

# Shortchanged

## The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy

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# Executive Summary

The last time Congress enacted substantial tax reform—in 1986—only 8.2% of American households owned personal computers. Today, more than 87% of American adults own a mobile phone and on-demand platforms like Uber, Etsy, Lyft, Airbnb, HomeAway, Amazon, and TaskRabbit have become household names by connecting businesses and consumers. Although millions of Americans are engaging in the on-demand platform economy every day as sellers and service providers, the tax compliance challenges this new frontier presents have gone relatively unnoticed. At the same time, these challenges will grow with this fastest growing segment of the labor economy—creating unnecessary and ongoing burdens for the small business operators who power the on-demand economy.

This report, in keeping with the mission of the Kogod Tax Policy Center to conduct non-partisan research on tax issues specific to small businesses and entrepreneurs, identifies the tax compliance challenges the on-demand economy presents for its small business operators. Having spent more than a year investigating this growing problem, we report that:

- More than 2.5 million U.S. taxpayers are participating in the on-demand platform economy as small business owners every year, and that number is set to more than double in the next few years.
- At best, these small business owners are shortchanged when filing their taxes; at worst, they fail to file altogether. In addition, these taxpayers face potential audit and penalty exposure for failure to comply with filing rules that are triggered by relatively low amounts of earned income and inconsistent reporting rule adoption.
- The current tax administration system isn't working for a significant percentage of these small business taxpayers or Treasury or IRS. The existing tax rules effectively create a \$19,399 reporting tax loophole impacting millions of taxpayers (the difference between the income thresholds triggering Forms 1099-K and 1099-MISC reporting), resulting in widespread confusion among taxpayers.
- The current state of play is one of unnecessary burden, potential audit and penalty exposure for on-demand platform economy players. We can do better.

# Introduction

The last time Congress enacted substantial tax reform—in 1986—only 8.2% of American households owned personal computers.<sup>1</sup> In 2014, 87% of American adults owned a mobile phone, of which 71% were smartphones (Internet-enabled).<sup>2</sup> Companies like Uber, Etsy, Lyft, Airbnb, HomeAway, Amazon, and TaskRabbit have become household names by connecting businesses and consumers through online and app-based platforms. In the past 10 years, the Internet and smartphones have fundamentally changed the way Americans purchase goods and services in cashless transactions. Today, we book travel with our thumbs.

Since its launch in 2008, Airbnb hosts have accommodated more than 60,000,000 guests worldwide. In the United States, the overall Airbnb host community has grown 85% year-over-year, with the typical host earning \$7,350 in supplemental income per year on just a single property.<sup>3</sup> As of February 2016, Uber reported that it has more than 500,000 drivers, who earned more than \$3.5 billion in take home wages in the first three quarters of 2015.<sup>4</sup> Data from the first major study of the “on-demand platform economy” using financial transactions found that in the last three years, an estimated 10.3 million people earned income from being either service providers or sellers using an online platform intermediary.<sup>5</sup>

More than 2.5 million Americans are earning income by renting rooms, giving rides, running errands, and selling goods as small business owners every month.<sup>6</sup> What’s more, the explosive growth of the on-demand platform economy is the latest example of a 66.5% increase in alternative work arrangements for U.S. workers from 14.2 million in 2005 to 23.6 million in 2015.<sup>7</sup>

But while the on-demand platform economy has experienced extraordinary growth since its inception, surprisingly little has been done to understand the tax compliance challenges this new frontier presents, or how the on-demand platform economy impacts Treasury and IRS’ ability to fairly and efficiently administer the U.S. tax code.<sup>8</sup> This report, in keeping with the mission of the Kogod Tax Policy Center to conduct non-partisan research on tax and compliance issues for small

businesses and entrepreneurs, targets the tax challenges of the on-demand economy’s small business operators and endeavors to shed light on these issues as Congress looks to move forward with tax reform.

Having spent more than a year investigating this growing problem, we report on what the existing literature has yet to acknowledge: that, for tax purposes, on-demand platform economy service providers and sellers are, in fact, small business owners. And there are millions of them working and earning income in ways that are not readily identifiable by existing government research. In particular, we explore why it’s tough to measure how pervasive the tax problems of these small businesses are because existing government research and methodologies for measuring the smallest of small businesses fall short.

We start by explaining just how pervasive the on-demand platform economy has become for consumers and the labor market, and the tax compliance challenges that go along with trying to adapt a twentieth-century tax code to a twenty-first century economy. We argue that these issues should be addressed—not only because millions of American taxpayers are needlessly burdened trying to comply with an antiquated, outdated tax system—but also because inaction has very real implications on Treasury and IRS’ ability to fairly and efficiently collect taxes.

## Our Approach, Data & Methodology

In the course of conducting this research and drafting this report, we reviewed the existing academic and industry literature and surveys on the on-demand platform economy as a first step in approximating just how many millions of U.S. taxpayers are earning income as its small business operators. We compared data sets, research criteria and findings of the latest studies, searching for commonalities to provide insight as to why estimates of the number of U.S. taxpayers earning income as service providers and sellers in the on-demand platform economy vary so widely. We reviewed existing government research (e.g., publicly available taxpayer filing data, U.S. Census Bureau (Census) data, Bureau of Labor Statistics (BLS) data, U.S. Government Accountability Office (GAO) reports, U.S. Department of Treasury (Treasury) technical papers), and identified

the limitations in the existing government research with respect to identifying and tracking those small businesses participating in the overall economy.

We then talked to federal government economists at Treasury, the Small Business Administration Office of Advocacy (Advocacy), and GAO as well as other agency officials responsible for studying and writing government research on small businesses, the self-employed and economic trends as well as taxpayer filing data. We consulted the National Taxpayer Advocate and tax preparer industry experts directly to understand what hurdles and frustrations this group of small businesses face as they navigate their way through tax filing season. We conferenced with on-demand platform company executives, industry experts and academics to solicit their views on both the extent to which U.S. taxpayers are operating in the on-demand platform economy and how those numbers are projected to grow over the next decade.

Finally, we talked to more than 50 individuals currently participating in the on-demand economy and administered our own survey of members of the National Association of the Self-Employed (NASE).

Our survey was designed to gauge existing self-identified self-employed workers' participation in the on-demand economy (e.g., how many hours worked; how much income earned) as well as respondents' understanding of their tax filing obligations (e.g., whether respondents kept records for their expenses or received a Form 1099 from their on-demand platform company). We conducted the survey Mar. 10, 2016 through Apr. 1, 2016, through email invitation sent to members by NASE. We received 518 completed responses from the approximately 40,000 NASE members invited to participate in the survey, which constitutes a statistically representative sampling size of NASE members.

Our intention in conducting the survey was not to prepare a statistically reliable estimate of the entire American population of the self-employed or freelancers or all workers in the on-demand platform economy, but rather to assess whether tax compliance challenges exist—even among a group of taxpayers, who, by their own self-selection as members of NASE, are self-employed small business owners.<sup>9</sup>

Ultimately, we concluded that:

1. More than 2.5 million U.S. taxpayers are participating in the on-demand platform economy as small business owners every year, and millions more are set to join their ranks in the next decade.
2. For tax purposes, on-demand economy service providers and sellers are small businesses owners, but their numbers aren't reflected in government data designed to track small business owners. In fact, these taxpayers don't necessarily realize they are small business owners until tax time or they receive an IRS notice.
3. At best, these small business owners are shortchanged when filing their taxes; at worst, they fail to file altogether. Approximately one-third of our on-demand platform operator survey respondents didn't know whether they were required to pay quarterly-estimated payments and almost half were unaware of any available deductions, expenses or credits they could claim to offset their tax liability. These taxpayers face potential audit and penalty exposure for failure to comply with filing rules that are triggered by relatively low amounts of earned income. Compounding this problem is inconsistent reporting rule adoption that results in widespread confusion among taxpayers.
4. The current tax administration system isn't working for a significant percentage of on-demand platform small business operators or Treasury or IRS. More than 60% of our survey respondents who worked for an on-demand platform company in 2015 reported that they did not receive a Form 1099-K or Form 1099-MISC from their on-demand platform, which likely means the IRS didn't either. The current state of play is one of unnecessary burden, potential audit and penalty exposure for on-demand platform economy players. We can do better.

## PART I

# Defining the Relationship: Airbnb is not Instagram and Other Measurement Challenges

According to the latest industry statistics, as of January 2016, there were more than 3.97 million apps available for download across several different platforms (e.g., Microsoft, Google, Amazon) that generate more than \$120 billion.<sup>10</sup> But not every smartphone app functions as part of the on-demand platform economy. Airbnb is not Instagram—they provide completely different services for users. Similarly, not every seller on eBay or Craigslist sells items regularly enough to be considered a business for tax purposes or generates enough income in any given year to trigger a tax filing requirement.

Some online sellers just sell a couple of used items online a couple of times a year, which generally doesn't trigger a tax filing requirement. At the same time, new on-demand platforms are being introduced every month. This acute reality presents one of the most confounding challenges for conducting tax research on these issues: *there is no singular definition or even consensus on how to define or measure the on-demand platform economy or the income that small businesses are deriving from it.* As a result, estimates of the number of small businesses operating in the on-demand platform economy are wildly inconsistent.

