The gig economy and lower 1099-K thresholds: What practitioners need to know

WHITE PAPER

THOMSON REUTERS®

There's a storm brewing. We're talking about a 1099-K storm that will impact the January 2023 filings for many clients in the gig economy. Now is the time to help impacted clients prepare.

As tax and accounting professionals are well aware, the American Rescue Plan Act of 2021, which was signed into law March 2021, brought significant changes to gig workers and the organizations they work through. Tax practitioners may be up to speed on the changes that took effect for the 2022 tax year, but many clients working in the gig economy may be in for a surprise come filing season when they will be getting Forms 1099-K for the first time in 2023.

This represents real opportunities for practitioners to proactively advise these taxpayers and help them prepare and navigate the complex tax rules to minimize their tax liability.

To help practitioners, this white paper will further explore the changes and the actionable steps they can take to help clients. Let's begin by taking a closer look at who will be impacted.

Defining a gig worker

The gig economy is big. And it's getting bigger. The emergence of such online gig platforms as Uber, Lyft, Airbnb, VRBO, Etsy, DoorDash, and TaskRabbit, to name a few, has added a new wrinkle to the workforce and broadened the way people can connect and take on jobs, whether on a full-time or part-time basis.

Consider these stats: a survey conducted by Pew Research Center in August 2021 found that 16% of Americans have earned money through an online gig platform in at least one of the following ways:

- Driving for a ride-hailing app;
- Shopping for or delivering groceries or household items;
- Performing household tasks like cleaning someone's home or assembling furniture, or running errands like picking up dry cleaning;
- Making deliveries from a restaurant or store for a delivery app;
- Using a personal vehicle to deliver packages to others via a mobile app or website such as Amazon Flex; or doing something else along these lines.

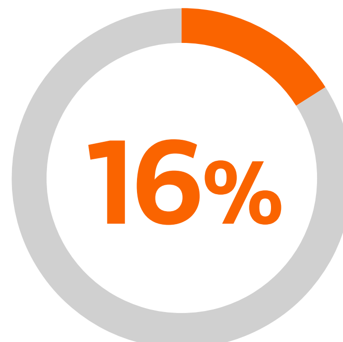
From a global perspective, a separate study found that the number of global gig workers — defined as "freelancers connected to customers via digital platforms" — is expected to rise from 43 million in 2018 to 78 million in 2023.

There are also people, such as a handyman or yoga teacher, who work with clients on a very casual basis and don't get their jobs through a digital platform and get paid via an app like PayPal, Venmo, or Thrive.

The gig economy, which spans many industries and occupations, is undoubtedly becoming a mainstay. And for many gig workers, tax-related changes are fast approaching.

As Shannon Christensen, Tax and Accounting Specialist Editor with Thomson Reuters Checkpoint®, explained in the Thomson Reuters webinar, Gig Economy Era: Advising on 1099-K, "Many of these gig workers probably went under the radar for the previous gross receipts reporting threshold. And now they'll be receiving this 1099-K for 2022. And, I think, oftentimes these folks don't realize they're truly budding entrepreneurs with their own business and own unique set of rules in recognizing income and deductions for tax purposes."

A survey conducted by Pew Research Center in August 2021 found that



of Americans have earned money through an online gig platform.

What's changed?

As mentioned previously, the American Rescue Plan Act of 2021 brought many changes to gig workers. Specifically, it substantially reduces the reporting threshold associated with Form 1099-K from $20,000 in aggregate payments and 200 transactions to a threshold of $600 in aggregate payments, with no minimum transaction requirement.

Beginning in 2022, third-party settlement organizations (TPSOs), including banks, online payment networks, and even online sellers' marketplaces, are now required to report payments of $600 or more to the IRS and payees on Form 1099-K, Merchant Card, and Third-Party Network Payments.

In other words, under the new guidelines, gig workers who get paid through online platforms like PayPal or who get paid through apps like Uber will receive Forms 1099-K in January 2023.

Jim Chapman, editor and author with Thomson Reuters Tax and Accounting Professionals, noted in the Thomson Reuters webinar, "This will be a new form for them. They won't necessarily know what they're doing or what to do with it. And this is where they'll turn to their tax preparers for help."

Not everyone has greeted the move with open arms. For instance, as pointed out in a KPMG report: "A November letter to House Speaker Pelosi, and the Ways and Means Chairman Neal, Rep. Pappas and 15 other members of Congress outlined the issues produced by the reduced threshold for Form 1099-K reporting. Notably, the letter states that the $600 threshold will lead to overreporting of income and overpayment of taxes, potentially rendering some taxpayers ineligible for certain tax benefits. The letter also points out that the increased reporting will require additional collection of personal information, potentially leading to privacy concerns for online sellers."

