LOWER-INCOME TAX PLANNING

*Manoj Viswanathan**

Tax planning is generally criticized by scholars as inefficient; that is, imposing welfare-reducing costs by incentivizing transactions with few non-tax economic benefits. This Article argues that this view is unacceptably narrow and makes the original claim that tax planning by lower-income taxpayers is often welfare-enhancing and should, as a normative matter, be encouraged. As such, various parties, including the IRS, law school clinics, legal academics, and tax practitioners should actively strategize to reduce the transaction costs currently hindering lower-income tax planning. This Article then applies that mandate to a specific cohort of lower-income taxpayers—drivers working in the sharing economy—and proposes a strategy through which these taxpayers can take advantage of both existing tax laws and the § 199A qualified business income deduction of the recently enacted Tax Cuts and Jobs Act. By judiciously operating their rideshare activities through S-corporations, rather than as sole proprietors, rideshare drivers can obtain significant tax savings.

TABLE OF CONTENTS

* Associate Professor of Law, UC Hastings College of the Law.

I. INTRODUCTION

The complexities of the Internal Revenue Code offer myriad legal ways to save taxpayers money—if the taxpayer has the resources to find them. This is particularly true in light of the new and often opaque Tax Cuts and Jobs Act ("TCJA") passed in December 2017.[1] Consider two taxpayers with opportunities to legally reduce their tax liabilities. One is wealthy, works for a startup, and was granted stock as part of her compensation. By making a proper election and waiting five years to sell, she could avoid paying taxes on up to $10 million of profit.[2] Another taxpayer is lower-income[3] and makes a living in the sharing economy as a driver for Uber and Lyft. By operating her rideshare business

1. *See generally* David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439 (2019).

2. *See* I.R.C. § 1202 (2018) (excluding up to $10 million of capital gain as "qualified small business stock"); I.R.C. § 83(b) (providing election to treat conditional grants as vested, thereby starting the § 1202 five-year clock).

3. For purposes of this Article, lower-income taxpayers refers to taxpayers for whom tax planning is typically not an economically viable option. In contrast to "low-income," the term "lower-income" includes taxpayers considered to be middle class.

through an S-corporation, she would save on self-employment taxes and avail herself of the TCJA's qualified business income deduction.[4]

Both of these taxpayers' options are legal, complicated, and could be arranged by tax professionals. But only the wealthy taxpayer is likely to engage in the required tax planning. Wealthy taxpayers not only have the liquidity to engage in costly tax planning but also the high marginal tax rates to most benefit from it. Whereas wealthy taxpayers can afford the most beneficial tax compliance, lower-income taxpayers typically only obtain the *simplest* tax compliance.

While the tax planning methods described above are legal, they are largely regarded by tax scholars as inefficient; that is, imposing welfare-reducing costs on society by incentivizing transactions with few non-tax economic benefits. Tax planning encourages taxpayers to change their behavior from what would have occurred absent any tax laws. This shift from the pre-tax, economically efficient equilibrium is therefore characterized by most scholars as wasteful.

But this view of tax planning is unacceptably narrow. This Article argues that the general characterization of tax planning as inefficient (and therefore undesirable) generally applies only to the tax planning of wealthy taxpayers. In contrast, tax planning by lower-income taxpayers is often, counter to existing scholarship, welfare-enhancing. As such, lower-income tax planning can actually correct for certain market failures and should, as a normative matter, be encouraged.

This Article proceeds in four parts. Part II demonstrates that lower-income tax planning, in contrast to tax planning for the wealthy, often implements important social policy and accomplishes worthy distributional goals, thereby increasing social welfare. Part III discusses the transaction costs associated with effective lower-income tax planning and the various parties that could be tasked with reducing these costs. Part IV looks at a large cohort of lower-income workers—rideshare drivers in the sharing economy—and identifies the tax considerations (under both existing law and the TCJA) most relevant for their tax planning. Part V applies this knowledge and proposes a specific working arrangement for sharing economy drivers. By judiciously operating rideshare activities through S-corporations rather than sole proprietorships, rideshare drivers can obtain significant tax savings and, in the process, increase overall social welfare.

II. The Normative Case for Lower-Income Tax Planning

Certain forms of tax planning, contrary to the bulk of existing scholarship, correct for identified market failures or advance worthwhile policy goals. In other words, some subset of tax planning, though changing taxpayer behavior and ostensibly creating inefficient deadweight losses, is likely to be welfare-enhancing. For reasons discussed below, the tax planning of lower-income taxpayers, generally overlooked by scholars, is more likely to increase social welfare rather than impose inefficiency costs and should therefore be encouraged.

4. *See infra* Parts IV–V.

A. The Costs (and Benefits) of Tax Planning

Tax planning, for purposes of this Article, can be defined as any behavior undertaken by taxpayers to obtain beneficial tax treatment. This broad definition encompasses a wide range of activity. Any action in which tax consequences are considered constitutes tax planning. Waiting longer than one year to sell stock,[5] choosing (or not choosing) to become a secondary household earner,[6] and forming a tax-exempt 501(c)(3) organization[7] all constitute, on some level, tax planning.[8]

Scholars generally characterize tax planning as economically inefficient and welfare-decreasing; that is, tax planning diminishes social welfare by creating costs.[9] This account of tax planning as socially wasteful is based on the classic microeconomic model wherein taxpayer behavior in the absence of tax laws results in an economically efficient outcome.[10] Under this model, behavioral responses to tax laws shift this equilibrium, creating inefficiencies.[11] For example, a consumer might be willing to pay up to $105 for a new pair of shoes with a sticker price of $100. A 6% state sales tax levied on the $100 pair of shoes increases the purchase price to $106, more than what the consumer is willing to pay. As a result, the consumer's behavior is changed and a transaction desired pre-tax is no longer consummated, creating a deadweight loss of at least $5.[12]

The inefficiencies associated with a given tax provision can be described as the costs created beyond the amount of tax revenue raised.[13] A buyer in the preceding example valuing the shoes at $110 would still consummate the transaction, resulting in $4 of utility for the buyer and $6 of tax revenue for the state.[14]

5. I.R.C. §§ 1221–1222.

6. *See, e.g.*, Shannon Weeks McCormack, *Postpartum Taxation and the Squeezed Out Mom*, 105 GEO. L.J. 1323, 1354 (2017); Kevin M. Walsh, *The Marriage Penalty: How Income Stacking Affects the Secondary Earner's Decision to Work*, 39 SETON HALL LEGIS. J. 83, 84 (2015).

7. *See, e.g.*, Matthew F. Jones, *The Other Family Tree: Leaving Your Legacy in a Private Foundation*, 63 ALB. L. REV. 567, 568–69 (1999).

8. These actions can, of course, implicate important non-tax considerations as well.

9. Leigh Osofsky, *Who's Naughty and Who's Nice? Frictions, Screening, and Tax Law Design*, 61 BUFF. L. REV. 1057, 1065 (2013) ("[T]he assumption regarding the deadweight loss from tax planning is prevalent in much tax scholarship."); Alex Raskolnikov, *The Cost of Norms: Tax Effects of Tacit Understandings*, 74 U. CHI. L. REV. 601, 643 (2007) ("In general, tax planning is inefficient because tax-motivated changes in behavior produce deadweight losses."); David A. Weisbach, *Line Drawing, Doctrine, and Efficiency in the Tax Law*, 84 CORNELL L. REV. 1627, 1650 (1998–1999) (assessing inefficiency by comparing pre-tax and post-tax taxpayer behavior).

10. Daniel N. Shaviro, *An Efficiency Analysis of Realization and Recognition Rules Under the Federal Income Tax*, 48 TAX L. REV. 1, 4 (1992) (describing efficient tax systems as ones where changes to taxpayer behaviors are minimized).

11. These inefficiencies are also known as deadweight losses. BERNARD SALANIÉ, THE ECONOMICS OF TAXATION 17 (Mass. Inst. of Tech. 2d ed. 2011).

12. The social utility lost by the transaction not occurring is the $5 of the buyer's foregone utility and whatever the seller's utility would have been.

13. Terrance O'Reilly, *Principles of Efficient Tax Law: Apocrypha*, 27 VA. TAX REV. 583, 585 (2008) (describing deadweight loss caused by behavioral changes as "the costs imposed by taxation beyond the amount of revenue raised").

14. This transaction also results in some unknown amount of utility for the seller. *See supra* note 12 and accompanying text.

Here, the utility gained absent tax considerations is equal to the after-tax utility of the buyer plus tax revenue generated for the state. Although this tax provision has most likely stifled other transactions as described above (thereby creating inefficiencies), for this specific buyer and seller, taxpayer behavior is unchanged by the tax provision and no inefficiency results. A tax provision not changing taxpayer behavior implies no loss in social welfare due to the tax provision.

Because tax planning by its very definition changes taxpayer behavior, it has been broadly described as normatively undesirable and inexorably introducing inefficiencies.[15] When taxpayers take taxes into account, they shift their behavioral equilibria from the assumed-to-be-efficient, pre-tax result to outcomes with foregone revenue and transaction costs. Traditional scholarship views this behavior as reducing total welfare by imposing undesirable costs on society. This makes sense in many contexts. If the District of Columbia's 10% sales tax motivates a buyer to travel to Delaware (which has no sales tax) to make a purchase, the transaction costs of the trip are clearly net welfare reducing.[16]

But tax planning promotes a wide range of behavioral responses.[17] Previous scholars have not adequately considered that the potential cost of tax avoidance depends on the specifics of the tax planning behavior. Although some tax planning clearly imposes undesirable costs on society, other forms of tax planning could conceivably *increase* social welfare. Tax planning can be subdivided into certain categories, with these categories varying in their likelihood of imposing welfare costs.

Tax *evasion*, for instance, can be considered a subset of our general definition of tax planning**,** which covers any behavior where tax consequences are taken into account. As per the Internal Revenue Code, tax evasion is the voluntary, intentional violation of a known legal duty in order to evade taxes.[18] If, in the preceding example, the shoe seller neither charges nor remits the sales tax in question, a buyer valuing the shoes at $105 makes the purchase. No inefficiency is created by a failure to consummate the transaction. Rather, costs are imposed by the change in behavior resulting in the tax avoidance. The expense of engaging in the tax evasion is a welfare-reducing cost created by the existence of the tax provision. Second, an increased tax burden is now borne by other law-abiding taxpayers, assuming raising a fixed revenue is required.[19] By reducing their tax

15. *See supra* note 9 and accompanying text.

16. Neither government has collected tax revenue, and the purchaser has suffered transaction costs.

17. Osofsky, *supra* note 9, at 1062 (describing the different types of behavioral responses designed to reduce tax liability, including real shifts in underlying behavior in response to tax, avoidance activity, and evasion activity).

18. I.R.C. § 7201 (2018). The Supreme Court has found willfulness when there exists a voluntary, intentional violation of a known legal duty. *See* United States v. Pomponio, 429 U.S. 10, 10 (1976) (defining "willfulness" for purposes of § 7206); United States v. Bishop, 412 U.S. 346, 361 (1973) (holding that "willfully" has the same meaning in § 7206(1) as in § 7207). *See Generally* Ira L. Tilzer, *What Constitutes "Willfulness" in Criminal Prosecution for Nonpayment of Taxes*, 47 J. TAX'N 164 (1977).

19. The fixed-revenue assumption is common when assessing the costs of tax planning. David A. Weisbach, *Disrupting the Market for Tax Planning*, 26 VA. TAX REV. 971, 973 (2007) (stating it is common to "assume that the government has a fixed revenue constraint, with the money to be spent, say, on a fixed set of public goods").

burdens in a normatively disfavored manner (that is, illegally), taxpayers engaging in tax evasion thus nearly always impose an impermissible cost on society.[20]

Tax *avoidance*, though also a subset of tax planning (as defined in this Article), can be distinguished from tax *evasion*. Although definitions vary, tax avoidance can be contrasted by its putative legality.[21] As put by Judge Learned Hand, a taxpayer "may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's tax."[22] But if this tax planning involves behavior unanticipated by Congress and the IRS, the taxpayer is avoiding taxes by technically complying with the law, but in a manner not contemplated by the government.[23] This behavior is not per se normatively flawed (as is tax evasion) but is likely to be normatively undesirable.[24]

For example, prior to the enactment of restricting statutes, a property owner could "sell" property to a "buyer" who would obtain no real benefits of ownership other than depreciation deductions.[25] Congress had no intent to bless these sale/leaseback transactions, which involved no substantive economic changes, with these tax preferences.[26] Similar to tax evasion, this form of tax avoidance

20. Graeme S. Cooper, *Analyzing Corporate Tax Evasion*, 50 TAX L. REV. 33, 39–40 (1994) (stating that due to noncompliance arising from tax evasion, there are deadweight economic costs, distributional consequences including erosion of the progressivity of marginal tax rates and distortion of official indicators of economic activity).

21. *See* Eric C. Chaffee & Karie Davis-Nozemack, *Corporate Tax Avoidance and Honoring the Fiduciary Duties Owed to the Corporation and Its Stockholders*, 58 B.C. L. REV. 1425, 1433 (2017) (defining tax avoidance as activity "that technically complies with the law, but violates the spirit or underlying policy of the law"); Roberto Greco de Souza Ferreira, *Form Versus Substance: A Comparison of Brazil's Tax System to the Tax System of the United States of America*, 35 U. MIAMI INTER-AM. L. REV. 311, 325 (2004) (defining tax avoidance as "taking advantage of legally available tax-planning opportunities to minimize one's tax liability"); *see also* Zoë Prebble & John Prebble, *The Morality of Tax Avoidance*, 43 CREIGHTON L. REV. 693, 705 (2010) (noting that tax avoidance is not easily defined).

