



ACT | The App Association

Testimony

of
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on
The Sharing Economy: A
Taxing Experience for New
Entrepreneurs, Part I

before the
House Committee on Small Business

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2361 Rayburn House Office
Building





Chairman Chabot, Ranking Member Velázquez, and distinguished members of the Committee: My name is Morgan Reed, and I am the executive director of ACT | The App Association. Thank you for holding this important hearing on the tax challenges faced by participants in the sharing economy.

ACT | The App Association represents more than 5,000 small business app makers and connected device companies across the United States. Our member companies leverage the connectivity of smart devices to create innovative solutions that make our lives better. These technologies have given rise to the sharing economy, which has revolutionized how people work, travel, learn, and consume goods both digital and physical. Our member companies drive the sharing economy, increasing efficiency and reducing wastefulness across American society.

In my testimony today, I want to highlight four key points:

- The dynamic mobile app industry has enabled the rise of the sharing economy, allowing innovative entrepreneurs and small businesses across America to better utilize products and services in meeting market demands. Tens of millions of Americans are earning more for their families with flexibility and autonomy.
- Congress and the Internal Revenue Service (IRS) should take great care to make sure that the federal tax code enables—rather than stifles—the sharing economy. Specifically, the treatment of all sharing economy workers as “employees” under the federal tax code would be detrimental to the sharing economy, especially small businesses.
- Congress should work to advance legislation that would provide taxpayers with certainty and transparency in the tax resolution process and would provide the ability to settle disputes with the IRS in an effective and efficient manner
- Congress should ensure fairness in the treatment of businesses in the sharing economy by guaranteeing that internet sales taxes are based on the seller’s location. We call on Congress to reject proposals that would force businesses to become tax experts for thousands of state and local jurisdictions across the United States.



I. The Rise of Mobile Fuels Sharing Economy

While many Americans are familiar with a few of the most prominent sharing economy companies—Uber, AirBnB, eBay, or PayPal—the concept of “sharing” products and services in order to reduce costs has long existed on a micro level. This “sharing resources” concept has existed in every neighborhood in America, where one might borrow a snow-blower, a set of tools to fix a car, or a pickup truck for a run to the dump; payment was usually a full tank of gas, a plate of cookies, or a six-pack.

Today, your neighborhood has gone national.

The rise of the sharing economy as we know it today has been enabled by the widespread use of mobile devices and the app economy, which have brought the concept of sharing from neighborhood to nationwide. In existence less than a decade, the app industry has experienced explosive growth alongside the rise of smartphones. As the most rapidly adopted technology in human history, smartphones have quickly become the center of our digital lives. Today, the app economy represents a \$120 billion industry that is led by U.S. companies.¹ Apps have provided new opportunities for entrepreneurs to leverage the capacity of a product or service that would otherwise go underutilized or unused.

From ride sharing to child and pet sitting, the sharing economy provides wide societal benefit through on-demand access to goods and services at reduced costs – and we are only scratching the surface. In fact, the global sharing economy is set to reach \$115 billion this year, up from \$3.5 billion in 2012, according to projections from Ernst & Young.² Shifting demographics in the United States have propelled this growth. Millennials have generally demonstrated reluctance to purchase products that can be accessed on-demand without the burdens of ownership. For example, according to a 2013 Goldman Sachs survey, 60 percent of Millennials expressed either opposition or indifference to car ownership.³ Further, between 2008 and 2014, the rate of licensing declined from 82 percent to 76.7 percent among 20 to 25-year-olds.⁴

Eighty-two percent of top grossing apps are made by small businesses from communities across the country, located in areas both urban and rural.⁵ These companies are driving innovation across all sectors of the economy, increasing efficiency and expanding economic opportunity.



The popular media tends to describe the sharing economy in terms of companies that displace or disrupt an existing business model – uberX replacing the taxi, and VRBO replacing hotels. But we believe that is a false, or at least limited, dichotomy. The sharing economy not only replaces, but it also creates new concepts in how people engage and interact. Here are just two examples of sharing economy businesses creating new markets and bringing new outcomes to the world:

Based in Chicago, Nomful,⁶ an ACT | The App Association member, utilizes a sharing platform to connect nutrition coaches from across the country to consumers seeking a healthier lifestyle. Using Nomful’s service, dedicated coaches answer questions, set goals, and help consumers meet their health goals.

Nomful does not merely connect you with a nutrition expert. They fundamentally change the paradigm by getting users to change bad habits through ongoing relationships, not just a once-a-month meeting. Users can take pictures of the food they are eating, share it with their coach, and get real-time feedback and re-enforcement. Coaches get insight about the existing habits of the user so that they can step in before a bad decision is made.

