

**Testimony of
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**Before the
House Committee on Small Business**

**Hearing on
“The Sharing Economy:
A Taxing Experience for New Entrepreneurs Part I”**

May 24, 2016
2360 Rayburn House Office Building
Washington, DC

INTRODUCTION

Thank you Chairman Chabot, Ranking member Velázquez, and members of the Committee. I am grateful for the opportunity to testify before you on the subject of taxes and the sharing economy.

The Information Technology and Innovation Foundation (ITIF) is a non-partisan think tank whose mission is to formulate and promote public policies to advance technological innovation and productivity internationally, in Washington, and in the states. Recognizing the vital role of technology in ensuring prosperity, ITIF focuses on innovation, productivity, and digital economy issues.

ITIF's approach to this subject is driven by three considerations. The first is that, while the sharing economy is growing rapidly, it still represents only a small fraction of an increasingly diverse labor market. In their report for the Hamilton Project at the Brookings Institution, Seth Harris and Alan Krueger estimated that 600,000 U.S. workers used an Internet platform to identify consumers interested in purchasing personal services. Of these, roughly 400,000 were Uber drivers.¹ These estimates are roughly consistent with others that have been published. The total should not be appreciably higher if we adding workers who make a living selling goods on Internet platforms such as Etsy and Artful Home. My testimony is mainly focused on those platforms that deal in personal services since they suffer the most from the current confusion in our labor laws.

However, these individuals are part of a much larger number of workers in "alternative arrangements". A 2015 report commissioned by Freelancers United and Upwork estimates that 54 million Americans, over one-third of the workforce, fall into one of the following five categories: independent contractors, moonlighters, diversified workers, temporary workers, or small business owners.² A study by Lawrence Katz and Alan Krueger estimated that the percentage of workers engaged in "alternative work arrangements," rose from 10.1 percent of the workforce in 2005 to 15.8 percent last year.³ Contract companies accounted for the largest share of this increase, although independent contractors make up the largest group, at 8.4 percent of the workforce. Workers who provide services through online intermediaries accounted for only 0.5 percent of workers.

Public debate over this segment of the workforce is hampered by three factors. The first is that the Department of Labor has not conducted its Contingent Work Survey since 2005. I am glad that the Department has announced its intention to renew data collection this year. Hopefully, its findings will shed more light on the size and composition of this large fraction of the labor market.

¹ Seth D. Harris and Alan B. Krueger, "A Proposal for Modernizing Labor Laws for Twenty-First-Century Work: The 'Independent Worker'" (discussion paper 2015-10, The Hamilton Project, The Brookings Institution, December 2015), http://www.hamiltonproject.org/assets/files/modernizing_labor_laws_for_twenty_first_century_work_krueger_harris.pdf

² Sara Horowitz, "Freelancing in America 2015 Report," Freelancers Union, October 1, 2015, <https://www.freelancersunion.org/blog/dispatches/2015/10/01/freelancing-america-2015/>.

³ Lawrence F. Katz and Alan B. Krueger, "The Rise and Nature of Alternative Work Arrangements in the United States, 1995-2015, March 29, 2016, https://krueger.princeton.edu/sites/default/files/akrueger/files/katz_krueger_cws_-_march_29_20165.pdf.

Our insight into the labor market and other parts of the economy is also hampered by a lack of sharing among the three main data agencies; the Census Bureau, the Bureau of Labor Statistics, and the Bureau of Economic Analysis. Unlike Canada, the U.S. statistical system is highly fragmented. This makes it difficult to gather consistent statistics across agencies. Tax law currently bars the agencies, mainly the Census Bureau, from sharing microdata with each other. The result is inaccurate and imprecise data. This in turn limits the ability of lawmakers and businesspeople to understand what is really happening in the economy. Sensible data sharing legislation could reduce costs and improve accuracy while still protecting taxpayer confidentiality.⁴

Finally, much of the debate around the sharing or gig economy has focused on Uber and Lyft. This is understandable since these two companies have introduced a new business model into the economy that employs a large majority of all "gig" platform workers. They have also been the focus of high-profile legislation and litigation. Yet the focus is also unfortunate because it diverts attention from the large number of other matching platforms that are pursuing different business models to connect buyers and sellers of various services and goods. A few platforms, such as Hello Alfred, hire their workers as employer. Most, however, classify their workers as independent contractors. Some platforms seek to offer a new service that consumers could not previously get. Others try to do a better job of connecting consumers and providers for traditional services like plumbing and legal advice. The platform may or may not become involved in specific activities such as setting prices, handling payments, maintaining a ratings system, or training workers. Platforms also differ in the amount of flexibility that they give workers to determine when they will work and which jobs to take.