For example, one recent Time Inc./Aspen Institute survey found that more than 45 million Americans had—at least once—worked or offered services through a ride-sharing, accommodation sharing, task services, short-term car rental or food/goods delivery platform.<sup>11</sup> At the same time, other notable experts including Seth Harris and Alan Krueger—excluding seller and home accommodation platforms (e.g., ETSY, Airbnb)—estimate that 1.9 million individuals are earning income as service providers using apps.<sup>12</sup>

Still other labor survey experts have concluded that there are more than 3.2 million Americans currently working in the on-demand platform economy and project that number to more than double by 2020.<sup>13</sup> The explanation for why these estimates range so

significantly is rooted in differences in definition. As illustrated in Table 1, including or excluding specific platforms can vary an estimate of the size of the on-demand platform economy and its players considerably.

Given our specific focus on the tax compliance challenges facing these small businesses, we think it makes sense for tax policy purposes to limit our analysis to platforms that generally reflect the following characteristics, which were developed by the first major study to track actual income earned using financial transaction data:

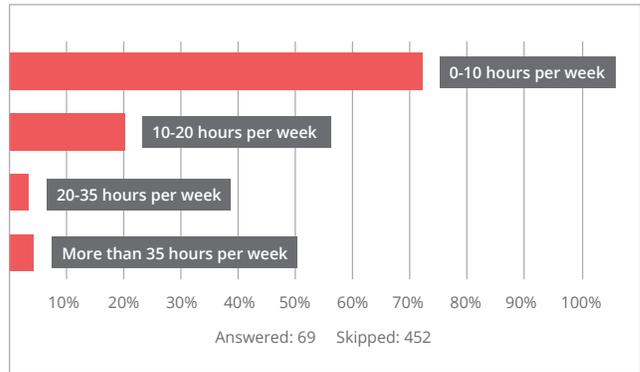
- platform directly connects service providers and sellers with consumers;
- platform processes payment electronically, using credit cards, debit cards or mobile payments;
- platform allows service providers to provide services or goods at provider discretion; and
- customers pay for a singular task or good.<sup>14</sup>

There is no question that out of a universe of 3.97 million apps, inevitably, there are some small businesses earning income from the on-demand platform economy that may not be captured by the foregoing criteria, but that would be included in publicly available taxpayer income filing data. However, Treasury has been explicit with Congress in explaining why existing aggregate tax data is “not very helpful in isolating trends in the on-demand economy or in the prevalence of its [workers and sellers].”<sup>15</sup> In contrast, recent work using the foregoing criteria on the income of Americans participating in the on-demand platform economy has identified important trends that are particularly relevant to our report's focus, including:

- More than 2.5 million Americans are actively participating in the on-demand platform economy every month, which is 1% of the adult American population;
- Although people do cycle in and out of the on-demand platform economy, during the months in which people are actively using platforms to earn income, their earnings “represented a sizeable but still secondary source of income;”
- In any given month, on-demand platform income represents roughly 20 to 30% of total income of people actively earning income in the on-demand platform economy; and
- Average monthly income from active participation ranges from \$533 to \$314, with the higher amounts usually stemming from working in connection with platforms such as Uber, Handy, TaskRabbit (labor platforms) as opposed to other platforms such as eBay, Airbnb (capital platforms) or sellers and accommodation providers).<sup>16</sup>

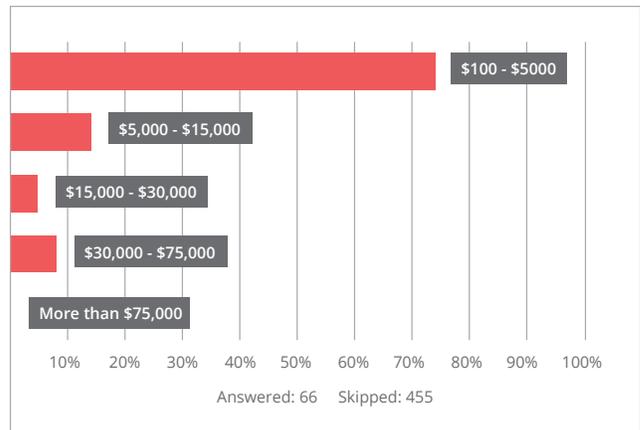
These monthly income averages are consistent with public reports from many of the on-demand platform companies themselves and tend to reflect the averages of hours worked. For example, in 2015, more than 75% of Lyft drivers reported working less than 15 hours per week, and more than half of Uber drivers worked less than 10 hours per week.<sup>17</sup> Our survey found that among respondents with income from on-demand economy work in 2015, 72% worked, on average, less than 10 hours a week with their on-demand platform company and that 92% of respondents worked less than 20 hours per week with their on-demand platform company.<sup>18</sup> We also found that of respondents operating in the on-demand platform economy, 88% earned less than \$15,000 in 2015.<sup>19</sup> Although studies to date have identified a core constituency of small business operators (ranging from 25% to 30%) that tend to work for on-demand platforms full-time and earn more, by and large, the majority of individuals in the on-demand platform economy work 12 hours per week.<sup>20</sup>

**Q1** On average, how many hours a week did you spend providing services or selling products using the sharing economy company platform or app?



Answer Choices	Responses
0-10 hours per week	50 (72.46%)
10-20 hours per week	14 (20.29%)
20-35 hours per week	2 (2.90%)
More than 35 hours per week	3 (4.35%)

**Q2** How much income did you earn in 2015 from your work with the sharing economy platform or app?



Answer Choices	Responses
\$100 - \$5,000	49 (74.24%)
\$5,000 - \$15,000	9 (13.64%)
\$15,000 - \$30,000	3 (4.55%)
\$30,000 - \$75,000	5 (7.58%)
More than \$75,000	0 (0.00%)

Table 1

Industry Study	Types of On-Demand Platform Operators Surveyed	Survey Method	Study Period	Estimated Number of On-Demand Platform Operators
Aspen Institute/ Time/Burson- Marsteller	Examples of specific platforms included: Uber, Lyft, Airbnb, VRBO, HOMEAWAY, Handy.com, TaskRabbit, care.com, Instacart, POSTMATES, Caviar, Zipcar, car2go, Getaround	Online interview of 3,000 American adults	Nov. 16-25, 2015	45 million people (22% of American adults) have offered some good or service at some point in the on-demand economy
JP Morgan Chase Institute	Examples of types of platforms included in study: Uber, Lyft, TaskRabbit, eBay, Airbnb	Random sample of 1 million Chase customers with a checking account in every month during the Study Period, 260,000 individuals received income at least once from one of 30 distinct platforms	Oct. 2012 to Sept. 2015	2.5 million every month and 10.3 million (4.2% of adults) in the last 3 years; the total increased 47-fold over 3 years
Emergent Research	Operators from 11 specific platforms: Upwork, Work Market, Fiverr, MBO Partners, Visually, OnForce, Deliv, Wonolo, HourlyNerd, Uber, FieldNation	Survey of 4,622 On-Demand Economy Operators of specific platforms	Sept. 11, 2015 – Oct. 1, 2015	3.2 million per year; estimated to increase to more than 7 million by 2020
Krueger & Katz	Questionnaire asked workers whether they engaged in selling through an intermediary (e.g., Uber or TaskRabbit); <i>did not include questions about accommodation platforms</i>	Online survey of 6,028 individuals; 3,844 respondents	Oct. 19, 2015 – Nov. 4, 2015	0.5% of all workers identify customers through an online intermediary
NASE/Kogod Tax Policy Center	Examples of platforms included: Lyft, Uber, TaskRabbit, Handy, HourlyNerd, Airbnb, Etsy, eBay	Emailed survey to 40,000 NASE Members; 518 Respondents	Mar. 10, 2016 – April 1, 2016	22% of Respondents (112 NASE survey respondents) offered services or sold goods through an On-Demand Platform in 2015

## A. Under the Radar: Small Businesses Operating in the On-Demand Platform Economy

Notwithstanding the on-demand platform economy's unprecedented growth and adoption by more than 86.5 million U.S. adults in just a few short years—Airbnb was founded in 2008,<sup>21</sup> the economic activity and growth of these small business owners has largely gone unacknowledged by most government measures for tracking small business activity.<sup>22</sup> At the same time, the problem isn't limited to government; tax practitioners report that “while many do not know it, renting a home short-term is basically running a small business and this requires tax compliance.”<sup>23</sup> And make no mistake, the individuals who are earning income from powering the on-demand platform economy are carrying on a trade or business as small business owners for U.S. tax purposes.<sup>24</sup>

Even so, most federal government agencies that measure small businesses concede just how challenging it is to define “small business” as a distinguishable category of taxpayers and readily acknowledge “a consensus does not exist on a definition of small businesses, including which specific attributes or thresholds distinguish small businesses from other firms.”<sup>25</sup> For example, the IRS Small Business and Self-Employed division is responsible for administering returns for individuals with business income and businesses with less than \$10 million of income, which is one official threshold for defining small business. Alternatively, the U.S. Small Business Administration generally considers a small business to be an independent business with fewer than 500 employees, although even that definition can vary by industry.<sup>26</sup>

Not unlike the numerous criteria used to measure the on-demand platform economy, how broadly (or narrowly) the term “small business” is defined can dictate results in terms of the data captured by a given government metric. For example, using taxpayer data, Treasury has developed a methodology to identify more than 23 million small businesses, however, SBA's Office of Advocacy, relying on Census data, has identified more than 28.2 million small businesses.<sup>27</sup>

Making matters more complicated is the fact that some relevant government measures for the smallest of small businesses that would otherwise capture the business activities and income earned by on-demand platform participants use terms *other than* small business (e.g.,

nonemployers, self-employed, microbusinesses) in developing data used to measure small business activities.<sup>28</sup> These inconsistencies exist throughout the official government research as well as the U.S. tax code itself<sup>29</sup> and are a major reason why small businesses operating in the on-demand economy have yet to be reflected in government research on small business and economic trends. But it's not just inconsistent terms; it's inconsistent metrics that matter too.