22. Helvering v. Gregory, 69 F.2d 809, 810 (2d Cir. 1934), *aff'd*, 293 U.S. 465 (1935). The Supreme Court noted that technical compliance with a statute is not sufficient; the transaction in question must have underlying economic substance. Although technical compliance with a statute generally precludes criminal liability, it may not be sufficient to retain the tax benefits associated with the transaction. *See generally* I.R.C. § 7701(o) (stating requirements for transactions to have economic substance).

23. These activities are commonly labeled as tax shelters. Jared T. Meier, Comment, *Understanding the Statutory Tax Practitioner Privilege: What Is Tax Shelter "Promotion"?*, 78 U. CHI. L. REV. 671, 673 (2011) ("Abusive tax shelters, on the other hand, typically seek to exploit the literal language of the Code and realize tax savings in ways not envisioned by Congress."); *see, e.g.*, Knetsch v. United States, 364 U.S. 361, 370 (1960) (holding that the transaction was not recognized for tax purposes because it only served the purpose of tax avoidance); ACM P'ship v. C.I.R., 157 F.3d 231, 247 (3d Cir. 1998) (noting that since the partnership's capital losses generated by purchase and immediate exchange of private placement notes lacked economic substance, they were not recognized for tax purposes).

24. Although unanticipated tax planning behavior might have social benefits, it is unlikely that revenue-reducing behavior unforeseen by Congress and the IRS would have salutary externalities.

25. *See, e.g.*, Estate of Franklin v. Commissioner, 544 F.2d 1045 (1976).

26. *See generally* Andantech L.L.C. v. Commissioner, 83 T.C.M. (CCH) 1476 (stating that, "although the form of a transaction may literally comply with the provisions of a Code section, the form will not be given effect where it has no business purpose and operates simply as a device to conceal the true character of a transaction").

burdens other taxpayers with higher tax burdens without encouraging any desired behavior contemplated by Congress, resulting in a net societal cost.[27]

Tax avoidance behavior *desired* by Congress and the IRS, however, can be contrasted with behavioral responses never contemplated. To the extent a behavioral change induced by a certain tax law is precisely what was intended by the statute, the behavioral responses are, at least according to Congress, social welfare enhancing.[28] If, for instance, an organization formed exclusively for charitable purposes completes the necessary paperwork to become tax-exempt under Section 501(c)(3), its otherwise taxable income becomes tax-exempt and donor contributions become deductible.[29] These tax savings result in a greater tax burden for all other taxpayers. But the social benefit obtained from the charitable activities of the organization is arguably greater than the tax revenue lost from the organization's tax-exempt status.[30] Congress enacted section 501(c)(3) knowing and intending that organizations would obtain the provision's benefits.[31]

Tax provisions affirmatively desiring to change taxpayer behavior are often attempting to correct for some perceived market failure, meaning a situation where the market has failed to independently find an efficient allocation of resources.[32] These market failures occur when markets are not perfectly competitive.[33] If, for instance, a market participant is not obligated to bear the cost it creates (generating a negative externality), the market's equilibrium will not be efficiency maximizing.[34] If producers of carbon, for instance, are insufficiently liable for the environmental costs they cause, a carbon tax might reduce carbon

27. Assuming, once more, a fixed-revenue model. *See supra* note 19 and accompanying text. There is the possibility that taxpayers avoiding taxes in unforeseen ways will do so in a way that somehow increases social welfare, but this seems unlikely. *See* Jasmine M. Fisher, *Fairer Shores: Tax Havens, Tax Avoidance, and Corporate Social Responsibility*, 94 B.U. L. REV. 337, 338 (2014) (stating that some corporate leaders believe that tax avoidance, if not yet made illegal by national governments, is not wrong and, "fiduciary responsibilities toward shareholders may even require their corporations to engage in such activities").

28. Michael L. Schler, *Ten More Truths About Tax Shelters: The Problem, Possible Solutions, and a Reply to Professor Weisbach*, 55 TAX L. REV. 325, 385 (2002) ("[I]f Congress enacts a tax credit for backflips, Congress has determined that backflips are socially desirable.").

29. Organizations "organized and operated exclusively for . . . charitable . . . purposes" are exempt from federal income tax. I.R.C. §§ 501(a), 501(c)(3) (2018). Contributions to § 501(c)(3) tax-exempt organizations are deductible by the donor. *See generally* I.R.C. § 170.

30. Ryan S. Keller, *Beyond Homo Economicus: The Prosocial Brain & The Charitable Tax Deduction*, 34 VA. TAX REV. 357, 366 (2015) ("The tax expenditure or subsidy view has become dominant, with most tax scholars now viewing the charitable tax deduction as a government expenditure whose justifiability derives from its net cost-benefit value.").

31. *Bob Jones Univ. v. United States*, 461 U.S. 574, 587–88 (1983) ("[I]n enacting both § 170 and § 501(c)(3), Congress sought to provide tax benefits to charitable organizations, to encourage the development of private institutions that serve a useful public purpose or supplement or take the place of public institutions of the same kind.").

32. Ryan Bubb & Richard H. Pildes, *How Behavioral Economics Trims Its Sails and Why*, 127 HARV. L. REV. 1593, 1602 (2014).

33. In the absence of perfectly competitive markets, government's only role is redistributive. *Id.*

34. Mollie Lee, Note, *Environmental Economics: A Market Failure Approach to the Commerce Clause*, 116 YALE L.J. 456, 478 (2006).

production so that carbon production is at its economically efficient level.[35] Analogously, Congressional intent to promote certain taxpayer behavior could be viewed as correcting for some market failure where, absent the tax incentive to engage in the behavior, the social welfare-maximizing amount of the behavior does not occur.

There is a distinction between statutes desiring to change taxpayer behavior and statutes where the behavioral response is expected but not intended. For example, the TCJA's across-the-board income tax decreases make it more likely that the secondary earner of a married couple enters the workforce.[36] Although this behavioral change was likely not the desired result of the rate decreases, that the legislative changes would promote this behavioral change was widely known.[37] To the extent that Congress considered that this behavior could happen, any associated costs should already have been factored into the efficacy of the provision. Similar to taxpayer behavior Congress intended to occur, any taxpayer behavior that Congress thought *might* occur, even if not specifically intended, should not, as previous scholars have done, automatically be treated as a cost.[38] Rather, this expected behavior could simply be the acceptable efficiency cost of a provision that Congress deems as still having a net welfare gain.

Because there is no clear demarcation between these various forms of tax avoidance, balancing the efficiency costs and welfare-increasing benefits of changed taxpayer behavior can be challenging. The lines between tax evasion and tax planning, and desired and undesired (or merely tolerated) taxpayer behavior, are often murky. For example, the deduction for charitable contributions may exist to properly measure income or to motivate taxpayers to contribute to charities.[39] Any assessment of the social "cost" of the behavior associated with the charitable contribution likely depends on the often difficult task of divining Congressional intent. Additionally, there is no assurance that any behavioral changes desired by Congress truly result in a net social benefit.[40] There is no guarantee, in other words, that Congress gets it right.

35. *See generally* Justin Gundlach, *To Negotiate a Carbon Tax: A Rough Map of Interactions, Tradeoffs, and Risks*, 43 COLUM. J. ENVTL. L. 269 (2018).

36. As marginal tax rates decrease, the after-tax value of a secondary earner's income increases. *See supra* Section II.A.

37. Wendy Richards, *An Analysis of Recent Tax Reforms from a Marital-Bias Perspective: It is Time to Oust Marriage from the Tax Code*, 2008 WIS. L. REV. 611, 638 (2008) (stating that "reducing the marginal rates eases the burdens on secondary earners and may encourage them to stay in, or return to, the workforce").

38. *See supra* Section II.A.

39. I.R.C. § 170 (2018); *see also* Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 316–17 (1976); Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1417 (1988).

40. The deduction for home mortgage interest, for instance, exists to, in part, promote American homeownership. Roberta F. Mann, *The (Not So) Little House on the Prairie: The Hidden Costs of the Home Mortgage Interest Deduction*, 32 ARIZ. ST. L.J. 1347, 1353 (2000) (quoting Senator Phil Gramm as saying "[Y]ou ought to be able to deduct interest on your home from your taxes. We have taken a position that home ownership is something that we want to promote, that it is an objective of our tax policy that is strongly supported, and it is reflected in this bill"). But it is not clear that the additional homeownership subsidy provided by the deduction has resulted in increased social welfare. *See, e.g.*, Nicholaus W. Norvell, *Transition Relief for Tax Reform's Third*

Even assuming that Congress weighs the social benefits of each tax provision to achieve what they consider to be normatively sound outcomes, legal tax planning will result in a range of normatively desirable and undesirable behaviors. These include intended behaviors, behaviors that are anticipated though not explicitly written into the code, and behaviors that are unanticipated and unintentionally permitted, often with no clear distinctions. But the argument herein is not that every instance of tax planning countenanced by Congress results in a net increase in social welfare. Rather, the claim is that some tax planning done by taxpayers, contrary to the bulk of existing scholarship, corrects for identified market failures or advances worthwhile policy goals. In other words, some subset of tax planning, despite changing taxpayer behavior and seemingly creating inefficiencies and deadweight losses, actually results in a net increase in social welfare. As the following Section demonstrates, tax provisions intended specifically for low-wage taxpayers are especially likely to result in a net social benefit rather than impose a net social cost.

B. The Normative Appeal of Lower-Income Tax Avoidance

Tax avoidance for lower-income taxpayers, defined as strategies lower-income taxpayers use to legally reduce tax liability, has normative appeal not generally applicable to the tax avoidance of wealthier taxpayers.[41] First, as discussed previously, behavioral changes in response to tax provisions intended by Congress and the IRS are more likely to increase social welfare while unexpected behavioral changes are likely social welfare reducing. Tax avoidance strategies of wealthier taxpayers involve unexpected behavioral changes, whereas the few tax avoidance options for lower-income taxpayers typically result from expected behavioral changes.[42] Second, tax planning of lower-income taxpayers often furthers favored distributional goals. Third, fairness concerns dictate that lower-income taxpayers be permitted to engage in tax planning to the same extent as wealthy taxpayers.

Rail: Reforming the Home Mortgage Interest Deduction After the Housing Market Crash, 49 SAN DIEGO L. REV. 1333, 1344 (2012).

41. In contrast, tax *evasion*, in contrast to tax avoidance, has limited normative appeal. *See supra* Section II.A.

42. Linda M. Beale, *Putting SEC Heat on Audit Firms and Corporate Tax Shelters: Responding to Tax Risk with Sunshine, Shame and Strict Liability*, 29 J. CORP. L. 219, 235 (2004) ("Major accounting firms other than Arthur Andersen have been increasingly involved in designing and promoting shelter transactions for wealthy individual and corporate clients, including audited companies and their managers and directors."); *A Gutted I.R.S. Makes the Rich Richer*, N.Y. TIMES, Dec. 25, 2018, at A18.

1. Lower-Income Tax Avoidance

The few tax planning options available to low-income taxpayers typically involve behavior contemplated by Congress. Lower-income taxpayers almost exclusively earn income via labor rather than from preferentially taxed capital gains.[43] In contrast to income from capital assets, fewer choices are available with respect to timing and valuation, the hallmarks of tax avoidance strategies, when workers earn wages.[44] Capital assets, by their very provenance as investments, often belie readily ascertainable fair market values. The ability to control valuation allows the wealthy taxpayers owning these assets to price them in whatever manner is tax-favored.[45] Similarly, the realization requirement, which only taxes accrued income from capital assets once assets are sold, allows wealthy taxpayers to control the timing of gain to achieve tax savings.[46] These options are simply not available for lower-income taxpayers earning income from labor.

Tax avoidance strategies unforeseen by Congress require taxpayers to interpret and implement tax laws in nonobvious ways. The costs associated with such strategies will therefore typically be higher than the costs associated with lower-income tax avoidance. The expense of this tax planning is only worthwhile if the taxpayers' expected benefits exceed the costs of engaging in the tax planning. Wealthier taxpayers are willing to spend this additional cost on tax planning for two reasons. First, their higher marginal tax rates make deductions more valuable than those obtained by lower-income taxpayers. For example, a certain tax-favored investment might allow for a taxpayer to claim an immediate deduction.[47] A wealthy taxpayer in a 35% marginal tax bracket investing $1,000 has obtained greater tax savings ($350) relative to a lower-income taxpayer in a 10% marginal tax bracket ($100) investing the same amount.[48] The lower-income taxpayer would only be willing to incur $100 of tax planning costs, while the wealthy taxpayer would be willing to incur a tax-planning cost of $350. Second,

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43. Approximately 24% of the income of the richest 1% of Americans comes from capital gains. For the bottom 80% of taxpayers, that percentage is approximately 2%. IRS, STATISTICS OF INCOME 2 (2013); Manoj Viswanathan, Letter to the Editor, *How We Tax*, NEW YORKER, Apr. 25, 2016, at 8.