The second consideration that shapes our approach to this issue is that task matching Internet platforms are delivering tremendous value to both consumers and workers. A survey of Uber drivers showed that the vast majority are happy working for the company.⁵ They greatly value the flexibility in terms of when and how much to work. This is reflected in significant variability in the number of hours worked per week. They also seem happy with the pay. One indication of this is that only seven percent of Uber drivers work more than 50 hours a week compared to 35 percent of taxi drivers. A second survey of over 4,600 workers from 11 platform companies found that 54 percent were highly satisfied with their on-demand job.⁶ Only 7 percent said they were dissatisfied. Sixty-three percent reported that they were happier because they were with an on-demand platform, in fact 33 percent work for more than one platform. Eighty-one percent said they would probably or definitely continue working with the platform for at least the next year. Half of the workers agreed that they would not go back to relying solely on a traditional job. Workers earned an average of \$7,900 over the last 12 months, accounting for 22 percent of their total household income. The average hourly earnings was \$28. For the large portion of workers who would be on their own anyway, platforms can offer an efficient way to advertise their services, build a reputation, and find work between projects.

⁴ Luke Stewart, "We Have a Sharing Problem," Information Technology and Innovation Foundation Innovation Files blog, June 13, 2012, <http://www.innovationfiles.org/we-have-a-sharing-problem/>.

⁵ Jonathan Hall and Alan Krueger, "An Analysis of the Labor Market for Uber's Driver-Partners in the United States."

⁶ "Dispatches from the New Economy: The On-Demand Workforce and the Future of Work," Intuit and Emergent Research, January 28, 2016, <http://www.slideshare.net/IntuitInc/dispatches-from-the-new-economy-the-ondemand-workforce-57613212>.

Gig platforms also deliver tremendous benefits for consumers. Buyers are able to find reliable workers at a competitive price. Rating systems give them some assurance of both the quality and safety of the work that will be done. A recent survey of five cities showed that Uber drivers were 30 to 50 percent more efficient than taxi cabs in terms of either time spent working or miles driven.⁷ This allows them to earn more per hour even while charging the rider less. Platforms are also much more likely to help underserved areas of the market. Because of these benefits, the spread of platforms should be encouraged not resisted.

The third consideration is that the traditional employee-independent contractor distinction no longer serves much purpose for a growing share of today's labor market. It is a relic of common law torts used to determine whether a person should be held responsible for the negligence of someone who works for another.⁸ Because this question hinges on the details of control in the relationship, courts have developed a highly subjective, multi-factor test that offers very little guidance to future companies and their workers, especially in an economy that is increasingly fluid and diversified.

Largely by default, the common law test has become the basis for determining whether all of the major federal and state labor laws apply. The result is a large amount of uncertainty and litigation, much of it serving no purpose other than to confuse and delay hiring decisions. Worse, the possibility that any discretionary support given to workers will be used to classify the work as an "employee," thereby invoking the full panoply of labor laws, whether or not they make sense in a given work relationship, discourages companies from supporting gig economy workers and consumers in a large variety of ways.

Absent the threat of labor litigation we would expect employers to support their workers whenever the cost of doing so is less than its value to workers. Some of the ways that companies have said that they would like to support the workers who use their platforms include training, business advice, recordkeeping, financial advice, and tax assistance. Such efforts could be enormously valuable to workers, who after all are now for all intents and purposes running their own businesses. In addition, these companies could add value to both workers and consumers by setting prices, handling transactions, letting parties rate each other, and conducting background checks. Yet such activities are often used as evidence that companies have created an employer-employee relationship.

Within the tax field, help with tax advice, recordkeeping, and withholding could be especially important. The tax laws are enormously complex. Workers need to make a number of important decisions including what form of business to create, whether to set up a new savings plan such as a SEP-IRA, how much to withhold, what salary to pay themselves, and how much to save. They need to determine what expenses are deductible and begin keeping the necessary records. And they need to complete their tax filings in a timely manner. In

⁷ Judd Cramer and Alan B. Krueger, "Disruptive Change in the Taxi Business: The Case of Uber, NBER Working Paper No. 22083, National Bureau of Economic Research, March 2016, www.nber.org/papers/w22083.

⁸ Richard R. Carlson, "Why the Law Still Can't Tell an Employee When It Sees One and How It Ought to Stop Trying," *Berkeley Journal of Employment & Labor Law* 22, no. 2, September 2001, <http://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1301&context=bjell>.

the Intuit survey referenced above, 20 percent of on-line workers listed understanding tax and legal obligations as one of their top challenges.⁹ There are many ways that platform companies could help. I suspect that in many cases, it will be fairly simple for the platform to alter its payroll system to withhold taxes from workers who do more than a threshold amount of business with them. This would substantially reduce the administrative burden on workers and could result in a larger percentage of taxes owed being paid.

Existing law is less than optimal. With respect to tax laws, companies have a legal obligation to report the income of their employees to the Internal Revenue Service (IRS) and to withhold income taxes and the employee's share of payroll taxes. They must also pay the employer's share of the payroll tax, although it is widely recognized that this cost is passed on to employees in the form of lower take-home wages. Finally, employers must pay unemployment taxes for their employees, even if the worker is a household worker who works for 10 or more households a month. No similar obligation exists with respect to independent contractors.

