TREASURY INSPECTOR GENERAL FOR TAX ADMINISTRATION

Office of Inspections and Evaluations

Additional Actions Are Needed to Make the Worker Misclassification Initiative With the Department of Labor a Success

February 20, 2018

Reference Number: 2018-IE-R002

Highlights

Highlights of Report Number: 2018-IE-R002 to the Internal Revenue Service Commissioner for the Small Business/Self-Employed Division.

WHY TIGTA DID THIS STUDY

This project was initiated to evaluate the IRS's progress in implementing a Joint Worker Misclassification Initiative with the Department of Labor (DOL) to reduce the incidence of employees misclassified as independent contractors.

The objective of this evaluation was to determine whether duties and responsibilities outlined in the Memorandum of Understanding (MOU) between the IRS and the DOL were adhered to and whether MOU objectives are being met.

IMPACT ON TAXPAYERS

The IRS and the DOL share concerns about the estimated millions of workers misclassified as independent contractors instead of employees. From a tax perspective, employers are avoiding the payment of payroll taxes, which are used to fund important programs such as Medicare and Social Security. In September 2011, the IRS signed an MOU with the DOL in order to share information and other materials as part of a joint initiative to reduce employee misclassification.

WHAT TIGTA FOUND

Overall, the IRS has not effectively implemented the worker misclassification MOU. The IRS cited staff turnover, resource limitations, and other competing priorities as reasons why the MOU had not been prioritized. As a result, the IRS and DOL have not developed the type of robust information exchange envisioned by the MOU.

IRS MOU Responsibilities and Implementation Status
Implemented
Evaluate and classify DOL referrals and conduct examinations to determine compliance with employment tax laws.
Share DOL referrals with the State and municipal agencies that are authorized to receive tax return information under approved agreements with the IRS.
Participate in joint outreach events with the DOL to the extent possible.
Not Implemented
Provide the DOL with information (other than taxpayer return information) that may constitute a violation of any Federal criminal law that the DOL enforces.
Provide the DOL annually with aggregate data relating to trends in misclassification.
Review the MOU annually to evaluate whether provisions require amendment or revision.
Partially Implemented
Meet on a regular basis as the DOL-IRS team to discuss issues of concern.
Provide annual reports to the DOL summarizing the results achieved by using DOL referrals.
Share employment tax training materials and opportunities with the DOL to the extent possible.

Moreover, DOL referrals were less productive than worker classification examinations that originated from other sources. In Fiscal Years 2015 and 2016, DOL referrals resulted in approximately $800,000 in adjustments. However, DOL referrals produced approximately $4,000 in adjustments per return—substantially less than other worker classification returns, which resulted in approximately $12,000 in adjustments per return. One possible cause of the large difference in results is that DOL referrals often did not provide key pieces of information needed by the IRS, such as the number of potentially misclassified workers or the materiality of the wages potentially misclassified. Finally, IRS officials acknowledge difficulties in developing metrics to assess the MOU's effectiveness due to a lack of available data and the small scope of MOU activities.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the Commissioner, Small Business/Self-Employed Division, consider whether provisions of the MOU require amendment, revision, or termination, and ensure that the duties and responsibilities of the IRS, as outlined in the MOU, are executed as required. In addition, the IRS should work with the DOL to design a standardized referral form. Finally, the IRS should develop performance measures in order to monitor the effectiveness of the MOU. The IRS agreed with our recommendations.

February 20, 2018

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION

FROM:　　　　　　　Gregory D. Kutz
　　　　　　　　　　　Acting Deputy Inspector General for Inspections and Evaluations

SUBJECT:　　　　　Final Evaluation Report – Additional Actions Are Needed to Make the
　　　　　　　　　　　Worker Misclassification Initiative With the Department of Labor a
　　　　　　　　　　　Success (# IE-17-001)

The report presents the results of our evaluation to determine whether duties and responsibilities outlined in the Memorandum of Understanding between the Internal Revenue Service and the Department of Labor were adhered to and whether the Memorandum of Understanding objectives are being met. This evaluation was included in our Treasury Inspector General for Tax Administration Fiscal Year 2017 Program Plan. This review addresses the major management challenge of Tax Compliance Initiatives.

Management's complete response to the draft report is included as Appendix IV.

If you have any questions about this report, you may contact me or Phil Shropshire, Director, Office of Inspections and Evaluations.

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Abbreviations

DOL	Department of Labor
EIN	Employer Identification Number
FY	Fiscal Year
GAO	Government Accountability Office
IRS	Internal Revenue Service
MOU	Memorandum of Understanding
TIGTA	Treasury Inspector General for Tax Administration

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Background

The misclassification of employees as independent contractors is a nationwide problem which affects millions of workers and contributes to the Tax Gap. Congress, the Internal Revenue Service (IRS), the Government Accountability Office (GAO), and the Treasury Inspector General for Tax Administration (TIGTA) all have repeatedly raised concerns regarding the misclassification of employees as independent contractors.

The determination of whether a worker is an employee or an independent contractor has significant tax implications for the worker, the employer, and the IRS. When a worker is determined to be an employee, the employer is responsible for paying Federal unemployment tax and the employer's portion of Social Security and Medicare taxes. The employer is also responsible for withholding from the employee's salary or wages the employee's portion of Social Security, Medicare, and Federal income taxes and paying it directly over to the IRS. An employer may also be responsible for State unemployment taxes, State worker's compensation and disability insurance, and the withholding of the employee's State and local income tax that are payable to the appropriate State or local taxing authority. When a worker is determined to be an independent contractor, the independent contractor is responsible for making quarterly estimated payments of Federal income tax and self-employment tax to the IRS.

