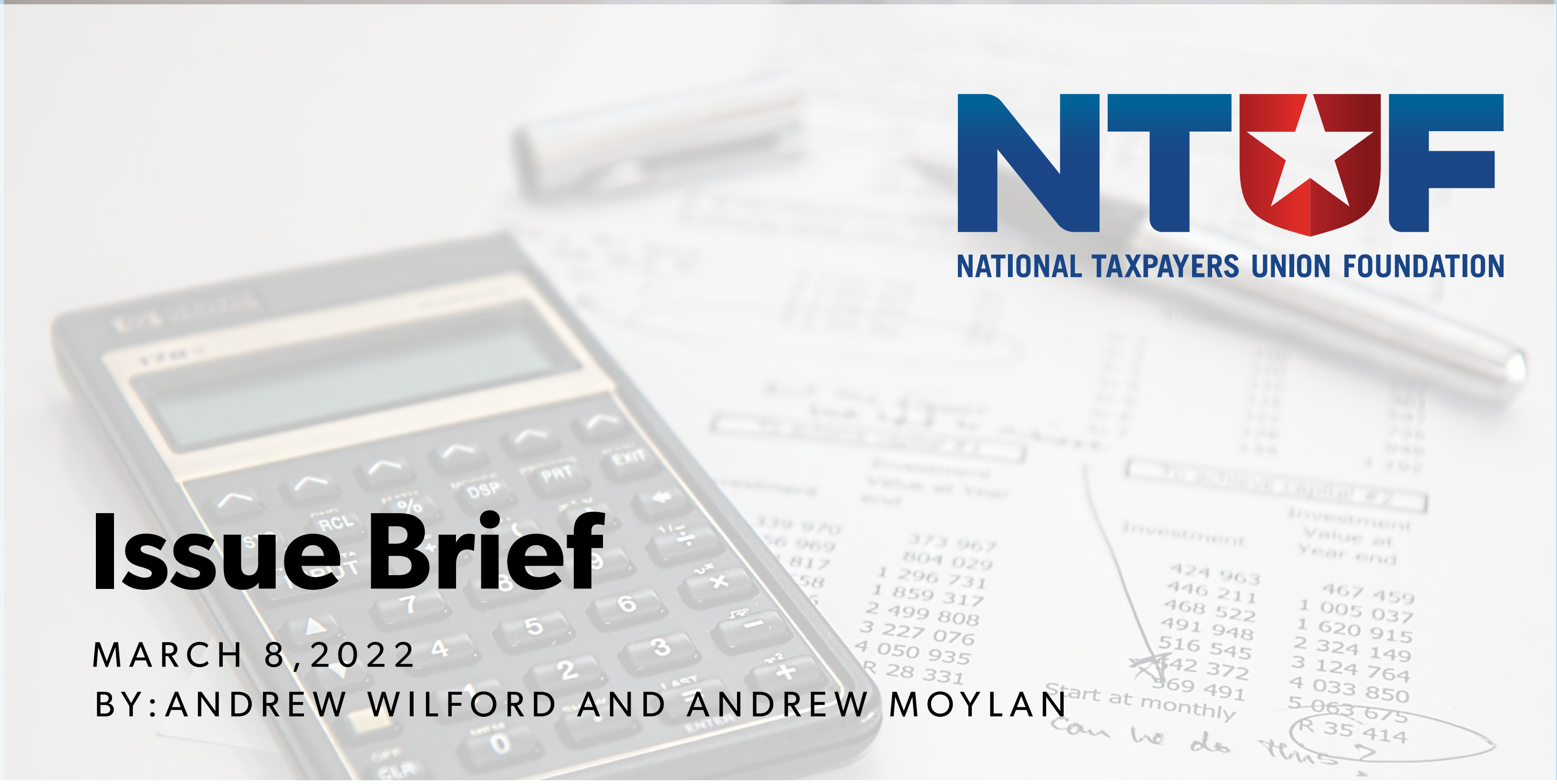

NATIONAL TAXPAYERS UNION FOUNDATION

Issue Brief

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Congress Needs to Act to Provide Relief to Taxpayers (and the IRS) From Burdensome 1099-K Requirement

In a recent paper, NTUF covered the state of the Internal Revenue Service (IRS), noting its mounting inability to keep up with the volume of returns and taxpayer correspondence it receives and the many negative effects on taxpayers. The paper closed by suggesting potential options for both short- and long-term fixes. But one issue addressed in this paper deserves a deeper dive: the new-for-2022 requirement that online businesses, including sales platforms and payment apps, issue 1099-K forms for anyone transacting more than $600.