For example, in a 2015 report to Congress on small business tax compliance issues, GAO concluded that most small businesses are individuals who report some individual business income as a sole proprietor (Schedule C) or as a landlord on a separate schedule (Schedule E).<sup>30</sup> This group of approximately 16 million small business taxpayers (69% of all small businesses), on average, earns \$100,000 (or less) per year and generates \$1.4 trillion of the total small business income reported to the IRS.<sup>31</sup> However, it is very likely that GAO's analysis, which incorporated a 2011 Treasury methodology to identify small businesses, does not and would never include income from the majority of taxpayers earning income from operating in the on-demand platform economy. The reason is simple: even though there are more than 2.5 million individuals actively earning business income as small businesses owners working in the on-demand platform economy every month, they generally don't earn enough income under Treasury's methodology defining small businesses to be included in their ranks.<sup>32</sup>

Specifically, the most comprehensive research on the income of on-demand platform economy active participants finds that monthly income averages range from \$533 to \$314, which translates to \$6,635 and \$3,768 annually. At those income levels, there's little chance that the average on-demand platform small business operator would meet Treasury's income thresholds (generally, more than \$10,000 in business income or \$5,000 in total business deductions) to be included in its small business measures.<sup>33</sup> In fact, these income thresholds would fail to capture the typical Airbnb host, who reports earning on average \$7,530 of annual income.

Our own survey found that 74% of respondents earned \$5,000 or less in 2015 from on-demand platform work.

## B. The On-Demand Platform Economy And Its Players Will Continue to Grow

Although the government research on measuring and defining the on-demand platform economy is evolving, industry experts who have been tracking the on-demand economy's growth have estimated that it will continue its trend of double-digit growth through 2025.<sup>34</sup> In fact, the number of individuals operating as small businesses in the on-demand platform economy is set to double to seven million Americans by 2020, if not more.<sup>35</sup> Although Census has yet to publish data reflecting this accelerated growth, it has found that there is a steady rise in "nonemployer businesses," which would be consistent with industry studies on the on-demand economy.<sup>36</sup>

"Even at the low end, both in terms of participation and dollars earned, [on-demand] platforms grew by about 50% per year, making it by far the *fastest growing segment of the labor market*."<sup>37</sup> This finding was recently corroborated by study of the rise of alternative worker arrangements from 1995 through 2015 that concluded that though the on-demand economy was "relatively small compared to other forms of alternative work arrangements...it is growing very rapidly."<sup>38</sup>

Indeed, as some financial industry analysts have observed, "the vast majority of U.S. entrepreneurial activity is small—nano small, [a]nd the ranks of self-employed 'solopreneurs' are growing fast, with 53 million Americans freelancing today, and upwards of 66 million Americans, or 40% of the workforce by 2020."<sup>39</sup> To be fair, not all of the millions of Americans who are projected to be freelancing by 2020 would necessarily be small businesses in the on-demand economy, but a good percentage of them will be.<sup>40</sup>

Our own survey of self-employed business owners found that approximately 22% of respondents (or a member of their household) had earned income in 2015 from operating in the on-demand platform economy from either providing services or selling goods.

## PART II

# Compliance Challenges of On-Demand Platform Operators: It's All about Timing & Communication

Overwhelming complexity and inefficiency are hallmarks of the current tax code and the Congressional record is replete with examples of how unduly burdensome the current system is across taxpayers' experience.<sup>41</sup> And we know from talking to some on-demand platform operators and surveying others that their tax compliance challenges are compounded by an antiquated tax administration system. At the same time, many on-demand platform operators are first-time, small business owners and have little experience with the requirements of quarterly-estimated payments or self-employment taxes.<sup>42</sup> This point is reflected in the findings of the first study of tax issues of ridesharing drivers conducted through tracking online forums where the authors determined that "many posters were new to filing taxes as independent contractors...[and] issues surrounding Schedule C filing and expense taking and documentation were often matters of first impression."<sup>43</sup>

“ Although I just started driving last October, I am very confused on how to file. This is my first year filing my taxes separate from my parents.”

— *Email from Ride-Sharing Driver to Tax Preparer, 2016*

### A. They Got 1099 Problems and Withholding Ain't One....<sup>44</sup>

The U.S. tax system is basically a "pay-as-you-earn-system" of tax collection. For employees, a portion of income earned throughout the calendar year is deducted (i.e., withheld) from wages by employers and remitted to the IRS in pre-payment of employees' tax liability. However, small businesses operating in the on-demand platform economy are not subject to employer withholding and are, instead, responsible for making tax payments to the IRS for both federal income and self-employment taxes (i.e., Social Security and Medicare taxes).<sup>45</sup> As a result, small businesses operators in the

on-demand platform economy often have different pain points than their employee counterparts with respect to their tax filings. For example, small businesses actively participating in the on-demand platform economy don't receive IRS Form W-2 (wage and tax statements) that they can use to fill out their tax returns. Instead, on-demand platform economy operators are subject to an entirely different set of rules and forms (e.g., the IRS Forms 1099; Self-Employment Tax Form, Quarterly-Estimated Payments) that have very different taxpayer filing requirements and with respect to self-employment taxes, different tax rates.<sup>46</sup>

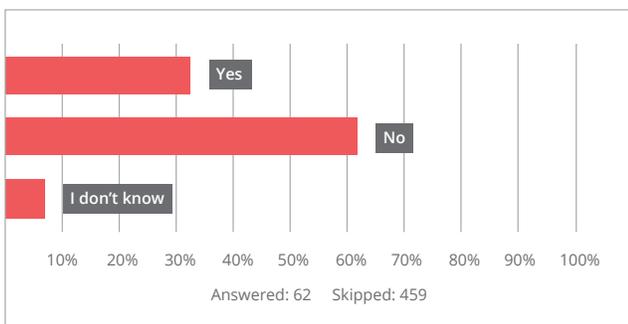
Under current tax law, payments for more than \$600 for services provided by nonemployees (e.g., independent contractors, freelancers, small business owners) are generally reported to the IRS on a Form 1099-MISC by a payor, and a copy is provided to the service provider.<sup>47</sup> However, if payments are made via credit card or debit card, and the aggregate number of transactions to one service provider exceeds 200 and the payments exceed \$20,000, then the payor (or, in this case, platform processing customers' credit card payments) is required file a Form 1099-K to report the income to the IRS and send a copy to the payee.<sup>48</sup> Confusing, right? It gets worse.

Some on-demand platforms only send a Form 1099-K to the IRS and small business operator if the service provider or seller satisfies both the 200 transaction/\$20,000 income thresholds.<sup>49</sup> This strategy is consistent with the IRS instructions on when sending Form 1099-Ks is appropriate as opposed to a Form 1099-MISC.<sup>50</sup> Other platforms send all of their small business operators a Form 1099-K, regardless of whether the small business owner meets the 200 transaction/\$20,000 income threshold.<sup>51</sup> And in certain circumstances, a platform company will send both.<sup>52</sup> This inconsistent reporting rule adoption among on-demand platform companies creates confusion among taxpayers about whether they can expect to receive a

Form 1099 at all. In fact, our survey found that only 32% of respondents who had earned income working with an on-demand platform economy in 2015 received a Form 1099-MISC or Form 1099-K from their on-demand platform company.<sup>53</sup>

In addition, we are aware, from talking to tax preparers who specialize in advising individuals who earn income from the on-demand platform economy, that when taxpayers do not receive any Form 1099, they are immediately confused as to whether they have to report that income on their returns. Regardless of whether a taxpayer receives a Form 1099, they are still responsible for reporting income earned in connection with platform work and taxes on that income. Failure to receive a 1099 does not exempt a taxpayer from reporting the income on their tax return.<sup>54</sup>

**Q3** Have you received a Form 1099-K or Form 1099-MISC from the sharing economy platform or app you worked with in 2015?



Answer Choices	Responses
Yes	20 (32.26%)
No	38 (61.29%)
I don't know	4 (6.45%)

## B. The Big Short(change) Story

Compounding the confusion of what forms a small business can expect to receive from its on-demand platform company (if any) is the overall challenge of calculating actual taxable income and how much is owed as well as figuring out when taxes should be paid. Timing is everything—particularly when it comes to taxes. For small business owners who owe at least \$1,000 in taxes, bad timing can result in penalties.

### 1. Timing: Quarterly-Estimated Tax Payments

“ Yep, I've been driving for two years while I've been going to school full-time getting my masters in transportation. Last year I grossed, let me think, maybe \$60,000? But I just gave my forms to my dad's neighbor who does taxes on the side...What's a quarterly-estimated payment?”