An employee misclassified as an independent contractor also loses critical workplace protections, like minimum wage and overtime protections, and the ability to receive unemployment payments. The tests used to determine whether a worker is an independent contractor or an employee are complex. In general, a person is considered an employee if he or she works in the service of another person (the employer) under an express or implied contract of hire, under which the employer has the right to control the details of work performance. A person is considered an independent contractor if he or she is entrusted to undertake a specific project but is left free to do the assigned work and to choose the method for accomplishing it.

Worker misclassification can affect Federal, State, and municipal governments due to lost revenue, while placing honest employers and businesses at a competitive disadvantage. No single agency is directly responsible for ensuring proper worker classification. Although employee misclassification itself is not a violation of law, it is often associated with labor and tax law violations. The IRS enforces worker classification compliance primarily through examinations of employers. In September 2011, the IRS Commissioner signed a Memorandum of Understanding (MOU)[1] with the Department of Labor (DOL) in order to share information and other materials in an effort to reduce worker misclassification.

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[1] See Appendix III for a copy of the MOU.

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> *This agreement takes the partnership between the IRS and Department of Labor to a new
> level. In this new phase of our relationship, we will work together more efficiently to
> address worker misclassification issues, and better serve the needs of small businesses
> and employees.*
>
> *- IRS Commissioner Douglas Shulman[2]*

The MOU outlines a number of broad objectives and spells out specific responsibilities for the
IRS, the DOL, and a joint IRS-DOL team. The MOU was developed in response to a GAO
report which recommended that the IRS and the DOL improve interagency coordination in
addressing worker misclassification.[3]

There is no current estimate on the nationwide extent of employee misclassification or the impact
misclassification has on the Tax Gap. Employee misclassification is difficult to estimate because
employers do not voluntarily report misclassification. The IRS last conducted a comprehensive
misclassification estimate in 1984. The IRS's National Research Program is currently
completing another comprehensive employment tax compliance study. The final results are
expected to be complete in late Calendar Year 2017. The GAO reviewed the preliminary
National Research Program data and found that worker classification issues were the third most
frequently examined issues, representing 20 percent of all issues that were examined.[4] In
addition, the GAO found that taxable wages for worker classification was the issue that most
frequently required an adjustment on payroll tax returns and estimated that wage adjustments
totaled more than $44 billion a year.

Employers who misclassify their employees as independent contractors are depriving Social
Security, Medicare, unemployment insurance, and worker's compensation funds of billions of
dollars and reducing Federal, State, and local tax revenues. By way of the MOU, the IRS and the
DOL pledged to work together to curb worker misclassification through enhanced information
sharing and collaboration.

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[2] DOL Release Number: 11-1373-NAT, *Labor Secretary, IRS Commissioner Sign Memorandum of Understanding
to Improve Agencies' Coordination on Employee Misclassification Compliance and Education*, September 19, 2011.
[3] GAO, GAO-09-717, *EMPLOYEE MISCLASSIFICATION: Improved Coordination, Outreach, and Targeting
Could Better Ensure Detection and Prevention* (August 2009).
[4] GAO, GAO-17-371, *EMPLOYMENT TAXES: Timely Use of National Research Program Results Would Help IRS
Improve Compliance and Tax Gap Estimates* (April 2017).

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Results of Review

The IRS has not prioritized implementation of the worker misclassification MOU with the DOL. As a result, many of the duties and responsibilities assigned to the IRS through the MOU have not been fully implemented. Moreover, DOL referrals that resulted in examinations were less productive than worker classification examinations that originated from other sources. TIGTA believes this may be the result of DOL referrals which do not contain sufficient information. Finally, IRS officials acknowledge difficulties in developing metrics to assess the MOU's effectiveness due to a lack of available data and the small scope of MOU activities.

The Internal Revenue Service Has Not Prioritized Implementation of the Department of Labor Memorandum of Understanding

While the IRS has taken some steps to carry out the MOU, overall, it has not prioritized implementation of the MOU and as a result, many of the MOU duties and responsibilities have not been fully addressed. The MOU outlines activities that the IRS is responsible for including sharing information with the DOL through regular meetings and providing an annual report summarizing the results achieved by using DOL referrals. However, the IRS has not fully implemented many of the duties and responsibilities outlined in the MOU.

More specifically, there were nine IRS responsibilities outlined in the MOU. Three responsibilities were fully implemented, three responsibilities were partially implemented, and three responsibilities were not implemented at all. Because implementing the MOU-related responsibilities was not a priority, there was limited progress towards meaningful data exchanges between the two agencies.

The IRS cited staff turnover, resource limitations, and other competing priorities as reasons why the MOU was not prioritized. According to the IRS, a Small Business/Self-Employed Division Examination function initiative is underway to evaluate the Examination function-related MOUs currently in effect, including the worker classification MOU with the DOL.

Figure 1 provides the implementation status of each of the IRS's responsibilities under the MOU.

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Figure 1: Status of IRS Responsibilities Outlined in the MOU With the DOL

Responsibilities	Status	Actions Taken
Evaluate and classify DOL referrals and conduct examinations to determine compliance with employment tax laws.	Implemented.	The IRS evaluated and classified more than 1,300 DOL referrals. Approximately 39 percent were selected for examination.
Share DOL referrals with the State and municipal agencies that are authorized to receive tax return information under approved agreements with the IRS.	Implemented.	The IRS referred a limited number of DOL-referred cases with State agencies through the Questionable Employment Tax Practices MOU.[5]
Participate in joint outreach events with the DOL to the extent possible.	Implemented.	Two joint outreach events between the IRS and the DOL have occurred since September 2011.
Provide the DOL with information (other than taxpayer return information) which may constitute a violation of any Federal criminal law that the DOL enforces.	Not Implemented.	The IRS did not refer any cases to the DOL.
Provide the DOL annually with aggregate data relating to trends in misclassification.	Not Implemented.	The IRS has not provided the DOL with aggregate data.
Review the MOU annually to evaluate whether provisions of this agreement require amendment or revision.	Not Implemented.	Between Fiscal Years (FY) 2012 and 2016, the IRS had not reviewed the MOU. No modifications to the MOU have been made since it was signed in September 2011.
Meet on a regular basis as the IRS-DOL team to discuss issues of concern.	Partially Implemented.	The IRS-DOL team held three discussions since September 2011.
Provide annual reports to the DOL summarizing the results achieved by using DOL referrals.	Partially Implemented.	The IRS provided one report of a limited nature related to FYs 2013 and 2014 DOL referral results.
Share employment tax training materials and opportunities with the DOL to the extent possible.	Partially Implemented.	The IRS shared limited training materials and one training opportunity.