Nomful has found that users who improve their daily nutrition habits are better able to handle chronic illnesses such as diabetes and special dietary situations like post-natal nutrition. This method of easy training for users is only possible through the use of Nomful’s contracted nutrition coaches who have the ability to choose the number of clients with whom they work and when they interact with their clients.

Feastly,⁷ a DC-based peer-to-peer startup that connects chefs and diners, has been called the “Airbnb for dinner.” Feastly’s platform is rather simple: they connect pre-approved chefs with potential diners for a set fee for hosted dinners, brunches, and cooking classes. Since its founding in 2012, Feastly has hosted thousands of meals for tens of thousands of diners across multiple markets, including Washington, DC, San Francisco, New York City, and Chicago.

Feastly offers an unlimited variety, as the number and chefs and disciplines is continually changing. Many chefs using the platform see this as a tremendous opportunity to experiment. In fact, many are forgoing employment other than work secured directly on the Feastly platform.



The benefits of the sharing economy extend beyond end users across consumer and enterprise contexts by creating new opportunities for any entrepreneurial American to earn extra income with flexibility and autonomy that was never possible before the widespread use of mobile devices. Parents looking to make supplementary income, or young professionals hoping to earn secondary income to support themselves, are no longer confined to cubicles or hour sheets.

Instead, Americans have the ability to work when and where they choose – sometimes through multiple sharing economy platforms. American engagement from this side of the sharing economy is already significant and growing.

A TIME Magazine poll recently found that 22 percent of American adults—45 million people—have already offered some kind of good or service in the shared economy, the vast majority of whom report positive experiences.⁸ Further, according to recent research from the American Action Forum, from 2002 to 2014 the number of workers in the gig economy expanded between 8.8 percent and 14.4 percent. And from 2010 to 2014, the gig economy accounted for 28.8 percent of all jobs, putting 2.1 million people to work.⁹ ACT | The App Association believes that these statistics clearly demonstrate how the sharing economy has and can further continue to benefit the lives of entrepreneurial Americans.

Today, the app economy represents a \$120 billion industry that is led by U.S. companies.

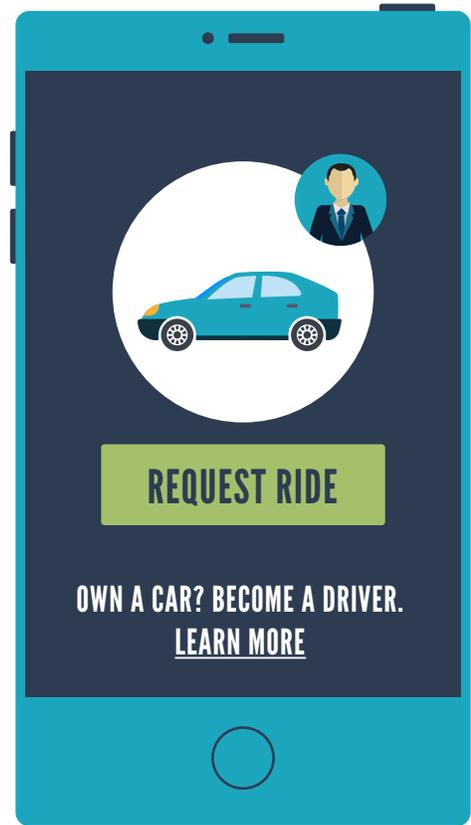
It is a constant struggle for government regulation to keep pace with innovation, from the federal to the local level. Like any new market entrant, sharing economy companies face barriers from legacy competitors and the legal and regulatory systems that have been built around established business practices. Existing legal and regulatory structures often discourage the innovations of the app economy, effectively reducing marketplace competitiveness, and ultimately harming consumers.

Of these legal and regulatory barriers, federal tax policies, which we are here today to discuss, consistently top small businesses' lists of concerns. Instead of worrying about federal taxation issues that may easily present "end of life" financial liabilities, small companies thrive when they are able to channel their energy and resources into more important issues such as growing their teams with talented software developers and protecting the security and privacy of their customers' data.



