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Tax Issues in the Sharing Economy

Implications for Workers

Shu-Yi Oei and Diane M. Ring

INTRODUCTION

The past several years have seen the rise of what is commonly referred to as the “sharing economy.” The term generally refers to the production or distribution of goods and services by individuals through a technological platform or “app.”¹ The platform seamlessly puts service providers and producers in touch with consumers of goods and services, allowing individuals to easily monetize their assets or services, often (though not invariably) by exploiting excess capacity. The types of activity done through sharing platforms vary, but common examples include renting property via platforms such as Airbnb, driving for Transportation Network Companies (TNCs) such as Uber or Lyft, performing tasks through TaskRabbit or Rover, or selling goods through a website like Etsy. While the magnitude and growth of work done on these platforms in the US economy are hard to quantify, there is some indication that it is significant. A recent Brookings study found – based on data on “nonemployer” firms in US census data – that such firms encompassed 24 million businesses in 2014, up from 15 million in 1997 and 22 million in 2007.² Moreover, such businesses are not limited to the US market. Many of the platforms that launched initially in the United States have expanded to other countries, and homegrown platforms have emerged in many foreign jurisdictions.

Regardless of specific numbers, what is clear is that a growing number of individuals now perform work in the sharing economy. This increase raises a number of tax and regulatory questions, including questions about the impact of sharing economy work on workers and service providers operating in this sector. One important set of questions confronting workers concerns how they are taxed, whether the tax system functions effectively with respect to this work, and relatedly, how such workers confront and ought to deal with tax compliance challenges.

¹ The sector is also sometimes referred to as the “gig economy,” “platform economy,” or “peer-to-peer economy.” See, e.g., Elka Torpey and Andrew Hogan, *Working in a Gig Economy*, U.S. Department of Labor, Bureau of Labor Statistics (May 2016), www.bls.gov/careeroutlook/2016/article/what-is-the-gig-economy.htm; Shu-Yi Oei, *The Trouble with Gig Talk: Ambiguity, Choice of Narrative, and the Abetting Function of Law*, 81 *Law & Contemp. Probs.* 107 (2018). In this chapter, we use the term “sharing economy” to refer to the sector.

² Ian Hathaway and Mark Muro, *Tracking the Gig Economy: New Numbers*, Brookings Institution (Oct. 13, 2016), www.brookings.edu/research/tracking-the-gig-economy-new-numbers/. “Nonemployer” firms are firms with at least \$1,000 of gross revenues but no employees. About 86 percent of nonemployer firms are sole proprietor independent contractors. *Id.* at note 5. The authors note that not all of the growth in nonemployer firms is due to sharing economy work; it also reflects the increased use of various investment vehicles. *Id.*

In this chapter, we survey some of the key tax issues that have confronted individuals operating in the sharing economy. While our discussion focuses on the United States, these classification, documentation, and compliance challenges frequently arise in other countries. Many of the tax implications of this work stem from the threshold decision by many platforms to classify such individuals as independent contractors rather than employees. Therefore, we first discuss how the threshold classification decision affects the substantive and compliance-related tax issues faced by individuals operating in the sharing economy. We briefly summarize the doctrinal tax rules governing income taxation of sharing economy workers, discussing both the rules for income inclusion and the rules for expense tracking and taking. We then discuss some of the compliance challenges experienced by sharing economy participants in fulfilling their tax obligations, including the need to allocate expenses between business and personal use, the need to file estimated taxes, liability for self-employment taxes, and the need to track income given imperfect information reporting. The chapter then examines tax-related factors (such as lack of withholding) that may affect the labor-supply decisions of sharing economy participants. For example, we examine the potential impacts of lack of withholding and of expense estimation difficulties on how these individuals calculate their likely profit or loss from engaging in such work. Finally, we discuss possible reforms to the taxation of sharing economy participation that may help alleviate compliance challenges associated with work in this sector or may help these individuals make more informed decisions, and we explore the downsides of such reforms.

Throughout our discussion, we draw upon our previous empirical and doctrinal work concerning participants in the sharing economy as well as on the scholarship of others.³

This chapter focuses on tax law, but legal analysis of the sharing economy cannot be conducted exclusively on a field-by-field basis. Assessments and recommendations derived in one legal context can intentionally or unintentionally impact outcomes in other areas. This observation especially holds where the same issue, such as worker classification, arises across legal regimes. Thus, for example, a policy recommendation on workers' classification for tax purposes may find its impact extends beyond taxation to influence classification of sharing workers in other legal regimes such as labor or tort law.⁴ Just because a rule may produce an appropriate outcome in the tax system does not mean that the rule similarly generates favorable policy results in other cases. As a result, some measure of caution is warranted in undertaking a predominantly field-specific analysis; the actual implementation of policy can have a more expansive effect.

³ See, e.g., Shu-Yi Oei and Diane M. Ring, *Can Sharing Be Taxed?*, 93 Wash. U. L. Rev. 989 (2016) [hereinafter *Can Sharing be Taxed?*]; Shu-Yi Oei and Diane M. Ring, *The Tax Lives of Uber Drivers: Evidence from Internet Discussion Forums*, 8 Colum. J. Tax L. 56 (2017) [hereinafter *The Tax Lives of Uber Drivers*]; Michèle Finck and Sofia Ranchordás, *Sharing and the City*, 49 Vand. J. Transnat'l L. 1299 (2017); Kathleen DeLaney Thomas, *Taxing the Gig Economy*, U. Pa. L. Rev. (forthcoming, 2018), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2894394; Jordan M. Barry and Paul L. Caron, *Tax Regulation, Transportation Innovation, and the Sharing Economy*, 81 Chi. L. Rev. Dialogue 69 (2015); Jordan Barry, this volume; Caroline Bruckner, *Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy*, Kogod Tax Policy Center (May 2016), <https://perma.cc/Z9J4-M49G>; Miriam A. Cherry and Antonio Aloisi, this volume; Manoj Viswanathan, this volume.

