AMERICAN UNIVERSITY

WASHINGTON, DC

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April 15, 2015

The Honorable Mike Enzi
The Honorable Charles Grassley
The Honorable Debbie Stabenow
Co-Chairs of the Bipartisan Individual Income Tax Reform Working Group
U.S. Senate Committee on Finance
SD-219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Sens. Enzi, Grassley and Stabenow,

The U.S. tax code was not written for the modern economy. In 1986—the last time Congress enacted substantial tax reform—only 17% of American households owned personal computers. In 2015, 64% of American adults own a smartphone and companies like Uber, Lyft, Airbnb, Instacart, and TaskRabbit, have become household names by facilitating business transactions between service providers and consumers online and through app-based platforms.[1]

Since its launch in 2008, Airbnb hosts have accommodated more than 25,000,000 guests worldwide. Last year, more than 160,000 drivers partnered with Uber to provide transportation services, and during just the last three months of 2014, Uber drivers earned $657 million in revenue.[2] The explosive growth of the "Uber economy" shows no signs of slowing, however, the service providers powering it are unnecessarily burdened by an antiquated tax code and an IRS that cannot address their questions.[3] These "Emerging Entrepreneurs" are small business owners that need tax laws and a tax administration system that gives them maximum flexibility to grow their businesses and enhance their contributions to this dynamic new sector of the American economy.

To date, serious tax reform efforts have not investigated how the current U.S. tax system triggers substantial inefficiencies and unnecessary burdens on the growing class of Emerging Entrepreneurs. However, as part of its mission to promote independent research on tax policy and compliance issues that informs the public and policy makers, and focuses on issues unique to small businesses and entrepreneurs, American University's Kogod School of Business Tax Center (the "Kogod Tax Center") is undertaking ground-breaking tax policy research to do just that.

In connection with this work, the Kogod Tax Center respectfully submits the following comments illustrating just some of the unnecessary burdens Emerging Entrepreneurs are facing this filing season as well as related growing compliance and federal budget consequences. Moving forward, the Kogod Tax Center recommends you and your colleagues consider and investigate the inadequacies of the current tax code on the Uber economy and, specifically, the Emerging Entrepreneurs who are driving it.

As you know, 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. This reality is particularly acute for many Emerging Entrepreneurs who are first-time, small business owners and have little experience with the requirements of quarterly estimated payments or self-employment taxes.[4] As a result, many Emerging Entrepreneurs are finding out for the first time that they are liable for tax underpayment penalties.[5]

In addition, as reported by the *Wall Street Journal* earlier this month, some Emerging Entrepreneurs are facing penalty and audit exposure, despite the fact that in some cases income earned from short-term residential rentals coordinated through an Uber economy platform provider (e.g., Airbnb, HomeAway, Onefinestay and Flipkey) is, in fact, tax free.[6] Kogod Tax Center preliminary research has identified these and other related issues as unnecessary burdens notwithstanding that, anecdotally at least, many Emerging Entrepreneurs "generally want to be honest and pay what they owe, but the tools and resources don't exist."[7]

The relative inexperience of many Emerging Entrepreneurs as small businesses owners is further compounded by the lack of uniformity in the income reporting forms used for Uber economy transactions. Although some Uber economy platform providers have attempted to designate the Form 1099-K, which is used to report credit card and third-party payments, as the industry standard, others use Form 1099-MISC, which is for miscellaneous income. Irrespective of whether taxpayers receive a Form 1099-K or Form 1099-MISC, neither of these forms was designed to accommodate these types of transactions and their increasing frequency. In fact, Congress enacted the Form 1099-K reporting requirements in 2008, well before the advent of the Uber economy, and the information reporting thresholds for Form 1099-MISC have not changed since 1954.[8]

The inadequacies of the current code and tax administration do not just burden Emerging Entrepreneurs, there are also significant compliance and budget consequences. Although some evidence suggests that Form 1099-K filings 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 subject to information reporting.[9]

In terms of the budget consequences, the most recent data available from the IRS estimates that the gross tax gap, or the amount of tax liability in a given year that is not paid voluntarily and in a timely manner, is $450 billion for tax year 2006."[10] Significantly, underreporting of "individual business income represents the largest portion of the tax gap."[11] This estimate predates the explosive growth of the Uber economy and its Emerging Entrepreneurs. Although Congress has attempted in recent years to enact legislation intended to curtail the tax gap, the absence of full consideration of the impact of increased reporting requirements on small businesses resulted in almost immediate repeal.[12]

The predominately electronic payment nature of transactions conducted in the Uber economy provides opportunities to both reduce the burden on and increase the compliance of Emerging Entrepreneurs. However, at no point have Emerging Entrepreneurs had the opportunity to testify as to how the tax code can be overhauled to make it simpler, fairer and more efficient. Tax reform should, at a minimum, consider whether and how the Internal Revenue Code can be revised to accommodate compliance and enforcement concerns, while minimizing burdens on Emerging Entrepreneurs.

In the coming months, the Kogod Tax Center will publish tax research and corresponding policy recommendations for you and your Committee colleagues to review. In the meantime, we recommend you hold a hearing to further investigate and discuss these issues.[13] Thank you in advance for your consideration of our submission.

Sincerely,

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Kogod School of Business
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[1] Pew Research Center, "U.S. Smartphone use in 2015." (April 1, 2015) online at http://www.pewinternet.org/files/2015/03/PI_Smartphones_0401151.pdf

[2] Jonathan Hall and Alan Krueger, "Analysis of the Labor Market for Uber's Driver-Partners in the United States," (Jan. 22, 2015) online at https://s3.amazonaws.com/uber-static/comms/PDF/Uber_Driver-Partners_Hall_Kreuger_2015.pdf

[3] Kathleen Pender, "Here's why Uber and Lyft send drivers such confusing tax forms." *SF Gate*, Feb. 20, 2015; Lisa Rein, "A standard dejection in the IRS helpline." *Washington Post*, April 7, 2015.

[4] *See* Pender, *SF Gate*, "many [Emerging Entrepreneurs] 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."

[5] Derek Davis (founder, www.sharedeconomycpa.com), email message to author, April 13, 2015.

[6] Laura Saunders, "Airbnb income may be tax-free – but there's a catch." *Wall Street Journal,* April 2, 2015.

[7] Derek Davis, in discussion with author, April 9, 2015.

[8] Mark P. Keightley, "Economic Analysis of the Enhanced Form 1099 Information Reporting Requirements." (Jan. 21, 2011), Congressional Research Service Report for Congress (R41400).

[9] Joel Slemrod, Brett Collins, Jeffrey Hoopes, Daniel Reck, & Michael Sebastiani "Does credit-card reporting improve small business tax compliance? (February 5, 2015). Available at SSRN: http://ssrn.com/abstract=2515630 or http://dx.doi.org/10.2139/ssrn.2515630

[10] See Joint Committee on Taxation Staff Report: *Complexity in the Federal Tax System.* https://www.jct.gov/publications.html?func=startdown&id=4738

[11] National Taxpayer Advocate 2014 Annual Report to Congress, "Estimating the Impact of Audits on the Subsequent Reporting Compliance of Small Business Taxpayers: Preliminary Results." Vol. II (Jan. 14, 2015) online at http://www.taxpayeradvocate.irs.gov/2014AnnualReport

[12] *Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011* (P.L. 112-9).

[13] Kogod Tax Center gratefully acknowledges James R. White, former GAO Director of Tax Issues, for his onging contributions to these comments and ongoing research on these issues.