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U.S. Senate Committee on Finance

Subcommittee on Taxation and IRS Oversight

Testimony in Connection with the July 26th Hearing

"Improving Tax Administration Today."

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Subcommittee Chair Portman, Ranking Member Warner, Members of the U.S. Senate Committee on Finance Subcommittee on Taxation and IRS Oversight (the "Committee") and staff, thank you for the opportunity to testify today. My name is Caroline Bruckner and I am a tax professor on the faculty at American University's Kogod School of Business. I also serve as the Managing Director of the Kogod Tax Policy Center (KTPC), which conducts non-partisan policy research on tax and compliance issues specific to small businesses and entrepreneurs. We develop and analyze solutions to tax-related problems faced by small businesses.

Prior to joining AU's faculty, I served on the staff of the U.S. Senate Committee on Small Business and Entrepreneurship, from 2009-2014, ultimately as Chief Counsel. Before public service, I worked in private practice in Washington D.C. as a tax attorney with both PaulHastings and PwC's Washington National Tax Services.

Since March 2015, I've directed the KTPC's efforts towards developing research on the tax and compliance issues impacting America's latest iteration of self-employed small business owners who are renting rooms, providing ride-sharing services, running errands, and selling goods to consumers in business transactions coordinated online and through app-based platforms developed by companies such as Airbnb, Etsy, Uber, Lyft, Taskrabbit, Instacart and others (i.e., the "sharing economy" or the "on-demand platform economy").[1]

In May 2016, we released groundbreaking research in a report titled, "Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy." Our research included—for the first time—survey data from a range of on-demand platform service providers and sellers that quantified the reality that under current tax rules, most of these taxpayers are not likely to receive any Form 1099 regarding the income they earn through these platforms.[2] One major consequence of this is that millions of these small businesses are working and earning income in ways that are not readily identifiable by existing government research or publicly-available taxpayer filing data.[3]

Our research concluded that this growing problem demands Congress' attention to more fully consider how to fairly and efficiently administer the U.S. tax code with respect to these small business taxpayers, who typically are required to report this income on a Schedule C or

[1] Kogod Tax Center, *Letter to U.S. Senate Committee on Finance Bipartisan Business Tax Working Group Submission* (April 15, 2015), *available at* https://www.finance.senate.gov/legislation/details/business-tax-working-group-submissions.

[2] Caroline Bruckner, *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy*, AMERICAN UNIVERSITY KOGOD TAX POLICY CENTER (May 2016), *available at* https://www.american.edu/kogod/research/upload/shortchanged.pdf

[3] *See e.g.*, Letter from the U.S. Department of the Treasury to Sen. Mark Warner, Tax Analysts (Oct. 27, 2015) Doc 2015-25376. However, there are some official measures of independent contractors and alternative contingent work. *See, e.g.*, the June 2018 U.S. Bureau of Labor Statistics (BLS) release of its 2017 measure of the alternative contingent workforce, *available at* https://www.bls.gov/news.release/conemp.nr0.htm. BLS is scheduled to release 2017 survey data specific to the gig economy on September 30, 2018.

Schedule E and are not subject to withholding on these earnings.[4] A number of findings we review in Shortchanged are particularly relevant to today's discussion, including:[5]

1. Size of the On-Demand Platform Economy: At least 2.5 million Americans are earning income via on-demand platforms every month (this translate to approximately 4.2% of adults or more than 10 million from 2012-2015);[6] and

2. Average Income of On-Demand Economy Small Businesses: 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." Average monthly income from active participation ranges from $533 to $314.[7] Other studies have found that an overwhelming majority—85%—of gig workers make less than $500 per month.[8]

In addition, as part of our research on the tax compliance challenges of these taxpayers, we initiated a 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).[9]

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[4] *See* Annette Nellen, Caroline Bruckner and Jennifer Brown, *Taxes and the Growing Gig Workforce: What to Know*, JOURNAL OF TAXATION, Vol. 128 No. 6 (June 2018) (summarizing the tax rules specific to on-demand platform economy service providers and sellers). A primary reason for why policymakers, tax and labor experts, and the online platforms companies have been slow to tackle the simmering tax and compliance issues underlying this evolving marketplace is the looming question of whether workers who provide services for customers via online platforms are really misclassified employees. Those issues are currently being litigated in courts in a number of jurisdictions across the country. Our view is that because the research to date consistently shows that millions of taxpayers actively participate in the on-demand platform economy as small business owners, addressing the existing tax compliance challenges these taxpayers face is warranted, notwithstanding the outcome of a specific misclassification case applicable to a single online platform company.