⁴ For example, recently proposed legislation in the Senate that purports to "clarify" the correctness of independent contractor classification of gig workers for tax purposes is likely to cement independent contractor treatment in other areas of law by endorsing such classification with a default presumption of correctness. See *The New Economy Works to Guarantee Independence and Growth (NEW GIG) Act of 2017*, 115th Congress, 1st Session (S. 1549), www.thunex.senate.gov/public/_cache/files/c9e8dda1-dbb6-4a78-8f2a-88f39c14be1e/D975731B1FE56963DD1D09F2CB8D78CC.ott7387.pdf (proposed by Sen. John Thune, R-S.D.).

I THE THRESHOLD QUESTION OF WORKER CLASSIFICATION

The tax consequences to a sharing economy worker depend in the first instance on whether that individual is classified as an independent contractor or an employee for tax purposes.⁵ The worker classification question is significant for a number of different legal areas, including state and federal labor protections.⁶ Indeed, though the nuances may differ, the worker classification question has arisen in jurisdictions other than the United States and many of the basic tensions, concerns, and tradeoffs will resonate with other countries.

Resolution of the worker classification question depends on the specific legal regime and the classification test it employs.⁷ Additionally, worker classification may differ from platform to platform, depending on the precise relationship between worker and platform. It is also theoretically possible that two different workers operating on the same platform might be appropriately placed in different classifications, depending on their job parameters. Classification may be more material to TNC drivers and those performing services and tasks (e.g., on TaskRabbit) than to other sharing economy participants (such as those offering property for rent on Airbnb). In short, the worker classification question is variable and complex. We summarize some of the main points, as they relate to tax, here.

If the worker is classified as an independent contractor for tax purposes, the US tax law effectively treats her as operating an independent small business as a sole proprietor. As a small business operator, she will therefore be responsible for paying self-employment taxes (social security and Medicare taxes) at a 15.3 percent rate by filing Schedule SE, but can deduct half these taxes on Form 1040, Line 27.⁸ This contrasts with the tax treatment of employees: if a worker is classified as an employee, the employer will be responsible for depositing and reporting payroll taxes, and the employer is nominally responsible for half the social security and Medicare taxes.⁹ Thus, the employer must not only withhold the employee's share of social security and Medicare taxes from employee wages but is also further responsible for paying an employer matching portion.¹⁰ In theory, the same amount of employment tax would be paid to the government on behalf of a worker, and the worker would net the same after tax in either scenario (employee or independent contractor). This comparison anticipates that in shifting from employee status to independent contractor status, for example, the worker would be able to negotiate a pay increase equal to the amount of tax previously borne by the employer and now owed by the independent contractor (and deductible by that taxpayer in the process of calculating taxable income). Of course, it is possible that the economic incidence may fall on the worker in the form of lower wages.¹¹

There are four further key differences between the tax treatment of employees and independent contractors. First, wages paid to employees are subject to income tax withholding by the platform-payor but amounts paid to independent contractors are not withheld but are merely subject to information reporting on Forms 1099, as described below. This means that

⁵ There are labor law and other consequences as well to the worker's classification but this chapter will focus on tax.

⁶ See, e.g., V. B. Dubal, *Wage Slave or Entrepreneur?: Contesting the Dualism of Legal Worker Identities*, 105 Cal. L. Rev. 101 (2017); Benjamin Means and Joseph Seiner, *Navigating the Uber Economy*, 49 U.C. Davis L. Rev. 1511 (2016). These issues are discussed in more depth elsewhere in this volume. See, e.g., Elizabeth Tippet; Brishen Rogers.

⁷ See, e.g., Shu-Yi Oei, *supra* note 1.

⁸ I.R.C. § 1401(a), (b); I.R.C. § 164(f)(1); *Can Sharing be Taxed?*, *supra* note 3, at 1019–20.

⁹ I.R.S. Publ'n No. 15 (*Circular E*), *Employer's Tax Guide* (2018).

¹⁰ *Id.*

¹¹ See, e.g., N. Gregory Mankiw, *Principles of Macroeconomics* 124 (8th ed., 2015).

those operating as independent contractors might need to file and pay estimated taxes on a quarterly basis in order to make up for the lack of withholding, and may be subject to underpayment penalties if they fail to do so.¹² Second, the federal income tax deductions available to employees are more severely restricted than those available to independent contractors. Unreimbursed expenses of employees are classified as “below the line deductions,” and their deductibility is subject to limitation based on the employee’s adjusted gross income.¹³ Third, businesses that hire employees must pay federal unemployment insurance tax (FUTA tax). Independent contractors do not pay this tax and cannot seek unemployment benefits.¹⁴

Finally, in December 2017, a new provision was enacted, Section 199A, that grants a deduction of up to 20 percent of “qualified business income” to passthrough businesses (i.e. not corporations and not employees). Policy makers, taxpayers, and tax advisers are just beginning to assess the potential impact of this new deduction. With respect to sharing economy workers, it is possible that this new deduction may make independent contractor classification attractive or at least more palatable for some workers depending on their overall work and benefits situation.

There are a number of different, but related, tests for determining appropriate worker classification, depending on the legal context.¹⁵ For tax purposes, the IRS has developed a 20-factor test for distinguishing independent contractors from employees.¹⁶ The factors examined include behavioral control (i.e., whether the company controls what work the worker does and how she does the work) and financial control (i.e., whether the company controls the business aspects of the job, such as what tools are used and how the worker is paid) as well as the type of relationship between the company and the worker (e.g., whether there are pensions, vacations, or insurance).¹⁷ In general, a worker will be classified as an independent contractor if the paying platform has the right to control and direct only the *result* of the work and not what and how it will be done.