— Conversation with Ride-Sharing Driver, 2015

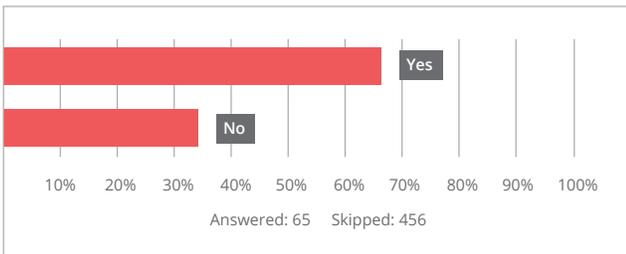
Under current tax rules, when small business owners are expected to owe at least \$1,000 in taxes and aren't subject to withholding, advance payments of estimated tax are due to the IRS throughout the year.<sup>55</sup> These payments are due quarterly on April 15, June 15, Sept. 15 and Jan. 15 and are referred to as quarterly-estimated payments.<sup>56</sup> However, “[p]utting aside outright tax cheats, young workers are financially inexperienced and, increasingly, part of a gig economy—driving for Uber, funding their creative work through Patreon—typically don't have their taxes withheld automatically and need to set up a program of quarterly-estimated tax payments on their own.”<sup>57</sup> Remember, it's a “pay-as-you-earn” tax system.

In calculating whether a taxpayer needs to make quarterly-estimated payments throughout the year, taxpayers need to include both income taxes and self-employment taxes owed—minus any refundable credits—on income earned from on-demand platform work. Added together, income tax and self-employment tax can quickly reach the \$1,000 threshold triggering quarterly-estimated payments.

Consider if a ride-sharing driver netted \$7,500 driving for a platform company part-time in 2015. That amount alone could translate to \$1,060 just in self-employment tax due (\$859 Social Security tax and \$201 Medicare tax), which, in turn, would trigger quarterly-estimated payment requirements—without even calculating

any income tax owed. It just doesn't take that much income to trip over these filing requirements. What's more troubling is that a good percentage of even self-identified self-employed taxpayers are unaware of quarterly-estimated payment filing requirements. Our survey revealed that among respondents who had earned income working with an on-demand platform company in 2015, 34% did not know whether they were required to file quarterly-estimated payments with the IRS on that income.

**Q4** Do you know whether or not you are required to file quarterly-estimated payments with the IRS?



Answer Choices	Responses
Yes	43 (66.15%)
No	22 (33.85%)

For those who are supposed to make quarterly-estimated payments and don't, penalties apply—even when a taxpayer files a return before the April 15 filing deadline.<sup>58</sup> In fact, penalties may be imposed on any underpayment for the number of days it remained unpaid, or if a taxpayer doesn't pay enough estimated tax or if the payments weren't made on time. This would be a particularly unwelcome surprise for any taxpayers who were required to pay quarterly-estimated payments in 2015 and failed to do so. It's not so hard to imagine a taxpayer, who earned \$7,500 in 2015 in the on-demand platform economy, and then, when she went to file her taxes on April 18, 2016, found out that not only did she fail to make quarterly-estimated payments for all of 2015, but that she had also owed for the first quarter of 2016.<sup>59</sup>

We followed up with one IRS Chief Counsel Office attorney operating in a field office about the incidence of failure to pay quarterly-estimated payments and were told, "I see it all the time. People get themselves into a hole and just can't get out of it when they fail to file their quarterly-estimated payments and then go to file their taxes. They owe way more than they can afford. They just walk away and don't file."<sup>60</sup>

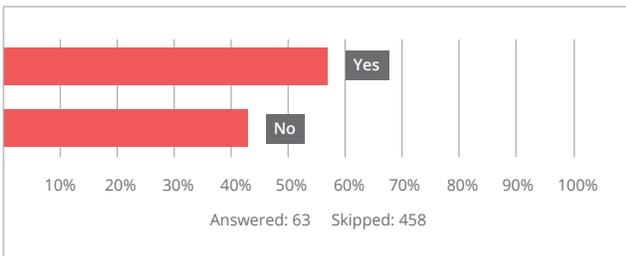
## 2. Communication: Self-Employment Tax Implications

Understanding the timing rules for when taxes must be paid on on-demand platform income is one thing, but actually calculating tax liability and including the 15.3% self-employment tax (i.e., 12.4% for Social Security and 2.9% for Medicare), can also be an unwelcome surprise for first-time small business filers. Like all other self-employed small businesses, on-demand platform small business operators are subject to self-employment tax and are required to file once they earn more than \$400 in net profit—even if this work is only a part-time gig.<sup>61</sup>

To encourage compliance, the tax law requires individuals with business income who want to claim business expenses to pay self-employment taxes.<sup>62</sup> A key challenge for these small business owners calculating their self-employment tax is that they are actually required to pay more in Social Security and Medicare taxes on this income than their employee counterparts because employees split Social Security and Medicare taxes with their employers, who automatically deduct and send amounts owed to the IRS.<sup>63</sup> No such luck for small business operators in the on-demand platform economy, who are on the hook for the entire amount—although half of the self-employment tax is deductible.

As noted earlier, self-employment taxes can add up quickly and trigger quarterly-estimated payment obligations; even where business income is only a portion of a taxpayer's overall income, which is the case for the average on-demand economy small business operator.<sup>64</sup> At the same time, we learned from talking to on-demand platform economy small business owners and some tax preparers that while taxpayers generally understood they would owe income tax on any income earned, many were surprised to learn that self-employment taxes were due too. These insights were echoed in our survey responses indicating that among respondents who earned on-demand platform economy income in 2015, 43% were unaware as to how much they would owe in taxes and did not set aside money for taxes on that income.<sup>65</sup>

**Q5** Did you set aside money or are you aware of how much you owe in taxes on the income you earned from working through a sharing economy platform or app during 2015?



Answer Choices	Responses
Yes	36 (57.14%)
No	27 (42.86%)

### 3. Communication: Expensing & Record Keeping

While actually forking over hard-earned income is likely the biggest complaint most taxpayers have, calculating how much is actually owed is a common compliance burden for small business operators in the on-demand economy. Moreover, identifying deductible business expenses and record-keeping are absolute musts in in order to properly determine how much a taxpayer actually owes.

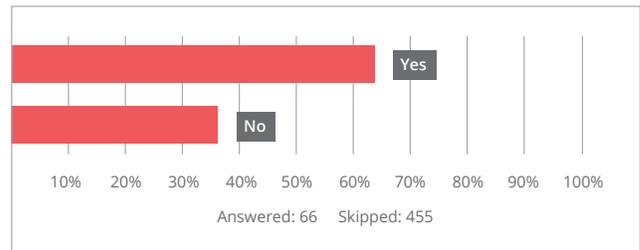
One of the most common business expenses that on-demand platform operators grapple with is how to calculate business expenses, such as miles driven or parking fees incurred. This tax compliance pain point is particularly acute for ridesharing drivers who use their personal cars to drive for on-demand platforms, but it also presents challenges for other types of platform work (i.e., running errands, purchasing supplies for customers). The tax code allows taxpayers to choose between taking a standard mileage deduction or deducting actual expenses incurred.<sup>66</sup> Research specific to the tax challenges of ridesharing drivers has identified mileage recordkeeping for business expensing as a frequent source of both confusion and frustration for drivers.<sup>67</sup>

For small businesses earning income using on-demand platforms other than ridesharing, a range of potential deductions and record-keeping requirements apply. In the accommodation platform context, if taxpayers want to take advantage of a tax provision that allows individuals to rent all or part of their home for up to 14 days tax free, deductions aren't allowed.<sup>68</sup> However, for those small business owners who do rent their properties out for longer (e.g., the typical Airbnb host

who rents their single property out for 66 days every year), deductible expenses include advertising, cleaning and maintenance, property insurance and taxes, service fees charged by the platform, and repairs.<sup>69</sup>

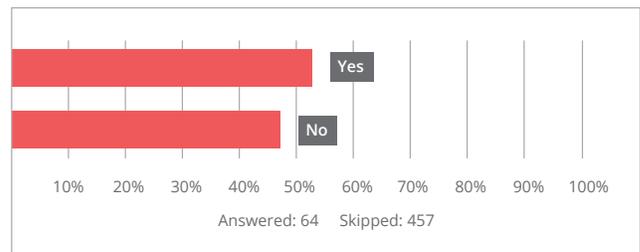
For online sellers using platforms, expensing questions become complicated, depending on where they work. In some cases, folks working out of their homes may be entitled to a home office deduction, but claiming that deduction has its challenges, and if taxpayers elect to take a simplified method of determining the deduction, they could very well be leaving money on the table.<sup>70</sup> We found through our survey of self-employed business owners who earned money in 2015 working with an on-demand platform that 36% of respondents didn't understand what kind of records they needed to keep for tax purposes and 47% didn't know about any tax deductions, expenses or credits that could be claimed related to their on-demand platform income.<sup>71</sup>

**Q6** Did you understand what kind of records you needed to keep for tax purposes for your business income and expenses generated from working with a sharing economy platform?



Answer Choices	Responses
Yes	42 (63.64%)
No	24 (36.36%)

**Q7** Do you know about any tax deductions, expenses or credits you could claim related to the income you earned working through a sharing economy platform or app?



Answer Choices	Responses
Yes	34 (53.13%)
No	30 (46.88%)

In general, this finding is not that surprising as the tax code doesn't necessarily include all that many provisions specific to individuals with business income.