[5] In *Shortchanged*, we adopted the on-demand platform economy criteria used in the first major study to track actual income earned using financial transaction data from platforms that: 1) directly connect service providers and sellers with consumers; 2) process payment electronically; 3) allow service providers and sellers to provide goods or services at their discretion; and 4) customers pay for a singular task or good. Bruckner, *supra* at n. 2 at 4.

[6] Diana Farrell & Fiona Greig, *Paychecks, Paydays, and the On-demand Platform Economy: Big Data on Income Volatility*, JP MORGAN CHASE INSTITUTE, (February 2016), https://www.jpmorganchase.com/corporate/institute/document/jpmc-institute-volatility-2-report.pdf. Other tax preparer industry experts we've consulted in our research have gone so far as to note that "their own studies found that 34% of the U.S. workforce participates in the gig economy, with this number projected to grow to 43% by 2020." Patrick Gillespie, *Intuit: Gig Economy is 34% of U.S. Workforce*, CNN MONEY, (May 24, 2017), *available at* https://money.cnn.com/2017/05/24/news/economy/gig-economy-intuit/index.html.

[7] Farrell, *supra* n. 6.

[8] Abha Bhattarai, *Side hustles are the new norm*, THE WASHINGTON POST (July 3, 2017), *available at* https://www.washingtonpost.com/news/business/wp/2017/07/03/side-hustles-are-the-new-norm-heres-how-much-they-really-pay/.

[9] 2016 Kogod Survey of National Association of the Self-Employed Membership (April 2016) (unpublished raw survey data, National Association of the Self-Employed). Our intention in conducting the survey was not to prepare a statistically reliable

Our survey results revealed that among respondents who had earned income working with an on-demand platform company in 2015, which was approximately 22% of all of our respondents:

- Approximately one-third did not know whether they were required to file quarterly-estimated payments with the IRS on their on-demand platform income;
- 36% did not understand what kind of records were needed for tax purposes for business income and expenses generated from working with a sharing economy partner;
- 43% were unaware as to how much they would owe in taxes and did not set aside money for taxes on that income; and
- Almost half did not know about any tax deductions, expenses or credits that could be claimed related to their on-demand platform income.

The population we surveyed can be generally considered experienced, self-employed taxpayers when viewed in terms of their NASE membership, and yet their responses indicate a significant lack of understanding and information available regarding self-employed tax filing obligations in addition to undue tax compliance burdens for reporting income earned in the on-demand platform economy.

Moreover, almost 70% of survey respondents received no tax guidance from platform they worked with, and most notably for tax administration purposes, <u>more than 60% of the sharing economy operators we surveyed did not receive any Form 1099 on their platform income and that means the IRS didn't either</u>.

Our survey findings are consistent with current law reporting requirements. In general, a Form 1099-MISC is required on amounts paid by nonemployers to service providers and sellers on amounts of $600, but, if a payment is made via a credit card or debit card, nonemployers are instructed to use a Form 1099-K.[10] However, in cases where a Form 1099-K is required, a taxpayer must have more than 200 transactions *and* payments exceeding $20,000 before the Form 1099-K reporting rules are triggered. As a result of the 200 transaction/$20,000 income thresholds for Form 1099-K filings, the majority of small business on-demand platform operators are not guaranteed to receive a Form 1099-K because, on average, they earn substantially less than $20,000 per year.[11]

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estimate of the entire American population of the self-employed or freelancers or all workers in the on-demand platform economy. Instead, our objective was 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. During March 2016, NASE invited approximately 40,000 members to participate in the survey and received 518 responses.

[10] Bruckner, *supra* n. 2.

[11] *Id.* at 7.

The failure of Congress to require Form 1099 be provided to these small business taxpayers by the platforms they contract with to sell goods and services has significant consequences for taxpayers and the IRS. Taxpayers are more likely to misreport their income and face audit and penalty exposure. According to the IRS' own research, in circumstances where there is no withholding or information reporting, the IRS has documented a 63% net misreporting rate.[12]

In fact, IRS taxpayer data released last year confirmed the ultimate impact of our research findings: for 2015, the number of filers penalized for underpaying estimated taxes rose nearly 40% between 2010 and 2015—to 10 million from 7.2 million.[13] At the same time, the government, too, is being shortchanged of the tax revenue its owed. In terms of budget consequences, the most recent analysis from GAO of the $458 billion net tax gap finds that underreporting of business income by sole proprietors "accounted for the largest share of individual income tax underreporting."[14]

However, in response to the release of Shortchanged, significant work has been done by both the IRS and industry stakeholders to help sharing economy operators navigate the complexity of the tax code. For example:

1. In August 2016, the IRS launched the Sharing Economy Tax Center on IRS.gov "to help taxpayers involved in the sharing economy quickly locate the resources they need to help them meet their tax obligations;"[15]

2. The National Taxpayer Advocate elevated the lack of tax guidance for sharing economy workers as one of the nation's most serious problems facing taxpayers on the basis of our survey of NASE members in her most recent annual report to Congress;[16] and

3. Some industry platforms began issuing Form 1099-Ks to sharing economy operators even though not required to under current law.[17]

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12 Internal Revenue Service, *Tax Gap Estimates for Tax Years 2008-2010* (May 2016), *available at* https://www.irs.gov/pub/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf.