As of this writing, key class action lawsuits have been brought by Uber and Lyft drivers, many of which remain unresolved.¹⁸ Plaintiffs have confronted significant litigation risks, most pertinently the effects of binding arbitration clauses that require disputes to be settled before arbitration tribunals rather than as class actions.¹⁹ In the meantime, many sharing economy firms have persisted in classifying their workers as independent contractors for tax and other purposes, issuing them yearly IRS Forms 1099 at tax time. As one of us has argued, the tax position taken by

¹² See I.R.C. § 6654(a), (d); see also *Tax Withholding and Estimated Tax*, I.R.S. Publ’n No. 505 (2018). According to the IRS Publication 505, taxpayers generally must pay estimated taxes for 2018 if they (1) “expect to owe at least \$1,000 in tax for 2018” and (2) expect their withholding and refundable credits to be less than the smaller of “90% of the tax to be shown” on the 2018 return or “100% of the tax shown on” the 2017 tax return. *Id.* at 22.

¹³ I.R.C. § 62(a)(2).

¹⁴ See I.R.C. § 3301–3311.

¹⁵ Tests applied include the common law agency test, the economic realities test, and the so-called ABC test applied by states. See, e.g., Robert L. Redfeam III, *Sharing Economy Misclassification: Employees and Independent Contractors in Transportation Network Companies*, 31 Berkeley Tech. L.J. 1023 (2016); Brishen Rogers, *Employment Rights in the Platform Economy: Getting Back to Basics*, 10 Harv. L. & Pol’y Rev. 480, 487 n. 48 (2016).

¹⁶ See, e.g., *Schramm v. Comm’r*, 102 T.C.M. (CCH) 223 (2011); *Levine v. Comm’r*, T.C.M. (RIA) 2005–86 (2005); Rev. Rul. 87–41, 1987–1 C.B. 296.

¹⁷ *Independent Contractor (Self-Employed) or Employee?*, IRS, www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee (last updated Apr. 18, 2017).

¹⁸ See, e.g., *Yucesoy v. Uber Techs., Inc.*, No. C-15–0262 EMC, 2015 U.S. Dist. LEXIS 98515 (N.D. Cal. July 28, 2015); *O’Connor v. Uber Techs., Inc.*, No. C-13–3826 EMC, 2015 U.S. Dist. LEXIS 116482 (N.D. Cal. Sept. 1, 2015); *Del Rio v. Uber Techs., Inc.*, No. 15-cv-03667-EMC, 2016 U.S. Dist. LEXIS 40615 (N.D. Cal. Mar. 28, 2016); *Lavitman v. Uber Techs., Inc.*, 32 Mass. L. Rep. 476 (2015); *Cotter v. Lyft, Inc.*, No. 13-cv-04065-VC, 2017 U.S. Dist. LEXIS 38256 (N.D. Cal. Mar. 16, 2017) (final settlement approved); *Mohamed v. Uber Technologies, Inc.*, 848 F.3d 1201 (9th Cir. 2016) (upholding Uber arbitration clause).

¹⁹ On November 21, 2016, in light of a 9th Circuit decision holding that the arbitration clauses entered into by drivers were enforceable, the California District Court stayed five related litigations pending appeals. *O’Comer v. Uber* and related cases, *Order re Stays*, No. 3:13-cv-03826-EMC, Docket No. 769 (N.D. Cal. Nov. 21, 2016).

the sharing economy firms is clearly chosen in order to be consistent – and indeed to advance – the desired independent contractor treatment of workers in other legal areas.²⁰ In light of this choice by the sharing economy firms, the remainder of this discussion discusses the tax law and compliance implications that arise should sharing economy workers continue to be classified as independent contractors for tax purposes.

II THE TAX LAW OF THE SHARING ECONOMY

We have argued in prior scholarship that the doctrinal tax issues concerning taxation of the sharing economy are relatively uncontroversial. However, the law itself may be quite complex. And that complexity may pose tax compliance challenges for sharing economy participants.²¹

A Income Inclusions

The substantive income tax laws that apply to sharing economy participants are not unlike those that apply to other unincorporated sole proprietors independently operating a small business. These individuals must include amounts earned (such as gross fares, rents, and other payments) in their gross income for tax purposes.²² They must also include in gross income any other payments received from the platform, such as driver referral bonuses in the case of TNCs, as well as tips. These receipts are includible in income for tax purposes, whether or not the worker actually receives a Form 1099 statement from the platform.

Most sharing economy participants will report income received from work performed (and deduct expenses) on Schedule C of Form 1040, Profit or Loss from Business. (In this regard, some sharing economy participants may be surprised to discover that they must file taxes just like any other individual small business entrepreneur.)²³ Those who rent out homes or apartments on a platform such as Airbnb will usually report rental income on Schedule E, Supplemental Income and Loss from real estate and other sources, or Schedule C.²⁴

B Deductible Expenses

While income receipts must be included in federal gross income, workers may deduct allowable business expenses on their tax return. The key issue that is likely to arise for those operating in the sharing economy is the need to apportion expenses between business and personal use. This is because the paradigmatic sharing economy operator is likely to operate part time and on more than one platform, and thus is likely to have property – such as a car, a home, or tools – that may be used sometimes for business purposes and sometimes for personal purposes. Business-related expenses are tax deductible but personal use expenses are not.²⁵

The precise rules for allocating costs between business and personal use differ depending on the context – for example, specific cost recovery rules may apply to TNC drivers driving miles

²⁰ Oei, *supra* note 1.

²¹ *Can Sharing be Taxed?*, *supra* note 3.

²² I.R.C. § 61.

²³ *The Tax Lives of Uber Drivers*, *supra* note 3, at 89–90.