Source: TIGTA analysis of the MOU between the IRS and the DOL dated September 19, 2011, and supporting documentation provided by the IRS.

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[5] The Questionable Employment Tax Practices MOU and State implementing agreements permit the IRS to share closed audit results with State tax agencies.

One of the key components of the MOU is information sharing between the DOL and the IRS. Under the MOU, the DOL will refer cases to the IRS that it believes raise worker misclassification compliance issues. Under the terms of the MOU, the IRS evaluates these referrals for examination potential, selects some, and conducts examinations to determine compliance with employment tax laws. Since FY 2012, the IRS has evaluated more than 1,300 DOL referrals and performed 210 DOL referral-related worker classification return examinations, resulting in recommended assessments of $1.1 million.

The IRS also agreed to provide the DOL with information (other than taxpayer return information) which may constitute evidence of a violation of any Federal criminal law that the DOL enforces. Although the IRS conducted almost 300,000 employment tax return examinations between FYs 2012 and 2016, it did not provide the DOL with any referrals related to criminal violations of Federal labor law.

In addition, the IRS agreed to review the MOU annually to evaluate whether its provisions required amendment or revision. However, between FYs 2012 and 2016, the IRS did not review the MOU and no modifications to the MOU have been made since it was signed.

Recommendation

Recommendation 1: The Commissioner, Small Business/Self-Employed Division, should evaluate whether provisions of the MOU require amendment, revision, or termination and ensure that the duties and responsibilities of the IRS, as outlined in the MOU, are executed as required.

> **Management's Response:** The IRS agreed with our recommendation and plans to:

1. Review the MOU and determine if changes, revisions, or a recommendation for termination are appropriate.

2. Subject to the decision to continue the MOU, the IRS will conduct a program review one year after the MOU is revised to ensure that the duties and responsibilities are executed as outlined in the revised MOU. Based on the results for the program review, appropriate recommendations will be made and implemented as needed.

Improving Information Available on Department of Labor Referrals Could Improve Results of the Joint Worker Misclassification Initiative

DOL referrals often lacked key information that would enable the IRS to determine whether an examination should take place. Because the IRS can examine only a small percentage of filed returns, it uses a process known as classification in which an employee reviews available information to determine whether a return should be selected for examination. For worker misclassification cases, the IRS considers several factors including the potential number of misclassified employees and the materiality of potential adjustments. However, DOL referrals

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often did not provide sufficient information such as the number of misclassified employees, materiality of potential adjustments, status of issuance of Form 1099-MISC, *Miscellaneous Income*, and past consistent treatment of workers in similar positions for IRS classifiers to evaluate. Although an IRS-DOL working group established certain criteria for when the DOL would refer cases, no standardized referral form or information fields were developed for the information to be sent to the IRS.

Because no standardized referral form exists, the DOL's District Offices differed in terms of the types and quantities of information they provided as part of their referrals. Some provided as little as the taxpayers name and a city and State, while others provided multipage investigative reports. Based on conversations with IRS classifiers and a review of IRS classification procedures, we determined that there are at least eight key pieces of information needed in a DOL worker misclassification referral. Figure 2 provides the key pieces of information and why they are important.

Figure 2: Key Referral Information Needed by IRS Classifiers
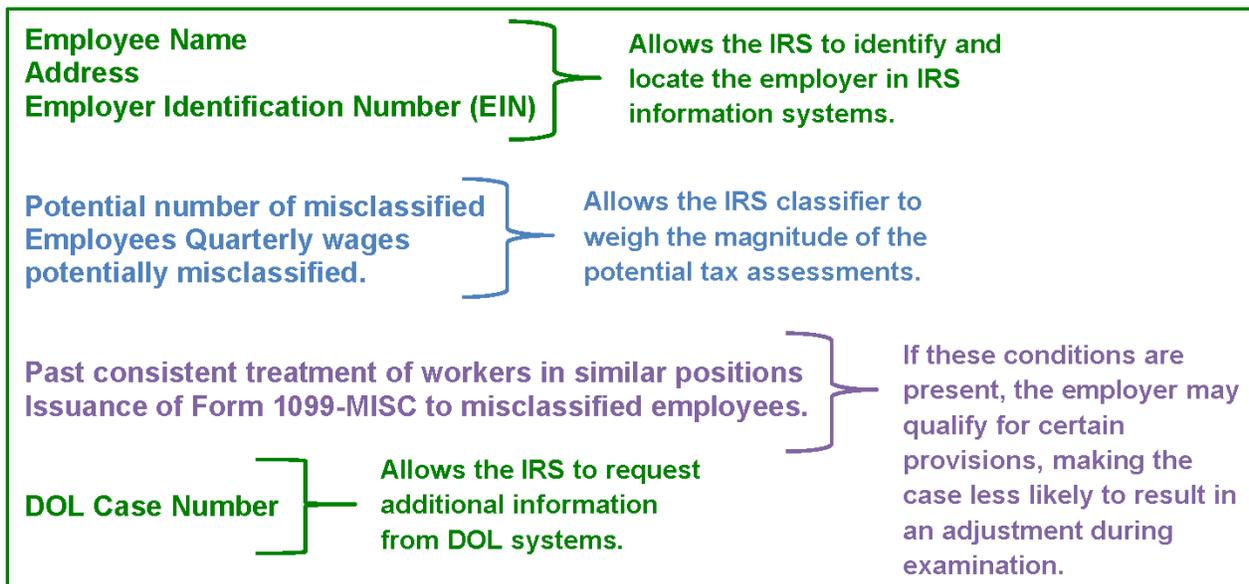
Source: TIGTA analysis based on discussions with Small Business/Self-Employed Division Employment Tax Workload Selection and Delivery unit personnel and review of IRS classification procedures.