"Notably, the letter states that the $600 threshold will lead to overreporting of income and overpayment of taxes, potentially rendering some taxpayers ineligible for certain tax benefits."

Bills have been introduced in Congress to raise the limits back to the $20,000/200 transactions; however, there is no guarantee they will pass.

Deductions and adjustments

Under the new guidelines, gig workers will receive a Form 1099-K from each platform or app from which they receive $600 in gross receipts. While it includes gross receipts, it will not include any deductions or adjustments. Therefore, good record-keeping is important since gross receipts will usually be greater than taxable incomes.

"With the new lower gross receipts reporting threshold for 1099-Ks, there's a real opportunity here for solo, small practitioners to step up, assist these clients who likely previously prepared their own 1040 income tax returns, but could really use advisory services to help them navigate the complex tax rules to minimize their tax liability," said Christensen.

"I mean, I think about how many clients don't realize that they can offset gross receipts with ordinary necessary business expenses," Christensen continued. "And they'll simply take those gross receipts amounts reported on the 1099-K and include that income without any deductions or offsets. So to me, it seems like there's going to be a lot of over-reported income for these gig workers."

Proper record-keeping will also be essential since these taxpayers will need to distinguish business receipts from personal payments. This is important because a lot of people use payment apps, like Venmo or PayPal, to send money to friends or family.

For example, a group of friends goes out to dinner, and one person gets the check. Everyone else at the table may then use Venmo or PayPal to reimburse that person for their portion of the tab.

Another common scenario: a group of family members goes in on a shared gift. One person picks up the gift, and the rest of the family members use a payment app to reimburse that person for their portion of the cost.

In these types of scenarios, the payments are not income, and they are not business related at all. If the payments are $600 or greater, these people will be getting 1099-Ks, but they should not report it as gross income because it's strictly personal.

As you can see, if a person uses a payment app to receive money for both gig jobs and personal matters, it can quickly become confusing if they do not distinguish and document the difference.

The ideal solution is for the gig worker to establish a separate bank account and to run all their business transactions through that account. Any personal payments should run through a completely different account.

"With the new lower gross receipts reporting threshold for 1099-Ks, there's a real opportunity here for solo, small practitioners to step up, assist these clients who likely previously prepared their own 1040 income tax returns, but could really use advisory services to help them navigate the complex tax rules to minimize their tax liability," said Christensen.

Expenses

It will also be important to account for and document ordinary and necessary business expenses. While there are basic expenses, like phone expenses, that are used in any business, it is important to keep in mind that there will be separate types of expenses for each type of gig business.

To further illustrate this point, let's take a closer look at some of the different types of expenses for rideshare or delivery, Etsy or "flipping" equipment, and Airbnb:

Rideshare or delivery expenses

- Either mileage or actual costs
- Tolls and parking (parking tickets and traffic tickets are nondeductible)
- Cell phone or data plan (to the extent a cell phone or data plan is used for driving, like to get fares off the app or Google Maps for navigation, etc.)
- Cleaning expenses (i.e., car washings, sanitizing wipes, etc.)

Etsy or "flipping" equipment expenses

- Materials and supplies
- Labor (if they've hired help)
- Fees to join the platform
- Note: For those "flipping" equipment, they likely paid some amount of cash for that item and can deduct that amount paid as basis.

"Communication is key here. I think if you have an upfront conversation with your clients about errors and omissions in their own record keeping, and how that responsibility is on them and not you as the practitioner — even better if you can get this in writing in an engagement letter," said Christensen.

Airbnb expenses

- Utilities
- Cleaning fees
- Internet
- Phone
- Depreciation
- 280A rules — "Vacation Home" limits for deducting expenses
- 469(i)(1) rules — Passive loss deductions up to $25,000 ($12,500 MFS), subject to a phase-out, attributable to active participation in rental real estate activities can offset ordinary income

Being proactive and establishing good record-keeping habits is key. Clients should not wait until there's an audit to justify expenses and attempt to create the documentation. Again, this can present significant opportunities for practitioners to advise and help guide clients.

"Communication is key here. I think if you have an upfront conversation with your clients about errors and omissions in their own record keeping, and how that responsibility is on them and not you as the practitioner — even better if you can get this in writing in an engagement letter," said Christensen.

"But sometimes there may be some hard lessons that need to be learned," Christensen explained. "[Filing in] 2022 may be a difficult year for folks who didn't keep proper records. But this is where your advisory services can really shine in making sure, on a go-forward basis, that your clients know what records are important to keep and maintain. And doing this contemporaneously throughout the year is much easier than trying to think back over the year at what expenses were incurred."