²⁴ It is possible that the IRS may assert that some Airbnb hosts are also providing services (e.g., breakfast) and thus are subject to employment taxes. See, e.g., *10 Tax Tips for Airbnb, HomeAway & VRBO Vacation Rentals*, Turbotax, <https://turbotax.intuit.com/tax-tools/tax-tips/Self-Employment-Taxes/10-Tax-Tips-for-Airbnb-HomeAway---VRBO-Vacation-Rentals/INF29184.html> (updated for tax year 2016) (raising the possibility that hosts would owe employment taxes); Aimee Picchi, *Tax Tips if You Made Money Through Airbnb*, Consumer Reports (Mar. 8, 2016) (same), www.consumerreports.org/taxes/tax-tips-if-you-made-money-through-airbnb/.

²⁵ I.R.C. §§ 162, 262.

for work, landlords renting out property on Airbnb that is also subject to frequent personal use, or other types of sharing economy work.

1 TNC Drivers

Those driving for TNCs may recover costs for miles driven for work. In determining how to recover such costs, TNC drivers may choose between using the actual costs method or the standard mileage method.²⁶ The actual costs method allows the driver to deduct the actual expenses incurred in driving for a platform. Covered expenses include: vehicle depreciation, garage rent, gas, insurance, lease payments, licensing fees, oil, parking fees, registration, repairs, tires, and tolls. If there is both business and personal use of the vehicle, then the driver must allocate these expenses between the business and personal use. This may be done based on miles driven, such that only the portion of expenses associated with work-related miles may be deducted.²⁷ The driver is therefore required to track the number of miles driven and to document the miles that relate to driving for a TNC.

Alternatively, the standard mileage method allows the driver to deduct a certain amount per mile driven – that rate was 54.5 cents per mile for 2018.²⁸ Drivers who use this method must also keep track of the miles driven for the TNC. A driver who chooses the standard mileage rate may not deduct actual expenses relating to the car (such as car lease payments, maintenance, repairs, and gasoline). However, that driver may deduct non-automobile costs (e.g., water or candy bars provided to passengers) incurred in providing the transportation service.

The important point, with respect to tax compliance, is that whether the driver uses the standard mileage rate or the actual costs method, the driver must keep track of miles driven in order to properly allocate expenses between business (deductible) and personal (non-deductible) uses. The need to accurately track business and personal expenses may raise compliance costs for those driving on TNC platforms.

2 Home-sharing

The home-sharing context presents a different but related set of issues from the TNC industry. Here, the potential application of Section 280A of the Internal Revenue Code is the primary focus for taxpayers. Section 280A limits the deductions allowable with respect to property used in part for personal use and in part for business use. If there is no personal use of the property – such as would be the case with respect to a property rented full time – then Section 280A would not apply. The sharing economy context (which often implicates excess-capacity business use of personal assets) raises the likelihood that the property being rented is of mixed use.

The Section 280A rules are complex, and are only briefly summarized here. First, as a threshold matter, a taxpayer may be able to avoid the application of Section 280A if the portion of the unit being rented qualifies as a hotel, motel, or similar establishment – even though this unit is in the taxpayer's home.²⁹ This exception seeks to allow taxpayers who are renting a portion of their home on a regular basis to paying customers (and who do not personally use that portion of the unit), to avoid the otherwise applicable Section 280A limits on rental expense

²⁶ See Treas. Reg. § 1.274-5(j)(2) (2000); I.R.S. Notice 2014-79, 2014-53, I.R.B. 1001, § 3; I.R.S. News Release IR-2014-114 (Dec. 10, 2014).

²⁷ See *Travel, Entertainment, Gift, and Car Expenses*, I.R.S. Publ'n No. 463, 16-17 (2018).

²⁸ *Id.* at 16; I.R.S. News Release IR-2017-204 (Dec. 14, 2017). There are some circumstances under which the standard mileage rate cannot be used.

²⁹ I.R.C. § 280A(f)(1)(B).

deductions.³⁰ However, it seems unlikely that many properties rented through sharing economy platforms would qualify for this hotel exception.

If the taxpayer rents a dwelling unit (e.g., a house, apartment, condominium unit, mobile home, boat, etc.) and uses the property personally, but *not* as his or her “residence,” then under Section 280A the taxpayer can take deductions based on the number of days rented compared to total number of days used.³¹ This outcome is generally preferable to the more restrictive Section 280A deduction rules (described below) that apply to rental of units that qualify as a “residence” of the taxpayer.³² Personal use will rise to the level of a residence if the use is for: (1) more than 14 days; or (2) 10 percent of the number of days for which the unit is rented at fair value.³³ Thus, for example, if a taxpayer owns a condominium and rents it out most of the year, but personally uses it for only five days during the year, then that use does not rise to the level of a residence, and the taxpayer should be entitled to deduct expenses under this more taxpayer-friendly rule.

If, however, the taxpayer rents a property that he or she uses in a manner that does rise to the level of a “residence,” then the tax consequences depend on the number of days the property is rented. If the property is rented out for fewer than 15 days, then income need not be reported and deductions correspondingly may not be taken on the rental activity.³⁴ If the property is rented for 15 days or more, then the taxpayers may only take deductions based on a statutory allocation formula that is more limiting than that used for the rental of units not qualifying as a residence (but for which there has been some personal use).³⁵

In short, the Section 280A rules for allocation of rental deductions are complex, and are more so in situations in which the property rented is a dwelling unit that is used as a residence. Evolving local regulation governing rental of properties on platforms such as Airbnb may increase the likelihood that taxpayers will be taxed under the Section 280A rules for rental of residences. For example, as local jurisdictions impose limits on the number of days a property may be rented on platforms such as Airbnb, the result may be more hosts renting property deemed “residential,” who are then subject to the most restrictive and confusing Section 280A rules for deducting rental expenses.