We reviewed the population of approximately 300 DOL referrals that were not selected for examination by the IRS between July 2015 and April 2017, and determined that referrals often did not provide sufficient information for IRS classifiers. While all referrals included the employer name, only 59 percent provided the EIN and only 16 percent provided information on the dollar value of the wages involved. Figure 3 provides information on the percentage of DOL referrals that were nonselected that contained key fields.

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Figure 3: Key Referral Information and How Often It Was Provided

Description	Percentage
Employer Name	100%
Employer Address	83%
DOL Case Number	74%
Federal EIN	59%
Status of the Number of Employees Involved	42%
Status Regarding Issuance of Form 1099-MISC	18%
Status of the Quarterly Wages Involved	16%
Status Regarding Consistent Treatment	13%

Source: TIGTA analysis of all nonselected DOL referrals received July 2015 to April 2017 in the Small Business/Self Employed Division Employment Tax Workload Selection and Delivery unit.

The IRS received more than 1,300 referrals from the DOL between FYs 2012 and 2016; however, more than 61 percent of the referrals were not selected for examination. A lack of sufficient information in DOL referrals may have contributed to the nonselection. For example, we found that 90 percent of referrals that did not contain a business EIN were not selected for examination because the IRS was "unable to locate" the business. Moreover, 85 percent of cases that were rejected because the IRS considered the case to have "low potential" had a referral that either contained no information about the potentially misclassified quarterly wages or the quarterly wages identified were below the agreed upon criteria.

The IRS needs consistent and uniform information from DOL referrals to properly determine the merit for examination. In 2012, an IRS-DOL working group agreed on a set of criteria for when the DOL would refer cases to the IRS which included considerations such as whether wages per quarter were over a specified amount and whether Forms 1099 were issued to misclassified employees. However, most DOL referrals provided little or none of this information.

Insufficient information available during classification can affect examination productivity by placing returns in the examination stream that produce less productive examination yields. In FYs 2015 and 2016, examination yield measured by dollars per return for DOL referrals was substantially less than other worker classification return examinations. In FYs 2015 and 2016, DOL referrals resulted in approximately $800,000 in adjustments. However, examination yield measured by dollars per return for DOL referrals was substantially less than other worker classification returns. For example, in FYs 2015 and 2016, the average DOL-referred case had a proposed assessment of approximately $4,000; whereas worker classification examinations from other sources had average proposed assessments of more than $12,000, about three times as

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much. Figure 4 provides information on the dollars per return for worker classification examinations in FYs 2015 and 2016.

**Figure 4: Dollars Per Return on Worker Classification
Examinations (FYs 2015 and 2016)**
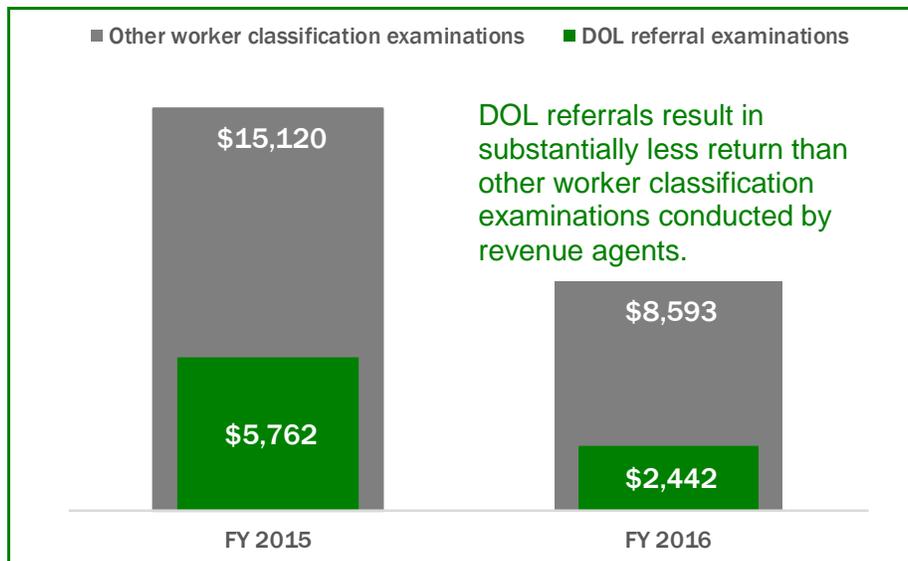
Source: TIGTA analysis of IRS data from FYs 2015 and 2016 for all revenue agent worker classification examinations.

It is difficult for the IRS to properly classify referrals when they do not contain key pieces of information. For example, knowing the materiality of the potential adjustment or wages involved allows the classifier to consider the magnitude of the issues and potential revenue when selecting returns for examination. Knowing that an employer may qualify for a safe harbor[6] provision allows the classifier to decide not to select the return for examination thus avoiding ineffective use of limited IRS resources. Improvements to the referrals process could have a positive impact on examination yields.

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[6] Section 530 of the Revenue Act of 1978 prevents the IRS from retroactively reclassifying "independent contractors" as employees and assessing employment taxes, penalties, and interest for the misclassification if the employer has: 1) a basis for treating the workers as independent contractors, 2) issued all required Forms 1099-MISC to workers, and 3) consistently treated all the same in similar positions.

