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## INSIGHT: IRS Form 1099-K in the Technology Platform Defense to California AB 5



CHRISTOPHER KARACHALE AND NANCY DOLLAR

Effective Jan. 1, 2020, the new legislation under California's Assembly Bill 5 (AB 5) is set to dramatically limit the classification of workers as independent contractors in the state. Companies relying on freelance or contract work in California to perform services that are within the usual course of their business may need to reclassify such workers as employees under the law's strict standard.

In response to the controversial [AB 5](#), technology platform companies have publicly raised a potential defense based on the nature of their core business as distinguishable from services provided by their gig workers. Platform companies that have patterned themselves as third-party payment intermediaries may be well served in this defense by their chosen method of IRS Form 1099 reporting.

### Defense Against the B in the ABC Test

AB 5's new standard for worker classification originated in the groundbreaking California Supreme Court decision [Dynamex Operations West Inc. v. Superior Court of Los Angeles](#) (Dynamex). The three-part ABC test under the ruling, now codified into statute, generally applies a presumption of employee status, absent an exemption. To avoid the default classification as an employee, a hiring company must show:

- (a) the worker is free from the company's control in performance of the work,
- (b) the worker performs work that is outside the usual course of the company's business, and
- (c) the worker is customarily engaged in an independent business of the same nature as the work performed for the company.

The second part of the test can be the most difficult to meet for businesses making use of on-demand workforces, particularly in the gig economy. As independent contractors may only perform work "outside the usual course of" the hirer's business under the new law, worker classification depends on what does and does not fall within the scope of a company's business.

[In a press release dated Sept. 12, 2019](#), Uber announced its intentions to continue classifying drivers as independent contractors after AB 5. The ride-hailing company has taken the position that the drivers do not perform work within the usual course of its business. Uber describes itself as "a technology platform for several different types of digital marketplaces" and argues the drivers perform work distinguished from that core business.

Companies with similar business models have also adopted the "technology platform" defense to AB 5. Notably, platform companies in the gig economy routinely adopt a specific method of reporting payments to the Internal Revenue Service and workers consistent with this position. Use of a relatively new IRS information reporting form serves a platform company's argument that it is in the business of processing payments between service providers and service recipients, rather than engaged in the underlying service itself.

### IRS Form 1099-K Reporting for Technology Platforms

Platform companies like Uber, Lyft, Airbnb, and TaskRabbit take a considered approach to information reporting on payments to workers they treat as independent contractors. For a worker classified as an employee for tax purposes, companies report wages, deductions, and other information on an IRS Form W-2. A

freelancer or an independent contractor typically receives an IRS Form 1099-MISC, subject to a \$600 payment minimum. However, platform companies provide IRS Form 1099-K's to their gig workers and the IRS to position themselves as third-party intermediaries.

[IRS Form 1099-K](#) was first introduced in 2008, before the rise of the gig economy that AB 5 was intended to address. Payment settlement entities must use IRS Form 1099-K to furnish certain information on payments to vendors and other parties, as provided under tax code Section 6050W. For example, credit card companies report payments settled through card transactions with merchants on IRS Form 1099-K. Payment settlement entities subject to IRS Form 1099-K reporting also include “third-party settlement organizations” (TPSO's).

A TPSO handles payments 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. The term TPSO was originally intended to address online businesses, such as PayPal, StubHub, or Ebay, that process payments as third parties in settlement of website sales. Since then, platform companies in the gig economy have adopted the theory that they also represent TP-SO's. For example, both Uber and Lyft issue drivers IRS Form 1099-K for rider payments through the app. The ride-hailing companies reserve IRS Form 1099-MISC for non-rider payments, such as referral bonuses or on-trip promotions.

Reporting under IRS Form 1099-K may be minimal due to the high applicable thresholds. Under IRC Section 6050W(e), IRS Form 1099-K reporting only applies if a person receives electronic payments of over \$20,000 and has more than 200 payment transactions during the calendar year. 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.

The IRS specifically blessed a platform company as a TPSO in [Private Letter Ruling 201836008](#) with respect to service recipient payments made to service providers through its mobile app. In the favorable ruling, the IRS determined each service provided by a gig worker con-

stituted a single “transaction” for purposes of IRS Form 1099-K. The ruling concluded each service was a single transaction, regardless of the number of service recipients (such as multiple passengers in a single rideshare trip). As a result, the IRS granted further relief on the IRS Form 1099-K information reporting requirements.

## The Usual Course of Third-Party Payment Processing

Identifying as a TPSO with IRS Form 1099-K may help companies present a technology platform defense to AB 5. Although PLR 201836008 required that the platform company not be the common law employer to the service providers to qualify as a TPSO, the common law test arguably represents only the first prong of the ABC test. A platform company may cite to the favorable ruling to justify its status as a TPSO and then, in turn, wield that conclusion against the second prong of the ABC test regarding the usual course of its business.

In mounting a technology platform defense, a company may comply with information reporting under IRS Form 1099-K to indicate it operates merely as an intermediary between service providers and service recipients. In the case of a ride-hailing platform, PLR 201836008 could serve as support that the usual course of such a business is largely limited to processing credit card payments between driver and passenger. If ventured as part of the ongoing defense against AB 5, it remains to be seen whether this line of argument will prevail in the coming years of litigation.

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## Author Information

*Christopher Karachale is a partner at Hanson Bridgett LLP in San Francisco. He advises individuals and business entities on a broad range of tax planning and tax controversy matters.*

*Nancy Dollar is an associate at Hanson Bridgett LLP in San Francisco. She works on a variety of federal, state, and international tax matters.*