3 Other Sharing Economy Work

Sharing economy work is not limited to home rentals and driving for TNCs. There is now an extensive array of online platforms that enable the provision of a wide variety of goods and services. Examples range from TaskRabbit³⁶ (assorted services) to Rover³⁷ (petsitting) to Fon (wifi).³⁸ In all of these contexts, microbusiness operators who earn income and incur related expenses must keep track of their expenses and must pay particular attention to how to distinguish between personal expenses (which are generally not deductible) and those incurred for business (which are generally deductible). To the extent that the sharing economy business model involves use of the taxpayer’s home or vehicle in the provision of services, the specific rules discussed above may

³⁰ Taxpayers renting a dwelling unit (defined to include basic living accommodations such as “sleeping space, a toilet, and cooking facilities”) are not covered by the hotel exception, which envisions rental of a room in the home “that is always available for short-term paying customers.” *Residential Rental Property*, IRS Publ’n No. 527, 17 (2018).

³¹ I.R.C. § 280A(d)(1).

³² I.R.C. § 280A(e)(1).

³³ I.R.C. § 280A(d)(1).

³⁴ I.R.C. §§ 280A(c)(5), (g).

³⁵ I.R.C. §§ 280A(c)(5), (e)(1).

³⁶ www.taskrabbit.com/.

³⁷ www.rover.com.

³⁸ <https://network.fon.com/>.

apply. More generally, where sharing economy participants employ otherwise personal assets in the performance of platform work, the mixed character of the asset use increases the complexity of the tax analysis and correspondingly increases the compliance burden on the taxpayer.

III COMPLIANCE AND CLASSIFICATION CHALLENGES IN THE SHARING ECONOMY

As Section II demonstrates, the fundamental substantive questions of how to tax income and allow expenses from sharing economy work are generally answered by existing law. On balance, existing tax rules that apply to all trades or businesses adequately describe the taxable income and expenses of sharing economy participants. But that conclusion does not mean that the existing tax regime is simple, intuitive, or streamlined for these workers. Rather, it is likely that workers will face documentation burdens, unexpected requirements, and some confusion. In response to these problems, a number of tax reforms have been recommended, both by us and by others, to tackle the more pressing tax challenges facing sharing economy workers. This section first explores tax compliance realities that confront workers. It then considers the viability of various tax reforms and the degree to which they would solve the problems identified.

A Tax Compliance Realities for Sharing Economy Workers

To the extent sharing economy workers are classified as independent contractors (the position adopted by most platforms), they will face both documentation burdens and compliance obligations that may be entirely unfamiliar. Effectively, the tax system considers such workers to be “in business” and, as such, they are responsible for their own employment taxes, and perhaps more unexpectedly, for their own quarterly payment of estimated taxes.³⁹

1 Understanding Form 1099-K

The two key items that workers must report from their sharing work are their income items and their expenses. Income is generally not difficult to determine in the abstract, but in some cases confusion over the income amount has arisen due to the documentation issued by the platform. Sharing businesses generally send a Form 1099-K to workers listing their income.⁴⁰ However, our research on TNC drivers suggests that some workers may misunderstand the numbers being reported. The Form 1099-K reported the *gross* amount generated by the worker. In the case of Uber drivers, this includes the basic fare charged to the passenger, the “safe rides” fee also charged by Uber to passengers, and the fees and commissions that Uber charges to the driver.⁴¹ In the case of Lyft, the gross income amount on Form 1099-K includes the Lyft commission and tolls, but not certain other service fees, third-party fees, and taxes.⁴² Workers are permitted to deduct the latter two amounts (the safe rides fee and Uber’s cut), as these amounts are actually retained by Uber not the driver. However, there is some risk that some drivers might not understand that the Form 1099-K income number reflects the gross amount they received from Uber (inclusive of Uber’s cut) and might thus fail to deduct the safe rides fee and Uber’s commission before reporting their taxable income.⁴³ Although some drivers have sought to educate others

³⁹ See *supra* notes 8, 12 and accompanying text.

⁴⁰ For a detailed discussion of the different Forms 1099 that might apply and the issues and gaps created under current law, see *Can Sharing Be Taxed?*, *supra* note 3, at 1034–41.

⁴¹ See, e.g., *How to Use your Uber 1099-K and 1099-Misc*, Stride, <https://perma.cc/LGA8-JZ4U>; *Uber Partner Reporting Guide*, H&R Block, <https://perma.cc/6YE4-475Z>.

⁴² See *2016 Tax Info for Drivers*, Lyft, <https://perma.cc/BU7R-F5GM>.

⁴³ See *The Tax Lives of Uber Drivers*, *supra* note 3, at 86–87.

on the correct reading of the Form 1099-K in various internet forums, the extent to which this continues to be a problem in the TNC sector and the degree to which the problem arises with other platforms and their workers remains unclear.

2 *Expenses: Tracking and Documentation*

A second compliance challenge concerns deductibility of expenses. Sharing economy participants whose work requires them either to use valuable personal assets in the performance of the task or to spend their own money in the performance of their services will want to deduct these costs. Beyond learning the substantive tax law detailing which expenses are deductible and how they are calculated, workers must: (1) calculate the quantity of business use versus personal use (which may involve making legal determinations regarding what counts as business use); (2) document that use; and (3) maintain records of their expenditures.