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Recommendation

Recommendation 2: The Commissioner, Small Business/Self-Employed Division, should initiate a meeting with counterparts at the DOL to discuss designing a mutually agreeable standardized referral form that contains all the elements necessary to assess the viability of the referrals.

> **Management's Response:** The IRS agreed with our recommendation and plans to coordinate a meeting with the DOL to discuss development of a standardized referral form.

The Memorandum of Understanding Needs Performance Indicators That Are Both Measurable and Achievable

The MOU between the IRS and the DOL had laudable goals such as helping to reduce worker misclassification, reducing the Tax Gap, and improving compliance with Federal tax and labor laws. However, the IRS did not develop any performance baselines to assess the MOU's effectiveness and the achievement of the stated goals. Due to a lack of available data, it would be extremely difficult, if not impossible, to determine whether the MOU elements were implemented or to quantify the effect of the MOU. For example, as shown in Figure 1, a basic tracking of the components of the MOU against the results would have indicated that the key elements of the MOU have not been effectively implemented. In addition, DOL referrals represent an incredibly small increment to the IRS's overall worker misclassification program. Therefore, it would be nearly impossible to isolate efforts undertaken as part of the MOU from the other worker classification activities underway by the IRS.

In addition to increasing information sharing and coordination between the IRS and the DOL, the MOU outlined a number of high-level objectives. Among the specific objectives were to reduce fraudulent filings, reduce abusive employment/unemployment tax schemes, reduce worker misclassification, and reduce questionable employment tax practices. Figure 5 shows the objectives outlined by the MOU.

Figure 5: MOU Objectives

Source: TIGTA analysis of the MOU between the IRS and the DOL, dated September 19, 2011.

The IRS did not establish any performance baselines for the MOU objectives which would be necessary to determine whether any progress was made. Moreover, based on our discussions with the Office of Research, Applied Analytics, and Statistics, the MOU objectives cannot be measured on an annual basis without the use of expensive, elaborate, and time-consuming compliance studies. Finally, because DOL referrals are such a small component of the IRS's overall worker misclassification program, it would be nearly impossible to determine specifically how these examinations helped the IRS achieve the MOU's objectives. For example, in FY 2016, IRS revenue agents conducted almost 4,300 worker classification return examinations which resulted in more than $36 million in recommended assessments. DOL referrals led to 95 examinations, or just 2 percent of the total, and resulted in tax assessments of $232,000.

Despite these inherent limitations, meaningful and measurable performance measures are necessary for management oversight and to ensure that the MOU achieves intended results. One of the purposes of the Government Performance and Results Act of 1993[7] was to improve Federal program effectiveness and public accountability by promoting a new focus on results. A key tenet is that performance measures should be tangible, measureable objectives, against which actual achievements can be compared.

The IRS has taken some steps to evaluate MOU activities, such as determining the rate that DOL referrals are selected for examination. However, the IRS has not developed a monitoring approach that includes performance output measures that are clearly linked to the MOU's objectives or that would allow the IRS to determine whether the MOU has been successful. This type of monitoring would have allowed the IRS to identify MOU implementation gaps and would allow the IRS to identify opportunities for future improvement.

Recommendation

Recommendation 3: The Commissioner, Small Business/Self-Employed Division, should establish measurable goals and related performance measures as part of a revised Joint Worker Classification Initiative MOU.

> *Management's Response:* The IRS agreed with our recommendation. Subject to the decision to continue the MOU, the IRS and the DOL will develop measurable goals and related performance measures to include in the revised MOU.

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[7] Pub. L. No. 103-62, 107 Stat. 285 (codified as amended in scattered sections of 5 U.S.C., 31 U.S.C., and 39 U.S.C.).

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Objective, Scope, and Methodology

The overall objective of the evaluation was to determine whether the MOU duties and responsibilities between the IRS and the U.S. DOL were adhered to and whether the MOU objectives are being met. To accomplish this objective, we:

- Determined if the IRS has adhered to the specific duties and responsibilities outlined in the MOU by interviewing relevant Small Business/Self-Employed Division employees and reviewing IRS documentation.

- Determined if, and to what extent, the overall objectives of the MOU between the IRS and the DOL have been accomplished by interviewing Small Business/Self Employed Division and Office of Research, Applied Analytics, and Statistics employees. We requested documentation related to baseline measurements for the MOU's objectives, and the IRS indicated that no baseline data existed. We also reviewed IRS and GAO reports relevant to the stated objectives of the MOU.

- Determined whether the employment tax return examinations based on DOL referrals are more productive than other IRS employment tax return examinations. We performed quantitative analysis of the data contained in various IRS systems to evaluate the productivity of DOL and non-DOL referrals.

This review was performed at the IRS's Small Business/Self-Employed Division Headquarters in New Carrollton, Maryland; the Small Business/Self-Employed Division Employment Workload Selection and Delivery unit in Florence, Kentucky; the Small Business/Self Employed Division Centralized Excise Tax Team at the Cincinnati Campus in Covington, Kentucky; and the Office of Research, Applied Analytics, and Statistics in Washington, D.C., during the period March through July 2017. We conducted this evaluation in accordance with the Council of the Inspectors General for Integrity and Efficiency Quality Standards for Inspection and Evaluation. Major contributors to this report were Gregory D. Kutz (Acting Deputy Inspector General for Inspections and Evaluations), Phil Shropshire (Director), Heather Hill (Supervisory Evaluator), and Earl Charles Burney (Lead Senior Program Analyst).