13 Laura Saunders, *Number of Americans Caught Underpaying Their Taxes Surges 40%*, THE WALL STREET JOURNAL, (Aug. 11, 2017) *available at* https://www.wsj.com/articles/the-numberof-americans-caught-underpayingsometaxes-surges-40-1502443801. In addition, we consulted tax form preparer industry stakeholders in connection with preparing this testimony who informed us, on a confidential basis, that fewer forms are being reported (reduced by 35% from 2016 to 2017) despite growth in the space and that the drop in 1099Ks correlates to fewer taxpayers reporting sharing economy income.

14 U.S. Government Accountability Office, *Tax Gap – IRS Needs Specific Goals and Strategies for Improving Compliance*, Report to Committee on Finance, U.S. Senate, GAO-18-39 (October 2018) *available at* https://www.gao.gov/products/GAO-18-39.

15 Press Release, IRS, *IRS Launches New Resource Center on IRS.gov, Provides Tips for Emerging Business Area* (Aug. 22, 2016) *available at* https://www.irs.gov/businesses/small-businesses-self-employed/sharing-economy-tax-center.

16 Taxpayer Advocate Service, *2017 Annual Report to Congress – Volume 1* (December 2017) *available at* https://taxpayeradvocate.irs.gov/Media/Default/Documents/2017-ARC/ARC17_Volume1_MSP_14_SharingEconomy.pdf

17 See e.g., Lyft, *Tax Information For U.S. Drivers*, available at https://help.lyft.com/hc/en-us/articles/115012926967-Tax-information-for-US-drivers.

But there is more work to be done. Congress can't rely on the goodwill of industry stakeholders who are not required by law to provide 1099s or tax guidance to these taxpayers. To facilitate tax administration, compliance and aid these smallest of small business owners, Congress needs to take additional action.

1. Align the Form 1099-MISC and 1099-K Reporting Thresholds

Congress should move forward with modernizing the information reporting regime by lowering the filing threshold for Form 1099-K to $1,500 to ensure at the very least taxpayers have the forms they need to file their taxes and claim any deductions or credits they may be entitled to in order to lower their tax liability. At the same time, Congress should update the Form 1099-MISC threshold by raising it from $600 to $1,500 to provide some relief for small businesses who are subject to the Form 1099-MISC filing rules. Keep in mind, the Form 1099-MISC filing thresholds have not been fundamentally reviewed or updated since at least 1954.[18] Adjusted for inflation, $600 in 1954 would be more than $5,000 in today's dollars.[19]

By creating a uniform reporting standard for filing for Form 1099-MISC and Form 1099-K, Congress is likely to enhance compliance by both taxpayers and reporting entities because more taxpayers will receive Form 1099s, which is abundantly supported by the existing research on tax compliance and information reporting, and will benefit other self-employed small business owners operating outside the sharing economy, but who primarily are paid via credit card transactions. Some states have already moved forward with this approach and aligned the 1099-K and 1099-MISC reporting thresholds at the current 1099-MISC level of $600 with positive results.[20]

2. Update Quarterly-Estimated Payment Due Dates

Under current tax rules, when self-employed taxpayers 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

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[18] See P.L. 83-591, which was enacted on Aug. 16, 1954 and which created IRC Section 6041 with the original $600 threshold.

[19] H.R. 3717 takes the approach of aligning the Form 1099 threshold filing requirements at $1,500, among other tax changes targeted to small business. Other bills, notably, S. 1549, would align the thresholds at $1,000. S. 1549 goes further and includes other provisions on misclassification and provides for voluntary withholding agreements to be instituted between platforms and their service providers and sellers. The Joint Committee on Taxation (JCT) provided a score for S. 1549 and estimated that aligning the information reporting thresholds for raises approximately $3.6 billion over a 10-year budget window. JCT, *Estimated Revenue Effects Of The Chairman's Mark Of The "Tax Cuts And Jobs Act," Scheduled For Markup By The Committee On Finance On November 13, 2017* (JCX-52-17) (Nov. 9. 2017), *available at* https://www.jct.gov/publications.html?func=startdown&id=5033. S. 1549 is laudable because it is an important marker for a larger overdue policy review of our current withholding regime, which Congress needs to comprehensively review and reform.