Thus, for example, TNC drivers must determine how many miles driven are for personal use, and how many are for business. This demands at the outset a legal conclusion as to what driving counts for business. The answer is easy when passengers are in the car, but is less clear when drivers are driving from home to their main pick-up location without a passenger, driving home without a passenger but with the TNC App on (evidencing willingness to pick up a fare), or running personal errands in between rides. In addition, once the threshold legal determination is made, TNC drivers must undertake the administrative task of keeping track of business versus personal miles driven. This is by no means a trivial task, given that platforms such as Uber only record miles driven with passengers in the vehicle, and do not include other miles that may potentially count as business miles, such as miles driven with the App on while looking for passengers but without an actual passenger in the car. Thus, the mileage total obtained from the TNC company understates business mileage for tax purposes, and drivers must do their own recording and documentation. In order to do this effectively, drivers have experimented with phone applications and with various electronic ledgers that help track and record mileage, but there is some uncertainty as to what types of documentation the IRS will deem acceptable.⁴⁴ Our research suggests that some drivers may not have been aware at the outset of the importance of recording mileage, or may have failed to appreciate that expense tracking and documentation is required (and that rough estimates are not acceptable).

3 *Estimated and Quarterly Tax Payments*

Sharing economy participants who are new to independent contractor status may also fail to realize that they likely have an obligation to file and pay estimated taxes during the year, and that their tax burden includes all components of the employment taxes. Briefly, quarterly estimated tax payments are required for taxpayers for whom amounts withheld and paid to the IRS throughout the year will be insufficient when compared with the eventual assessed tax liability.⁴⁵ Insufficient withholding becomes a possibility where the worker is self-employed and hence not subject to employer withholding – as is the case for most sharing economy workers. Although some workers may be able to avoid estimated tax filing burdens and liabilities by increasing withholding from W-2 jobs, others will not be able to avoid these obligations.

Sharing economy participants who are subject to estimated tax obligations must not only undertake the administrative burden of accurately computing and paying over such taxes. They must also make decisions about how much to set aside to meet estimated tax obligations. If they fail to meet

⁴⁴ *Id.* at 84–86.

⁴⁵ See, *supra* note 12; see also *Estimated Taxes*, IRS, www.irs.gov/businesses/small-businesses-self-employed/estimated-taxes (last updated Apr. 26, 2018).

estimated tax obligations, they will have to pay interest and penalties due to their failure to file. These administrative and substantive obligations may result in consumption shocks to taxpayers who may not be financially savvy enough to appropriately allocate funds and manage finances.

4 Tax Law's Impact on Labor Supply Choices of Sharing Economy Workers

Beyond compliance burdens, the structure and administration of the tax system can impact the labor decisions of sharing economy workers. Some of these impacts may result from misinformation or lack of clarity, which may raise troubling questions.

First, and perhaps most importantly, workers may experience an effect known as “spotlighting.” This term captures circumstances in which workers do not accurately know the costs of undertaking sharing economy work, and therefore overestimate the net benefits of such work and risk oversupplying labor. Taxation of sharing economy work may potentially cause spotlighting on payments received from the platform for sharing economy work. For example, a TNC driver may receive these payments well in advance of having to take into account the expenses (including vehicle wear and tear) from driving and the taxes owed, which may cause her to overestimate the return on her labor. Taxation may exacerbate these effects, because tax filing (aside from estimated taxes) occurs on an annual basis, after the fact.

Another possibility is that workers may focus on average tax rates rather than marginal tax rates when deciding how much to work in the sharing economy. This may occur, for instance, where workers “just guesstimate” what their year-end tax liability is likely to be. “Guesstimating” may be a particular risk when the worker faces multiple tax rate schedules – for example, state and federal taxes – and may be compounded where the worker has more than one job, or does sharing economy work on top of a regular job. Such workers may not have a clear idea of what their eventual income bracket (and hence tax liability) is likely to be, and this may cause them to supply labor at a higher than optimal level.

In short, taxation is distortionary, and one possible margin of distortion regards how much workers decide to work. Due to the realities of the annual tax year, the lack of withholding on amounts paid to Form 1099-K workers, and the fragmented nature of work in the sharing economy, workers may be particularly likely to experience challenges in determining how much they are making and how much they should work.

The overall burden for sharing economy workers of learning to read a Form 1099-K, learning the substantive tax law governing deductions, allocating expenses between business and personal use, tracking and documenting business use and actual expenses, and managing quarterly estimated tax filings can seem significant. This assessment may be particularly true for those workers who are not familiar with taxation of small businesses (e.g., first-time independent contractors), who are pursuing sharing economy work on a part-time or short-term basis, or who earn relatively little compared to the costs of compliance (including securing competent tax return advice).

B Is Employee Classification a Tax Solution?

Is the significant administrative and compliance burden on sharing economy “micro-entrepreneurs” a problem that warrants legal reform? On the one hand, these tax compliance obligations are not new and have long been in place for self-employed individuals engaged in trade or business. Thus, it would seem that any suggestion that reform is needed ought to take into account burdens of the tax compliance regime on sole proprietors generally, not just sharing economy workers. On the other hand, there is a non-trivial risk that even if these tax compliance burdens are not excessive for self-employed individuals engaged in more traditional

businesses, these burdens may not scale down appropriately for “microbusiness” individuals – that is, individuals engaged in business on a very small scale, for whom compliance burdens may outstrip any benefit to be gained from occasional platform work.

One possible way in which compliance burdens on sharing economy workers might be mitigated is if workers were classified as employees rather than independent contractors. Employee classification would result in sharing economy workers receiving Form W-2 instead of Form 1099-K, and would at least alleviate the compliance burdens associated with having to file quarterly estimated taxes and social security taxes. Employee status for sharing economy workers has been advocated by various actors, both as a conclusion of fact under existing law, and as a normatively desirable legal policy. However, the primary driver for such advocacy has been labor law and related worker protection issues, not tax law.

Yet, even if employee classification might yield labor law and worker protection benefits, it is not clear that such classification would uniformly yield positive impacts for workers with respect to tax. Three distinct points highlight the tax risks of classification as an employee.

