



National Taxpayer Advocate Public Forum

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Thank you for the opportunity to join you today to discuss taxpayer service issues and whether the IRS' announced "Future State" plan as currently envisioned will adequately address taxpayer needs. My name is Caroline Bruckner and I am a tax professor on the faculty at American University's Kogod School of Business. As part of my responsibilities at American University, I am also the Managing Director of the Kogod Tax Policy Center, which conducts non-partisan research on tax and compliance issues specific to small businesses and entrepreneurs. The Center develops and analyzes solutions to tax-related problems faced by small businesses and promotes public dialogue concerning tax issues critical to small businesses and entrepreneurs.

Prior to my appointment at Kogod, I served from 2009 until 2014 on the U.S. Senate Committee on Small Business and Entrepreneurship (the "Committee"), ultimately as Chief Counsel. During my tenure with the Committee, I handled tax, labor and budget issues, and worked with small business stakeholders across the country and political spectrum to develop small business tax legislation, including the Small Business Jobs Act of 2010 (P.L.111-240), which provided more than \$12 billion of tax relief for small businesses. Before entering public service, I worked as a senior associate with the international tax services group of PricewaterhouseCoopers, LLP - Washington National Tax Services and as an associate in the employee benefits group of Paul Hastings LLP.

In my current role at Kogod, I direct our team of small business tax policy experts, economists and researchers, and we are currently focused on the tax and compliance issues impacting America's latest iteration of small businesses 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 (the "on-demand platform economy").

Although 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.¹ Our research, which we are publishing on May 23 in a report titled, "Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy," targets the tax challenges of the on-demand economy's small businesses and endeavors to shed light on these issues.

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 or publicly-available taxpayer filings.²

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 argue that these issues should be considered by Congress and the IRS—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. A number of findings included in our research are particularly relevant to today's discussion.

- More than 2.5 million Americans are earning income in the on-demand platform economy as small business owners every month.³ “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.*”⁴ 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.⁵
- 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 2015.⁶ In other words, 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 2015.⁷
- 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,⁸ the economic activity and growth of these small business owners has largely gone unacknowledged by most government measures for tracking small business activity.⁹

In addition, as part of our research, we spoke with dozens of 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).¹⁰ 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. Our survey revealed that among respondents who had earned income working with an on-demand platform company in 2015 (approximately 22% of all of our respondents)—either by selling goods or providing services:

- 34% 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 didn't set aside money for taxes on that income;
- 47% did not know about any tax deductions, expenses or credits that could be claimed related to their on-demand platform income; and
- 69% did not receive any tax guidance from the shared economy platform they worked with in 2015.¹¹

The survey, taken together with our additional research, indicates that, at best, these small business owners are shortchanged when filing their taxes; at worst, they fail to file altogether. Moreover, a significant percentage of 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.¹² 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 need for better outreach and education of taxpayer filing requirements. Consequently, we think the IRS should focus not only on the convenience of online accounts in its "Future State" plan, but also the education and outreach needed to educate taxpayers about their filing responsibilities prior to tax day.

In addition, we think that any IRS strategic plan should focus, in part, on the tax compliance challenges of the self-employed small business owner—not only because of their projected growth—but also because of

the potential tax gap implications. The estimates for the future growth of this cohort of taxpayers is noteworthy. 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.”¹³ 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.¹⁴ At the same time, 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.”¹⁵ 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.¹⁶

Again, I thank you for the opportunity to join today’s discussion and for the work you do on behalf of America’s taxpayers.

¹ 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>.

² *See e.g.*, *Letter from the U.S. Department of the Treasury to Sen. Mark Warner*, Tax Analysts (Oct. 27, 2015) Doc 2015-25376.

³ 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>.

⁴ JP Morgan Chase Institute, *The Online Platform Economy: What is the Growth Trajectory?* Insight blogpost, (May 2, 2016) <https://www.jpmorganchase.com/corporate/institute/institute-insights.htm>.

⁵ Steve King & Carolyn Ockels, *Emergent Research Survey of On-Demand Economy (ODE) Survey* (2016) (unpublished raw data).

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/>.

⁶ 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.

⁷ *Id.*

⁸ 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, (Jan. 6, 2016) <http://www.aspeninstitute.org/news/2016/01/06/forty-five-million-americans-say-they-have-worked-demand-economy-while-865-million>.

⁹ 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>.

¹⁰ 2016 Kogod Survey of National Association of the Self-Employed Membership (April 2016) (unpublished raw survey data, National Association of the Self-Employed). 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 sample of NASE members.

¹¹ *Id.*

¹² 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. *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>.

¹³ 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).

¹⁴ 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.

¹⁵ 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.

¹⁶ 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>).