[20] In 2017 both Vermont and Massachusetts began to require information reporting for income earned by small business on-demand platform operators and paid electronically at the current 1099-MISC threshold of $600. According to the industry experts we consulted in preparing this testimony, the lower reporting threshold in Massachusetts "catapulted reporting by over 100%."

throughout the year in the form of quarterly-estimated payments.[21] It just doesn't take that much income to trip over these filing requirements. Our survey found that more than one-third of respondents did not know whether they were required to file quarterly-estimated payments on the income they earned working with a platform.[22]

As the National Taxpayer Advocate has repeatedly recommended, anything that can be done "to help taxpayers make their estimated tax payments more easily and lessen the burden of saving to make such payments is likely to increase compliance."[23] In order to facilitate tax compliance and ease taxpayer burden, Congress should update the filing deadlines for second and third quarter installment payments set forth in IRC Section 6654(c) to be due two weeks after a quarter's end, rather than in the middle of a quarter as is required under current law.

The bipartisan small business tax bill proposed by the House Small Business Committee (H.R. 3717) in this Congress does just that and modernizes the existing filing deadlines to reflect business reality of the second and third quarters' end. As a result, this change is likely to increase compliance because under current law "taxpayers must remember oddly spaced payment dates…[that] do not consistently coincide with calendar quarters, making difficult to calculate net income and confusing to tax payers."[24] By simply changing existing due dates to fall after a quarter's end, Congress can ease the burdensome process of estimating income for purposes of remitting quarterly-estimated payments because taxpayers will know how much they earned the preceding quarter rather than requiring taxpayers to make their best guess.

3. **Require the IRS to Develop and Publish Guidance for On-Demand Platforms to Provide Service Providers and Sellers as Part of the On-Boarding Process.**

Our survey data of experienced self-employed taxpayers operating in the sharing economy found that there is a significant knowledge gap between what taxpayers understand their tax obligations to be, if any, and what they actually are. From talking to industry stakeholders, we know that many platforms are hesitant to provide tax information to their service providers and sellers due to ongoing concerns and litigation over misclassification issues. To address the knowledge gap, the National Taxpayer Advocate has recommended the IRS develop a checklist for first-time, self-employed on-demand economy workers and sellers. We couldn't agree more. Time and again we have heard from IRS lawyers and tax preparers that most

[21] Form 1040 Estimated Tax for Individuals, Internal Revenue Service (July 23, 2018), https://www.irs.gov/forms-pubs/about-form-1040-es.

[22] The Sharing Economy: A Tax Experience for New Entrepreneurs Part I: Hearing Before the House Comm. on Small Business, 113th Congress (2016)(statement of Caroline Bruckner, Managing Director, Kogod Tax Policy Center) *available at* https://smallbusiness.house.gov/uploadedfiles/5-24-16_bruckner_testimony_.pdf.

[23] *The Sharing Economy: A Tax Experience for New Entrepreneurs Part II: Hearing Before the House Comm. on Small Business*, 113th Congress (2016)(statement of Nina Olson, IRS National Taxpayer Advocate) *available at* https://smallbusiness.house.gov/uploadedfiles/national_taxpayer_advocate_testimony-5-26-2016_hearing.pdf.

[24] *Id.*

folks want to do right thing, but are unfamiliar with the requirements of quarterly-estimated payments. By the time taxpayers learn that they have failed to file quarterly-estimated payments on this income, many just walk away and fail to file altogether. By developing accessible content that platforms can distribute to service providers and sellers as part of the onboarding process, the IRS can make immediate progress in addressing the knowledge gap even experienced, self-employed small business owners have. This is particularly important for 2018 as many on-demand small business owners will benefit from changes included in 2017's tax reform bill.

Conclusion

Current tax administration rules are shortchanging the small business taxpayers powering the on-demand platform economy—who in most instances don't earn enough income to warrant receiving tax reporting forms from the online platforms they work with to file the taxes they owe and claim any offsets or deductions they are entitled to lower their tax bills as well as credit their Social Security accounts for amounts earned.[25]

Taken together with our additional research, our findings suggest that, at best, many small business owners are shortchanged when filing their taxes on their platform income; at worst, they fail to report it altogether. Moreover, a significant percentage of these taxpayers could face potential audit and penalty exposure for failure to comply with filing rules that are triggered by relatively low amounts of earned income. Congress has the tools at its disposal to make significant progress in remedying this growing problem. Thank you for the opportunity to share our research with you today and I welcome your questions regarding the foregoing testimony.

[25] *See* Bruckner, *supra* n. 2. *See also*, Caroline Bruckner, Jen Brown and Thomas Hungerford, *Failure to Contribute: The Consequences of Non-and Underpayment of Self-Employment Taxes of On-Demand Workers on Social Security*, American University Kogod Tax Policy Center (forthcoming October 2018) (draft on file with witness).