44. John Buckley, *Tax Changes Since Woodworth's Time: Implications for Future Tax Reform*, 34 OHIO N.U. L. REV. 1, 13 (2008) (stating that most behavioral responses to tax laws involve timing modifications and that labor responses are relatively minor); Michael Simkovic, *The Knowledge Tax*, 82 U. CHI. L. REV. 1981, 2027 (2015) ("The realization requirement makes it easier for individuals to time taxable income from gains (or losses) on property, but timing taxable income from earnings is more difficult.").

45. Property taxes based on assessed property values are typically lower than the true fair market value of the home. Jay Romano, *Your Home; Market vs. Appraisal: What's the Real Value?*, N.Y. TIMES, Aug. 8, 2004, § 11, at 12 ("[A]ssessed value should be the same as market value. Typically, however, it is not.").

46. Ilan Benshalom & Kendra Stead, *Realization and Progressivity*, 3 COLUM. J. TAX L. 43, 52 (2011) ("Because the majority of capital assets are owned by affluent taxpayers, the realization requirement provides a tax benefit that is primarily skewed toward the wealthy. Consequently, in the current tax regime, the realization requirement is justly viewed as an inherently regressive feature that hinders the income tax's wealth redistribution objectives.").

47. *See, e.g.*, I.R.C. § 219 (2018) (providing a maximum federal income tax deduction, in 2018, of up to $5,500 for contributions to traditional individual retirement accounts).

48. In this example, the wealthy taxpayer obtains tax savings of $350 ($1,000 x 35%) compared to the $100 tax savings of the poorer taxpayer ($1,000 x 10%).

wealthier taxpayers simply have more money to allocate to tax avoidance activities. If the tax-favored investment described above permitted taxpayers to invest up to $50,000, a lower-income taxpayer is less likely to have the funds available to take full advantage of the tax avoidance strategy.

As a result, Congressionally unintended tax avoidance, which is typically both inefficient and not social welfare increasing, is not likely to be conducted by lower-income taxpayers. There is little financial incentive for lower-income taxpayers (or profit-seeking tax strategists) to invest resources into devising unintended tax avoidance strategies when tax avoidance from labor income is hard to implement and when the savings from any such avoidance is likely small.

To the extent, however, that tax planning *intended* by Congress has transaction costs, it is most likely lower-income taxpayers who, due to their cost sensitivity as described above, will fail to obtain the tax savings. Health Savings Accounts ("HSAs") are illustrative. Congress created HSAs in 2003 to allow individuals to pay for qualified medical expenses with pre-tax dollars.[49] Although taxpayers of all income groups benefit from HSAs, a 2008 Government Accountability Office report found that HSAs were disproportionately used by wealthier taxpayers.[50] Prohibitive costs were found to be a contributing factor.[51] The result is that there is social welfare (as judged by Congress) that is not being realized due to the prohibitively high transaction costs associated with HSAs. HSAs are but a specific instance of a general phenomenon: the transaction costs associated with lower-income taxpayers' tax planning often prevent the realization of social value identified by Congress.

2. *Distributional Consequences of Lower-Income Tax Planning*

The previous Section focused on the potential social benefits of changed taxpayer behavior and demonstrated that the changed behavior of lower-income taxpayers, since generally intended by Congress, often results in a net increase in social welfare. But even without a substantive change in taxpayer behavior (beyond effectuating the necessary tax planning), the distributional results of lower-income tax planning can still result in welfare-enhancing outcomes that are preferable to no tax planning at all.

Consider a tax provision wherein a qualifying taxpayer need only file a form in order to obtain a significant income tax credit. If this credit is predicated on some immutable attribute, such as a taxpayer being greater than seventy years old, the credit will not result in any significant behavioral change.[52] Qualifying

49. Medicare Prescription Drug, Improvement, and Modernization Act of 2003, Pub. L. No. 108-173, § 1201, 117 Stat. 2066, 2469 (2003).

50. JOHN E. DICKEN, GOVERNMENT ACCOUNTABILITY OFFICE, HEALTH SAVINGS ACCOUNTS: PARTICIPATION INCREASED AND WAS MORE COMMON AMONG INDIVIDUALS WITH HIGHER INCOMES 3 (Apr. 1, 2008) (stating that average adjusted gross incomes of HSA users was $139,000, compared to $57,000 for filers as a whole).

51. *Id.* at 6 ("Reasons survey respondents cited for not planning to open an HSA included that . . . they could not afford them.").

52. Other than, of course, requiring the taxpayer to file the form necessary to obtain the credit.

taxpayers will simply have greater amounts of after-tax income. Even if Congress intended all eligible taxpayers to obtain the credit, there are no changed behaviors to create positive externalities and no market failure being remedied.[53] In contrast, a tax provision subsidizing the purchase of an electric car,[54] for example, would lower the cost of electric cars and result in more electric cars purchased. The increased number of electric cars could conceivably have positive externalities and result in greater social welfare.

Even tax planning consisting of "paper shuffling," that is, simply filing paperwork rather than engaging in substantively different behavior, however, has the potential to be welfare-enhancing. If conducted by lower-income taxpayers, this tax planning will generally increase after-tax income for lower-income taxpayers relative to wealthy taxpayers, assuming a fixed-revenue model and a pro rata tax liability increase for all other taxpayers.[55] Because wealthy taxpayers already pay a larger proportion of total income tax revenue relative to lower-income taxpayers,[56] even "paper shuffling" tax planning tends to promote progressivity. To the extent progressivity is a desirable distributional goal, even this form of tax planning is welfare increasing.[57]

These same beneficial distributional consequences do not result when *wealthy* taxpayers engage in "paper shuffling" tax planning. To the extent a wealthy taxpayer is able to reduce her tax liability by simply filing paperwork, there is no conceivable welfare enhancing behavioral change, and no progressivity-promoting distributional result.

3. *Fairness Concerns*

Some tax-planning conducted by lower-income taxpayers may, of course, have little to no social utility. An ill-conceived tax provision could arguably reduce social welfare if taxpayers, even lower-income ones, are encouraged to act in ways detrimental to society. Tax subsidies promoting, say, the consumption of fossil fuels could have negative long-term effects on the environment or long-term climate change. Even if Congress intended taxpayers to act in a certain manner, *i.e.*, consume more fossil fuels, this intended behavior could have costly negative externalities.[58]

Although lower-income tax planning is likely to increase social welfare, lower-income tax planning *not* increasing social welfare can still be defended on fairness grounds. Notwithstanding the potential social cost, fairness concerns dictate that lower-income taxpayers be allowed to participate in tax planning to

53. Positive externalities could still result from the changed distribution of after-tax income, however.

54. *See* I.R.C. § 30D (2018) (providing tax credit for certain purchases of electric vehicles).

55. *See supra* note 19 and accompanying text.

56. Robert Bellafiore, *Summary of the Latest Federal Income Tax Data, 2018 Update*, TAX FOUNDATION (Nov. 13, 2018), https://taxfoundation.org/summary-latest-federal-income-tax-data-2018-update/.

57. The extent to which welfare is increased depends on the extent to which certain distributional results are desired.

58. *See supra* note 40 and accompanying text.

the same extent as wealthier taxpayers. Wealthy taxpayers are able to avail themselves of tax savings because they have the resources to engage in tax planning. Lower-income taxpayers should be permitted to similarly benefit from tax planning even if the associated transaction costs make it infeasible for lower-income taxpayers to pay for these services directly.

Congress has already recognized that some tax assistance for lower-income taxpayers is worthy of subsidy. Low-income taxpayer clinics ("LITCs"), first sponsored by Congress in the late 1990s, provide low-income taxpayers assistance in controversies with the IRS.[59] Since their inception more than twenty years ago, LITCs have helped taxpayers with offers-in-compromise, earned income tax credit examinations, installment agreement plans, and other litigious matters where the IRS is a counterparty.[60] Though the IRS is adverse to these taxpayers, subsidizing these taxpayers' representations is seen as normatively desirable because this representation, as described by the IRS, is necessary to "ensure the fairness and integrity of the federal tax system for all taxpayers."[61] Similarly, the IRS also provides grants to organizations assisting taxpayers with low-income taxpayer filing. Volunteer Income Tax Assistance ("VITA") and Tax Counseling for the Elderly ("TCE") programs provide services in order to, among other things, reach underserved populations and heighten quality control.[62]

LITCs and VITA/TCE programs are both funded by IRS grant programs.[63] But none of these IRS-funded programs assist lower-income taxpayers with preemptive tax planning; meaning, tax planning that permits taxpayers to minimize tax liability or avoid ex ante litigation with the IRS. The normative justifications for not providing these services is based on the traditional notions that tax planning is per se inefficient and is a burden on social welfare.[64] As discussed previously, these justifications are flawed. As discussed in the next Section, this tax planning assistance to lower-income taxpayers could be provided from a variety of sources, including, but not limited, to the IRS and/or Congress.

59. I.R.C. § 7526 (providing federal funds and stating criteria for low-income taxpayer clinics); *see* Keith Fogg, *Taxation with Representation: The Creation and Development of Low-Income Taxpayer Clinics*, 67 TAX LAW. 3, 30 (2013). At least 90% of the taxpayers represented by these clinics must have incomes that do not exceed 250% of the federal poverty level. I.R.C. § 7526(b)(1)(B).

60. *See* OFFICE OF THE TAXPAYER ADVOCATE, IRS, PROVIDING ACCESS TO JUSTICE FOR U.S. TAXPAYERS 6 (2018).

61. OFFICE OF THE TAXPAYER ADVOCATE, IRS, 2020 GRANT APPLICATION PACKAGE AND GUIDELINES 1 (2019).

62. VOLUNTEER INCOME TAX ASSISTANCE, IRS, PUB. NO. 4671, VITA GRANT PROGRAM OVERVIEW AND APPLICATION INSTRUCTIONS (2019); GRANT PROGRAM OFFICE, IRS, PUB. NO. 1101, APPLICATION PACKAGE AND GUIDELINES FOR MANAGING A TCE PROGRAM (2019).

63. *See* 2020 GRANT APPLICATION, *supra* note 61, at 1; VITA GRANT PROGRAM, *supra* note 62.

64. *See generally* Section II.A–B.

III. Lower-Income Tax Planning in Practice

The inability of lower-income taxpayers to engage in legally permissible tax planning not only economically disadvantages these taxpayers relative to wealthier taxpayers, but also often subverts the very outcomes Congress is promoting. Consider a low-income taxpayer eligible for an earned income tax credit ("EITC") of $6,000 who sells stock she received in an inheritance for a capital gain of $3,500. A properly advised taxpayer would know that a capital gain of $3,500 (for tax year 2018) results in losing her entire $6,000 EITC.[65] Had the taxpayer realized just one dollar less of capital gain, her EITC would have been unaffected.[66] The EITC was enacted by Congress in part as an anti-poverty measure.[67] To the extent the taxpayer in the preceding example is unable to effectively tax plan and obtain her EITC, Congress' goal of increasing after-tax income for lower-income taxpayers is frustrated.

Lower-income taxpayers fail to engage in adequate tax planning because the associated transaction costs, either actual or perceived, outweigh the perceived benefits. Lowering the transaction costs associated with tax planning can therefore increase the likelihood that lower-income taxpayers obtain tax planning that both benefits them economically and promotes congressional intent. These transaction costs can be reduced by expanding the scope of taxpayer services for which Congress provides funding, developing specific clinical programs at law schools, and tasking pro bono practitioners (from academia and private practice) to address these taxpayers' tax planning needs.

A. Expansion of Current IRS-Funded Programs

The IRS administers several grant programs that award funds to organizations providing services to underserved taxpayers. There are grant programs for Low-Income Taxpayer Clinics, Volunteer Income Tax Assistance centers, and TCE sites.[68] These programs are controlled by the terms of their grants in various ways. These constraints include restricting the attributes of the taxpayers

65. I.R.C. § 32(i)–(j) (2018); IRS, PUB. NO. 596, EARNED INCOME CREDIT 5 (2018). The maximum amount of investment income permitted is indexed for inflation. I.R.C. § 32(b).

66. *See also* Manoj Viswanathan, *The Hidden Costs of Cliff Effects in the Internal Revenue Code*, 164 U. PA. L. REV. 931, 938 (2016) (describing the cliff effects associated with the earned income tax credit).

67. CHRISTINE SCOTT & MARGOT L. CRANDALL-HOLLICK, CONG. RESEARCH SERV., THE EARNED INCOME TAX CREDIT (EITC): AN OVERVIEW 25 (2014) (describing EITC as a planned replacement for federal-state welfare programs); Susannah Camic Tahk, *The Tax War on Poverty*, 56 ARIZ. L. REV. 791, 800 (2014) ("The purpose of the [progenitor of the EITC] was to replace existing federal anti-poverty programs with a guaranteed minimum income for every U.S. family.").

68. *See generally* 2020 GRANT APPLICATION, *supra* note 61; VITA GRANT PROGRAM, *supra* note 62; MANAGING A TCE PROGRAM, *supra* note 62.

served[69] and the providers serving them,[70] requiring organizations receiving grants to obtain matching funding,[71] and limiting the services permitted to be provided.[72]

Some of the current restrictions attempt to maximize efficacy of services provided by making basic competency broadly available to needy taxpayers. In the transactional context, this results in VITA/TCE volunteers only addressing issues that are common amongst lower-income taxpayers and not addressing more specialized issues that might still be of relevance to some lower-income earners. For example, even though depreciation deductions are an important business expense for many small business owners, guidance on how to calculate them are beyond the scope of what VITA and TCE volunteers are allowed to provide.[73] Limiting transactional assistance to only basic issues lets volunteers provide assistance with a modicum of training.[74] But this narrowness of services provided precludes the possibility of volunteers providing anything beyond rudimentary transactional tax planning advice.