“ When tax code provisions provide preferential treatment to small businesses, the provisions usually target expenses such as equipment investment (e.g., Section 179 expensing), cost of goods sold, (e.g., exceptions to inventory accounting), and start-up costs. Preferential [tax] treatment is not targeted towards individuals who provide only labor services. Those individuals generally do not benefit from provisions targeted to small businesses in the tax code.”<sup>72</sup>

Some platform operators inevitably pay the price for their inexperience in filing as small business owners the first time they file, but then develop a system of recordkeeping and familiarity with the process that keeps them out of trouble.<sup>73</sup> Others aren't so lucky.

To be sure, the private sector has developed any number of products and apps targeted to relieving these expensing and recordkeeping burdens, and in speaking to tax preparers and industry experts, we know that there is an exponentially growing market for these products.

#### 4. Timing: Cost of Compliance

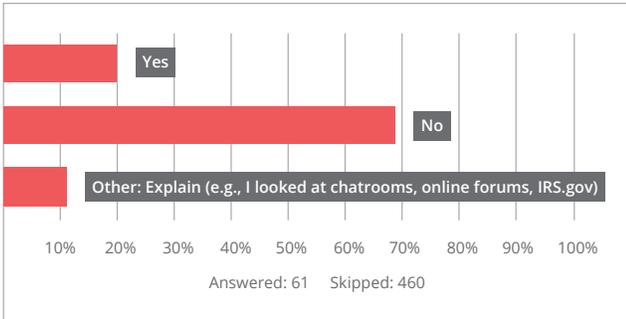
In 2014 testimony before the U.S. House of Representatives Small Business Committee, tax experts explained how tax compliance places a significant burden on small businesses, both in the aggregate and relative to large businesses, and cited IRS estimates that “businesses with less than \$1 million in revenue bear almost two-thirds of those costs.”<sup>74</sup> With respect to the on-demand platform economy, at least one tax expert has observed, “[p]robably most of those providing services through the new service companies have no experience with the tax obligations of businesses...to comply with tax laws, these microentrepreneurs will be spending relatively large amounts on return preparation assistance and devoting large hours to record keeping...the sharing economy will be bearing significantly larger than average tax compliance costs.”<sup>75</sup>

Costs can be quantified in terms of time spent preparing returns and chasing down answers to complex tax questions from the IRS. In her annual report to Congress, the National Taxpayer Advocate noted that during the 2015 tax filing season, only 37% of taxpayer calls routed to customer service representatives overall, and the hold time for taxpayers who got through averaged 23 minutes.<sup>76</sup> We heard time and again from both taxpayers and tax preparers that small businesses operating in the on-demand economy “generally want to be honest and pay what they owe, but the tools and resources don't exist.”<sup>77</sup>

Indeed, 69% of our survey respondents who earned income operating in the on-demand platform economy indicated that they did not receive any tax guidance or advice from the on-demand platform company with which they contracted.

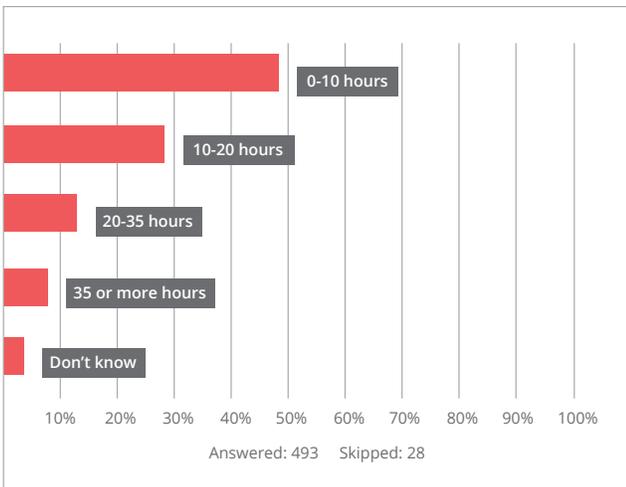
Evidence from our research and survey responses suggests that this lack of information and guidance results in undue burden on a significant portion of the 2.5 million on-demand platform economy operators in terms of compliance costs. Almost half of all our survey respondents indicated that they spent between 10 to 35 hours or more preparing their taxes for 2015.

**Q8** Did you receive any tax guidance or advice from the sharing economy platform or app you worked with?



Answer Choices	Responses
Yes	12 (19.67%)
No	42 (68.85%)
Other: Explain (e.g., I looked at chatrooms, online forums, IRS.gov)	7 (11.48%)

**Q9** How much time did you spend last year doing your taxes and/or preparing for your tax filing?



Answer Choices	Responses
0-10 Hours	237 (48.07%)
10-20 Hours	139 (28.19%)
20- 35 Hours	63 (12.78%)
35 or more hours	37 (7.51%)
Don't know	17 (3.45%)

## PART III

# Treasury is Probably Getting Shortchanged Too

Not only do inefficiencies of the current tax code and administration system result in unnecessary tax compliance challenges for small business operators in the on-demand platform economy, they directly translate to IRS' ability to fairly administer the tax system and Treasury's bottom line. In terms of budget consequences, the most recent data available from the IRS estimates that more than 42% (\$194 billion) of the tax gap, or the amount of tax liability in a given year that is not paid voluntarily and in a timely manner, is attributable to the misreporting of individual business income and related self-employment taxes from Schedule C filers that underreport receipts (e.g., failing to report cash transactions) or over-report expenses, which aren't subject to information reporting.<sup>78</sup>

Overall, compliance is highest where there is third-party reporting and/or withholding.<sup>79</sup> According to IRS statistics, in cases where employers do withholding, only 1% of wage and salary income is misreported; but in cases where there was no withholding or information reporting, the IRS has documented a 63% net misreporting rate.<sup>80</sup>

One reason small businesses are often considered major contributors to the tax gap is because they often deal in cash.<sup>81</sup> Not so with the on-demand platform economy operators—they deal exclusively in credit card, debit card or mobile payment transactions. Although some evidence suggests that Form 1099-K filings, which are used for reporting some credit and payment card transactions do trigger increases in small business' compliance in reporting gross receipts, the same study found that this increase of receipts was "largely offset" by increased reported expenses, which are not readily verifiable because they are not subject to information reporting.<sup>82</sup>

Even though sending Form 1099s to the IRS and taxpayers to report income is "widely acknowledged to increase voluntary tax compliance in part because taxpayers know that IRS is aware of their income,"<sup>83</sup> in order for this third-party reporting to be effective, *both the IRS and taxpayers have to actually receive a Form 1099.*<sup>84</sup> However, this outcome is not by any means

guaranteed by the current information reporting regime. As noted earlier, the current instructions to the Form 1099-MISC clearly state that "[p]ayments made with a credit card or payment card and certain other types of payments, including third party network transactions, must be reported on Form 1099-K...and are not subject to reporting on Form 1099-MISC."<sup>85</sup> At the same time, the Form 1099-K has its own 200 transaction/\$20,000 income threshold for payments made by credit card.<sup>86</sup>

As a result, the existing information reporting regime effectively creates a \$19,399 tax reporting loophole, which is the difference between \$20,000 and \$601—the income thresholds for Forms 1099-K and 1099-MISC.<sup>87</sup>

For example, under the current tax rules, a platform company isn't required to send a Form 1099-K or a Form 1099-MISC to the IRS for a small business operator who makes \$18,000 through 189 different transactions—all of which are payment card transactions and are described as de minimis payments for purposes of Form 1099-K.<sup>88</sup> Given what the research has documented regarding the monthly income of average on-demand platform economy operators, it's likely that the existing reporting rules are not operating to trigger Form 1099-Ks to be generated for a substantial number of taxpayers.

Remember, the average monthly income of on-demand platform small businesses ranges from \$533 to \$314 (roughly \$6,396 to \$3,700 annually), which means that the Form 1099-K \$20,000 income reporting threshold isn't being tripped by a significant portion of on-demand platform operators.<sup>89</sup> This income would otherwise be reported on a Form 1099-MISC, but for the fact that the payments were made via credit card and subject to the Form 1099-K 200 transaction/\$20,000 reporting threshold. This likely explains why 61% of our survey respondents who earned income in 2015 from working with an on-demand platform company indicated that they did not receive any Form 1099.

As a consequence of these rules, there is an increased likelihood that taxpayers will be unaware of the full extent of their tax compliance obligations. And less inclined to pay them. We have already started to document, at least anecdotally, the significance of this reporting hole.

“ I got tons of questions this year from [prospective clients] asking, ‘should I report my income?’ - I always advise to do so, otherwise, it would be tax evasion, but I would say more often times than not, people ask if they had to report their income if they aren’t receiving a 1099.”