Though efforts in Congress to increase the volume of taxpayer financial information that the IRS has access to in order to improve tax enforcement efforts have largely foundered, this change has already gone into effect and risks making a disastrous tax filing year even worse. Not only is this change likely already creating significant issues for taxpayers, platforms, and the IRS itself, but it can be fixed extremely easily.

The Problem

Prior to the passage of the American Rescue Plan Act (ARPA) in early 2021, web platforms (like online marketplaces, gig economy businesses, and apps that facilitate peer-to-peer payment) were re-

Key Facts:

As the Internal Revenue Service continues to struggle with mountains of unprocessed tax returns and paperwork, new reporting requirements for online transactions are making the problem worse.

By lowering thresholds substantially for mandatory reporting of income earned through web platforms, Congress dramatically increased paperwork requirements for online businesses and individuals, many of whom won't even owe income tax on the dollars reported on a 1099-K form.

As it considers how to more comprehensively address IRS dysfunction and smarter tax treatment for online commerce and labor, Congress should work to increase the threshold at which a 1099-K form is required to be produced.

quired to issue a Form 1099-K to taxpayers only if they had more than 200 such transactions and exceeded $20,000 in gross income. This paperwork requirement exists so that non-wage income doesn't escape completely reporting regimes that the IRS uses to ensure compliance, and also to help taxpayers fully understand their non-wage income for tax filing season.

A 200 transaction/$20,000 safe harbor helped to prevent the generation of unnecessary Form 1099-Ks. After all, if no safe harbor existed, online businesses and taxpayers alike would be awash in tax forms reporting details of the millions of web transactions that take place every day.

Unfortunately, a provision included in ARPA took what was previously a significant threshold that exempted nearly all casual online exchange and replaced it with a new one requiring the issuance of a 1099-K form for anyone receiving more than $600. Starting at the beginning this year, online platforms must issue 1099-K forms at the much lower level, which is likely to flood both taxpayers and the IRS itself with paperwork — despite the fact that much of the activity described on the forms won't even yield income tax obligations.

After all, many transactions that take place online are not "business" transactions at all. A great deal of commerce that takes place on web platforms bears more resemblance to a digital garage sale than a professional digital storefront — individuals selling off used personal items not as a business, but as a way to get rid of some unused items and make some money in the process.

Of course, the sale of used personal items is not taxable when it does not exceed the original purchase price. College students selling their textbooks online are almost never going to make a profit doing so — yet could easily hit the $600 threshold from this alone. When they receive a Form 1099-K in the mail, they could easily be misled into thinking that this represents taxable income they must report.

What's more, as NTUF noted in its recent paper, additional paperwork is a real problem for the IRS, particularly when it is paperwork that is unnecessary. As of last month, the IRS has a [backlog of 24 million returns] that remain unprocessed from last year, on top of returns from *this* year that are still coming in. Added paperwork for the IRS to muddle through is not just a waste, it contributes to the agency's sluggishness in performing its responsibilities.

It's also a problem for platforms that have to generate the additional paperwork. Generating and sending out millions of Form 1099-Ks to taxpayers and the government is a significant administrative burden on web platforms. It requires them to collect sensitive personal information, like Social Security numbers, which they must then secure against leaks and cyberattacks.

The Context

The change to Form 1099-K was just the beginning of a broad push to crack down on tax non-compliance. Buoyed by ([somewhat fantastical]) claims of a $1 trillion tax gap, lawmakers and administration officials proposed [huge increases in IRS enforcement funding] and extending [vast new enforcement powers to the IRS]. The prospect of "free" revenue, without having to raise taxes, was particularly enticing to Democratic lawmakers already planning large infrastructure and social spending bills.

In particular, lawmakers saw the change to Form 1099-K thresholds as a means of ensuring that gig economy income was taxed. After all, by that point, the gig economy was only continuing to grow as the pandemic forced workers out of traditional employment arrangements.

Unfortunately, Form 1099-K involves no context for the income that it reports, and it doesn't just capture gig economy work that does in fact incur income tax obligations. A 1099-K form does not take into account deductible expenses or fees paid to a payment processor. If a gig economy worker reported the income on their Form 1099-K without the associated write-offs, they would end up paying far more tax than they actually owe. A 1099-K issued for sales on an online marketplace, meanwhile, might fool a taxpayer into thinking it represents taxable income even if the sales it covers were all of used items.

This highlights some of the broader challenges with gig economy work and taxation. Those earning income on platforms like Lyft or TaskRabbit may not be accustomed to the record-keeping and paperwork requirements that small business owners and the self-employed know well, leading to confusion at tax time. While reform of the system is desperately needed to modernize tax paperwork and make it easier for people to comply with their obligations, a clumsy reduction of the 1099-K threshold that would flood taxpayers and the IRS with paperwork is not a productive step in that direction.