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Data Validation Methodology

We assessed the reliability of the Audit Information Management System[1] for examination of Form 940, *Employer's Annual Federal Unemployment Tax (FUTA) Return*; Form 941, *Employer's QUARTERLY Federal Tax Return*; Form 943, *Employer's Annual Federal Tax Return for Agricultural Employees*; Form 944, *Employer's ANNUAL Federal Tax Return*; and Form 945, *Annual Return of Withheld Federal Income Tax*, for FYs 2012 through 2016. We assessed the reliability of the data by:

1. Reconciling the number of returns back to Table 37, Examination Program Monitoring[2] and Table SC38, Examination Program[3] for each fiscal year.

2. Verifying that all fields requested in our download queries were received.

3. Electronically testing the frequency and outliers of the fields Table 37 Amount (recommended assessments) and Examiner Time fields in Table 37. We found that the information appeared normal, within bounds, and as expected.

We determined that the data were sufficiently reliable for the purposes of this report.

Populations

We reviewed the population of 294 nonselected DOL referrals that were accumulated in the IRS's Employment Workload, Selection, and Delivery unit in Florence, Kentucky, between July 2015 and April 2017.

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[1] The Audit Information Management System is the computer system used by the IRS Examination function to control returns, input assessments/adjustments to the Master File, and provide management reports.

[2] Table 37, Examination Program Monitoring, provides data from the Examination Time Report used to monitor resources (staff year) and data from the Audit Information Management System, which is used to monitor examinations, inventory, surveyed returns, and accepted returns from classification.

[3] Table SC38 provides data from the Audit Information Management System which is used to monitor completed examinations at the campuses. The table provides data to monitor examinations, inventory, surveyed returns, and accepted returns from classification.

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Report Distribution List

Deputy Commissioner for Services and Enforcement
Director, Headquarters Exam, Small Business/Self-Employed Division
Office of Legislative Affairs
Director, Office of Program Evaluation and Risk Analysis
Director, Office of Audit Coordination
Deputy Inspector General for Audit

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Memorandum of Understanding Between the Internal Revenue Service and the Department of Labor

MEMORANDUM OF UNDERSTANDING
BETWEEN
THE INTERNAL REVENUE SERVICE
AND
THE US DEPARTMENT OF LABOR

1. INTRODUCTION:

This Memorandum of Understanding (MOU) between the Internal Revenue Service (IRS) and the United States Department of Labor (DOL) sets forth the agreement of the parties with respect to a joint initiative to improve compliance with laws and regulations administered by the IRS and DOL. This will be accomplished through enhanced information sharing and other collaboration. A joint IRS-DOL team will lead this initiative.

2. AUTHORITY:

This MOU is entered into between the IRS and the DOL pursuant to Internal Revenue Code Section 7602(a)(1), 29 U.S.C. § 551, 29 U.S.C. § 1136(a), and 44 U.S.C. § 3510.

3. PURPOSE:

A. The sharing of information and collaboration between the parties will help reduce the incidence of misclassification of employees as independent contractors, help reduce the tax gap, and improve compliance with federal labor laws. Increased collaboration will also strengthen the relationship between the IRS and DOL, enable both agencies to leverage existing resources and send a consistent message to employers about their duties to properly pay their employees and to pay employment taxes. This multi-agency approach presents a united compliance front to employers and their representatives.

B. Specific objectives of this initiative include the following:
- Expand the IRS-DOL partnership launched in the Questionable Employment Tax Practices program
- Reduce the employment tax portion of the tax gap
- Increase compliance with federal employment and unemployment tax requirements
- Increase compliance with federal labor laws enforced by the DOL
- Reduce fraudulent filings
- Reduce abusive employment/unemployment tax schemes
- Reduce worker misclassification
- Reduce questionable employment tax practices
- Work together to create educational and outreach materials and guidance for employers and workers

4. CONTACTS:

Contacts for the purpose of this MOU will be the IRS Small Business/Self Employed Division designee, the IRS Governmental Liaison designee, the IRS Disclosure Office Designee, and the DOL designee (see Attachment I).

5. JOINT OUTREACH:

The parties to this agreement will coordinate national outreach activities relating to worker classification and other issues of mutual interest. These include, but are not limited to, joint national press releases, joint messages to national stakeholder organizations, and other education/outreach efforts.

6. DUTIES AND RESPONSIBILITIES OF THE IRS-DOL TEAM:

The team is comprised of representatives from the IRS and DOL.

A. The members of the team will meet on a regular basis to discuss issues of concern, review MOU actions, and make recommendations for improvement in partnership activities. The team will monitor trends and developing issues.

B. The team will create processes with all stakeholders in mind. Recommendations will focus on educating taxpayers/employers, promoting fairness and improved compliance, and creating a level playing field for law-abiding taxpayers and employers.

7. DUTIES AND RESPONSIBILITIES OF THE DOL:

A. The DOL will refer to the IRS, at DOL's discretion and consistent with applicable law, Wage and Hour Division investigation information and other data that DOL believes may raise Internal Revenue employment tax compliance issues related to misclassification.

B. The DOL will share DOL Wage and Hour Division training materials and opportunities with the IRS to the extent possible.

C. The DOL will participate in joint outreach events with the IRS to the extent possible.

8. DUTIES AND RESPONSIBILITIES OF THE IRS:

A. The IRS will evaluate and classify employment tax referrals provided by the DOL and at the IRS's discretion, conduct examinations to determine compliance with employment tax laws.

B. The IRS will, at its discretion and consistent with applicable federal laws, share the employment tax referrals provided by the DOL with the state and municipal taxing agencies that are authorized to receive tax return information under approved agreements with the IRS.

C. The IRS will provide annual reports to the DOL summarizing the results achieved by using DOL referrals. These reports will be provided only if the results can be compiled in a manner that protects return information, including taxpayer identities, in accordance with legal requirements.

D. The IRS will share employment tax training materials and opportunities with the DOL to the extent possible.

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E. The IRS will participate in joint outreach events with the DOL to the extent possible.