Taxpayers are increasingly earning income outside of the traditional employer/employee context, such as via the on-demand platform ("gig" or "sharing") economy.[75] As the nature of low-income earning evolves, the traditional forms of IRS-sponsored taxpayer assistance will become increasingly obsolete, absent an expansion of what IRS-sponsored programs provide. For example, most companies associated with the "sharing" economy characterize workers as independent contractors rather than employees.[76] These workers are technically

69. 2020 GRANT APPLICATION, *supra* note 61, at 1 ("At least 90% of an LITC's clients must be low-income, defined as having income not exceeding 250% of Federal Poverty Guidelines."). VITA centers assist taxpayers who "generally make $55,000 or less, persons with disabilities and limited English speaking taxpayers who need assistance in preparing their own tax returns." *Free Tax Return Preparation for Qualifying Taxpayers*, IRS, https://www.irs.gov/individuals/free-tax-return-preparation-for-you-by-volunteers (last updated Nov. 19, 2019). TCE-eligible taxpayers must be at least sixty years of age. STAKEHOLDER PARTNERSHIPS, EDUCATION AND COMMUNICATION, IRS, PUB. NO. 1084, VOLUNTEER SITE COORDINATOR HANDBOOK: 2020 EDITION 7 (2019).

70. For instance, LITC, VITA, and TCE grantees must be tax-exempt organizations. I.R.C. § 7526(b)(2) (2018); VITA GRANT PROGRAM, *supra* note 62, at 11; MANAGING A TCE PROGRAM, *supra* note 62, at 6.

71. *See, e.g.*, I.R.C. § 7526(c)(5) (2018) (requiring LITC grantees to provide matching funds for all dollars awarded by the IRS); VITA GRANT PROGRAM, *supra* note 62, at 12 (requiring VITA grantees to obtain 100% cost sharing or matching of federal funds).

72. For example, LITCs can only assist clients with controversies smaller than $50,000. I.R.C. §§ 7463(a), 7526(b)(1)(B).

73. IRS, PUB. NO. 4491, VITA/TCE TRAINING GUIDE 10-8 (2018).

74. VITA certification requires passing an open-book, untimed exam with a score of 80% or better. *See* IRS, VITA/TCE VOLUNTEER RESOURCE GUIDE (2018).

75. Niam Yaraghi & Shamika Ravi, *The Current and Future State of the Sharing Economy*, BROOKINGS INST. (Dec. 29, 2016), https://www.brookings.edu/research/the-current-and-future-state-of-the-sharing-economy/ (estimating size of sharing economy to be $335 billion in 2025 from $14 billion in 2014); CAROLINE BRUCKNER, SHORTCHANGED: THE TAX COMPLIANCE CHALLENGES OF SMALL BUSINESS OPERATORS DRIVING THE ON-DEMAND PLATFORM ECONOMY 1, 3 (2016) ("More than 2.5 million U.S. taxpayers are participating in the on-demand platform economy as small business owners every year, and millions more are set to join their ranks in the next decade.").

76. *See*, *e.g.*, Berwick v. Uber Technologies, Inc., 80 Cal. Comp. Cases 936 (W.C.A.B. June 03, 2015); IRS, PUB. NO. 1779, INDEPENDENT CONTRACTOR OR EMPLOYEE (2012).

small businesses rather than employees and thus have tax issues that will often be outside the scope of VITA/TCE programs.[77]

Grant programs administered by the IRS should fund programs providing assistance to taxpayers ex ante, before tax-relevant decisions have been made, rather than only ex post. LITCs and VITA/TCE sites generally help taxpayers only after the taxpayer has made decisions with serious consequences. Tax filing assistance, for instance, is only provided after the close of the tax year, at which time the taxpayer has lost most of her tax-planning optionality.[78] By sponsoring programs giving taxpayers advice ex ante, during the taxable year and before tax-relevant decisions have been made, the IRS could advance these taxpayers' interests beyond simply filing returns. This advice will necessarily be more complicated than the more basic services provided via existing IRS-funded programs. Advising a small business owner on tax-efficient organizational structures is certainly more complex than simply filing a return. But for many lower-income taxpayers, this additional complexity comes with significant tax savings.

Not every volunteer in these programs will be able to assist taxpayers that have unique tax planning needs. But volunteers providing tax planning advice need not be responsible for devising the *strategies* giving lower-income taxpayers their tax savings, but rather the *implementation*. The development of cost-effective strategies for lower-income taxpayers could come from a variety of other sources, including law school clinics, academics, and pro bono practitioners.

B. Law School Clinics

Law schools have a unique ability to assist with lower-income tax planning. They have the technical expertise to devise innovative tax-planning techniques specific to lower-income taxpayers and the institutional capacity to counsel these taxpayers on how to implement these strategies. As discussed previously, tax planning for lower-income taxpayers has not been a priority for any for-profit tax planning professional. The tax planning costs for lower-income taxpayers can easily exceed the resulting tax savings.[79] But for law schools, this tax planning has a function beyond generating revenue. The intellectual exercise of creating and implementing these strategies can provide pedagogical benefits for students, promote clinical values such as social justice, and offer avenues for academics to engage in socially beneficial scholarship and research.

Clinical programs at law schools give students the opportunity to be exposed to and actively participate in the practice of law.[80] Under the supervision

77. Manoj Viswanathan, *Tax Compliance in a Decentralizing Economy*, 34 GA. ST. U. L. REV. 283, 316 (2018) ("Most earnings from the on-demand economy are characterized as something other than Form W-2 wages.").

78. MANAGING A TCE PROGRAM, *supra* note 62, at 45.

79. *See infra* Part V.

80. Suzanne Valdez Carey, *An Essay on the Evolution of Clinical Legal Education and Its Impact on Student Trial Practice*, 51 U. KAN. L. REV. 509, 513 (2003).

of clinical professors, students work with actual clients to resolve legal issues.[81] Clients, students, and law schools all benefit from this arrangement: clients obtain discounted (usually free) legal representation, students get legal practice and skills development, and the law school advances its social justice mission and other institutional goals.[82]

Law school clinical programs could and should provide tax planning assistance for lower-income taxpayers beyond what LITCs and VITA/TCE centers currently provide. Nearly every law school offers at least one transactional clinic that addresses issues of business law rather than representing clients in adversarial proceedings.[83] These transactional clinics typically represent organizations rather than individual clients.[84] But this need not be the case. Similar to the normative justifications for LITCs and VITA/TCE centers, namely, that these underserved populations should have access to this assistance, transactional clinics could expand their scope of representation to include tax planning for individual clients without compromising institutional goals and values. The objectives of providing quality legal services, skills development, and advancement of social justice would all be advanced by providing this additional representation.

The tax planning issues of these lower-income taxpayers could be complex. But the complexity of these matters does not preclude a law school clinic from addressing them. Tax planning strategies devised by the clinic could be used by more than just one client; an involved tax planning strategy associated with addressing one client's tax planning needs could result in a solution applicable to many other clients' needs as well.

The need and opportunity for lower-income tax planning was made especially relevant by the TCJA. By introducing provisions that could easily apply to lower-income taxpayers, such as the qualified business income deduction,[85] and without providing the clarifications needed to effectively use them, many lower-income taxpayers will not avail themselves of potentially helpful provisions. Well-off taxpayers can seek counsel from well-compensated accountants and other tax professionals. Lower-income taxpayers cannot.

81. Margaret B. Kwoka, *Intersecting Experiential Education and Social Justice Teaching*, 6 NE. U. L.J. 111, 114 (2013).

82. *See generally* DAVID F. CHAVKIN, CLINICAL LEGAL EDUCATION: A TEXTBOOK FOR LAW SCHOOL CLINICAL PROGRAMS (2002); Alicia Alvarez, *Community Development Clinics: What Does Poverty Have to Do With Them?*, 34 FORDHAM URB. L.J. 1269 (2007); Praveen Kosuri, *"Impact" in 3D—Maximizing Impact Through Transactional Clinics*, 18 CLINICAL L. REV. 1 (2011). A nonexclusive list of these institutional goals include promoting social justice, engaging with local communities, and helping small businesses.

83. Alina Ball & Manoj Viswanathan, *From Business Tax Theory to Practice*, 24 CLINICAL L. REV. 27, 50 (2017).

84. Alicia E. Plerhoples & Amanda M. Spratley, *Engaging Outside Counsel in Transactional Law Clinics*, 20 CLINICAL L. REV. 379, 383 (2014) ("Transactional law clinic clients are nonprofit organizations, small businesses, microenterprises, social enterprises, and innovative startups.").

85. *See infra* Subsection IV.B.1.

C. *Academics and Practitioners*

Law school clinics are not the only space in law schools where lower-income tax planning can be promoted. The exploration of lower-income tax planning techniques could constitute a worthy component of an academic's research agenda.[86] Indeed, the extent to which tax avoidance schemes constitute valid tax planning techniques is the subject of much academic writing.[87] This research could easily prioritize the tax planning opportunities of lower-income taxpayers with a focus not on devising tax shelters outside the scope of what Congress intended. Instead, this research could prioritize creating techniques to help lower-income taxpayers reduce transaction costs to achieve tax savings Congress has already deemed to be appropriate.[88]

* * *

The lower-income tax planning discussed above need not be a theoretical abstraction. The following Parts consider the tax issues facing a growing demographic of lower-income earners, sharing economy workers, and provides a tax planning strategy through which a specific group of sharing economy workers, rideshare drivers, could restructure their working arrangements to best take advantage of the TCJA and reap tax savings. Promoting this strategy could reduce the expenses associated with implementation, allowing for these taxpayers to achieve these tax savings with minimum transaction costs.

IV. TAX CONSIDERATIONS OF SHARING ECONOMY WORKERS

As discussed previously, tax planning for lower-income taxpayers is likely to increase social welfare. One category of lower-income workers for whom such tax planning could be especially useful is sharing economy workers. As nonemployees, these workers have flexibility in structuring their working lives relative to traditional workers. This flexibility gives sharing economy workers some choice with regard to tax treatment. As discussed previously, the transaction costs associated with optimal tax planning, however, often renders this planning inaccessible to lower-income workers. This tax planning is often structurally complicated, calls for action far in advance of filing deadlines, and requires significant time and expensive, personalized expertise. Further, while worker blogs and tax filing software can offer general suggestions, nonpersonalized advice can

86. *See infra* Part V; *see also* Jacob Goldin, *Tax Benefit Complexity and Take-up: Lessons from the Earned Income Tax Credit*, TAX L. REV. (forthcoming 2019).

87. *See, e.g.*, Dan L. Burk & Brett H. McDonnell, *Patents, Tax Shelters, and the Firm*, 26 VA. TAX REV. 981, 982 (2007); Brian Galle, *Interpretative Theory and Tax Shelter Regulation*, 26 VA. TAX REV. 357, 358 (2006); Roland Hartung, *In or Out: How to Treat Foreign Taxes Under the Economic Substance Doctrine*, 75 WASH. & LEE L. REV. 1171, 1172 (2018); Alex Raskolnikov, *Relational Tax Planning Under Risk-Based Rules*, 156 U. PA. L. REV. 1181, 1183 (2008).

88. *See, e.g.*, Rebecca Valencia, *Get Ready for the Return! How to Make Filing Tax Returns More Efficient: Applying the State of California Franchise Tax Board's Readyreturn to the Federal Tax System*, 37 RUTGERS COMPUTER & TECH. L.J. 130, 132 (2011) (describing the Readyreturn, a low-cost alternative to for-profit tax filing services).

also lead workers astray. Thus, sharing economy workers demonstrate a compelling need for the tax planning proposals above.

This Part provides an overview of the tax considerations of sharing economy workers, with a special focus on how these tax considerations apply to drivers working for rideshare companies such as Uber and Lyft. First, I outline the typical information reporting structures used by sharing economy companies and workers. In the rideshare context, these interdependent reporting decisions inform whether and how workers pay taxes on their earnings. I then describe the relevant impacts of the 2017 Tax Cuts and Jobs Act, focusing on new incentives for some sharing economy workers to incorporate as S-corporations. Finally, I demonstrate how tax planning can help these lower-income workers navigate the TCJA's complexities and achieve optimal tax treatment.

A. Information Reporting of Sharing Economy Workers

How sharing economy companies categorize their workers and structure their tax information reporting has a unique (and complicating) impact on those workers' options for optimizing their tax planning. Sharing economy companies typically disclaim employee status for the individuals providing revenue-generating labor and capital on behalf of the sharing economy company.[89] Rather, these companies describe themselves as technology companies that facilitate transactions between sharing economy workers and the consumer.[90] By characterizing themselves as "third party settlement organizations," intermediaries between a buyer and a seller that merely transfer funds between accounts in settlement of a purchase, sharing economy companies subject themselves to far less onerous reporting obligations.[91] Third-party settlement organizations report payments only if both the total value of all payments made to a single entity exceed $20,000 and the total number of transactions with that entity is greater than 200.[92]

89. Viswanathan, *supra* note 77, at 316.

90. *See id.*

91. *See* 26 C.F.R. § 1.6041-3 (2013); *Third Party Network Transactions FAQs*, IRS, https://www.irs.gov/payments/third-party-network-transactions-faqs (last updated Aug. 9, 2019); *see also* Shu-Yi Oei & Diane M. Ring, *Can Sharing Be Taxed?*, 93 WASH. U. L. REV. 989, 1033 (2016); Erik J. Christenson & Amanda T. Kottke, *Guidance Needed to Clarify Reporting Obligations for Online Marketplaces and Peer-to-Peer Platforms*, TAX MGMT. MEMORANDUM, July 2014, at 6.