— *Email from Small Business Tax Advisor, 2016*<sup>90</sup>

The IRS was informed of this tax reporting loophole in 2014, and issued a statement that noted, “[w]e are aware of a potential for 1099-MISC and 1099-K double reporting, and are constantly monitoring our case selection criteria to address this. We do expect to provide more guidance, but we also do not expect this issue to lead to an increase in examinations.”<sup>91</sup>

It’s two years later, and the on-demand economy has continued to grow to include more than 2.5 million U.S. taxpayers and is projected to include more than 7 million by 2020.<sup>92</sup> No guidance has been forthcoming, however, IRS Commissioner Koskinen recently reiterated the importance of third-party information reporting in the context of the tax gap noting, “when there is information reporting, such as 1099s, income is only underreported about 7 percent of the time...but that number jumps to 63% for income not subject to any third-party reporting or withholding.”<sup>93</sup>

Tax gap issues, particularly when they involve small businesses, are persistent and hard to resolve. Congress has attempted in recent years to enact legislation intended to curtail the tax gap using increased information reporting, but the impact of increased reporting requirements on small businesses resulted in almost immediate repeal.<sup>94</sup> Nevertheless, the Obama Administration has also recognized the tax gap as a pervasive issue and included, among other proposals targeted to addressing misclassification, a proposal to allow “independent contractors receiving payments of \$600 or more from a service recipient to require the service recipient to withhold for Federal tax purposes a flat rate percentage of their gross payments, with the flat rate percentage being selected by the contractor.”<sup>95</sup>

Notably, at least one on-demand platform is taking steps in that general direction. In October 2015, Airbnb announced plans to collect and remit state and local hotel and occupancy taxes in several jurisdictions including Washington state; Rhode Island; Washington, D.C.; Portland, OR; San Francisco, San Diego, Palo Alto and San Jose, CA; Philadelphia, PA; Phoenix, AZ and Paris, France.<sup>96</sup> In fact, Airbnb estimated that these additional tax collection revenue efforts could generate as much as \$2 billion in potential revenue for America’s cities.<sup>97</sup>

While a statutory or policy remedy may be premature for addressing the tax compliance challenges of on-demand platform operators and their impact on the tax administration system, Congressional investigation for purposes of tax reform is certainly warranted given the existing compliance challenges the current information reporting regime presents for the on-demand platform economy’s small businesses and the IRS’ ability to efficiently administer the tax code.

In the meantime, the IRS can take proactive steps to try and ease the tax compliance burden of on-demand economy participants and facilitate their compliance. Many small business owners we talked to had no idea what quarterly-estimated payments were much less when they were due and very few of the folks we chatted with had any idea that they would be liable for self-employment tax in addition to income taxes. Many of the on-demand platform companies we spoke with were very willing to do more to help their small business operators, but were constrained from doing so over concerns of raising misclassification challenges.

# Conclusion

Our assessment of the general confusion state of play when it comes to filing taxes on income earned from on-demand platform work was consistently reinforced by interviews with tax preparers, industry experts and the existing literature. At a minimum, the IRS should explore strategies in which it could leverage third parties (e.g., on-demand platform companies, tax software companies, tax preparers), to address this inefficient state of affairs. Everyone is losing under the current rules. Both taxpayers and the IRS deserve greater efficiency and less hassle. We can do better.

To be sure, the on-demand platform economy “adds an important element to existing labor markets, where finding new or additional work typically involves a lot of effort and high transaction costs...landing a platform job is often easier and quicker.”<sup>98</sup> And the on-demand platform economy is going to continue to grow and provide these opportunities.<sup>99</sup>

1. More than 2.5 million U.S. taxpayers are participating in the on-demand platform economy as small business owners every year, and millions more are set to join their ranks in the next decade.
2. For tax purposes, on-demand economy service providers and sellers are small businesses owners, but their numbers aren't reflected in government data designed to track small business owners. In fact, these taxpayers don't

necessarily realize they are small business owners until tax time or they receive an IRS notice.

3. At best, these small business owners are shortchanged when filing their taxes; at worst, they fail to file altogether. Approximately one-third of our on-demand platform operator survey respondents didn't know whether they were required to pay quarterly-estimated payments and almost half were unaware of any available deductions, expenses or credits they could claim to offset their tax liability. These taxpayers face potential audit and penalty exposure for failure to comply with filing rules that are triggered by relatively low amounts of earned income. Compounding this problem is inconsistent reporting rule adoption.
4. The current tax administration system isn't working for a significant percentage of on-demand platform small business operators or Treasury or IRS. More than 60% of our survey respondents who worked for an on-demand platform company in 2015 reported that they did not receive a Form 1099-K or Form 1099-MISC from their on-demand platform, which likely means the IRS didn't either. The current state of play is one of unnecessary burden, potential audit and penalty exposure for on-demand platform economy players. We can do better.

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- <sup>1</sup> *Computer and Internet Use Main*, U.S. Census Bureau (Mar. 30, 2016), <http://www.census.gov/hhes/computer/>.
- <sup>2</sup> Alexandra Brown, Sam Dodini, Arturo Gonzalez, Ellen Merry & Logan Thomas, *Consumers and Mobile Financial Services 2015*, Board of Governors of the Federal Reserve, 4 (Mar. 2015), <http://www.federalreserve.gov/econresdata/consumers-and-mobile-financial-services-report-201503.pdf>.  
See also, Aaron Smith & Diana Page, *The Smartphone Difference*, Pew Research Center (Apr. 1, 2015), [http://www.pewinternet.org/files/2015/03/PI\\_Smartphones\\_0401151.pdf](http://www.pewinternet.org/files/2015/03/PI_Smartphones_0401151.pdf).
- <sup>3</sup> *Airbnb's Growing Community of 60+ Women Hosts*, Airbnb (Mar. 2016), [https://www.airbnbaction.com/wp-content/uploads/2016/03/Airbnb\\_60\\_Plus\\_Women\\_Report.pdf](https://www.airbnbaction.com/wp-content/uploads/2016/03/Airbnb_60_Plus_Women_Report.pdf).  
  
Gene Sperling, *How Airbnb Combats Middle Class Income Stagnation*, Airbnb (June 21, 2015), <http://publicpolicy.airbnb.com/new-report-impact-airbnb-middle-class-income-stagnation>.
- <sup>4</sup> This is reflective of Uber's incredible growth. As of December 2014, Uber counted 160,000 as driver partners, and during just the last three months of 2014, Uber drivers earned \$657 million in revenue. Telephone Interview with Jonathan Hall, Head of Economic Research, Policy and Legal, Uber (Feb. 25, 2016).  
  
See also, Jonathan Hall and Alan Krueger, *Analysis of the Labor Market for Uber's Driver-Partners in the United States*, (Jan. 22, 2015), [https://s3.amazonaws.com/uber-static/comms/PDF/Uber\\_Driver-Partners\\_Hall\\_Krueger\\_2015.pdf](https://s3.amazonaws.com/uber-static/comms/PDF/Uber_Driver-Partners_Hall_Krueger_2015.pdf).
- <sup>5</sup> Diana Farrell & Fiona Greig, *Paychecks, Paydays, and the On-demand Platform Economy: Big Data on Income Volatility*, JP Morgan Chase Institute, 1-43 (2016) (The "2016 JP Morgan Chase Report"), <https://www.jpmorganchase.com/corporate/institute/document/jpmc-institute-volatility-2-report.pdf>.
- <sup>6</sup> *Id.*
- <sup>7</sup> "The percentage of workers engaged in alternative work arrangements – defined as temporary help agency workers, on-call workers, contract workers and independent contractors or freelancers – rose from 10.1% in February 2005 to 15.8% in late 2015." Lawrence F. Katz & Alan B. Krueger, *The Rise and Nature of Alternative Work Arrangements in the United States, 1995-2015*, (Mar. 29, 2016), [http://scholar.harvard.edu/files/lkatz/files/katz\\_krueger\\_cws\\_v3.pdf?m=1459369766](http://scholar.harvard.edu/files/lkatz/files/katz_krueger_cws_v3.pdf?m=1459369766).
- <sup>8</sup> A primary reason for why policymakers, tax and labor experts, and the online platforms companies have been slow to tackle the simmering tax issues underlying this evolving marketplace is the looming question of whether workers who provide services for customers via online platforms are really misclassified employees. If so, then the tax and labor questions at the heart of the on-demand platform economy have very different and measurable consequences for taxpayers, the on-demand platform companies and the IRS. Those issues are currently being litigated in courts in a number of jurisdictions across the country. See generally, Tracey Lein, *Meet the Attorney Suing Uber, Lyft, GrubHub and a Dozen California Tech Firms*, Los Angeles Times (Jan. 24, 2016), <http://www.latimes.com/business/technology/la-fi-class-action-lawyer-20160124-story.html>.  
  
This report takes the position that because the research to date consistently shows that millions of taxpayers are participating in the on-demand platform economy as small businesses, and millions more are set to join their ranks, for purposes of tax reform, review of the existing tax compliance challenges these taxpayers face is warranted, notwithstanding the outcome of a specific misclassification case. See also, Johana Bhuiyan, *Why the Uber Drivers' Lawyer Settled Their Fight to Become Employees*, <http://recode.net/2016/04/30/uber-drivers-employees-contractors-lawyer> (Apr. 30, 2016).
- <sup>9</sup> 2016 Kogod Survey of National Association of the Self-Employed Membership (April 2016) (unpublished raw survey data, National Association of the Self-Employed).
- <sup>10</sup> Jonathan Godfrey, Courtney Bernard & Nick Miller, *The State of the App Economy 4<sup>th</sup> Edition*, ACT The App Association (Mar. 21, 2016), [http://actonline.org/wp-content/uploads/2016\\_State\\_of\\_App\\_Economy.pdf](http://actonline.org/wp-content/uploads/2016_State_of_App_Economy.pdf).
- <sup>11</sup> Katy Steinmetz, *Exclusive: See How Big the Gig Economy Really Is*, Time (Jan. 6, 2016), <http://time.com/4169532/sharing-economy-poll/>.
- <sup>12</sup> Seth D. Harris & Alan B. Krueger, *A Proposal for Modernizing Labor Laws for Twenty-First-Century Work: The "Independent Worker,"* 10th ed. Vol. 2015. Hamilton Project, (2015).
- <sup>13</sup> We spoke with the primary author of this study who indicated that the results of the Emergent Survey were generally consistent with the results of the 2016 JP Morgan Chase Report. Steve King & Carolyn Ockels, Emergent Research Survey of On-Demand Economy (ODE) Survey (2016) (unpublished raw data).
- <sup>14</sup> Farrell, *supra* at n. 5.
- <sup>15</sup> For a host of reasons the U.S. Treasury Department outlined in a letter to Sen. Mark Warner in October 2015, publicly available taxpayer filings "do not provide a good measure of contingent workforce or independent contractor income, let alone the on-demand economy." Letter from the U.S. Department of the Treasury to Sen. Mark Warner (Oct. 27, 2015) TaxAnalysts Doc 2015-25376.
- <sup>16</sup> Farrell, *supra* at n. 5.
- <sup>17</sup> *Sharing Economy: Staff briefing of U.S. House of Representatives Sharing Economy Caucus*, 114<sup>th</sup> Congress (Feb. 4, 2016).
- <sup>18</sup> Kogod Survey, *supra* at n. 9.
- <sup>19</sup> In addition, among those respondents who indicated that they had earned money in 2015 from the on-demand platform economy, 74% earned less than \$5,000. *Id.*

<sup>20</sup> See King, *supra* at n. 13. See also, Farrell, *supra* at n. 5.