F. The IRS will annually provide the DOL with aggregate data relating to trends in misclassification. The IRS will not share confidential Federal Tax Information with DOL unless disclosure is authorized by 26 U.S.C. § 6103.

G. The IRS will, at its discretion and pursuant to 26 U.S.C. § 6103(i)(3)(A)(i), provide DOL with information (other than taxpayer return information) which may constitute evidence of a violation of any Federal criminal law (not involving tax administration) that the DOL enforces.

DISCLOSURE, SAFEGUARDS, AND RECORD KEEPING REQUIREMENTS:

9. It is the policy of DOL to cooperate with other government agencies to the fullest extent possible under the law, subject to the general limitations that any such cooperation must be consistent with the DOL's statutory obligations and enforcement efforts. It is the DOL's view that an exchange of information in cases in which both entities are proceeding on related matters is to our mutual benefit. There is a need for the government to provide information to other law enforcement bodies without making a public disclosure.

Accordingly, the parties intend to pursue their common interests by exchanging information pursuant to this MOU without waiving any legal privileges or other legal protections against disclosure to any entities or persons that are not party to his MOU. Further:

- Exchange of such information pursuant to this Agreement is not a public disclosure under the Freedom of Information Act, 5 U.S.C. § 552.

- When confidential information is exchanged, the receiving party shall use and access it only for the limited purposes of carrying out activities pursuant to this Agreement as described herein. The receiving party shall also comply with the requirements of the Trade Secrets Act, 18 U.S.C. § 1905, the Privacy Act, 5 U.S.C. § 552a, and the Right to Financial Privacy Act, 12 U.S.C. § 3401 *et seq.*, or any other laws and regulations to the extent that they apply to confidential information.

- Confidential information means information that may be exempt from disclosure to the public or other unauthorized persons under state and federal statutes. Confidential information includes: the identities of persons who have given information to the parties in confidence or under circumstances in which confidentiality can be implied; any employee statements in DOL enforcement files that were obtained under such conditions; internal opinions and recommendations of federal or state personnel, including (but not limited to) investigators and supervisors; information or records covered by, but not limited to, the attorney-client privilege and the protections against disclosure of attorney-work-product product and the deliberative process, investigative files, confidential informants, and confidentiality agreements and orders that may apply to shared information; personal information on living persons; individually identifiable health information, confidential business information and trade secrets, and any other information so labeled by the parties. Such information will remain confidential and subject to the privileges and protections of this MOU notwithstanding its termination.

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- In the event that there is a judicial proceeding brought by the employer after an IRS examination based on information from a DOL referral, the IRS will, when possible, provide DOL with a copy of the filed complaint or petition. If records in DOL's possession are relevant and necessary for use in the proceeding, the IRS will follow DOL's *Touhy* regulations, 29 CFR Part 2, Subpart C, if the IRS seeks DOL records, or testimony from DOL's employees.

10. TRANSMITTAL PROCEDURES:

A. Transmissions from DOL to IRS:

- At its discretion, the DOL will send any information, data, and materials subject to this MOU to the IRS at the following address:

  > IRS
  > Employment /Excise Tax
  > Stop 5702A
  > Covington, KY 41011

- All information exchanged will include a Document Transmittal (IRS Form 3210 or equivalent) or other means of verifying receipt, with a count of documents by type and a brief description of the information being provided.

- The Document Transmittal and documents will be inserted in an envelope marked "TO BE OPENED BY ADDRESSEE ONLY" and inscribed with the name of the official designated to receive the information. The package will be hand delivered to the designated official or mailed via the United States Postal Service, Federal Express, United Parcel Service, or a federally accredited expedited mail delivery service, in a second envelope inscribed with the address of the designated official.

B. Transmissions from IRS to DOL:

- At its discretion, IRS will send any information, data, and materials subject to this MOU to the DOL designees (See Attachment I).

11. LIABILITY:

The liability of IRS and the DOL is governed by the Federal Tort Claims Act [28 U.S.C. § 1346(b), 2672, et seq.], or other applicable federal statutory authority.

12. THIRD PARTY RIGHTS:

This MOU does not confer any rights or benefits on any third party.

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13. PRIVACY:

The IRS and DOL will assure the integrity and accuracy of personal and financial data as required by the relevant section of the Privacy Act of 1974, 5 U.S.C. § 552a and the Right to Financial Privacy Act, 12 U.S.C. § 3401, *et seq.* The IRS and DOL will perform their duties in a manner that recognizes and enhances individuals' rights of privacy and will make certain that their activities are consistent with applicable laws, regulations, and sound administrative practices and procedures.

14. EFFECTIVE DATE:

The effective date of this MOU is the date it has been signed by all parties to the agreement.

15. AMENDMENT OF MOU:

This MOU may be amended by deletion or modification of any provisions, provided that such amendment is in writing and is signed by authorized representatives of the IRS and DOL.

16. TERMINATION OF MOU:

This MOU may be cancelled upon thirty days written notice by either the IRS or the DOL or immediately by signed agreement of the IRS and the DOL.

17. LIMITATIONS:

The terms of this MOU are not intended to alter, amend, or rescind any current agreement or provision of federal law now in effect. Any provision of this MOU which conflicts with federal law will be null and void.

This agreement contains all the terms and conditions agreed upon by the parties. No other understandings, oral or otherwise, regarding the subject matter of this agreement shall be deemed to exist or be binding upon the parties.

This agreement does not authorize the expenditure or reimbursement of any funds. Nothing in this agreement obligates the parties to expend appropriations or enter into any contract or other obligations.

Nothing in this agreement will be interpreted as limiting, superseding, or otherwise affecting the parties' normal operations or decisions in carrying out its statutory and regulatory duties, or other current or future agreements between DOL or its component agencies and the IRS. This agreement also does not limit or restrict the parties from participating in similar activities or arrangement with other entities.

