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## Amend Internal Revenue Code Section 3402(p) to Allow Voluntary Withholding for Independent Contractors

### TAXPAYER RIGHTS IMPACTED<sup>1</sup>

- *The Right to Quality Service*
- *The Right to a Fair and Just Tax System*

### PROBLEM

The sharing economy (also known as the gig economy) links a willing provider to a consumer of goods or services. Typically, there are three parties involved in a sharing economy transaction. Here, we will refer to them as *service providers* (the freelancers who provide the goods or services), *service recipients* (the consumers of such goods or services), and *service coordinators* (the third-party platforms that facilitate the transactions).<sup>2</sup>

Many service providers consider themselves as independent contractors, rather than employees of their service coordinator. As such, withholding is not required on payments made by the service coordinator to the service provider. However, some service providers may desire to have income tax withheld for them by the service coordinators, just as if they were employees. With the prevalence of gig workers in a sharing economy who do not work for an employer in the traditional sense, voluntary withholding agreements would benefit both the IRS (which would be ensured of receiving timely payment of taxes) and service providers (who would be able to avoid the burdens of making or missing quarterly estimated tax payments).

### EXAMPLE

Taxpayer A uses his personal car to provide rides to passengers using both Lyft and Uber platforms. Taxpayer A is not an employee of either service coordinator, but instead operates as an independent contractor. Taxpayer A's passengers pay for the shared ride service through the Lyft or Uber app, and then the service coordinator pays Taxpayer A an agreed-upon percentage of the revenue received from the service recipient. Taxpayer A approaches the service coordinator and explains that he is having difficulty making timely estimated tax payments. Taxpayer A asks the service coordinator if it would be willing to withhold a certain percentage of each payment to Taxpayer A and send it to the IRS. The service coordinator responds that it is not sure if such voluntary withholding arrangements are authorized and is concerned that doing so would imply that Taxpayer A is an employee of the service coordinator.

1 See Taxpayer Bill of Rights (TBOR), [www.TaxpayerAdvocate.irs.gov/Taxpayer-Rights](http://www.TaxpayerAdvocate.irs.gov/Taxpayer-Rights). The rights contained in the TBOR that was adopted by the IRS are now listed in the Internal Revenue Code (IRC). See Consolidated Appropriations Act, 2016, Pub. L. No 114-113, Division Q, Title IV, § 401(a) (2015) (codified at IRC §7803(a)(3)).

2 For an in-depth discussion of the sharing economy and how the IRS can provide better service to its participants, see Most Serious Problem: *Participants in the Sharing Economy Lack Adequate Guidance from the IRS*, *supra*.

## RECOMMENDATION

The National Taxpayer Advocate recommends that Congress:

- Amend Internal Revenue Code (IRC) § 3402(p)(3) to specifically authorize voluntary withholding agreements between independent contractors and service recipients.

## PRESENT LAW

IRC § 3402(p) allows for voluntary income tax withholding agreements.<sup>3</sup> Specifically, IRC § 3402(p)(3) authorizes the Secretary of Treasury to promulgate regulations for withholding from any payment where the Secretary of Treasury finds that withholding would be appropriate, if the payor and the payee agree to such withholding.

The Secretary of Treasury has issued regulations that specify that an *employee and employer* may voluntarily enter into an agreement under IRC § 3402(p)(3)(A) to provide for the withholding of income tax.<sup>4</sup> However, the regulations do not specifically authorize voluntary withholding agreements between payees and payors that do not have an employee-employer relationship.

## REASONS FOR CHANGE

Payments to employees are subject to income tax withholding.<sup>5</sup> Tax gap data shows that 99 percent of payments subject to third-party information reporting and income tax withholding are reported by taxpayers to the IRS.<sup>6</sup>

In contrast, payors are not required to withhold income tax on payments to independent contractors. Congress should permit independent contractors to enter into voluntary withholding agreements even if the payments are not wages. Service providers such as those in the sharing economy may not be accustomed to making periodic estimated tax payments to the IRS, and may prefer to have the option of asking the service coordinator to withhold income taxes as a way of reducing taxpayer burden and avoiding noncompliance.

Although current regulations provide that the Secretary of Treasury may issue guidance by publication in the Internal Revenue Bulletin describing other payments for which withholding under a voluntary withholding agreement would be appropriate, to date no such guidance has been issued that permits voluntary withholding agreements for independent contractors.<sup>7</sup> By explicitly expanding voluntary withholding agreements to include independent contractors, Congress will make it easier for independent contractors to meet their tax compliance obligations.

3 IRC § 3402(p)(1) provides for voluntary withholding on certain federal payments (such as Social Security benefits). IRC § 3402(p)(2) provides for voluntary withholding on unemployment compensation payments. IRC § 3402(p)(3) provides for “other voluntary withholding” agreements and authorizes the Secretary, by regulation, to provide for withholding from (1) payments from employer to employee that do not constitute wages, and (2) “any other type of payment with respect to which the Secretary finds that withholding would be appropriate....”

4 See Treas. Reg. § 31.3402(p)-1(a).

5 See, e.g., IRC § 3402(a).

6 IRS, *Tax Gap Estimates for Tax Years 2008-2010* (Apr. 2016).

7 See Treas. Reg. § 31.3402(p)-1(c).

## EXPLANATION OF RECOMMENDATION

Congress should amend IRC § 3402(p) to specifically allow payors and payees who do not have an employer-employee relationship to enter into voluntary withholding agreements. By doing so, it will help independent contractors (including many gig economy workers) meet their income tax payment obligations and reduce compliance burdens.<sup>8</sup>

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8 The legislation should also make clear that the agreement would not be taken into account in determining whether the service provider is an employee (rather than an independent contractor) for tax purposes.