92. I.R.C. § 6050W(e) (2018). A third party settlement organization is defined as "the central organization which has the contractual obligation to make payment to participating payees of third party network transactions." I.R.C. § 6050W(b)(3) (2018). Third party network transactions are defined as "any transaction which is settled through a third party payment network." I.R.C. § 6050W(c)(3) (2018). A third party payment network is "any agreement or arrangement—(A) which involves the establishment of accounts with a central organization by a substantial number of persons who—(i) are unrelated to such organization, (ii) provide goods or services, and (iii) have agreed to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement—(B) which provides for standards and mechanisms for settling such transactions, and—(C) which guarantees persons providing goods or services pursuant to such agreement or arrangement that such persons will be paid for providing such goods or services." *Id.* § 6050W(d)(3). *See generally* Manoj Viswanathan, *Tax Compliance and the Sharing Economy, in* THE CAMBRIDGE HANDBOOK ON THE SHARING ECONOMY (Cambridge Univ. Press 1 ed. 2018).

Only if both of these thresholds are met does the typical sharing economy company submit an information return (a 1099-K) to the sharing economy worker.[93]

Sharing economy companies have at least two incentives to characterize payments made to sharing economy workers as 1099-K third-party settlement transactions rather than wages to employees. First, because these payments are not considered wages, they do not, similar to 1099-MISC payments made to an independent contractor, create any collateral costs to the sharing economy company.[94] Second, to the extent that workers' earnings do not trigger the 1099-K reporting requirements, payments made by sharing economy companies are often unreported by the recipient, resulting in no income taxes being paid on these earnings.[95] To the extent that workers are incentivized to work because they do not plan on paying taxes on their sharing economy income, companies capture some of this benefit by paying drivers less, with this "subsidy" provided by the federal government. Notably, the risk of nonreporting of income (in the form of civil or criminal sanctions) still falls entirely on the workers.[96]

1. Information Reporting Policies of Ridesharing Companies

Like most sharing economy companies, Uber and Lyft currently issue Form 1099-K to drivers only when the $20,000 and 200 transactions thresholds are exceeded.[97] This approach accords with the approach taken by most sharing economy companies.[98] Uber temporarily departed from this practice between 2015 and sometime in 2017, however, issuing a Form 1099-K to all drivers, regardless of earnings, during this window.[99] While it is unclear what motivated this temporary policy shift, it *is* clear that Uber's decision to end this practice in 2017 resulted in an increase of unreported income by its drivers.[100]

93. I.R.C. § 6050W(e).

94. John O. McGinnis, *The Sharing Economy as an Equalizing Economy*, 94 NOTRE DAME L. REV. 329, 359–60 (2018) (stating that the conversion of independent contractors to employees may "increase an employer's costs by about 25% to 40% per worker").

95. IRS, PUB. NO. 1415, FEDERAL TAX COMPLIANCE RESEARCH: TAX GAP ESTIMATES FOR TAX YEARS 2008-2010 1 (2016), https://www.irs.gov/pub/irs-soi/p1415.pdf. Income items that are not reported to the IRS via information returns have a high incidence of nonreporting by the recipient taxpayer.

96. *See also* Viswanathan, *supra* note 92. I was not able to find any cases in which a taxpayer was subjected to either civil or criminal sanctions for failure to report earnings obtained from sharing economy earnings.

97. Shu-Yi Oei & Diane M. Ring, *The Tax Lives of Uber Drivers: Evidence from Internet Discussion Forums*, 8 COLUM. J. TAX L. 56, 65 (2017); *What Tax Documents Will I Receive?*, UBER, https://help.uber.com/h/6b3084d7-d0fa-4535-9868-8d314b3869ba (last visited Dec. 9, 2019). It is unclear why Uber temporarily took this approach. *See also* Viswanathan, *supra* note 92.

98. *Tax Information for US Drivers*, LYFT, https://help.lyft.com/hc/en-us/articles/115012926967-Tax-information-for-US-drivers (last visited Dec. 9, 2019).

99. *What Tax Documents Will I Receive?*, *supra* note 97.

100. *See* Oei & Ring, *supra* note 97, at 77.

B. The Tax Cuts and Jobs Act

The December 2017 enactment of the TCJA made sweeping changes to the Internal Revenue Code.[101] In addition to reducing rates for both individual and corporate taxpayers, the TCJA introduced several modifications relevant to sharing economy providers. First, the TCJA created a new "qualified business income" deduction for certain types of "pass through" business entities.[102] This new deduction has critical consequences for workers choosing whether and how to incorporate. Second, the act eliminated a deduction for employees' business expenses.[103] This significant change impacts how workers optimally structure their roles within any entity they might form.

1. Entity Formation: The Impacts of the Section 199A "Qualified Business Income" Deduction

Section 199A of the TCJA gives noncorporate taxpayers obtaining income via sole proprietorships, S-corporations, and partnerships—all known as "pass-through entities" because their income is only taxed at the level of the individual shareholder—a 20% deduction for receiving "qualified business income" ("QBI").[104] QBI is generally defined as the net income a taxpayer receives from any qualified trade or business.[105] Although subject to limitations based on taxable income,[106] filing status,[107] line of business,[108] capital investment,[109] size of payroll,[110] and choice of entity,[111] the QBI deduction in its simplest form reduces a taxpayer's taxable business income by 20%.[112] The deduction is taken as a below-the-line deduction but does not require the taxpayer to itemize.[113]

The tax policy justifications behind section 199A (as well as many other provisions of the TCJA) are far from clear. Unlike other deductions in the Internal Revenue Code, the QBI deduction does not exist to more accurately measure taxpayer income, as evidenced by the fact that it is applied to net income.[114] Nor does it advance clear distributional goals, given that there is no absolute cap on

101. *See generally* Kamin et al., *supra* note 1.
102. I.R.C. § 199A(a) (2018).
103. H.R. REP. NO. 115-466, at 97 (2017) (Conf. Rep.).
104. I.R.C. § 199A(a).
105. I.R.C. § 199A(c)(1).
106. I.R.C. § 199A(b)(3).
107. *See* I.R.C. §§ 199A(b)(3)(B)(i)(I), (b)(3)(B)(ii)(II), (d)(3)(A), (d)(3)(B)(ii), (e)(2)(A) (stating thresholds for joint filers).
108. I.R.C. § 199A(d)(2).
109. I.R.C. §§ 199A(b)(2)(B)(ii), (d)(3)(A)(ii), (f)(1), (g)(1)(B) (specifying how unadjusted bases of qualifying property affects QBI deduction).
110. I.R.C. § 199A(b)(2)(B), (b)(4), (d)(3)(A), (f)(1) (specifying various ways in which wages paid will affect QBI deduction).
111. *See infra* notes 118–37 and accompanying text.
112. I.R.C. § 199A(a)(1)(B) (assuming the entirety of a taxpayer's earnings is derived from qualified business income and that no limitations apply).
113. I.R.C. § 63(b)(3). Below-the-line deductions are typically only of value when, in the aggregate, they exceed the standard deduction. The QBI deduction is an exception to this rule.
114. I.R.C. § 199A(c)(1) (defining qualified business income).

the income of taxpayers who may take it.[115] It is also unclear if the QBI deduction is intended to reward businesses currently eligible for the enhanced deduction or if it is meant to induce businesses to modify their structures and/or operations to avail themselves of the provision.

Whether intended or not, however, the QBI deduction helps maintain the pre-TCJA preference for taxpayers to operate businesses via pass-through entities rather than C-corporations, which the TCJA now blesses with a 21% income tax rate.[116] If income earned by a C-corporation is distributed to shareholders as qualified dividends taxed at the highest rate, the top combined C-corporation/qualified dividend rate is 39.8%.[117] Net business income entitled to the full QBI deduction is now taxed at a top effective rate of 29.6%.[118] This difference of approximately 10% is comparable to the 10% advantage pass-through entities enjoyed over C-corporations prior to the TCJA.[119]

There are indications that the deduction is intended to benefit the owners and investors in businesses, rather than directly benefit the workers within those businesses. A two-page memo jointly released by the Senate Finance and House Ways and Means Committees stated that the QBI deduction was intended to "deliver significant relief to Main Street job creators" and that "wage income does not receive the lower marginal effective tax rates on business income."[120] This bias against labor is explicit in section 199A, which carves out wages earned as an employee from the definition of QBI.[121]

Section 199A also states that QBI does not include "reasonable compensation" paid to taxpayers "by any qualified trade or business of the taxpayer" for services rendered with respect to the trade or business; section 707(c) guaranteed payments made to a partner from a partnership; and section 707(a) payments for services made by a partnership to a partner with respect to the trade or business.[122] The first category precludes QBI treatment for taxpayers working in

115. Income limits do apply to particular portions of § 199A, for example, those concerning specified services businesses. *See* I.R.C. § 199A(d)(3) (reducing the QBI deduction for specified service businesses at certain income thresholds).

116. I.R.C. § 11(b).

117. I.R.C. § 1411(c). Qualified dividends subject to the 3.8% net investment income tax ("NIIT") are taxed at a top rate of 23.8%, resulting in a combined rate of 21% + (1-21%) x 23.8% = 39.8%. The threshold income levels for which the NIIT applies are (1) $250,000 for a married couple filers; (2) $125,000 for persons married filing separately; and (3) $200,000 for all other individual filers. I.R.C. § 1411(b); Treas. Reg. § 1.1411-2(d)(1) (2014).

118. Since the top individual rate is 37%, QBI income has a top effective rate of (100% – 20%) x 37% = 29.6%. I.R.C. § 1(j).

119. Prior to the TCJA, the top corporate rate was 35%, giving a combined corporate/dividend rate of 35% + (1-35%) x 23.8% = 50.5%. I.R.C. § 1(i)(3). The top individual tax rate was 39.6%, resulting in the same approximate 10% differential.

120. TAX CUTS & JOBS ACT, HOUSE AND SENATE CONFERENCE COMMITTEE, POLICY HIGHLIGHTS (2017), https://waysandmeansforms.house.gov/uploadedfiles/12.15_tcja_policy_highlights.pdf.

121. I.R.C. § 199A(d)(1)(B).

122. I.R.C. § 199A(c)(4).

specified services trades and businesses.[123] Although seemingly consistent with the intent to preclude taxpayers providing labor (as opposed to capital), the inapplicability of the QBI deduction for "reasonable compensation" only applies to compensation provided by S-corporations and not sole proprietorships.

The application (or lack thereof) of Section 199A's "reasonable compensation" standard to business entities has a strong influence on the choice of entity for sharing economy workers. For purposes of this Section, we can safely assume that sharing economy workers will not be subject to the income limitations of the QBI deduction, which begin at $157,500 for single filers and $315,000 for married filers.[124]

a. Sole Proprietorships

Sole proprietors earn income absent the existence of a formal entity, with income generally reported on Form 1040, Schedule C.[125] Schedule C income is subject to self-employment taxes and typically reflects income earned as a result of a taxpayer's labor. Income items from a taxpayer's investment activities would typically be provided on other Form 1040 schedules, with potentially favorable tax treatment. Capital gains and losses, for instance, are reported on Schedule D.[126] Although sole proprietors can earn income not subjected to self-employment taxes, such as income from passive activities like real estate rental and royalties under Schedule E, Schedule C income comprises the overwhelming majority of sole proprietor income.[127] As a return on labor, it was plausible that a sole proprietor's income subject to self-employment taxes could have been considered "reasonable compensation" for purposes of Section 199A and therefore excluded from QBI eligibility.[128] The putative applicability of 199A to sole proprietorships was largely confirmed, however, by the August 2018 proposed regulations.[129]

123. I.R.C. § 199A(d)(1)(A). Regulations proposed in August 2018 provide much needed clarity on what constitutes "a specified service trade or business." Qualified Business Income Deduction, 83 Fed. Reg. 40,884, 40,895 (proposed Aug. 16, 2018) (to be codified at 26 C.F.R. pt. 1).

124. I.R.C. § 199A(e)(2), (b)(3), (d)(3). These phaseouts reduce the QBI deduction for undercapitalized business not paying W-2 wages and for specified service businesses. I.R.C. § 199A(d)(3).

125. I.R.S. Instructions Cat. No. 24329W (Jan. 11, 2018). Specific sole proprietor income is reported on other schedules, such as Schedule E (rental income and royalties) and Schedule F (farm income).

126. I.R.S. Instructions Cat. No. 243311 (Oct. 27, 2017).

127. In 2015, total income reported on Schedule C was approximately $332 billion. Total income reported on Schedule E was approximately $53 billion. JOHN A. KOSKINEN ET AL., IRS, STATISTICS OF INCOME: INDIVIDUAL INCOME TAX RETURNS LINE ITEM ESTIMATES, 2015 36–47 (2015). As rental income (albeit short-term), revenue earned from Airbnb is typically reported on Schedule E.