Nothing in this agreement is intended to diminish or otherwise affect the authority of either agency to implement its respective statutory or regulatory functions.
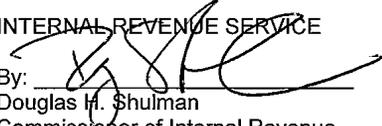
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18. EVALUATION OF DATA EXCHANGE:

The IRS and DOL will review this MOU annually (or more frequently as necessary) to evaluate the existing data exchange, examine the continuing needs for a data exchange, to discuss the utility of categories of data heretofore exchanged, and determine whether the provisions of this agreement require amendment or revision. The method of review (conference call, meeting, email) will be jointly determined by the IRS Governmental Liaison Office, Office of Safeguards, Business Operating Division, and the DOL designees.

APPROVALS:

INTERNAL REVENUE SERVICE

By: _____

Douglas H. Shulman
Commissioner of Internal Revenue

September 19, 2011

UNITED STATES DEPARTMENT OF LABOR

By: _____

Hilda L. Solis
Secretary of Labor

September 19, 2011

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Management's Response to the Draft Report

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

COMMISSIONER
SMALL BUSINESS/SELF-EMPLOYED DIVISION

January 19, 2018

MEMORANDUM FOR GREGORY D. KUTZ
                ACTING DEPUTY INSPECTOR GENERAL FOR INSPECTIONS
                AND EVALUATIONS

FROM: Mary Beth Murphy
                Commissioner, Small Business/Self-Employed Division

SUBJECT: Draft Evaluation Report – *Additional Actions Are Needed to Make
                the Worker Misclassification Initiative With the Department of
                Labor a Success* (#IE-17-001)

Thank you for the opportunity to review the above subject draft report. We appreciate
your perspective on the status of the Memorandum of Understanding (MOU) with the
Department of Labor (DOL) and agree with your recommendations.

Worker misclassification is an important issue.   When employers misclassify their
employees as independent contractors, those workers do not receive protections and
benefits to which they are entitled. Also, those employers are depriving Social Security,
Medicare, unemployment insurance, and worker's compensation funds of billions of
dollars. The MOU between the IRS and the DOL seeks to curb worker misclassification
through enhanced information sharing and collaboration.

We appreciate your acknowledgment of the steps we have taken to implement the
MOU. We have evaluated and classified more than 1,300 DOL referrals.
Approximately 39 percent were selected for examination; with an additional limited
number referred to state agencies. We also conducted joint outreach events with DOL.
However, declining resources and competing priorities have prevented us from fully
implementing the MOU. We will review the existing MOU to determine the best path
forward, whether it is amending, revising or possibly terminating the agreement. As your
report states, the DOL referrals result in fewer dollars per hour compared to other
worker classification cases. Although there may be multiple factors contributing to the
productivity of these cases, we agree that standardizing the referral form will assist the
IRS to gather additional information and could improve the productivity of DOL referrals
selected for examination. We acknowledge that the MOU currently does not contain
baseline performance objectives and that any such objectives cannot be measured

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annually without using expensive, elaborate and time-consuming compliance studies, especially as the DOL referrals comprise such a small part of our overall worker misclassification program. If changes are made to the existing MOU, we agree to include performance goals and measures.

Attached is a detailed response outlining our corrective actions to address your recommendations.

If you have any questions, please contact me, or a member of your staff may contact Brenda Dial, Director Examination.

Attachment

Additional Actions Are Needed to Make the
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Attachment

RECOMMENDATION 1:
The Commissioner, Small Business/Self-Employed Division, should evaluate whether provisions of the MOU require amendment, revision, or termination and ensure that the duties and responsibilities of the IRS, as outlined in the MOU, are executed as required.

CORRECTIVE ACTIONS:
1. We will review the MOU and determine if any changes, revisions, or a recommendation for termination are appropriate.
2. Subject to the decision to continue the MOU, we will conduct a program review one year after the MOU is revised to ensure the duties and responsibilities are executed as outlined in the revised MOU. Based on the results of the program review, appropriate recommendations will be made and implemented as needed.

IMPLEMENTATION DATES:
1. December 15, 2018
2. March 15, 2020

RESPONSIBLE OFFICIAL:
Director, SB/SE Examination Operations, Headquarters Exam

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 2:
The Commissioner, Small Business/Self-Employed Division, should initiate a meeting with counterparts at the DOL to discuss designing a mutually agreeable standardized referral form that contains all the elements necessary to assess the viability of the referrals.

CORRECTIVE ACTION:
We will coordinate a meeting with DOL to discuss development of a standardized referral form.

IMPLEMENTATION DATE:
December 15, 2018

RESPONSIBLE OFFICIAL:
Assistant Director, Exam Case Selection-Specialty, SB/SE

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CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

RECOMMENDATION 3:
The Commissioner Small Business/Self-Employed Division should establish measurable goals and related performance measures as part of a revised Joint Worker Classification Initiative MOU.

CORRECTIVE ACTION:
Subject to the decision to continue the MOU, representatives from Employment Tax (ET) Workload Selection and Delivery, ET Policy, and DOL will develop measurable goals and related performance measures to be included in the revised MOU.

IMPLEMENTATION DATE:
December 15, 2018

RESPONSIBLE OFFICIAL:
Director, SB/SE Examination Operations Headquarters Exam

CORRECTIVE ACTION MONITORING PLAN:
IRS will monitor this corrective action as part of our internal management system of controls.

To report fraud, waste, or abuse, call our toll-free hotline at:

1-800-366-4484

By Web:

www.treasury.gov/tigta/

Or Write:

Treasury Inspector General for Tax Administration
P.O. Box 589
Ben Franklin Station
Washington, D.C. 20044-0589

Information you provide is confidential and you may remain anonymous.