



INDEPENDENT CONTRACTORS:

IT and Engineering Consultants Should be Treated the Same as Professionals in Other Industries

Section 530, known as the “Safe Harbor” provision, was enacted in 1978 to provide certainty and guidance following taxpayer complaints of overly zealous IRS action to retroactively reclassify independent contractors as employees; reclassification resulted in taxes owed, penalties, and interest.

Congress dramatically shifted the playing field when it enacted Section 1706 of the Tax Reform Act of 1986. This provision removed the “Section 530 employment tax safe havens” for businesses known as “technical services firms”—IT and engineering staffing firms generally meet the definition of “technical services firms.” As a result, if a technical services firm utilizes an independent contractor the firm must prove to the IRS that this worker is an independent contractor under a fact-intensive, centuries-old 20-factor “common law” employment test. This test is vague and open to interpretation, exposing these companies to IRS reclassification tax liability. The lack of protections for technical services firms under the Section 530 “Safe Harbor” provision make it uniquely difficult and legally risky for companies within the industry to hire IT and engineering professionals *who prefer* to work as independent contractors.

The high-tech industry and the delivery of professional IT/engineering services have changed dramatically since 1986. TechServe Alliance urges the Administration and the 115th Congress to include in any tax reform proposals a modern “Safe Harbor” provision that fully accommodates independent professionals working within the IT and engineering staffing and solutions industry.

Congress should restore “Safe Harbor” certainty and guidance for “technical services firms” –

IT and Engineering Professional Self-Select Independent Contractor Status. A number of IT and engineering professionals choose to operate their own businesses by providing services as independent contractors. They tend to be among the most highly educated, highly skilled professionals with very marketable skill sets. Virtually all have four-year degrees and many have advanced degrees in order to keep up with new technologies and constantly improve their highly sought-after skills. Most independent contractors in the IT and engineering staffing industry earn far above the median wage levels in the workplace, with the majority generating an income in excess of \$80,000 per year. Due to the nature of their expertise, independent contractors who work in IT and engineering prefer to operate independently, deciding when and where they will work, and at what rate.

The Lack of a “Safe Harbor” Harms Workers, Industry, and the Economy. The harm to high-tech firms and workers caused by the lack of a safe harbor for the technical services firm category is more than theoretical. Technical services firms that use independent contractors—even if the firm acts in good faith—can be severely penalized by the IRS and forced to pay “unpaid” employment taxes even though the contractors have already paid those same taxes in full. Left with only the common law employment test to defend a worker’s status to the IRS, many high-tech firms will not hire independent contractors. They do not want to “attract” an IRS audit because the time and legal costs of fighting the IRS means that “winning” the audit is ultimately a net “loss” in financial terms.

Tax Reform Should Accommodate the Independent IT Professional Business Model. Congress in recent years considered changes to the “Safe Harbor” provision, but the proposals would have likely excluded IT and engineering professionals and firms. Under previous proposals, a business would be ineligible for the safe harbor if the independent contractor is primarily paid by the hour. Most IT/engineering consultants working within the industry *are* paid by the hour. Previous proposals also required the independent contractor to incur “significant unreimbursed” expenses to be eligible. While contractors in the IT/engineering staffing industry do incur unreimbursed expenses, it is unclear whether these expenses would be considered “significant.” The 115th Congress should ensure that any tax reform proposal fully accommodates independent professionals working within the IT and engineering staffing and solutions industry.