First, documentation and compliance burdens might remain high. Take, for example, TNC drivers: assuming that after being classified as employees, drivers continued to conduct their operations as before – continuing to use their personal vehicle for driving and to incur passenger-related costs (such as insurance, water, etc.) – these taxpayers would still need to determine the business–personal split of their miles driven, appropriately record their miles, determine which costs are deductible and how, and maintain proper documentation of the outlays for which a deduction would be sought. This is the case for two reasons. First, if the employee would like to take a tax deduction for unreimbursed employee expenses, these documentation and compliance requirements remain. Second, the documentation and tracking burdens also exist if the worker is seeking reimbursement from her employer (for example, if the employer is required to bear worker expenses under certain state laws).⁴⁶ To be sure, some burdens would be lifted, in particular the obligation to file quarterly and ensuring that appropriate taxes had been paid during the course of the year, as this task would be taken on by the employer, the ride-sharing company. It is also possible that some of the salience-related effects on labor supply decisions may be improved.

Second, and related to the first point, the shift to employee status alone, without any corresponding change in the fundamental business model of TNC platforms, would mean that drivers would continue to bear significant work-related costs.⁴⁷ Not only would the tax burdens related to monitoring these costs continue, but the tax benefit from having made these outlays will disappear due to a new tax provision (Section 67(g)) enacted in December 2017. Even without this new rule, employees were more limited than independent contractors in their ability to deduct business expenses. Independent contractors must satisfy the core Section 162 test that the expense “be ordinary and necessary” in order to be deductible, and they must meet any additional limitations imposed by Section 274 (intended to help police the business/personal line and otherwise prevent abuse).⁴⁸ However, once those hurdles are met, independent contractors may deduct those expenses without further limitation.

By contrast, up through December 2017, employees who incurred identical business costs in the performance of the same function were subject to a further tax limitation. In their cases,

⁴⁶ See *infra* note 46.

⁴⁷ There may be some exceptions to this on a state-by-state basis, where for example, state labor law requires the employer to reimburse an employee for certain significant expenses borne by the employee. In such cases, by operation of law the employee would no longer bear such costs even though the business model had not been formally renegotiated with the employer. See, e.g., Cal. Labor Code § 2802.

⁴⁸ In some circumstances, special rules may govern certain types of outlays, such as Section 195 (startup costs).

the deductions were taken “below the line,” meaning that they were subject to Section 67 of the Internal Revenue Code, which allowed the deduction of expenses incurred by employees in the “trade or business of being an employee” only to the extent that these outlays (along with some others) in aggregate exceeded 2 percent of the taxpayer’s adjusted gross income.⁴⁹ If those substantive tax law provisions governing employee expenses had remained in place, the shift to employee status would result in the loss of tax deductions for sharing economy workers who provide personal assets to use in their work and who incur significant unreimbursed costs in the context of their sharing economy work.⁵⁰ However, new Section 67(g) (introduced in the December 2017 tax reform) suspends any deduction of these trade or business expenses by employees for taxable years beginning before January 1, 2026. Thus, until 2026, being classified as an employee means a complete loss of tax deductions for these expenses, rather than merely a “haircut.”

Third, the introduction of the new deduction in Section 199A for passthrough businesses including independent contractors (but not employees) creates a further tax wedge between the two worker classifications. Classification as an employee requires a taxpayer to sacrifice access to the new 20 percent deduction. Many sharing economy businesses clearly consider independent contractor classification for workers to be the desired classification for their business model. Many have advocated for independent contractor treatment for workers through litigation, through regulatory filings, and through the ways they talk about and market their business models.⁵¹ Presumably, this reflects an assessment that this classification is most advantageous in terms of the business’s own profitability (savings in taxes and benefits) and business risk (e.g. tort liability).

C Other Possible Fixes?

Worker reclassification aside, are there other possibilities for reform? Some commentators have suggested maybe so. Although some of the challenges raised by the sharing economy arise on the side of administration and enforcement for the taxing authority,⁵² many of the key compliance and related challenges are those confronting workers. There are several possibilities for alleviating these challenges. However, there are also risks inherent in each of these possibilities. Most pertinently, each of these fixes and recommendations developed within the tax context

⁴⁹ I.R.C. § 67.

⁵⁰ The tax rules in place through December 2017 are captured by the following simplified example. Imagine a worker who earns \$10,000 in gross income from sharing economy work and \$45,000 from other employment, and spends \$2,000 on qualified business expenses in the conduct of the sharing economy work. If the worker is classified as an independent contractor with respect to the sharing economy work, the \$2,000 of expenses will be considered “above the line” expenses under Section 62. Such above-the-line expenses may be fully deducted in arriving at the taxpayer’s “adjusted gross income,” which would be \$53,000, and will accordingly reduce the taxpayer’s taxable income by a full \$2,000. In contrast, if the worker is classified as an employee with respect to the sharing economy work, the \$2,000 of employee expenses will be miscellaneous itemized deductions under Section 67 (because Section 62 excludes employee expenses), and will be disallowed to the extent they do not exceed 2 percent of the taxpayer’s adjusted gross income. In this case, the worker’s adjusted gross income remains at \$55,000. Two percent of adjusted gross income is \$1,100. Thus, the taxpayer will only be permitted to deduct \$900 out of the \$2,000 expenses incurred from her \$55,000 of adjusted gross income. The taxpayer will not be able to deduct anywhere on her tax return the remaining \$1,100 spent.

⁵¹ Oei, *supra* note 1 (discussing sharing economy firm strategies for advocating for “gig” classification); see also Francine McKenna, *Uber Believes it has SEC Nod for Earnings Approach that Mirrors Business Model*, Marketwatch (Oct. 26, 2017), www.marketwatch.com/story/uber-an-early-adopter-of-new-revenue-recognition-rules-believes-it-has-secs-blessing-of-its-business-model-2017-10-25?mg=prod/accounts-mw (noting that Uber is taking the position for SEC filing purposes that its customers are the drivers, not the passengers).

