

IRS Form 1099-K Payment Reporting Under California AB 5

On September 18, 2019, California Governor Gavin Newsom approved [Assembly Bill 5](#) (AB 5) to limit the classification of workers as independent contractors in the state. The new law, effective January 1, 2020, will increase payroll tax responsibilities for California companies that must reclassify workers as employees. While the landscape of worker classification has dramatically shifted, companies that have patterned themselves as third party settlement organizations (TPSO's) may decide to launch a defense from a federal tax reporting perspective.

The B in the ABC Test

AB 5 codified the groundbreaking California Supreme Court decision [Dynamex Operations West Inc. v. Superior Court of Los Angeles](#) (Dynamex). Under the ruling and subsequent bill signed into law, businesses must apply the ABC test to determine whether a worker is an employee, unless an exemption applies. To hire an independent contractor, businesses must show:

1. the worker is free from the company's control in performance of the work,
2. the worker performs work that is outside the usual course of the company's business, *and*
3. the worker is customarily engaged in an independent business of the same nature as the work performed for the company.

Of the three prongs, the second is the most concerning to businesses with on-demand workforces, particularly in the gig economy. As work representing the usual course of business for the company disqualifies a worker as an independent contractor, the issue depends on what falls within a company's central business and what can be distinguished.

[On a press release dated September 12, 2019](#), Uber made public that it does not intend to reclassify drivers as employees because it does not consider their work part of its usual course of business. Instead, Uber characterizes itself as "a technology platform for several different types of digital marketplaces." To help make the case, similar companies have historically considered and adopted a method of reporting payments to the IRS and workers consistent with this position. Making use of a



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relatively new IRS information reporting form allows a company to argue that it is in the business of processing payments between service providers and service recipients, rather than engaged in the business of the service itself.

The Rise of Form 1099-K

Uber, Lyft, Airbnb, TaskRabbit, and other platforms in the sharing economy have taken a strategic approach to payment reporting. For a traditional employee, companies report wages, deductions, and other information on an IRS Form W-2. On the other hand, a freelancer or an independent contractor typically receives an IRS Form 1099-MISC, subject to a \$600 minimum threshold. Online hiring platforms have taken the expedient route of sending out IRS Form 1099-K's to position themselves as third-party intermediaries.

[IRS Form 1099-K](#) was created prior to the rise of the gig economy that AB 5 was intended to address. The new reporting form was introduced in 2008 under Internal Revenue Code (IRC) Section 6050W for payment settlement entities to furnish information on payments to vendors and other parties. For example, credit card companies use Form 1099-K to report payments settled through card transactions with merchants. Payment settlement entities also include TPSO's.

TPSO's use IRS Form 1099-K to report payments handled between persons providing goods or services and the purchasers of those goods or services. The TPSO guarantees payment for the goods or services purchased on the network. When originally introduced, a TPSO was considered to be an online business, such as PayPal, StubHub, or Ebay, that processed payments in settlement of website sales. Since then, online platforms in the gig economy have taken up the theory that they also represent TPSO's. For example, both Uber and Lyft issue drivers IRS Form 1099-K for rider payments and reserve IRS Form 1099-MISC for non-rider payments, such as referral bonuses or on-trip promotions.

However, IRS Form 1099-K only applies if a person receives electronic payments of over \$20,000 and has more than 200 payment transactions during the calendar year under the de minimis rule of IRC Section 6050W(e). In other words, a gig worker with \$25,000 in electronic payments with 199 transactions is not required to receive an IRS Form 1099-K.

In [PLR 201836008](#), the Internal Revenue Service blessed a company as a TPSO with respect to service recipient payments made to service providers through its mobile application and online payment platform. Moreover, each service provided by a gig worker constituted a single "transaction" for purposes of Form 1099-K, allowing further relief on payment reporting. The ruling specified that each service was a single transaction regardless of the number of service recipients (such as multiple passengers in a single rideshare trip). The analysis provided that treatment as a TPSO was available to the company because it was not a common-law employer with respect to the payee.

Usual Course of Business of TPSO's After AB 5

Using the IRS Form 1099-K to identify as a TPSO may help companies argue they are in fact technology platforms. Although PLR 201836008 required that the company not be the common law employer to the service providers to qualify as a TPSO, this test represents only the first prong of the ABC test. It is possible that a company operating an online platform will cite to the favorable private letter ruling (PLR) to justify its status as a TPSO and then, in turn, wield that conclusion against the second prong of the ABC test.

In other words, businesses may point to their IRS Form 1099-K compliance as proper because they operate only as an intermediary between the service provider and service recipient. In the case of ride-sharing platforms, a company may cite to the PLR as an indication that the usual course of its business should be seen as simply processing credit card payments between driver and passenger. If ventured in the challenge against AB 5, it is unclear whether this argument will prevail in the coming years of litigation.

Conclusion

While there are certain industry-specific exemptions, the ABC test made into law by AB 5 will have sweeping consequences for many California companies. Any company that relies on freelance or contract work in the state should examine AB 5's impact on its business, including the way in which it reports payments to its workforce and the IRS. It remains to be seen how the debate will ultimately play out in connection with the seldom considered IRS payment reporting forms.

For legal assistance with tax obligations in the wake of California AB 5, please contact Christopher Karachale or Nancy Dollar.

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