
TAX LAW'S WORKPLACE SHIFT

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ABSTRACT

In December 2017, Congress passed major tax reform. The reform included an important new provision that granted independent contractors and other pass-through taxpayers—but not employees or corporations—a potential tax deduction equal to 20% of their qualified business income. Critics have argued that this new deduction (codified at 26 U.S.C. § 199A) could lead to a widespread shift toward independent contractor jobs as workers seek to reduce taxes paid. This shift could cause workers to lose important employee protections and leave them more economically vulnerable.

This Article examines whether this new tax provision will create a large-scale workplace shift and, if it does, how that shift should be normatively evaluated. It argues that while tax law in general has important and underappreciated effects on work arrangements, it is difficult to isolate § 199A as the driver of a broad workplace shift. Several other nontax legal changes and nonlegal economic developments are transforming work arrangements and classification choices; § 199A is only one factor. Moreover, § 199A is not the only tax law change that is likely to impact classification choices.

Drawing on empirical data on contemporary workplace trends, this Article also argues that even if new § 199A induces a workplace shift, how this shift is evaluated must depend on the types of workers and the work at issue. While an independent contractor shift may increase precariousness for some workers, empirical data suggests that for others a shift may be less troubling or troubling for different reasons. This Article lays a framework for analyzing how tax law contributes to and interacts with other factors in ultimately shaping contemporary work arrangements.

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INTRODUCTION

At the end of 2017, Congress passed the most significant tax reform since the Internal Revenue Code of 1986.¹ One of the most important new provisions is § 199A, which grants independent contractors, partners, and other pass-through taxpayers—but not employees or corporate taxpayers—a deduction equal to 20% of their qualified business income (“QBI”).² The deduction could be a significant boon to those eligible and is likely to affect tens of millions of American individuals and businesses.³ Thus, in the aftermath of the provision’s passage, vigorous debate erupted over the effects of and problems with this new Code provision.

A key theme that has emerged in the years since the 2017 tax reform’s passage is concern over the potential effect of § 199A on work and labor. This concern has manifested itself in a specific critique that is symptomatic of a more generalized worry. The specific critique that commentators have advanced is that the new deduction creates a strong incentive for individuals to give up employee status and its accompanying benefits in order to become independent contractors and thus become eligible to claim the deduction.⁴ This shift, if it occurs, could signal a dramatic transformation of the American workplace. A worker’s status as employee or as independent contractor has implications that extend far beyond tax law into minimum-wage, collective-bargaining, workplace-benefits, health-and-safety, and antidiscrimination law.⁵ Widespread

¹ See Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (codified as amended at I.R.C. §§ 1-7702 (2018)).

² I.R.C. § 199A.

³ Martin A. Sullivan, *The Market for Passthrough Deduction Tax Advice*, 160 TAX NOTES 165, 165 (2018) (estimating that 17.2 million small-business taxpayers will generate § 199A deductions of less than \$1000, 4.8 million will generate deductions exceeding \$1000, and 3.3 million will generate deductions of unknown amounts).

⁴ See David Kamin et al., *The Games They Will Play: Tax Games, Roadblocks, and Glitches Under the 2017 Tax Legislation*, 103 MINN. L. REV. 1439, 1459-64 (2019) (outlining how new rules create “tremendous incentives for taxpayers to attempt to shoehorn their income into the ‘qualified’ category” and harms that may accompany such attempts); Daniel Shaviro, *Evaluating the New US Pass-Through Rules*, 2018 BRIT. TAX REV. 49, 63-64 (“The pass-through rules create a tax incentive to be a ‘business owner’ rather than an employee. This may simply involve formal restructuring, such as by calling oneself an independent contractor, rather than an employee . . .”); Lily Batchelder & David Kamin, Opinion, *Republican Tax ‘Reform’ Creates One of the Largest New Loopholes in Decades; the 20% Deduction for ‘Pass-Through Income’ Will Make Many of the Richest Americans Richer*, L.A. TIMES, Dec. 31, 2017, at A18; Andrew Khouri, *Contract Workers Get Tax Cut Under New Law; Earners in the Gig Economy Can Deduct 20% of Their Income*, L.A. TIMES, Jan. 16, 2018, at C1 (discussing how new § 199A benefits independent contractors).

