SOS to SS-8: Time to "Stand Down"; Independent Contractor Safe Harbor: Time to "Stand Up"

Independent contractor issues are all in the news recently. The Treasury Inspector General for Tax Administration (TIGTA) has just issued a report (TIGTA 2004-30-055) reviewing the SS-8 program without critically evaluating its applicability or determining its relevance and validity vis-à-vis the Small Business Job Protection Act of 1996 (SBJPA of 1996), the Tax Reform and Restructuring Act of 1997, the seminal McClellan case, the worker classification training materials, or the classification settlement program, all of which mandate that any worker classification issue begin with section 530. In fact, by statute, section 530 is required to be considered without any determination of worker status. In light of the statutory requirement that section 530 precede any worker determination inquiry it is difficult to understand why the SS-8 program is even required anymore. Even if it is determined that the SS-8 program should continue, it should adhere to the same statutory scheme, that is, before a business is forced to respond – section 530 should be considered. This protection for the business is required because workers generate virtually all SS-8s, not businesses as TIGTA suggests.

Prior to the SBJPA of 1996, the IRS used worker status as a cudgel to browbeat businesses into changing their independent contractors to employees. They did this by:

(a) Not offering section 530 relief first, but instead saying worker status must be determined before anything else, and by
(b) Using SS-8s that were usually submitted by disgruntled employees and determining, often without business response, that the worker is an employee. According to statistics approximately 95% of all SS-8 determinations conclude the worker is an employee.

Against this prejudice, businesses were forced into protracted and expensive litigation just to win section 530 protection. Thus the SBJPA of 1996 and the McClellan case serves two purposes. First, it instructs the IRS to determine section 530 protection before a worker status determination, and second and most important a business need only make a "prima facie" case to shift the burden of proof to the IRS that the worker is not an independent contractor.

Taxpayer advocate, Nina Olsen recently announced that her number 2 issue, behind alternative minimum tax, is independent contractor reporting. Her proposal is to mandate withholding for 1099s. Approximately ten years ago, this proposal was vetted to

numerous organizations, including the IRS, when I chaired the Small Business Taxation Committee for the American Institute of Certified Public Accountants (AICPA). Our proposal however was designed as a safe harbor to quell the incessant disagreements that occurred between the IRS and small business. The safe harbor consisted of 3 parts:

1. A simple written agreement where the parties acknowledged non-employee status
2. All 1099s are filed
3. De minimis withholding

The safe harbor would not prevent businesses from availing themselves of the other protections in the law (i.e. Section 530), but would be an ironclad defense that avoids expensive controversy over this issue.

So, SOS to the Taxpayer Advocate – time for the independent contractor safe harbor to "stand up"! Call me.

Michael J. Knight, CPA – mjk@mjkcpas.com
www.mjkcpas.com
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