<sup>21</sup> Catherine Sullivan Burson-Marsteller, *Forty-Five Million Americans Say They Have Worked in the On-Demand Economy, While 86.5 Million Have Used It*, Aspen Institute, n. 11 (Jan. 6, 2016) <http://www.aspeninstitute.org/news/2016/01/06/forty-five-million-americans-say-they-have-worked-demand-economy-while-865-million>.

<sup>22</sup> This is not altogether surprising given that while nonemployer small businesses constitute “nearly three-quarters of all businesses...they contribute less than 4% of overall sales and receipts data...[and] due to their small economic impact, these firms are excluded from most other Census Bureau statistics.” *Nonemployer Statistics*, Census Bureau (2016), <https://www.census.gov/econ/nonemployer/index.html>.

<sup>23</sup> David McAfee, *Airbnb, Hosts Face Compliance Issues, Practitioners Say*, Bloomberg BNA Daily Tax Report (Oct. 22, 2015), [http://news.bna.com/dtln/DTLNWB/split\\_display.adp?fedfid=78043755&vname=dtrnot&wsn=512146000&searchid=27264877&doctypeid=1&type=date&mode=doc&split=0&scm=DTLNWB&pg=0](http://news.bna.com/dtln/DTLNWB/split_display.adp?fedfid=78043755&vname=dtrnot&wsn=512146000&searchid=27264877&doctypeid=1&type=date&mode=doc&split=0&scm=DTLNWB&pg=0).

<sup>24</sup> Carrying on a trade or business has been defined by the courts and IRS administrative guidance as the act of “engag[ing] in the selling of goods or services,” as a “livelihood or in good faith to make a profit,” in a “regular, frequent and continuous” manner. (*Deputy v. DuPont*, 308 U.S. 488 (1940)). Clear profit motive of small businesses has been confirmed by industry surveys that have identified the desire to make more money as the primary reason the majority of people work in the on-demand platform economy. See Emergent Research Survey, *supra* at n. 13. Further, in explaining what a trade or business is for purposes of determining whether a taxpayer is self-employed, the IRS Self-Employed Individuals Tax Center explains that a taxpayer does “not have to carry on regular full-time business activities to be self-employed...[h]aving a part-time business in addition to your regular job or business also may be self-employment.” *Business Activities*, Internal Revenue Services (Apr. 16, 2016), <https://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/Business-Activities>).

<sup>25</sup> U.S. Gov’t Accountability Office, GAO-15-513, *Small Businesses: IRS Considers Taxpayer Burden in Tax Administration, but Needs a Plan to Evaluate the Use of Payment Card Information for Compliance Efforts* (June 30, 2015), <http://gao.gov/products/GAO-15-513>.

<sup>26</sup> *Frequently Asked Questions about Small Business*, Small Business Association Office of Advocacy (March 2014), [https://www.sba.gov/sites/default/files/advocacy/FAQ\\_March\\_2014\\_0.pdf](https://www.sba.gov/sites/default/files/advocacy/FAQ_March_2014_0.pdf).

<sup>27</sup> *Id.* See also, GAO-15-513, *supra* at n. 25.

<sup>28</sup> For example, “nonemployer business is “one that has no paid employees, has annual business receipts of \$1,000 or more (\$1 or more in the construction industries), and is subject to federal income taxes.” Receipts include “gross receipts, sales, commissions, and income from trades and businesses, as reported on annual business income tax returns.” Given the data available on the average monthly income of small businesses operating in the on-demand economy, it would appear that most of those small businesses would meet Census’ criteria of “nonemployer businesses.” Sarah A. Donovan, David H. Bradley & Jon O. Shimabukuro, Cong. Research Serv. No. R44365, *What Does the Gig Economy Mean for Workers?* (Feb. 5, 2016), <https://www.fas.org/sgp/crs/misc/R44365.pdf>.

<sup>29</sup> U.S. Gov’t Accountability Office, GAO-14-652R, *Tax Policy: Differences in Definitions and Rules in the Tax Code*, (July 8, 2014), <http://gao.gov/products/GAO-14-652R>. (Concluding that “the definition of small business can depend on number of employees, amount of gross receipts, and other characteristics.”).

<sup>30</sup> See GAO-15-513, *supra* at n. 25.

<sup>31</sup> *Id.*

<sup>32</sup> Specifically, GAO began its analysis with identifying what groups of taxpayers were small businesses, using two distinct litmus tests developed by Treasury in 2011 as a more “nuanced approach to identifying small businesses.” Each of these tests had specific income thresholds that a business return would first have to meet. Under the *De Minimis Test*, total income or deductions would need to exceed \$10,000 or their sum exceed \$15,000, and under the *Business Activities Test*, total deductions should exceed \$5,000 in order for a return to be counted as a small businesses. Notably, in 2011, when Treasury first developed these tests, it used them to measure taxpayers with some business income as reported on 2007 Schedule C returns—well-before the advent of the on-demand platform economy—and found that 12.5 million Schedule C filers did not meet the *De Minimis Test* and 2.3 filers failed the *Business Activities Test*. Similarly, the two business tests eliminated 5.0 million Schedule E rental filers as small businesses. On average, the Schedule C filers that failed these income thresholds reported \$7,000 of total income and \$4,600 of net income, whereas the excluded Schedule E filers reported an average of \$8,400 of total income and \$800 of net income. In developing this approach, OTA focused on incorporating income thresholds to ensure that misclassified employees and non-business income, or hobby income, were excluded in the methodology. Office of Tax Analysis, OTA Technical Paper No. 4, *Methodology to Identify Small Businesses and Their Owners* (Aug. 8, 2011), <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/OTA-TP-4.pdf>.

<sup>33</sup> We reiterate that these monthly income averages are just that, averages. There are likely numerous examples of Etsy sellers or TaskRabbit taskers or Lyft drivers earning well in excess of these averages. However, current taxpayer filing data precludes a more precise understanding of income earned by small businesses. Farrell, *supra* at n. 5. See Also, Treasury Letter to Warner, *supra* at n. 15.

<sup>34</sup> Furthermore, one estimate suggested that sharing economy companies have the potential to increase global revenues from roughly \$15 billion today to around \$335 billion by 2025. PwC, *The Sharing Economy: Consumer Intelligence Series*,(2015). <https://www.pwc.com/us/en/technology/publications/assets/pwc-consumer-intelligence-series-the-sharing-economy.pdf> (2015).

<sup>35</sup> Emergent Research Survey *supra* at n. 13. See also, Rob Wile, *There Are Probably Way More People in the ‘Gig Economy’ Than We Realize*, Fusion (July 27, 2015) <http://fusion.net/story/173244/there-are-probably-way-more-people-in-the-gig-economy-than-we-realize/>.

<sup>36</sup> See CRS R44365 *supra* at n. 28.

<sup>37</sup> 2016 JP Morgan Chase & Co. Institute, *The Online Platform Economy: What is the Growth Trajectory?* Insight blogpost (May 2, 2016), <https://www.jpmorganchase.com/corporate/institute/institute-insights.htm>.

<sup>38</sup> In contrast, some government measures of the smallest of small businesses do not reflect a similar growth. In particular, BLS data tends to indicate that in the period from 2002 through 2015, self-employment gradually declined and subsequently flattened. That noted, the Katz & Krueger Report determined

that the proportion of workers in alternative contingent relationships (i.e., independent contractors, temps, on-call and on-demand economy workers) showed an increase of 9.4 million from 2005 to 2015. However, these estimates only consider full-time positions and not part-time positions. Katz & Krueger Report, *supra* at n. 7.

<sup>39</sup> Arjan Schutte & Colleen Poynton, *1099 Problems And W2s Ain't One: The 1099 Economy's Problems, Advantages, and Outlook*, CB Insights Blog, (Sept. 15, 2015) <https://www.cbinsights.com/blog/1099-economy-opportunities-threats> (citing, *Intuit 2020 Report*, Intuit (Oct. 2010) [http://http-download.intuit.com/http.intuit/CMO/intuit/futureofsmallbusiness/intuit\\_2020\\_report.pdf](http://http-download.intuit.com/http.intuit/CMO/intuit/futureofsmallbusiness/intuit_2020_report.pdf)).