This distinction raises several issues. The first is the desirability of drawing a clear line between employees and independent contractors. The guidelines of distinguishing between a worker and an employee are set out in IRS Publication 15-A.¹⁰ Today's labor market is distinguished by a broad spectrum of arrangements between these two poles with individual work arrangements characterized by literally dozens of factors that can vary not only from worker to worker but also can change with respect to individual workers over time. For instance, experienced workers might be given much more flexibility and discretion than beginners. They might also qualify for more benefits. Tax law tries to reflect this complexity by looking at the details of the work relationship. IRS Publication 15-A lists eleven criteria divided into three categories, essentially incorporating the common law liability test. None of these look at the intention of the two parties.

Because of its fact-based nature and the subjectivity of many of the criteria, the guidelines give little guidance to either companies or workers. Despite the fact that reasonable people can easily disagree on how the law applies to specific cases, the penalties for misclassification are significant. Besides resulting in significant uncertainty, litigation, and administrative costs, the guidelines actually give companies perverse incentives. For example, a company's decision to give its workers vacation pay or insurance or to take efforts to reduce turnover would make it more likely that the IRS would classify the worker as an employee. As such, gig platforms are provided an incentive to do little other than pay the gig worker. Clearer thresholds could eliminate this confusion while improving tax collection.

Second, it is not clear why so many of the obligations are bundled in an all or nothing form. For example, why, if we want a company to withhold and pay taxes on behalf of its workers, should we also automatically decide that the workers are now entitled to form a union, receive family leave or be entitled to a minimum wage? Conversely, if we decide that a person should not have these tax burdens, why does that automatically mean that discrimination laws do not protect the worker? With respect to tax laws, it would seem to make

⁹ "Dispatches from the New Economy: The On-Demand Workforce and the Future of Work."

¹⁰ Internal Revenue Service (IRS), "Publication 15-A: Employers' Supplemental Tax Guide," Department of the Treasury, 2016: 7–10, <https://www.irs.gov/pub/irs-pdf/p15a.pdf>.

more sense to draw bright lines that everyone could understand. We may not want to burden individuals with the need to calculate and withhold taxes for their baby sitters, figuring that in most cases the consumer is no better positioned to perform this administrative work than the worker and that relieving the consumer of this burden also relieves the worker of the danger that the individual will misappropriate the taxes. Similarly, if a company only pays someone \$500 over the course of a year, withholding may introduce more complexity than we need. On the other hand, if a company is paying a worker more than \$5,000 over the course of a year and is also paying at least four other people that much money, the company is probably in a better position to do the withholding than are any of its workers, irrespective of the details of the particular work arrangement. But once we have decided on these thresholds, why would we also adopt them for the purpose of other federal and state labor laws?

Public policy should encourage companies to support their workers' careers, irrespective of their work relationship. If a company offers withholding to all workers, or pays for access to tax or business advice, why would we want to discourage that by insisting that it must also be subject to minimum wage, collective bargaining, and unemployment insurance legislation if those workers are not clearly employees rather than contractors?

In a recent ITIF report, I argue that there are three approaches that Congress can take to begin modernizing the nation's labor laws.¹¹ The best option would be for Congress to amend each federal labor law by throwing away the common law test and replacing it with a clearer one specific to that particular piece of legislation. The exact scope of coverage should probably depend on the purpose of the statute, the size of the two contracting parties, the intention of the parties, which side is best equipped to fulfill the underlying social goal, and the desirability of a clear line. I have suggested some ways that these criteria might be satisfied in tax law. Even though the amendment of each law could proceed separately, I recognize that updating major legislation is a tall order for Congress.

The second approach is to define a third category of workers somewhere between employee and independent contractor. This is the approach Seth Harris and Alan Krueger take in their report for the Hamilton Project. The downside of this approach is that courts now have to distinguish between three classes rather than two. It also requires Congress to amend the existing labor laws in order to make it clear which laws would apply to the third category. In this case, however, it would be much more difficult to amend each law separately.

Finally, Congress could give platforms devoted to personal services a temporary exemption from most labor laws. The workers of many of these platforms are clearly independent contractors anyway. The small size of the gig economy and the temporary nature of the exemption reduce any risk to the broader labor markets. The platforms should have to serve a broad section of the public and give workers significant freedom to choose when and for whom to work. In return Congress would see whether companies stepped up to offer their workers more support. If most did not, the legislation could be allowed to expire on its own. If they did, then hopefully the gig economy could serve as a model for the larger variety of alternative work arrangements.

¹¹ Joseph V. Kennedy, *Three Paths to Update Labor Law for the Gig Economy*, Information Technology and Innovation Foundation, April 2016, <https://itif.org/publications/2016/04/18/three-paths-update-labor-law-gig-economy>.

The world around us is rapidly changing. We see this in the technology we use, our expectations of the private sector and government, and in our economy, including the labor market. Work arrangements will continue to diversify as companies respond, changing competition and new technology and as new generations of workers replace the Baby Boomers. Congress cannot dictate the shape of future work arrangements. It can, however, play a large role in helping workers get the kind of support they need to have rewarding careers that fit into their lives and allow them to accumulate the resources needed for a good life.

Thank you again for this opportunity to appear before you today.