⁵² We discuss these and potential solutions to tax administration difficulties in *Can Sharing be Taxed?*, *supra* note 3. They will not be further discussed here.

could, if pursued, have implications for legal outcomes in other fields, and some of these effects could be costly.

For example, Congress could enact safe harbors for expense deductions (akin to the standard mileage rate currently in place for miles driven on business), to obviate the need for detailed expense allocation and tracking. One concrete proposal along these lines comes from Prof. Kathleen Thomas in the form of a “standard business deduction” for sharing economy workers, which would allow workers to deduct a certain preset amount (computed as a percentage of total gross receipts) and would eliminate the need for workers to document and track expenses throughout the year.⁵³ Such an approach might raise other issues, including the problem of deciding who should be eligible to take the deduction, and the level at which the deduction should be set. However, it would certainly alleviate the compliance, documentation, and expense-tracking burdens that currently confront workers engaged in microbusiness, and may make particular sense in a sector where the compliance and documentation costs might far outweigh the amounts actually earned. The bigger risk is that creating a simplified tax regime for sharing economy workers might represent a piecemeal approach to ameliorating challenges confronted by these workers at the expense of more comprehensive protections. Simplified regimes may obscure the (plausible) argument that independent contractor classification is a poor fit for sharing economy workers by allowing firms to claim that operating as an independent contractor in this sector is now “easy.”

Another direct way to alleviate some worker compliance burdens is to clarify for platforms what payments need to be reported. Specifically, one challenge that has confronted a subset of sharing economy participants arises in the event the worker does not receive a Form 1099 from the platform. The rule is that even if an amount paid is not reported on Form 1099, it must still be included in the recipient’s gross income. Thus, if a worker does not receive a Form 1099, she will be faced with the burden of totaling up amounts earned throughout the year for purposes of income inclusion. Nonissuance of a Form 1099 may occur, for example, in cases where the platform claims that it need not issue Form 1099 because the amount earned does not meet the appropriate threshold for Form 1099 issuance (such as the 200 transaction/\$20,000 threshold under the regulations governing issuance of Form 1099-K).⁵⁴ As we have discussed in prior work, there is some ambiguity regarding whether this threshold in fact applies to sharing economy work.⁵⁵ A simple way of alleviating the compliance burden on workers would be for the IRS to clarify that issuance of a Form 1099 is required at all income levels.

Even a worker who has received a Form 1099 may be unprepared to complete her tax return accurately. As noted earlier, some workers have been confused regarding the numbers reported on the Form 1099 and have not appreciated that the numbers are gross numbers (and not net of the various platform fees and the cut owed to the platform). This confusion could be mitigated either by clearer instructions issued by the platform accompanying the Form 1099, or by redesign of the form itself by the IRS (such redesign could highlight the difference between gross and net, and better guide the worker to reporting the proper numbers in the proper places on Schedule C).

As noted above, the structures and realities of tax compliance may have impacts on the behaviors of taxpayers operating in the sharing economy. In particular, the lack of withholding on

⁵³ Thomas, *supra* note 3.

⁵⁴ *Can Sharing Be Taxed?*, *supra* note 3, at 1031–41 (discussing the Form 1099-K reporting positions taken by various platforms and the potential compliance effects of these positions).

⁵⁵ *Id.*

independent contractor payments may both increase compliance burdens on sharing economy operators and may distort their labor supply choices. A possible reform that may alleviate these effects would be to require tax withholding on certain non-employee payments. Along these lines, Professor Thomas has suggested that non-employee withholding for sharing economy workers might be imposed up front for just these reasons.⁵⁶ Such up-front wage withholding – if properly designed – would alleviate estimated tax burdens and would allow workers to more accurately understand how much of a tax burden they are likely to experience on the back end, and to make decisions accordingly. But again, the risk is that these types of piecemeal reforms in one arena (tax) may undercut movement in favor of more comprehensive protections for workers across other fields.

Finally, the importance of taxpayer education cannot be overstated. The sharing economy is an emerging sector that has drawn in many new participants. Some of these new workers might not understand that they are required to report income, or how they are supposed to report income. Others may experience confusion regarding which expenses to track, or how to track them. In prior work, we have suggested some ways in which such taxpayer education about tax compliance obligations may be accomplished. At the time of writing, the IRS, in partnership with the National Taxpayer Advocate, has launched a Sharing Economy Tax Center, a website containing resources for workers and platforms operating in the sharing economy.⁵⁷ That website includes a number of resources and links that inform those working in the sharing economy of their tax obligations and help them meet those obligations. This is a good start; however, more could be done to educate taxpayers on tax compliance obligations, even as measures are considered to alleviate these obligations.

Each of these fixes and recommendations developed within the tax context could, if pursued, have implications for legal outcomes in other fields.

CONCLUSION

The phenomenon of work in the sharing economy has generated notable discussion and debate. Much of that discussion has focused on worker protections such as collective bargaining, fragmentation of the labor market, and undercutting of traditional industries. However, tax issues also play an important part in the ultimate experience of sharing economy workers, though the role of tax has attracted relatively little notice so far. The individual who performs work in the sector through the new technology platforms will be forced to confront the realities of tax compliance and reporting in due course. Thus, the tax design choices we make may help encourage work in the sharing economy or, alternatively, may act as a brake on that sector's development. Moreover, we should expect that the design choices we make with respect to the tax treatment of sharing economy workers will inevitably have impacts on and spillovers into the labor law and broader worker protection conversation. Policymakers should therefore give serious attention to the tax system's impacts on microbusiness.

⁵⁶ Thomas, *supra* note 3.

⁵⁷ *Sharing Economy Tax Center*, IRS, www.irs.gov/businesses/small-businesses-self-employed/sharing-economy-tax-center (last updated Feb 2, 2018).