already complex determination. A concern with approaches that seek to replace the existing rules is that such approaches are likely to have their own uncertainties and thus may not result in a practical reduction in the misclassification of workers. In addition, the likely effects of the proposals raise significant policy issues.

General policy implications

Any modification to the worker classification rules is likely to produce different results in some cases than would present law. That is, some workers that are properly classified as employees under present law may be classified as independent contractors under modified rules (or vice versa). Depending on the specifics of any given proposal, a change to the law could result in the reclassification of significant numbers of workers, which could have a variety of consequences. For example, a change to the Federal tax rules applicable to the worker and the service recipient would require a substantial adjustment to behavior from a tax and a personal viewpoint. The eligibility of the worker for employee benefits, such as health care and pension benefits would change. Compliance and Federal tax revenues also could be affected by the reclassifications of large numbers of workers. Further, even if a proposal were intended to be limited to the Federal tax laws, any new Federal tax rules regarding worker status may spill over into State tax rules, as well as Federal and State nontax rules relating to workers (e.g., various worker protection laws). Finally, how a worker views himself or herself may be affected by reclassification.

If a proposal results in more workers being classified as independent contractors, the proposal may significantly increase such workers' compliance responsibilities. One reason for this is that employees are subject to wage withholding, whereas independent contractors are required to make quarterly estimated tax payments. In addition, workers previously classified as employees would now be required to calculate and pay self-employment taxes, rather than have FICA taxes withheld and remitted by their employer. Further, employees are generally eligible for employee benefit and pension plans, whereas independent contractors are not. Thus, for example, if an employee who was participating in an employer-sponsored retirement plan is reclassified as an independent contractor, the individual would no longer be eligible to participate in the employer plan but would be eligible to establish his or her own qualified retirement plan. Although such plans may in some cases provide greater benefits than an employer's plan, they also involve greater complexity. To the extent that workers do not realize benefits from being reclassified as independent contractors, they may view themselves as worse off by having to deal with more complicated tax rules.

Effects on compliance

As discussed above, there is revenue loss associated with lower compliance rates of independent contractors and service recipients compared to employees and their employers. Thus, compliance and tax revenues could be affected by proposals that reclassify large numbers of workers.

Effects on pension and benefit coverage

As previously mentioned, employees are eligible to participate in certain employer-sponsored benefit plans. While independent contractors generally cannot participate in the benefit plans of the service recipient, they can set up their own plan. In some cases, an independent contractor may be able to establish a plan that provides greater benefits than does a typical employer plan.

For example, an independent contractor would be able to set up his or her own profit-sharing plan and make contributions to the plan of up to $45,000 (for 2007) per year. As an employee, a worker is subject to the limits on contributions and benefits contained in the employer plan, which for most workers are lower than the maximum permitted contributions. Thus, an independent contractor may receive greater pension benefits under his or her own plan than under an employer plan. On the other hand, some employees who are reclassified as independent contractors may not take advantage of the opportunities available to them, thereby possibly causing a reduction in future retirement savings. In short, the effect of reclassification of a worker from an employee to an independent contractor (or vice versa) on retirement plan or other benefit coverage is unclear.

B. Issues Under Specific Proposals

"Check-the-box" approach

One method for determining worker status that has been suggested is to let the parties decide by contract whether the worker is to be treated for all Federal tax purposes as an employee or independent contractor.[16] This approach would generally eliminate misclassification errors. However, the approach places a significant burden on workers because they would need to understand the consequences of deciding which status to choose.

This approach essentially shifts the basis for determining worker status from a fact-based determination to a determination grounded in which party has the greater bargaining power. As a result, this approach has the potential for producing significantly different results than the present-law rules, or other proposals that attempt to narrow the factors that are relevant to determining worker status.

Specifying relevant factors

A number of proposals attempt to eliminate the uncertainty surrounding the determination of worker status by limiting the number of relevant factors, either by way of an additional safe harbor or by replacing the present-law rules. Because workplace situations vary substantially, it may be difficult to develop a limited set of specific factors that are relevant in all situations.[17] On the other hand, the factors need to be drawn so that they have some effect; otherwise the proposal may in practice be a "check-the-box" approach. For example, some proposals provide that, subject to the agreement of the parties, a worker may be treated as an independent contractor if the worker has a substantial investment in training or education. Such a proposal could be interpreted to mean that any worker with a college degree could be treated as an independent contractor if the contract between the worker and the service recipient so provides.

Another potential issue with respect to proposals that specify relevant factors is that the factors themselves may give rise to factual questions of interpretation that could lead to disputes between taxpayers and the IRS, and ultimately, to litigation. For example, some proposals provide that a worker may be treated as (or is) an independent contractor if the worker has a "substantial" investment in work facilities or "substantial" unreimbursed business expenses.

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[16] Under this approach, rules would need to be developed as to the specific manner in which the decision is made, e.g., pursuant to a written contract meeting certain requirements. Rules would also be necessary to address situations in which the parties have not specified worker status by contract. For example, in the absence of a contract, a worker could be deemed to be an employee. Alternatively, in the absence of a contract, the common-law rules could be used to determine worker status. The latter alternative would involve the uncertainties of present law.

[17] It is precisely this difficulty that has led to the present-law multifactor facts and circumstances approach.

This raises the question of what "substantial" means. For example, it could be based on a flat dollar amount, or some percentage of the worker's gross receipts. What is considered "small" might be different for different occupations. Similarly, some proposals have provided that workers with "special skills" may be treated as independent contractors. To provide clarity, the proposal would need to define what is meant by "special skills." In other words, some proposals introduce new factual questions that may be as complex and as uncertain as present law.

Providing similar treatment of workers for all Federal tax purposes

As discussed above, a major reason that worker classification is significant is that the Federal tax treatment of employees and independent contractors varies. Some commentators have suggested that worker classification should be made irrelevant (or at least minimized) by providing similar treatment for all workers.

Such an approach would involve significant changes to a variety of Federal tax laws and would raise policy issues. Major areas of the law that would require modification to achieve conformity of treatment, and some of the policy issues involved, are summarized below.

1. Withholding and estimated tax rules.–In general, employees are subject to withholding, whereas independent contractors are required to make quarterly estimated tax payments. To provide consistent treatment, withholding would have to be extended to all taxpayers or all taxpayers would have to be required to make estimated tax payments. As mentioned above, imposing estimated taxes on all workers would add substantial complexity compared to present law, and could also have an adverse effect on compliance. A variety of issues would also need to be addressed if withholding were imposed on independent contractors. For example, the appropriate level of withholding can be difficult if the independent contractor works for multiple service providers.

2. Eligibility for employee benefit plans.–Conformity of treatment with respect to pension and benefit plans could be achieved by providing that independent contractors must be treated as employees for purposes of employee plan coverage. Alternatively, employees could be given the same opportunity for tax-favored benefits as independent contractors (e.g., employees could be allowed to establish their own retirement plan as if they were an independent contractor). Either approach would involve significant changes to present law and significant policy issues.

3. Deductibility of business expenses.–Independent contractors have greater ability to deduct business expenses than employees, who generally can deduct such expenses only as an itemized deduction and only to the extent all miscellaneous itemized deductions (including employee business expenses) exceed two percent of adjusted gross income. This disparate treatment would need to be addressed.