128. *See* I.R.C. § 1401 (levying a 15.3% total tax on an individual taxpayer's self-employment income).

129. *See* Prop. I.R.S. Reg. § 1.199A-1 Fed. Reg. 107892 (Aug. 16, 2018) (applying "reasonable compensation" only to S-corporations).

b. S-corporations

Unlike C-corporations, S-corporations are not subject to tax at the entity level. Unlike partners of partnerships and members of limited liability companies, shareholders of S-corporations may also either (1) be employees of the S-corporation and be paid wages reported on Form W-2 or (2) independent contractors of the S-corporation paid via Form 1099-MISC.[130] Only the portion of income treated as wages is subject to employment tax obligations under FICA.[131] As a result, S-corporation shareholders are uniquely able to limit their income to a single level of tax while not subjecting the entirety of that income to employment taxes.[132] Shareholder/employees of S-corporations thus have an incentive to characterize income from the S-corporation as nonwage, Section 1368 distributions rather than as wages for two reasons: the nonwage allocation (1) is not subject to self-employment taxes[133] and (2) *is* entitled to the QBI deduction.[134]

To prevent shareholder/employees from allocating all S-corporation revenue as nonwage allocations, S-corporations are required to pay "reasonable compensation" to workers.[135] The IRS has questioned payments from an S-corporation to shareholders that grossly understate wage amounts.[136] In determining what constitutes "reasonable compensation" for S-corporation officers, factors such as the training and experience of workers, payments to nonshareholder employees, and wages paid by comparable businesses are all relevant.[137] The bulk of "reasonable compensation" cases, however, involve professionals receiving nonwage income far in excess of the Form W-2 income (if anything) paid to them by their S-corporation.[138] Unlike the nonwage allocation, this "reasonable compensation" is not eligible for the QBI deduction.[139]

c. Partnerships and Limited Liability Companies

Partnerships and limited liability companies electing treatment as partnerships both enjoy a single level of taxation, but sharing economy workers will have a difficult time using these entities to take advantage of both the QBI deduction and the potential exclusion from self-employment taxes. Although the

130. *See* Grey v. Comm'r, 119 T.C. 121, 132 (2002) (considering whether shareholder working for S-corporation could be classified as an independent contractor).

131. *See generally* I.R.C. §§ 3101, 3111.

132. Brian R. Greenstein, Mark Persellin & Beth Vermeer, *S Corporation Compensation Planning: Determining Reasonableness*, 41 J. CORP. TAX'N 3, 3–4 (2014).

133. *Id.* at 3.

134. *Id.* at 11.

135. I.R.C. § 1366(e).

136. *See, e.g.*, Watson v. United States, 668 F.3d 1008 (8th Cir. 2012); Grey v. Comm'r, 119 T.C. 121 (2002); Glass Blocks v. Comm'r, 106 T.C.M. (CCH) 96 (2013); Nu–Look Design, Inc. v. Comm'r, 85 T.C.M. 927 (2003).

137. IRS, WAGE COMPENSATION FOR S CORPORATION OFFICERS 28 (2008).

138. *See generally supra* note 136 and accompanying text.

139. *See Tax Cuts and Jobs Act, Provision 11011 Section 199A - Qualified Business Income Deduction FAQs*, IRS, https://www.irs.gov/newsroom/tax-cuts-and-jobs-act-provision-11011-section-199a-qualified-business-income-deduction-faqs (last updated July 16, 2019).

distributive share of a limited partner is excluded from self-employment taxes,[140] this exclusion does not apply to partners providing active services to the partnership.[141] Even when a limited partnership interest has been established, limited partners acting in any capacity, other than a passive investor, will generally lose the ability to avoid self-employment taxes.[142] A sharing economy provider earning income through a partnership or LLC will, most likely, be subject to self-employment taxes on the entirety of their income, yielding (tax) results equivalent to a sole proprietorship, but with additional complications. Additionally, neither payments made by the partnership (1) to a partner who is not acting in her capacity as partner nor (2) that are guaranteed payments are eligible for the QBI deduction.[143]

2. *Worker Status as an Employee or Nonemployee*

As discussed above, sharing economy companies rarely, if ever, classify their workers as employees.[144] This classification is relevant under various federal and state regulatory regimes, including labor, employment, and taxation. These different statutes often apply their own standards, resulting in a worker's classification as an employee under one set of rules, but as an independent contractor (or something else) for another.[145] For example, the IRS applies a right-to-control test that focuses on (1) behavioral control of the employer; (2) financial control of the employer; and (3) the type of relationship between the worker and employer.[146] For a worker to be classified as an employee under the Fair Labor Standards Act, however, an "economic realities" test applies.[147] Here a worker is an employee if the worker is "economically dependent on an employer . . . or permitted to work by the employer."[148] Still other standards exist under various state statutes.[149]

Although classification as an employee for one purpose does not necessarily result in employee classification across other classifications, it is possible

140. I.R.C. § 1402(a)(13).

141. *Id.*

142. Renkemeyer, Campbell & Weaver, LLP v. Comm'r, 136 T.C. 137 (2011); Memorandum from the Office of Chief Counsel, IRS to the Associate Area Counsel (Philadelphia), No. 201436049 (May 20, 2014).

143. I.R.C. § 199A(c)(4).

144. *See* discussion *supra* Section IV.A.

145. *See* Andrew G. Malik, *Worker Classification and the Gig-Economy*, 69 RUTGERS U. L. REV. 1729, 1733 (2017) ("[T]he test applied for workers' rights and labor purposes is different from the test used for federal tax laws.").

146. IRS, PUB. NO. 15, EMPLOYER'S TAX GUIDE 7 (2015). The IRS has provided guidance on how these three factors can either favor or disfavor employee classification. *See also* Section III.A.1.

147. Tony & Susan Alamo Found. v. Sec'y of Labor, 471 U.S. 290, 301 (1985).

148. Richard B. Keeton, *An Uber Dilemma: The Conflict Between the Seattle Rideshare Ordinance, the NLRA, and for-Hire Driver Worker Classification*, 52 GONZ. L. REV. 207, 220 (2017); David Weil, *Administrator's Interpretation No. 2015-1*, DEP'T OF LABOR 2 (July 15, 2015), https://www.blr.com/html_email/AI2015-1.pdf.

149. In just California, for example, different tests apply depending on whether the worker classification question relates to a wage order or an issue arising under the Labor Code. *See* Dynamex Operations W. v. Superior Court, 416 P.3d 1, 6 (Cal. 2018), *reh'g denied*.

that employers will treat their workers as employees for *all* purposes if forced to treat them as employees for one.[150] Additionally, even though there is no requirement that one agency respect the worker classification made by another state or federal agency, the initial classification could have a presumptive effect on subsequent classifications. Classification of Uber drivers by the state of California, for instance, could result in the IRS treating these same workers as employees for federal tax purposes.[151]

Under the TCJA, such a ruling could have severe implications for sharing economy workers. Because they are not classified as employees, sharing economy workers are deemed to be small businesses. The gross revenue earned by these workers is generally reduced by the expenses incurred by the worker.[152] The net result is the worker/small business owner's taxable income.[153] Rideshare drivers, for instance, might gross $200 in payments from a ridesharing company. If the driver drove 100 miles to earn that $200, she could deduct $58 from her gross income.[154]

If sharing economy workers were instead classified as employees for federal tax purposes, they would lose the benefit of deducting work-related expenses. This is because the TCJA eliminated the deduction for any employee expenses that are not reimbursed by the employer.[155] The rideshare driver in the preceding example would not be permitted to deduct the $58, nor any other expenses incurred in the course of her employment. Although unreimbursed employee expenses had limited deductibility prior to the TCJA, the TCJA made the limitation absolute.[156]

V. TAX PLANNING FOR RIDESHARE DRIVERS

Rideshare drivers with certain attributes could obtain financial benefits from conducting driving activity through an S-corporation. Most rideshare drivers operate as sole proprietors without using any formalized business entity.[157] If instead a rideshare driver was the sole owner of her own S-corporation, this struc-

150. *See* Heather Field, *Tax Implications of the Recent Dynamex Worker Classification Ruling*, SURLY SUBGROUP (May 3, 2018), https://surlysubgroup.com/2018/05/03/tax-implications-of-the-recent-dynamex-worker-classification-ruling/ (expressing doubt that employers would conduct a nuanced, case-by-case assessment of status).

151. *See generally* Dynamex Operations W., 416 P.3d at 6.

152. Annette Nellen, Caroline Bruckner & Jennifer Brown, *Taxes and the Growing Gig Workforce: What to Know*, J. OF TAX'N, Jun. 2018, at 6, 8.

153. *See id.* at 7; I.R.C. § 61, 162 (2018).

154. In 2019, the standard per mile expense rate is 59¢ per mile. *IRS Issues Standard Mileage Rate Rates for 2019*, IRS (Dec. 14, 2018), http://www.irs.gov/newsroom/irs-issues-standard-mileage-rates-for-2019.

155. H.R. REP. NO. 115-466, at 9 (2017) (Conf. Rep.).

156. Prior to the TCJA unreimbursed employee expenses were itemized deductions limited to the excess of 2% of adjusted gross income. *See* I.R.C. §§ 62, 63, 67. Certain educator expenses are exempted.

157. *See* Keeton, *supra* note 148, 268–71.

ture would result in tax savings if the driver's nonwage income allocation is approximately one-quarter of overall revenue.[158] Using one S-corporation for multiple drivers could result in even more tax savings.

A. The Utility of S-Corporations to Sharing Economy Workers

A sharing economy worker desiring the most tax-efficient structure through which to generate income will likely select either a sole proprietorship or an S-corporation. The net earnings of the sole proprietorship will be entitled to the 20% QBI deduction, but the entirety of the worker's taxable income will also be subjected to self-employment taxes. For S-corporations, the net earnings of the S-corporation will be taxed as some combination of wages and a nonwage income allocation.[159] The latter is entitled to the QBI deduction; the former is not. If the entirety of a worker's income from an S-corporation is deemed to be wages, the worker should operate via a sole proprietorship. If a large enough proportion of S-corporation revenue can be characterized as a nonwage income allocation, the S-corporation will provide tax savings relative to a sole proprietorship.

For rideshare drivers in the sharing economy, the S-corporation will likely be most beneficial. Assuming the rideshare driver is in a 22% marginal tax bracket, earning $100 of net income as a sole proprietor obligates the worker to pay self-employment taxes but entitles her to the QBI deduction, resulting in after-tax income of approximately $70.[160] If instead the rideshare driver earned his or her money through an S-corporation, the after-tax income would vary depending on the proportion of the income characterized as wages (which are not eligible for the QBI deduction) and the proportion characterized as a nonwage income allocation excluded from self-employment taxes (which *are* eligible for the QBI deduction). If all of his or her income were deemed to be wages, the after-tax income would be approximately $65.[161] If, unrealistically, all of the income were

158. *See supra* Section II.C.

159. "Non-wage income allocations" refer to distributions paid under § 1368 of the Internal Revenue Code. *See* I.R.C. § 1368.

160. For sole proprietors, 92.35% of net income *N* is subject to self-employment taxes of 15.3%. Half of self-employment taxes paid are deductible from income tax. The 20% QBI deduction applies to what would otherwise be taxable income; that is, net income minus the deductible portion of self-employment taxes, or $N - N$*(0.5)(92.35%)(15.3%) = 0.929*N*. The total QBI deduction is thus (20%)(0.929*N*) = 0.186*N*. For sole proprietors, assuming a 22% marginal tax rate, total tax owed on net income *N* is [(15.3%)(92.35%) + (22%)*(1-(0.5)(15.3%)(92.35%))*(1-20%)]**N* = 0.305*N*. $100 of net income results in approximately $14 of employment taxes (half of which are deductible for income tax purposes) and $16 of income taxes, resulting in after-tax income of approximately $70.

161. If all income earned by the S-corporation goes towards paying wages, the S-corporation (as the employer) must pay 7.65% in payroll taxes on any wages paid. If the net income of the S-corporation is $100, $92.89 is paid to the employee, and $7.11 = (7.65%)($92.89) of payroll taxes is paid by the S-corporation. The employee then pays *her* $7.11 share of payroll taxes, and also the income tax owed = (22%)($92.89) = $20.43. This leaves $65.34 = $92.89 - $7.11 - $20.43 for the employee. If *N* is net income of the S-corporation, total taxes paid (by the S-corporation and the employee) is 0.346*N*. Relative to the sole proprietor, the S-corporation loses about $19 of deductions. Here, between the S-corporation and filer, the taxpayer would pay approximately $14 of employment taxes (half of which are deductible for income tax purposes) and $20 in income taxes, resulting in after-tax income of approximately $65.

deemed to be a nonwage income allocation, the after-tax income would be approximately $82.[162]

In reality, the S-corporation allocation between the nonwage income allocation and the amount of wages would not be a binary determination. Some proportion of the S-corporation's net income must be a nonwage income allocation in order for the tax consequences of the S-corporation to surpass the tax consequences of a sole proprietorship. In order for the S-corporation to outperform the sole proprietorship, approximately 24% of the S-corporation's net income must be a nonwage income allocation.[163]

The tax savings associated with the S-corporation structure will only benefit drivers to the extent they are actually paying taxes on the income they earn. As a result, it is unlikely that sharing economy workers working on a limited basis will find using an S-corporation appealing. But even though the S-corporation structure may not result in immediate tax savings, there are at least two reasons why even these drivers might benefit from such an arrangement.[164] First, information reporting standards could change, either at the initiative of individual sharing economy companies or by congressional action. Similar to Uber's reversal of policy in 2017, a company could, on its own initiative, change its reporting policy and issue information returns to all workers. Alternatively, Congress might adopt proposals to lower the Form 1099-K reporting thresholds to align with the $600 threshold associated with Form 1099-MISC.[165] Either change could happen during a tax year, forcing the provider to report income she might not have otherwise reported.