<sup>40</sup> Anna Louie Sussman & Josh Zumbrun, *Contract Workforce Outpaces Growth in Silicon-Valley Style 'Gig' Jobs*, The Wall Street Journal (Mar. 25, 2016) <http://www.wsj.com/articles/contract-workforce-outpaces-growth-in-silicon-valley-style-gig-jobs-1458948608>. See also, Katz & Krueger Report, *supra* at n. 7.

<sup>41</sup> See U.S. Sen. Comm. on Finance, *The Business Income Tax Bipartisan Tax Working Group Report* (July 2015) <http://www.finance.senate.gov/newsroom/chairman/release/?id=e9eefc66-7e11-4276-939f-3eca6fd6d959>.

<sup>42</sup> "Many [small businesses] are self-employed for the first time and unaware of the need to keep careful records and make estimated tax payments four times a year. They've never filed a Schedule C, or paid self-employment taxes." Kathleen Pender, *Here's Why Uber and Lyft Send Drivers Such Confusing Tax Forms*, San Francisco Gate (Feb. 20, 2015) <http://www.sfgate.com/business/networth/article/Here-s-why-Uber-and-Lyft-send-drivers-such-6092403.php>.

<sup>43</sup> Shu-Yi Oei & Diane M. Ring, *The Tax Lives of Uber Drivers: Evidence from Internet Discussion Forums*. (Feb. 10, 2016), [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2730893](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2730893).

<sup>44</sup> Schutte, *supra* at n. 39.

<sup>45</sup> Harris, *supra* at n. 12.

<sup>46</sup> Robert W. Wood, *Do You Want a 1099 or a W-2?*, Forbes, (Nov. 21, 2013) <http://www.forbes.com/sites/robertwood/2013/11/21/do-you-want-a-1099-or-a-w-2/#3bd642c449f1>.

<sup>47</sup> IRC § 6041.

<sup>48</sup> IRC § 6050W.

<sup>49</sup> See generally, Lyft, <https://help.lyft.com/hc/en-us/articles/213582038-Tax-Information> (last visited Apr. 16, 2016); Airbnb, <https://www.airbnb.com/help/article/414/should-i-expect-to-receive-a-tax-form-from-airbnb> (last visited Apr. 16, 2016); and Etsy, <https://www.etsy.com/seller-handbook/article/taxes-101-for-etsy-sellers/22721885775> (last visited Apr. 16, 2016).

<sup>50</sup> *2016 Instructions to Form 1099-MISC*, Internal Revenue Service, <https://www.irs.gov/pub/irs-pdf/i1099misc.pdf>.

<sup>51</sup> How to Access my 1099, Uber, <https://help.uber.com/h/9666752c-b088-4090-8e58-ba923938253a> (last visited Apr. 16, 2016).

<sup>52</sup> Both Uber and Lyft include language on their websites explaining circumstances when their drivers may expect to receive both types of Forms 1099.

<sup>53</sup> Kogod, *supra* at n. 9.

<sup>54</sup> Mark P. Keightly, Cong. Research Service, R41400, *Economic Analysis of the Enhanced Form 1099 Information Reporting Requirements* (2011) [http://www.ncsl.org/documents/health/Analysis1099\\_12111.pdf](http://www.ncsl.org/documents/health/Analysis1099_12111.pdf).

<sup>55</sup> There is an exception to this requirement where a taxpayer had no tax liability and was a U.S. citizen or resident for the prior 12-month period.

<sup>56</sup> *Form 1040 Estimated Tax for Individuals*, Internal Revenue Service (Apr. 16, 2016), <https://www.irs.gov/uac/Form-1040-ES,-Estimated-Tax-for-Individuals-1>.

<sup>57</sup> Polly Mosendz, *Young, Broke, and Scared of the IRS: The Millennial Tax Trap*, BloombergBusiness, (Mar. 24, 2016), <http://www.bloomberg.com/news/articles/2016-03-24/young-broke-and-scared-of-the-irs-the-millennial-tax-trap>.

<sup>58</sup> *Form 1040 Estimated Tax*, *supra* at n. 56.

<sup>59</sup> *Id.*

<sup>60</sup> Interview with Chief Counsel Field Attorney, Internal Revenue Service, (Mar. 16, 2016). Notes and follow-up texts on file with author.

<sup>61</sup> *Self-Employed Individuals Tax Center*, Internal Revenue Service (2016), <https://www.irs.gov/Individuals/Self-Employed>.

<sup>62</sup> Jennifer Spiesz & Charles Harter, *Self-Employment or Other Income?*, Journal of Accountancy (Jul. 2009), <http://www.journalofaccountancy.com/issues/2009/jul/20091639.html#sthash.CRYfHqzh.dpuf>.

<sup>63</sup> Tara Siegel Bernard, *Tax Tips for Those Who Make Money in the Gig Economy*, The New York Times (Mar. 31, 2016), [http://www.nytimes.com/2016/03/05/your-money/tax-tips-for-those-who-make-money-in-the-gig-economy.html?\\_r=0](http://www.nytimes.com/2016/03/05/your-money/tax-tips-for-those-who-make-money-in-the-gig-economy.html?_r=0).

<sup>64</sup> King, *supra* at n. 13.

<sup>65</sup> Kogod, *supra* at n. 9.

<sup>66</sup> IRC §274(d). <https://www.irs.gov/publications/p463/ch04.html>.

<sup>67</sup> Oh, and commuting miles? Forget it—those generally aren't deductible. Oei, *supra* at n. 43.

- <sup>68</sup> Laura Saunders, *Airbnb Income May Be Tax-Free – But There’s a Catch*, Wall Street Journal (Apr. 2, 2015) <http://www.wsj.com/articles/popular-tax-break-can-lead-to-filing-hassles-1427982638>.
- <sup>69</sup> *Airbnb: General Guidance on the Taxation of Rental Income*, Airbnb (Mar. 31, 2016) <http://assets.airbnb.com/eyguidance/us.pdf>.
- <sup>70</sup> Bernard, *supra* at n. 63.
- <sup>71</sup> Kogod, *supra* at n. 9.
- <sup>72</sup> OTA Tech. Paper No. 4, *supra* n. 32.
- <sup>73</sup> Bernard, *supra* n. 63.
- <sup>74</sup> Donald J. Marron, *Tax Issues Facing Small Business*, Testimony before the House Small Business Committee, (Apr. 9, 2014), <http://www.urban.org/sites/default/files/alfresco/publication-pdfs/904621-Tax-Issues-Facing-Small-Business.PDF>.
- <sup>75</sup> Martin A. Sullivan, *10 Tax Challenges for the Sharing Economy*, Tax Notes (July 13, 2015), <http://www.taxnotes.com/tax-notes/excise-taxes/economic-analysis-10-tax-challenges-sharing-economy/2015/07/13/14910186>.
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- <sup>77</sup> Interview with Derek Davis, Founder, [www.sharedeconomycpa.com](http://www.sharedeconomycpa.com) (Apr. 13, 2015). Davis is the Founder of [www.sharedeconomycpa.com](http://www.sharedeconomycpa.com), a company he launched in 2014 to specialize in providing tax preparation services for individuals participating in the on-demand platform economy. Since its founding, SharedEconomyCPA has grown 300%.
- <sup>78</sup> *Tax Gap Estimates for Tax Years 2008-2010*, Internal Revenue Service (April 2016) <https://www.irs.gov/PUP/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf>.
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- <sup>80</sup> *Id.*
- <sup>81</sup> Marron, *supra* n. 74.
- <sup>82</sup> Joel Slemrod, Brett Collins, Jeffrey Hoopes, Daniel Reck, & Michael Sebastiani, *Does Credit-Card Reporting Improve Small Business Tax Compliance?* (Oct. 2, 2015), <http://ssrn.com/abstract=2515630> or <http://dx.doi.org/10.2139/ssrn.2515630>.
- <sup>83</sup> U.S. Gov’t Accountability Office, GAO-11-218T, *Small Businesses: Tax Compliance Benefits and Opportunities to Mitigate Costs on Third Parties of Miscellaneous Income Reporting Requirements* (2010), <http://www.gao.gov/new.items/d11218t.pdf>.
- <sup>84</sup> Cohn, *supra* at n. 79.
- <sup>85</sup> *2016 Instructions to Form 1099-MISC*, *supra* at n. 50.
- <sup>86</sup> *2016 Instructions to Form 1099-K*, Internal Revenue Service (2016), <https://www.irs.gov/pub/irs-pdf/i1099k.pdf>.
- <sup>87</sup> Kelly Phillips Erb, *Credit Cards, the IRS, Form 1099-K and the \$19,399 Reporting Hole*, Forbes Magazine (Mar. 28, 2016) <http://www.forbes.com/sites/kellyphillipserb/2014/08/29/credit-cards-the-irs-form-1099-k-and-the-19399-reporting-hole/#369f81916c37>.
- <sup>88</sup> *2016 Instructions to Form 1099-K*, *supra* at n. 86.
- <sup>89</sup> *Id.* Uber being a notable exception—they send every one of their driver-partners a Form 1099-K, regardless of income earned.
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- <sup>91</sup> Erb, *supra* at n. 87.
- <sup>92</sup> King, *supra* at n. 13.
- <sup>93</sup> Cohn, *supra* at n. 79.
- <sup>94</sup> Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011, P.L. 112-9.
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