And it wouldn't be the first attempt by Congress to enact a clumsy $600 threshold. That number in particular has popped up multiple times now, often to be withdrawn as overly burdensome.

This first happened with the passage of the Affordable Care Act (ACA). The ACA attempted to place the onus on small businesses, requiring them to report all transactions that exceeded $600 to the IRS. Soon after the requirement was implemented, it was scrapped, with President Obama conceding that the requirement was "too burdensome" and "counterproductive."

More recently, some lawmakers pushed for a change that would require financial institutions of all types to report information to the IRS on all accounts that exceeded $600 in gross inflows and outflows. In response to criticism that this would create an overly broad dragnet on taxpayer information, the proposed threshold was amended to $10,000, with payroll deposits and expenses up to the level of payroll income being exempted. Nevertheless, the proposal remains dangerously broad, particularly given the IRS's poor recent history of protecting taxpayer data, and rightly has encountered significant skepticism in Congress.

Nevertheless, Congress's aims for IRS reform badly need to shift to fixing the structural shortcomings of the IRS in the taxpayer services department before it considers how best to tackle the tax gap. Until the IRS can process returns and respond to taxpayer and tax professional correspondence in a timely manner, Congress must weigh any proposals to step up IRS enforcement in light of their impact on already shoddy taxpayer services.

The Solution

The simplest, though not necessarily best, solution would be to revert the change to Form 1099-K thresholds to the pre-ARPA level of $20,000 and 200 transactions. At least in the short term, until the IRS gets its house in order, this could help to eliminate one pain point for taxpayers and the agency in the midst of an already-painful filing season. After all, the IRS's inability to process paperwork is costing the government money just as it is costing taxpayers — a recent investigation by the Treasury Inspector General for Tax Administration found that the IRS lost $56 million last year alone entirely from unearned interest because of delays in opening taxpayer mail that contained checks.

Likewise, the threshold could simply be raised to a level sufficient to exempt casual or low-level online activity. Setting the level at, say, $5,000 would not eliminate the entirety of the paperwork challenges associated with a new 1099-K standard, but it would make significant progress toward that goal while shielding taxpayers, platforms, and the IRS from some of the worst administrative fallout.

When the IRS is in a better position to handle its most basic responsibilities, Congress should pursue more comprehensive reforms. As we covered above, there are two separate issues caught up in the change to Form 1099-K thresholds: unreported taxable income that the IRS should know about, and non-taxable income that the IRS should *not* care about.

Future changes to Form 1099-K must make more of an effort to distinguish between the two. A lower threshold makes some sense for gig economy income that is going unreported, provided it also incorporates some reforms discussed below.

The problem of gig economy workers being subjected to a self-employment tax system they are unfamiliar with is one that could be solved several ways. One would be to create a new employment classification outside the somewhat outdated independent contractor/traditional employee distinction.

The truth is that while gig economy workers are like independent contractors in many ways, such as setting their own hours and not reporting to a manager, they would benefit from being able to receive expense compensation from the platform they "work for," such as reimbursement for vehicle mileage and gas for delivery drivers, without necessarily forcing them into a traditional full-time employee structure. Similarly, a new classification could allow for gig economy platforms to withhold income and self-employment taxes on behalf of their workers without triggering all of the obligations of full-time employment.

Another positive change would be to institute some form of standard deduction for gig economy workers' receipts. This would eliminate the requirement to keep precise records of vehicle mileage, for example. Taxpayers who cannot or do not keep such records could simply claim this standard deduction to their gig economy income instead.

But while there could conceivably be value in stepping up reporting requirements on gig economy transactions, lawmakers must be sure to pair such changes with efforts to reduce the complication and confusion for gig economy workers filing their taxes. Particularly this year, as the IRS struggles mightily with responding to taxpayer correspondence, blindsided gig economy workers are in a bad position to deal with tax filing changes.

Conclusion

Congress needs to act quickly to alleviate the numerous challenges taxpayers face this filing season. Yet while it makes an effort to address issues at the IRS like staff shortages, Congress should also take the opportunity to rectify problems of its own making before the IRS's issues became so dire.

Ensuring that Americans who owe taxes pay them is a worthy pursuit, but it must come with assurances that taxpayers can file their taxes while counting on timely processing and response from taxpayer service representatives. Until the IRS can get its house in order and Congress can enact other needed reforms, Congress should act to reduce the added burden and confusion caused by its recent change to Form 1099-K.

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