Second, the IRS could more heavily scrutinize sharing economy workers. Sharing economy companies transfer payments to workers electronically. Because the registration process of nearly all sharing economy companies requires submitting proof of identification,[166] the sharing economy companies maintain records of all workers to whom payments have been made. The IRS could simply request this information from sharing economy companies to ensure that workers have included this income on their returns.[167] The city of San Francisco adopted a similar approach when it successfully subpoenaed Homeaway, a short-term

162. Here the QBI deduction would pay zero self-employment taxes and receive the full QBI deduction of $20 = (20%)($100). As a result, the taxpayer would pay $0 in employment taxes and about $18 in income taxes = (22%)($80) = $17.60, resulting in after-tax income of approximately $82.

163. If N is net income of the driver, sole proprietors owe $0.305N$ in taxes, assuming a 22% marginal tax rate. For pure W2 income, taxes owed equals $((15.3\%+22\%)/1.0765))N = 0.346N$. For a pure non-wage allocation from an S-corporation, taxes owed $= (1\text{-}20\%)(22\%)N = 0.176N$. A non-wage allocation that is 24% of net income N and a W2 wage allocation that is 76% of net income N results in total taxes paid of $0.305N$, equivalent to that of a sole proprietorship.

164. These are reasons beyond the simple normative justification that taxpayers should report and pay taxes on all income earned.

165. *See, e.g.*, Oei & Ring, *supra* note 91, at 1061–62.

166. *What's Required to Become a Tasker?*, TASKRABBIT, https://support.taskrabbit.com/hc/en-us/articles/204411070-What-do-I-need-to-be-a-Tasker- (last visited Dec. 9, 2019); *What Are the Steps to Sign Up?*, UBER, https://help.uber.com/h/88b80350-8701-40c0-8493-9b21189a71ec (last visited Dec. 9, 2019).

167. Viswanathan, *supra* note 92.

rental company, in order to obtain payment records to ensure hosts were properly remitting San Francisco occupancy taxes.[168]

1. Determining Reasonable Compensation for Rideshare Drivers

Maximizing tax savings by shifting rideshare drivers from sole proprietorships to S-corporations requires minimizing the "reasonable compensation" wage income and maximizing the nonwage income allocation. As illustrated earlier, the S-corporation structure is likely beneficial if approximately one-quarter of total revenue earned is deemed a non-wage income allocation.

Although dependent on a variety of factors unique to each driver (insurance cost, car used, et cetera) and the market in which a driver operates, it is likely that rideshare drivers conducting operations through an S-corporation will be able to minimize the wage income allocated to them in favor of receiving a nonwage, allocative income share. Rideshare driving is a relatively unskilled profession that does not require advanced training or skills. Becoming a driver for Uber and Lyft requires little more than submitting a copy of your license, proof of insurance, and passing a background check.[169] Although the time that rideshare drivers will spend driving has the potential to be significant, the pay deemed to be "reasonable compensation" is likely to be low.

In addition, rideshare drivers differ from the majority of taxpayers whose S-corporation "reasonable compensation" the IRS has challenged. These scrutinized taxpayers are predominantly professionals operating in service industries, with incomes quite reasonably linked to their specialized training. In contrast, rideshare drivers are generating revenue by using an investment of capital—namely, their cars. The hourly wage deemed to be "reasonable compensation" should necessarily be lower than the hourly rate earned by rideshare drivers generally, since some component of those earnings represent a return on capital. Depending on the locality, "reasonable compensation" may only need to be the federal minimum wage.[170]

An S-corporation could also pay its "reasonable compensation" not via Form W-2 wages to an employee, but as Form 1099-MISC payments to an independent contractor. Ridesharing companies such as Uber and Lyft state that classifying workers as employees is inappropriate due to the lack of control these companies exercise over the workers.[171] Although these classifications have been

168. *See* City & Cty. of San Francisco v. HomeAway.com, Inc., 230 Cal. Rptr. 3d 901, 904 (Cal Ct. App. 5th 2018).

169. *See Driver Requirements*, UBER, https://www.uber.com/us/en/drive/requirements/ (last visited Dec. 9, 2019); *Drive Toward What Matters*, LYFT, https://www.lyft.com/drive-with-lyft (last visited Dec. 9, 2019).

170. Current federal minimum wage is $7.25 per hour. *See* 29 U.S.C. § 206 (2019). For jurisdictions where minimum wage is higher than the federal rate, exceptions typically apply for closely held small businesses, such as family-run businesses.

171. Uber and Lyft claim that they are technology companies, rather than transportation companies. Nicholas L. DeBruyne, *Uber Drivers: A Disputed Employment Relationship in Light of the Sharing Economy*, 92 CHI.-KENT L. REV. 289, 295 (2017).

attacked at the state level,[172] they remain intact at the federal level. The same arguments in favor of independent contractor status could potentially be used by S-corporations classifying their worker/shareholders. Rather than being a shareholder/employee, the S-corporation owner could instead be a shareholder/independent contractor. Although Form 1099 payments to these shareholder/independent contractors would be subject to self-employment taxes, they would be reported on Schedule C and could be eligible for the QBI deduction.[173]

Paying S-corporation worker/shareholders as independent contractors rather than employees would only be possible if the worker/shareholder is not an officer of the S-corporation. Any payments of compensation to an officer of an S-corporation is a payment of wages, for the officer is statutorily deemed to be an employee for purposes of compensation.[174] If each rideshare driver formed an S-corporation, this approach would not work since the sole shareholder would necessarily also be an officer of the S-corporation. If, however, rideshare drivers were able to form one S-corporation with multiple driver/shareholders,[175] this approach would result in significant savings.

2. *Collateral Consequences of Decreased Wage Income*

Recharacterization of wage income as investment income has non-tax consequences. Because wage income will be reduced, eligibility for certain earnings-based programs might be affected. For example, the receipt of social security benefits requires earning at least forty social security credits before retirement.[176] A social security credit is earned only if wages in a quarter exceed $1,360.[177] Social security benefits are calculated on the thirty-five highest years of wages earned.[178] A decrease of wage income in favor of a nonwage income allocation results in a decrease in retirement benefits.[179]

Although decreased wages might increase eligibility for means-tested programs, other programs preclude eligibility once certain maximum income limits are reached. For example, eligibility for the earned income tax credit would be jeopardized if a nonwage income allocation replaces wage income. The earned income tax credit is precluded for taxpayers earning more than, in 2018, $3,500

172. Berwick v. Uber Techs., Inc., No. CGC-15-546378 (Cal. App. Dep't Super Ct. June 3, 2015); Brad Avakian, Advisory Opinion of the Commissioner of the Bur. of Lab. and Indust., OR. BUREAU LABOR AND INDUS. (Oct. 14, 2015).

173. Jane R. Livingstone, *New Deduction for Qualified Business Income of Pass-Through Entities: A First Look*, 100 PRACTICAL TAX STRATEGIES 4, 5 (2018) ("Since a Schedule C does not include investment income, the net profit . . . reported on the schedule is likely to be the entity's QBI.").

174. *See* I.R.C. §§ 3121(d)(1), 3306(i), 3401(c) (2018).

175. *See supra* Section II.A.

176. Laura C. Bornstein, *Homemakers and Social Security: Giving Credits Where Credits Are Due*, 24 WIS. J.L. GENDER & SOC'Y 255, 258 (2009).

177. Quarter of Coverage, SOCIAL SECURITY ADMINISTRATION (2019), https://www.ssa.gov/OACT/COLA/QC.html.

178. SOCIAL SECURITY ADMINISTRATION, PUB. NO. 05-10070, YOUR RETIREMENT BENEFIT: HOW IT'S FIGURED (2018).

179. Other situations in which taxpayers could be affected by decreased wages include loan eligibility and serving as a guarantor.

of investment income.[180] S-corporation allocations are deemed to be "investment income" for purposes of the earned income tax credit, rendering rideshare drivers with greater than $3,500 of nonwage income allocations ineligible for a potentially valuable credit.

3. *S-Corporation Restrictions*

The pass-through taxation of S-corporations is associated with a variety of restrictions.[181] Most relevantly for sharing economy workers, S-corporations may only have one class of stock and a maximum of 100 shareholders.[182] As discussed in more detail in Section V.C, these restrictions might chill the extent to which a single S-corporation can be the organizing entity under which multiple drivers work.[183]

4. *S-Corporations: Why Now?*

The TCJA, by virtue of the QBI deduction, makes earning income through an S-corporation especially tax efficient. But because of the tax savings associated with avoiding self-employment taxes, the benefits of S-corporation status for rideshare drivers of S-corporation status predate passage of the TCJA. Yet most rideshare drivers appear to operate as sole proprietors.[184] Given the benefits of operating as an S-corporation, why have rideshare drivers not embraced this organizational form?

a. Transaction Costs

Although the expense of forming an S-corporation is generally minor, annual franchise taxes may be significant. In California, for example, S-corporation formation costs $100, with an $800 annual fee.[185] Assessing whether the annual costs are worth the tax savings requires predicting expected earnings. Such a prediction undermines some of the allure of sharing economy work—many drivers place a premium on the ability to start and stop rideshare work at their convenience.[186]

Beyond the explicit annual fees for maintaining the S-corporation, incorporators must also commit additional time to administrative compliance, such as

180. EARNED INCOME CREDIT, *supra* note 65; *see also* Viswanathan, *supra* note 66, at 937–38.

181. In addition to the restrictions discussed below, shareholders of S-corporations may not be partnerships, another corporation, or a nonresident alien individual. I.R.C. § 1361 (2018); s*ee* I.R.C. § 7701(b). This does not prohibit undocumented workers from becoming shareholders provided the shareholders in question satisfy a "substantial presence test." An undocumented worker spending over half of the tax year in the United States passes the substantial presence test. *See* I.R.C. § 7701(b).

182. I.R.C. § 1361(b)(1)(A), (D).

183. *See supra* Section IV.C.

184. Although definitive data is hard to find, the majority of posters on Uberpeople.net, a rideshare driver online community, operate as sole proprietors.

185. *See generally S Corporations*, CAL. FRANCHISE TAX BD., https://www.ftb.ca.gov/file/business/types/corporations/s-corporations.html (last updated June 22, 2019).

186. Oei & Ring*, supra* note 97, at 96.

drafting articles of incorporation, bylaws, and other organizational documents. Annual filing of returns can also be complex. Unsophisticated taxpayers might understandably prefer to avoid unnecessary paperwork when the potential benefits are unclear. This is especially true when rideshare driving is intended to be a part-time or temporary endeavor with limited earnings.

b. Non-reporting of Income Below $20,000

As discussed previously, ridesharing companies, like many companies in the sharing economy, use Form 1099-K to report payments paid to workers.[187] This form is only submitted when payments to workers exceed $20,000 and the total number of transactions is greater than 200.[188] Although this income should still be included in workers' gross income, there is evidence demonstrating that workers earning money in the sharing economy often do not report this income unless they receive an information return.[189] Since forming an S-corporation subjects a taxpayer to more onerous reporting requirements, taxpayers earning less than $20,000 (from each ridesharing service on which they work) might be disincentivized to form an S-corporation.

c. Lack of Clarity on Company Protocol

Both Uber and Lyft permit drivers to submit an S-corporation's taxpayer identification number instead of the more common social security number. As such, both platforms permit drivers to operate as drivers via S-corporations or any other business entity choice. Even if Uber and Lyft did require rideshare drivers to submit individual social security numbers as taxpayer identification numbers, the revenue allocated to these individuals could still be properly assigned to a parent S-corporation. But anecdotal evidence suggests that few drivers know they may conduct ridesharing activities through entities other than a sole proprietorship.

B. One Driver, One S-Corporation

Certain rideshare drivers will obtain significant tax savings by conducting driving activities through an S-corporation. Applying 2019 tax law, if a rideshare driver working in California grossed $36,000 a year as a sole proprietor with $12,000 of expenses, his or her final take home pay would be approximately $19,500.[190] If this same driver's $36,000 of gross income was split equally between expenses, wage income, and a nonwage allocation from the S-corporation,

187. *See supra* note 95 and accompanying text; Oei & Ring, *supra* note 91, at 1034. In 2018 Uber changed their Form 1099-K policy to match industry norms. Uber currently distributes a Form 1099-K only when the $20,000/200 transactions thresholds are met.

188. I.R.C. § 6050W(e) (2018).

189. *See generally* BRUCKNER, *supra* note 75.