THE SHARING ECONOMY

- ✓ **Reduces costs** by “sharing” products and services
- ✓ **Gives new opportunities** for any entrepreneurial Americans to earn extra income with flexibility and autonomy that was never possible before the widespread use of mobile devices



22% OF AMERICAN ADULTS

have already offered some kind of good or service in the shared economy



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II. Internal Revenue Service Treatment of Sharing Economy Employees

The IRS approach predates the existence of our modern mobile, sharing economy. Traditionally, for tax purposes, a worker is regarded by the IRS either as an employee or a contractor. The employer makes this assessment, and the consequences of erroneously categorizing an employee are serious.¹⁰ Clarity in guidance from the IRS would be beneficial, particularly for small businesses that rely on their good faith determinations of worker status.

Heavy-handed application of outdated tax regulations threatens both the innovation driving the sharing economy as well as the incentives workers have to offer their skills to it. At a fundamental level, sharing economy businesses do not tell the contractors when to work, where to work, or how many hours to work. Further, as discussed below, while an American can find a job as a contractor or as a full-time employee, workers' basic needs are addressed through existing laws and marketplace availabilities. ACT | The App Association, therefore, is concerned with proposals for the blanket treatment of sharing economy workers as "employees" under the existing tax code and urges Congress to carefully examine the tax treatment of the growing sharing economy before making policy changes that could have widespread impact. Instead, we believe that by focusing on removing the barriers workers face to obtaining governmental and market-based services, sharing economy small businesses can be encouraged to develop and grow.

Under the IRS' "Common Law Rules," the degree of control, and independence of, a worker must be considered when determining whether they are an employee or independent contractor based on facts that fall into three categories: behavioral, financial, and the type of relationship.¹¹ Each of these categories and the factors within them are explored in an appended analysis from NetChoice,¹² from the traditional "employee," "independent contractor," and—representing the sharing economy use case—a "transportation network company" driver. Their analysis demonstrates that the typical sharing economy worker clearly does not fit within the definition of the traditional employee. Further, practical application issues would arise should the IRS use the traditional employee approach for shared economy workers, such as for unemployment insurance. Carrying these burdens through to the sharing economy would severely harm small businesses unable to carry such liabilities for part-time workers and would diminish the growth opportunity and societal benefits of the sharing economy.



To sustain this growth and its widespread benefits, the IRS should offer guidance to the sharing economy that clearly allows for the kinds of resource and property sharing we see making up this sector. For example, as small sharing economy companies strive to attract the best workers, many offer training and other educational instruction, yet face uncertainty in the Common Law Rules determination due to a lack of guidance from the IRS. For example, if Nomful provides training for its contractors on how to best handle their taxes or how to better engage with new users, does that trigger a change in status from contractor to employee? Such guidance does not require Congressional action and could be provided today.

ACT | The App Association urges this Committee and the IRS to recognize that, whether an American works as a contractor or as a full-time employee, their basic needs are addressed through existing laws (either at the federal or state level – or both) and market place availabilities. For example:

- **Health Insurance:** since the passage of the Affordable Care Act, individuals are required to have health insurance.¹³
- **Social Security and Medicare:** whether working as an employee or working as an independent contractor, contributions towards Social Security and Medicare are collected.¹⁴
- **Workman’s Compensation:** insurers today provide tools for contractors to protect themselves. For example, the marketplace today offers customizable “contractors insurance” which can provide general liability insurance, workers’ compensation insurance, and commercial auto insurance.¹⁵

There are a variety of proposals before Congress today to address IRS treatment of sharing economy workers. We are committed to an inclusive public discourse to inform any policy changes related to the sharing economy and believe that Congress should carefully consider any changes to the tax code made to address the rise of the sharing economy before moving forward. The livelihoods of tens of millions of Americans who offer their services through sharing economy platforms today and the countless Americans who save money and time through sharing economy consumption depend upon the careful consideration of these policies.



III. Troubling Trends in IRS Auditing Practices

In addition to the tax-related challenges discussed for the sharing economy, IRS audits have become increasingly inefficient and pose an additional threat to the growth of the small business app economy at large and the sharing economy specifically. In recent years, the IRS has taken steps to create new precedents within its auditing process that should be of particular concern to this Committee. Such practices include denying taxpayers the ability to seek review with the IRS Appeals office, the use of intimidation tactics to coerce taxpayers into extending the statute of limitations, the hiring of third party litigation law firms to engage in tax audits, and repeated failure to provide statutorily-mandated reports on its auditing practices to Congress, among others.



As a founding member of the Coalition for Effective & Efficient Tax Administration (CEETA),¹⁶ we have worked with the broad interests of this coalition to identify several areas of concern with how audits are currently conducted, including those noted above. These areas of concern fall into three broad categories:

- Need for transparency along with centralized management and accountability in IRS management of audits;
- Implementation of the new Information Document Request (IDR) process; and
- Impact of litigation strategies on IRS audits.