Taxes

Another important factor to consider is taxes. More specifically, self-employment taxes, estimated taxes, and sales tax. There's a good chance these are areas your clients in the gig economy will need help navigating to ensure they are in compliance.

Let's start with employment taxes. Gig workers will have to pay self-employment tax, which is 15.3% of net earnings (their gross receipts minus their expenses from their self-employment income). They are, however, entitled to an income tax deduction of half of the employment tax they pay. Furthermore, self-employment income is aggregated with W-2 wages for the purposes of applying the Social Security wage gap.

"I think it's important to advise your clients on self-employment tax rules because they do get that employer share equivalent deduction for half of the employment tax that they would pay. And when you explain this to clients, it seems like there's a little bit of accounting magic happening on the tax return. Because we show the full self-employment tax on the return, and then we take a deduction for half of it out, which may seem strange to a non-tax accountant. But it's definitely something that's worth explaining to your client," Christensen said.

"I think it's important to advise your clients on self-employment tax rules because they do get that employer share equivalent deduction for half of the employment tax that they would pay. And when you explain this to clients, it seems like there's a little bit of accounting magic happening on the tax return. Because we show the full self-employment tax on the return, and then we take a deduction for half of it out, which may seem strange to a non-tax accountant. But it's definitely something that's worth explaining to your client," Christensen said.

Then there's estimated taxes. This may be foreign territory if the taxpayer is used to working for an employer who does the withholding for them and sends them a Form W-2. However, being self-employed means they're required to withhold their own taxes and pay quarterly estimated taxes. Failure to do so can result in a penalty.

Clients may avoid the penalty if:

- Their filed tax return shows they owe less than $1,000, or
- They've paid at least 90% of the tax shown on the return for the taxable year, or 100% of the tax shown on the return for the prior year — whichever amount is less. This can increase to 110% based on adjusted gross income (AGI) for individuals whose AGI exceeds $150,000 ($75,000 for those married filing separate returns).

Paying quarterly estimated taxes can seem inconvenient, but coaching the client on the importance of doing so is important. Making smaller payments throughout the year is no doubt less painful than getting hit with a large tax bill at the end of the year. And paying estimated taxes is especially important given the current economic climate.

"Paying in estimated taxes, however small it may be, is really prudent right now because you'd hate for them to get to the end of the year and not have that cash to be able to make the tax payment," said Christensen. "And what I saw in practice was that many clients who didn't pay those estimated taxes wound up having to take out loans. Taking out a loan can be very costly and expensive depending on interest rates. So, it can be a hard pill to swallow, but it's definitely going to be worth their while to pay estimated taxes as opposed to waiting until year-end."

If the client is selling inventory, another factor to consider, and a potential advisory opportunity, is reporting sales tax. Depending on the state law where the client is based, many of these sellers must collect and remit sales tax.

Inaccurate 1099-Ks

Your client tells you that they've received an inaccurate Form 1099-K. Now what?

Given that the upcoming tax season will be the first year for the lower thresholds, there's a good chance that some clients may think they are receiving a Form 1099-K in error, or that there are inaccuracies.

The client may or may not be correct, but it is important for practitioners to follow-up on any discrepancies they claim (within reason). If there is an error, it obviously needs to be fixed, and it also helps strengthen your position as their trusted advisor.

So, what steps can practitioners take? First of all, keep in mind that the client may not have kept good records and properly tracked refunds, credits, and other items. So, the Form 1099-K is likely accurate. However, if the form is inaccurate, request a corrected one from the issuer.

It is also important to ensure that the gross receipts reported actually belong to the individual. Here are a few questions to consider:

- Are the receipts collected on behalf of a third party?
- Does the individual receive payments under their social security number rather than a business tax ID (when they have formed a separate entity)?
- Are there shared credit card terminals or shared accounts? Ideally, the individual should furnish Form 1099-Ks to appropriate people for their allocated amounts of the gross receipts.
- Did they form or dissolve a business entity during the year? If so, notify the third-party network of the business tax ID and request a corrected 1099-K.

In the event the gross receipts amount reported is inaccurate and the issuer is not responding, the IRS does have guidance on its web site. But, as Christensen explains, there are things practitioners can do.

"So, what you need to do is advise your clients to report that full amount of the gross receipt as shown on the 1099-K, then, assuming you're comfortable with your client's supporting documentation and evidence that the gross receipt amount should really be something less than what's reported, you make an adjusting entry on Schedule C. There's an area under other expenses. I would actually clearly label this as an adjustment to gross receipts."