190. *See* I.R.C. § 1(h) (providing current year federal tax rates). Because permissible deductions typically greatly exceed actual economic costs, true economic loss is typically much less than this $12,000 of allowed deductions.

the take-home pay would be approximately $20,900, a savings of about $1,400.[191] Keeping the proportion of expenses constant, a rideshare driver grossing instead $72,000 a year would obtain tax savings of approximately $2,200.

These tax savings increase if the proportion of net income allocated to wages decreases from 50% in the above example to 25%. For the taxpayer grossing $36,000, this smaller allocation to wage income results in the S-corporation arrangement saving about $2,100 relative to the sole proprietor. For the taxpayer grossing $72,000, the S-corporation saves the taxpayer approximately $3,800.

As noted above, the costs associated with maintaining an S-corporation vary between states and can be high. For instance, in California, there is an annual franchise tax of $800 in addition to a net income tax of 1.5%.[192] In other states, such as New York, these costs are minimal.[193] If these fees are fixed costs levied by the states, they might be prohibitively expensive. To the extent that the associated costs are simply administrative costs, however, these burdens could be mitigated by providing resources to assist these workers, similar to the resources currently being provided to low-income tax filers. Filing the paperwork necessary for the successful operation of an S-corporation could be streamlined by, say, a law school clinic, so that benefitting taxpayers could easily obtain the tax benefits of S-corporation status.

Drivers acting as the sole shareholders of their S-corporations will likely not be able to characterize payments of compensation as anything other than wage income of an employee reportable on Form W-2.[194] As the sole shareholder of the S-corporation, the shareholder/driver would be deemed a statutory employee; that is, presumptively an employee rather than an independent contractor.[195] As a result, any compensation paid to the sole shareholder/driver would be characterized as income earned by an employee. In contrast to payments earned through work as an independent contractor, employees receiving wage payments from the S-corporation would not be entitled to the QBI deduction.

Although the one-S-corporation-per-driver model lacks the reduced transactional costs and bonus QBI deduction of the one-S-corporation-with-many-drivers model below, it has certain advantages. As an S-corporation with one shareholder, there is no required coordination amongst parties to launch the entity. There would be little risk that the solely owned S-corporation would engage in behavior that would result in termination of S-corporation status, whereas the addition and removal of drivers in the multi-driver S-corporation model has many potential pitfalls.

191. This hourly rate is the average reported rate from a survey of rideshare drivers.

192. *S-corporations*, *supra* note 185.

193. In New York, the initial S-corporation filing fee is $125, with a $9 fee for the required biennial statement. *Corporate Fee Schedule*, N.Y. DEP'T OF STATE, https://www.dos.ny.gov/corps/fees_corp.html (last visited Oct. 31, 2019). The New York annual state tax owed by S-corporations with minimal capital is $25, provided receipts are less than $100,000. *See* N.Y. Tax Law § 209 (Consol. 2019).

194. *See* Joseph M. Grey Pub. Acct., P.C. v. Comm'r, 119 T.C. 121, 129 (2002) (deeming officer-shareholder of S-corporation to be an employee rather than an independent contractor).

195. I.R.C. §§ 3121(d)(1), 3306(i), 3401(c); *see* note 174 and accompanying text.

C. One S-Corporation with Multiple Drivers

The most beneficial S-corporation model would consist of a single S-corporation with multiple (limited to 100) shareholder/drivers. This configuration has advantages over a model in which each driver is the sole shareholder for her own S-corporation. If the drivers are not deemed to be statutory employees, all compensation would be eligible for the QBI deduction: the labor income would be akin to sole proprietor income, with the remaining compensation coming from the driver's S-corporation nonwage allocation. Although this structure would obtain the most tax benefits, it would require careful drafting of organizational documents to avoid running afoul of the prohibition against an S-corporation having more than one class of stock.

1. Drivers as Independent Contractors

The multi-shareholder/driver model could permit shareholder/drivers who are not officers to be paid their required reasonable compensation as independent contractors rather than wage-earning employees.[196] This would allow these shareholder/drivers to receive a QBI deduction on not just their non-wage income allocations, but their 1099-MISC, Schedule C income allocation received from working as an independent contractor.[197] Proposed regulations reiterate that the QBI deduction does not include reasonable compensation paid by an S-corporation.[198] But the preamble to the regulation states: "The rule for reasonable compensation is merely a clarification that, even if an S corporation fails to pay a reasonable wage to its shareholder-employees, the shareholder-employees are nonetheless prevented from including an amount equal to reasonable compensation in QBI."[199]

This at least raises the possibility that shareholder/*independent contractors*, in contrast to shareholder/employees, would indeed be eligible for the QBI deduction for payments characterized as being made to independent contractors. This is equivalent to each driver being a sole proprietor with regard to the driving services performed for the S-corporation, and a shareholder with regard to the nonwage income allocations made by the S-corporation. Although self-employment taxes must still be paid on any amounts paid to independent contractors, the possibility of the QBI deduction makes this characterization preferable, assuming no compelling non-tax reasons exist for desiring payments of wages.[200]

For federal tax purposes, the S-corporation's ability to classify drivers as independent contractors depends on behavioral control, financial control, and the

196. *See supra* notes 167–71 and accompanying text.

197. *See supra* note 169 and accompanying text. The lack of definitive guidance with regard to the QBI deduction of section 199A precludes assurance on this point.

198. Prop. Treas. Reg. § 1.199a-3(b)(2)(ii)(H).

199. Qualified Business Income Deduction, 83 Fed. Reg. 40,884, 40,893 (proposed Aug. 16, 2018) (to be codified at 26 C.F.R. pt. 1).

200. *See supra* note 180 and accompanying text. The S-corporation would want to avoid employee status for its workers for many of the same reasons sharing economy companies want to.

relationship of the parties.[201] There is no absolute test for determining whether or not a worker is an employee or an independent contractor, but the qualitative factors provided by the IRS imply that S-corporation drivers should qualify as independent contractors. The S-corporation would exhibit no behavioral control over the drivers. Drivers would not be told how, when, or where to do the work or what equipment to use. Similarly, drivers would retain financial control. The S-corporation would invest nothing in the work of each individual driver. Each driver would bear all the financial risk of incurring expenses in excess of whatever amount she would be paid by the S-corporation. The S-corporation would provide no fringe benefits or paid leave, evincing independent contractor status.[202]

The S-corporation should also structure its payments to drivers in a way that maximizes the likelihood that these payments will be treated as payments to independent contractors, rather than wages paid to employees. Although several choices exist, one possible option would be to pay drivers a per mileage rate that approximates the standard IRS reimbursement rate. Drivers would earn 1099-MISC income that would vary depending on how much they drove, supporting the claim that drivers retain financial control.[203] Drivers would then be able to take the per mile deduction, reducing their independent contractor income (and self-employment tax obligations) to essentially zero.[204]

2. *One Class of Stock*

Any configuration involving multiple shareholders/drivers and a single S-corporation should result in each shareholder driver obtaining the same net revenue she would have obtained as a sole proprietor but with preferential tax treatment. The shareholder/drivers will be formally generating revenue for the S-corporation, which will then distribute funds (via some combination of nonwage income allocations and returns on labor) to individual shareholder/drivers. Because no consistency between driver earnings (or hours worked or miles driven) exists, any such arrangement must be carefully drafted to not violate the S-corporation prohibition against multiple classes of stock.[205] This arrangement would be complex, in that the addition of shareholders could complicate the S-corporation's operations. A properly drafted shareholder agreement would be needed to ensure that malicious shareholders do not, for example, destroy S-corporation status by transferring their shares to an ineligible entity.

201. *See* INDEPENDENT CONTRACTOR OR EMPLOYEE, *supra* note 76.

202. *See id.* (providing additional clarity on the three categories of factors).

203. Simpson v. Commissioner, 64 T.C. 974, 988 (1975) (stating that earnings based on a worker's efforts and skills, as opposed to a fixed time-based wage, is consistent with status as an independent contractor).

204. The S-corporation could also pay drivers a percentage of gross earnings generated or on a per hour basis.

205. I.R.C. § 1361(b)(1)(D) (2018).

3. Reduced Transaction Costs

The multiple shareholders/drivers-using-a-single-S-corporation model also has non-tax benefits. The transaction costs borne by drivers would necessarily be lower with a multi-driver/shareholder model. Not only would the fixed costs of incorporating, maintaining, and filing the annual returns of the S-corporation be spread over all drivers rather than over a single individual, but other unexpected costs would be diffused as well. Changes in law that require consultation with professionals (such as accountants) could be paid by the S-corporation, with minimal involvement from the individual driver/shareholders.

* * *

The tax planning strategies described above are not meant to exhaust the myriad ways in which rideshare drivers could possibly obtain tax savings. Rather, it is meant to demonstrate that the high transaction costs precluding many lower-income taxpayers from effectively minimizing their tax burden can possibly be reduced if the burden of devising these strategies is borne by other parties.[206] As described in Part III, these other parties (the IRS, academia, and public interest-minded practitioners) should work to develop strategies that permit lower-income taxpayers to best take advantage of beneficial tax laws.

D. Non-Tax Considerations for Sharing Economy Workers

Tax consequences are not, of course, the only considerations relevant to lower-income workers. Much has been written on how employers in the sharing economy have classified workers as independent contractors instead of employees.[207] Without employee status, negotiating for workers' rights is difficult. Independent contractors are not eligible for the collective bargaining protections established by the National Labor Relations Act ("NLRA").[208] Local jurisdictions attempting to establish employee-esque collective bargaining rights for independent contractors have faced legal challenges[209] that focus on two claims: first, that giving independent contractors the ability to organize violates the antitrust provisions of the Sherman Act and second, that attempts to bestow these rights are preempted by the NLRA.[210]

Current attempts to create affiliations between sharing economy workers and existing unions have been largely ineffective. These affiliations typically

206. Including, but not limited to, legal academics.

207. *See, e.g.*, Nicholas L. DeBruyne, *Uber Drivers: A Disputed Employment Relationship in Light of the Sharing Economy*, 92 CHI.-KENT L. REV. 289 (2017); Pamela A. Izvanariu, *Matters Settled but Not Resolved: Worker Misclassification in the Rideshare Sector*, 66 DEPAUL L. REV. 133 (2016); Keeton, *supra* note 148, at 209; Robert L. Redfearn III, *Sharing Economy Misclassification: Employees and Independent Contractors in Transportation Network Companies*, 31 BERKELEY TECH. L.J. 1023, 1023 (2016).

208. 29 U.S.C. §§ 151–169 (2018). The NLRA specifically removes "independent contractors" from its definition of employee.

209. *See, e.g.*, Chamber of Commerce of the U.S. v. City of Seattle, No. C16-0322RSL, 2016 WL 4595981, at *1 (W.D. Wash. Aug. 9, 2016).

210. *See, e.g.*, Complaint, Chamber of Commerce of the U.S. v. City of Seattle, 2016 WL 836320 (W.D. Wash. 2016).

also involve the sharing economy companies for whom the workers work, naturally generating skepticism amongst those blaming the companies for worker woes.[211] The Independent Drivers League, formed as part of an agreement for the New York City area between Uber and a regional branch of the International Association of Machinists and Aerospace Workers, has been viewed, in part, as reluctant to confront issues likely to cause tension with Uber.[212]

It is possible that an S-corporation structure could give rideshare drivers greater organizing power. If multiple drivers are working for one S-corporation, these drivers could more effectively coordinate efforts to achieve their labor-based goals. This organizing could be done directly by the S-corporation or by an affiliated tax-exempt 501(c)(6) business league.[213] A properly structured business league could adequately protect the interests of sharing economy workers without running afoul of either statutory prohibitions or cooption by the businesses often adverse to these workers' interests.

V. CONCLUSION

Tax planning has long been considered inefficient and socially wasteful. This narrative is incomplete. In contrast to tax planning by the wealthy, tax planning for lower-income taxpayers typically consists of promoting behavior intended by Congress. As such, the transaction costs for lower-income tax planning should be reduced by the parties able to do so: the IRS, law school clinics, legal academics, and tax practitioners. This Article provides an example of how one cohort of taxpayers, rideshare drivers in the sharing economy, could significantly reduce their tax liability by taking advantage of S-corporations and the new qualified business income deduction of the Tax Cuts and Jobs Act. Rather than speaking definitively on how rideshare drivers (or any other group of lower-income taxpayers) should conduct their revenue generating activities, the approaches described in this Article are meant to increase dialog on how to best accomplish a single normative goal: assisting lower-income taxpayers in effectively engaging in tax planning.

211. *See* Josh Eidelson, *Uber-Union Proposal on Benefits Met with Skepticism from Labor*, BLOOMBERG NEWS (Jan. 25, 2018, 2:52 PM), https://www.bloomberg.com/news/articles/2018-01-25/uber-union-proposal-on-benefits-met-with-skepticism-from-labor.

212. Noam Scheiber, *Uber Has a Union of Sorts, but Faces Doubts on Its Autonomy*, N.Y. TIMES (May 12, 2017), https://www.nytimes.com/2017/05/12/business/economy/uber-drivers-union.html.

213. Engineers Club of San Francisco v. United States, 791 F.2d 686, 689 (9th Cir. 1986) (quoting Treas. Reg. §1.501(c)(6)-1) ("A business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit."). "Individual persons" refers not only to members but also to non-member individuals and entities. JOHN F. REILLY, CARTER C. HULL & BARBARA A.B. ALLEN, IRS, IRC 501(c)(6) ORGANIZATIONS K-3 (2003).