CEETA has publicly provided detailed analyses on these specific concerns and has further put forward workable legislative changes to improve the situation.¹⁷ More recently, we were pleased to support legislation introduced by Senator Rob Portman of Ohio to amend the Internal Revenue Code of 1986 to preserve taxpayers’ rights to administrative appeal of deficiency determinations (S.2809). Senator Portman’s proposal would:

- **Provide taxpayers with the opportunity to resolve issues in the IRS Appeals office before being forced to litigate in Tax Court.** Allowing Appeals review of a case by seasoned Appeals officers is more efficient and cost effective for the courts, the government, and taxpayers than going directly to expensive and time consuming litigation in Tax Court. If the IRS position is strong, the issue will likely be resolved in Appeals. If the IRS position is not strong, it may obtain a better result in Appeals rather than risk a loss in Tax Court.
- **Restrict the ability of the IRS to designate cases for litigation to “listed transactions” (tax shelter issues).** This would allow the IRS to designate cases for litigation for “listed transactions” to obtain precedent but would allow other issues to be resolved (or not) by IRS Appeals before engaging in Tax Court litigation.
- **Shifting the burden of demonstrating taxpayer uncooperativeness to the IRS in a more transparent process.** S.2809 would introduce needed accountability into this process by clarifying the ability of the IRS to unilaterally suspend the statute of limitations in a tax controversy through a designated summons by requiring documented review and written approval of that summons, and to require the IRS to demonstrate the taxpayer was uncooperative. Importantly, this does not prevent the IRS from issuing a designated summons against an uncooperative taxpayer – it merely provides safeguards for the use of this extraordinary tool to unilateral extend the statute of limitations.
- **Bar the IRS from hiring outside law firms to participate in a tax audit.** Small businesses, including those in the sharing economy, are concerned that if the IRS continues to expand its practice of hiring litigation law firms to engage in tax audits, small businesses will be targeted due to motivation on the part of these law firms to earn fees.

ACT | The App Association strongly urges the Committee to work to advance proposals consistent with S.2809 to foster the ability of taxpayers—including small businesses—to resolve disputes with the IRS in an effective and efficient manner. We commit ourselves to working with you and other stakeholders to address these issues.



IV. Internet Sales Taxation Proposals That Threaten the Sharing Economy

Small businesses that conduct sales online, including those that are part of the sharing economy, are threatened by additional proposals that this Committee is encouraged to confront today. Specifically, both the Marketplace Fairness Act (MFA), S.698, and the Remote Transaction Parity Act (RTPA), H.R.2775, if enacted, would seriously inhibit small businesses' existence and growth opportunities through flawed tax policy approaches.

The MFA would subject the entirety of U.S. online and catalog merchants, including sharing economy small businesses, to submit to 10,000 local jurisdictions' sales tax laws, creating an impossible situation for interstate commerce through an avalanche of compliance and cost burdens American small businesses have never seen before. Further, the MFA would enable any U.S. business to be audited by any of 46 states. In practice, this is a storm that only a select few large incumbent companies could weather. The small businesses across the country that this

The MFA would subject the entirety of U.S. online and catalog merchants, including the sharing economy small businesses, to submit to 10,000 local jurisdictions' sales tax laws, creating an impossible situation for interstate commerce.

Committee is committed to assisting, however, would face insurmountable barriers through having to track and comply with the regulations of 46 different states.

Proposed to remedy some of the issues posed by the MFA yet compounding the damage, the RTPA would require these same small businesses to utilize "free software" in order to comply with the thousands of U.S. tax jurisdictions. However, in providing this "free" software, the RTPA would unleash a slew of directly related expenses associated with software installation and maintenance. Further, the RTPA would again expose these small businesses to the possibility of audits from 46 states that utilize a sales tax. An exemption in the RTPA for small businesses would sunset in only three years. Finally, perhaps as troubling is the fact that the RTPA, unlike the MFA, eliminates federal preemption and federal court jurisdiction, preventing impacted businesses from seeking federal judicial review of state activity under the RTPA. The effects of these policies would be particularly harmful to sharing economy platforms, such as eBay, which enable thousands of small businesses to conduct interstate sales over the internet.



As an alternative to the MFA and RTPA, we support House Judiciary Committee Chairman Bob Goodlatte’s proposal, which would instead base internet and catalog sales taxes on the seller’s location, rather than the that of the customer. We believe this approach, which is consistent with how brick-and-mortar retailers collect sales taxes today, will permit businesses to avoid exposing thousands of American small businesses to regulatory and tax liability in double-digit jurisdictions.