Christensen continued, "And then you attach a statement to the tax return explaining the adjusting entry, and again, proper substantiation is key, because the larger variance between the gross receipts reported on the 1099-K and the actual gross receipts the client is claiming they owe tax on, the riskier your issue. So, make sure you have that evidence to support why the amount report, the gross receipts reported on the 1099-K are something different than what your client is going to include in taxable income."

Is your head spinning yet? Clearly, dealing with all of this can get messy pretty easily. So, it's best to stay ahead of potential complications and try to stop them before they even start. This means identifying and addressing all factors that can contribute to inaccurate 1099-Ks.

Interest and penalties

It is important for clients to understand that compliance and proper record-keeping can help avoid interest and penalties. In addition, preparers can face penalties for failure to report income. Therefore, client communication is critical. Let's take a closer look at interest and potential penalties, for both taxpayers and preparers:

Interest

- Interest on underpayment is short-term AFR plus 3%
- No interest on underpayment of estimated tax, but there are penalties

Taxpayer penalties

There's a 20% underpayment penalty for negligence or disregard of rules or substantial understatement of tax. Understatement of tax is substantial if it exceeds the greater of $5,000 or 10% of the tax required to be shown on the return.

Preparer penalties

- Understatement due to unreasonable positions (greater of $1,000 or 50% of preparer's income to prepare the return)
- Understatement due to willful or reckless conduct (greater of $5,000 or 75% of preparer's income to prepare the return)

"So, even if the client does not want to report this income, or doesn't think they should have to report this income, if the preparer goes along with that they could be subjecting themselves to penalties. And sometimes it's a difficult conversation to have with the client, but it's one they need to have," Chapman said.

"So, even if the client does not want to report this income, or doesn't think they should have to report this income, if the preparer goes along with that they could be subjecting themselves to penalties. And sometimes it's a difficult conversation to have with the client, but it's one they need to have," Chapman said.

Be proactive

Take steps now to help ensure your gig worker clients are prepared for the changes to Form 1099-K. Being proactive not only helps save you and your clients from future headaches but also helps strengthen client loyalty and your role as their trusted advisor. Here are a few proactive steps to consider:

- Encourage clients to **establish a separate bank account** and to run all their business transactions through that account. Any personal payments should run through a completely different account.
- Encourage clients to **get a separate cell phone and data plan** for business purposes, especially if they use the phone to get fares off the app or use Google Maps for navigation. This makes it easier to track and document those deductible expenses.
- **Create templated spreadsheets or workpapers for gig worker clients.** Then push it back to them, ask them to fill in the information themselves, and then provide that information back to you to support their expenses.
- **Get creative, if necessary.** Gig worker clients may not be used to keeping a general ledger or regularly keeping invoices, tracking accounts receivable, accounts payable, etc. If need be, consider other ways to support the deductions they can take. For example, maybe the gig worker has a very extensive and well-maintained Outlook calendar that can be used to help support travel mileage expenses.
- Be sure to **proactively communicate with clients** to help ensure they understand what's required of them and any interest or penalties they could face for noncompliance. Send out client letters now to existing clients who you know are going to be receiving a 1099-K.
- For new clients, **have a packet of information ready to go**. This could include a client letter that addresses some of the most common issues and a standard set of workpapers they can use to get started. This can help minimize the amount of time spent coaching them.
- **Have the right tools and resources in place.** This includes leveraging an intelligent tax and accounting research tool — powered by AI and machine learning — to get the answers you need in less time.

Conclusion

With the changes set in motion by the signing of the American Rescue Plan Act of 2021, the Form 1099-K storm is brewing. Tax practitioners may be up to speed on the change, but many clients working in the gig economy may be in for a surprise.

This represents a real opportunity for practitioners to proactively advise these taxpayers, and to help them prepare and navigate the complex tax rules to minimize their tax liability.

To strategically advise clients and drive greater firm efficiencies during times of change, consider turning to a solutions provider like Thomson Reuters. Thomson Reuters has the tools and resources today's practitioners need to remain competitive and strengthen their roles as trusted advisors.

Solutions from Thomson Reuters

Thomson Reuters® Practice Forward

To learn more about how you can unlock advisory opportunities for a more profitable tax season, visit **tax.tr.com/practice-forward** for the latest insights and tools. Expectations are changing. Make sure your firm is ready.

Checkpoint Edge

Need the right answer quickly, so you can be on your way to a more profitable firm? Checkpoint Edge is the next generation of our Checkpoint research and guidance tool for tax and accounting professionals. It delivers the latest in artificial intelligence, cognitive computing, and machine learning technologies, combined with the tax and accounting expertise of our editorial staff. It enables you to find fast, accurate answers with a more fluid and intuitive user experience. Learn more at **tax.tr.com/en/checkpoint/edge**.