We urge members of Congress, and this Committee in particular, to seriously examine the MFA and RTPA and their impacts. We believe that this Committee should work to oppose its flawed policies and oppose both bills.

Conclusion

The app ecosystem that powers the sharing economy offers incredible benefits to each and every American. This Committee has taken an important step towards addressing a threshold tax issue for a growing number of innovative small businesses across the United States.

I thank you again for the opportunity to present testimony about the extraordinary app ecosystem and the sharing economy. I look forward to our continued work together and pledge our support to help advance measures that empower innovation.



End Notes

- 1 ACT | The App Association, State of the App Economy (4th Edition) (Jan. 2016) at 4, <http://actonline.org/state-of-the-app-economy-2016/> (App Economy 2016 Report).
- 2 Ernst & Young, The rise of the sharing economy: The Indian landscape (Oct. 2015), [http://www.ey.com/Publication/vwLUAssets/ey-the-rise-of-the-sharing-economy/\\$FILE/ey-the-rise-of-the-sharing-economy.pdf](http://www.ey.com/Publication/vwLUAssets/ey-the-rise-of-the-sharing-economy/$FILE/ey-the-rise-of-the-sharing-economy.pdf).
- 3 Goldman Sachs, Millennials: Coming of Age, <http://www.goldmansachs.com/our-thinking/pages/millennials/> (last visited May 23, 2016).
- 4 Joe Cortright, StreetsBlog USA, Are Millennials Racing to Buy Cars? Nope, <http://usa.streetsblog.org/2016/04/25/are-millennials-racing-to-buy-cars-again-nope/> (last visited May 23, 2016).
- 5 App Economy 2016 Report at 4.
- 6 See Nomful, be nomful about food, <http://www.nomful.com/> (last visited May 23, 2016).
- 7 See Feastly, Feastly, <https://eatfeastly.com/> (last visited May 23, 2016).
- 8 Katy Steinmetz, TIME, “Exclusive: See How Big the Gig Economy Really Is” (Jan. 6, 2016), available at <http://time.com/4169532/sharing-economy-poll/> (last visited May 23, 2016).
- 9 Will Rinehart and Ben Gitis, American Action Forum, Research: Independent Contractors and the Emerging Gig Economy (Jul. 29, 2015), available at <http://www.americanactionforum.org/research/independent-contractors-and-the-emerging-gig-economy/> (last visited May 23, 2016).
- 10 See Internal Revenue Code section 3509. See also Robert W. Wood, Forbes, IRS Inspector Urges Crackdown on Mislabeling ‘Independent Contractors’ (Jul. 30, 2013), available at <http://www.forbes.com/sites/robertwood/2013/07/30/irs-inspector-urges-crackdown-on-mislabeling-independent-contractors/#741fec3e2450> (last visited May 23, 2016) (describing the tax consequences of misidentifying workers as contractors).
- 11 IRS, “Publication 15-A: Employers’ Supplemental Tax Guide,” Department of the Treasury, 2016: 7–10, <https://www.irs.gov/pub/irs-pdf/p15a.pdf>.
- 12 NetChoice is a trade association of eCommerce businesses and online consumers all of whom share the goal of promoting convenience, choice, and commerce on the net. See <https://netchoice.org/>.
- 13 26 U.S.C. § 5000A.



¹⁴ The IRS states that “[s]elf-employed individuals generally must pay self-employment tax (SE tax) as well as income tax. SE tax is a Social Security and Medicare tax primarily for individuals who work for themselves. It is similar to the Social Security and Medicare taxes withheld from the pay of most wage earners. In general, anytime the wording ‘self-employment tax’ is used, it only refers to Social Security and Medicare taxes and not any other tax (like income tax).” See <https://www.irs.gov/individuals/self-employed>.

¹⁵ See, e.g., Progressive, Contractors Insurance, <https://www.progressivecommercial.com/insurance/contractors-insurance/> (last visited May 23, 2016); see also Pacific United Insurance, Contractor Workers Compensation Insurance Protects Both Your Employees and Your Company, <http://pacificunitedins.com/services/workers-comp/> (last visited May 23, 2016).

¹⁶ CEETA, Home, <http://www.eetax.org/> (last visited May 23, 2016).

¹⁷ CEETA, Coalition for Effective & Efficient Tax Administration Position Paper, available at http://www.eetax.org/images/EETAX/CEETA_PositionPapers11132015.pdf (last visited May 23, 2016).