⁵ See generally, e.g., Charlotte S. Alexander, *Misclassification and Antidiscrimination: An Empirical Analysis*, 101 MINN. L. REV. 907 (2017) (examining implications of worker misclassification for antidiscrimination statutes); V.B. Dubal, *Wage Slave or Entrepreneur?*:

reclassification of workers as independent contractors or large-scale abandonment of traditional jobs in favor of self-employment could significantly decrease worker eligibility for these protections, increasing the precariousness of work.

The more generalized worry underpinning the specific critique is that work itself and the security it offers are changing, and that tax law may be accelerating that transformation. New § 199A is one example of a tax provision that could make precarious work relationships more pervasive and lead to a decline in worker security. But the generalized worry about tax law's effects extends beyond just § 199A. For example, those who worry about the future of work also worry that tax law's disparate treatment of labor and capital may favor the adoption of automation and capital investment rather than the hiring of workers, leading to a decline in work.⁶ This risk has prompted some to propose a tax on automation in order to slow down the disappearance of human jobs.⁷ Others have

Contesting the Dualism of Legal Worker Identities, 105 CALIF. L. REV. 65 (2017) [hereinafter Dubal, *Wage Slave or Entrepreneur?*] (describing on-the-ground impacts of worker classification); V.B. Dubal, *Winning the Battle, Losing the War?: Assessing the Impact of Misclassification Litigation on Workers in the Gig Economy*, 2017 WIS. L. REV. 739 [hereinafter Dubal, *Winning the Battle, Losing the War?*] (examining long-term ramifications of worker classification lawsuits for precarity of gig economy workers).

⁶ See, e.g., Ryan Abbott & Bret Bogenschneider, *Should Robots Pay Taxes? Tax Policy in the Age of Automation*, 12 HARV. L. & POL'Y REV. 145, 175 (2018) (arguing for tax-law neutrality between humans and robots); Orly Mazur, *Taxing the Robots*, 46 PEPP. L. REV. 277, 328-29 (2019) (recommending parity in taxing labor and capital but cautioning against robot tax); Jay A. Soled & Kathleen DeLaney Thomas, *Taxes in the Age of Technology*, 161 TAX NOTES 459, 464 (2018) ("[I]n light of the heavy taxes Congress currently imposes on labor income and the increasing availability of labor substitutes, current tax policy incentivizes industry and employers to find other modes of productivity that are less costly to employ."); Daniel Hemel, Essay, *Does the Tax Code Favor Robots?* 13-17 (Dec. 14, 2019) (unpublished manuscript), <https://ssrn.com/abstract=3503911> [<https://perma.cc/6RA4-JYKG>] (critiquing claims that U.S. tax law favors capital; automation; and, hence, robots); Kevin J. Delaney, *The Robot That Takes Your Job Should Pay Taxes, Says Bill Gates*, QUARTZ (Feb. 17, 2017), <https://qz.com/911968/bill-gates-the-robot-that-takes-your-job-should-pay-taxes/> [<https://perma.cc/LBK5-X8TX>] ("‘You ought to be willing to raise the tax level and even slow down the speed’ of automation, Gates argues. That’s because the technology and business cases for replacing humans in a wide range of jobs are arriving simultaneously, and it’s important to be able to manage that displacement.”).

⁷ See Hideto Koizumi, *Optimal Uniform Capital Taxation in a Partially Automated Society* 2 (Oct. 22, 2019) (unpublished manuscript), <https://ssrn.com/abstract=3486827> [<https://perma.cc/LP4E-EYT6>] (using robot tax proposals as launching point to explore whether capital investments should be taxed differently depending on whether they are routine or nonroutine and labor displacing or labor enhancing).

proposed a universal basic income—potentially delivered through the tax system—as a safeguard against disappearing work.⁸

How should we think about § 199A's role in potentially precipitating a widespread shift toward precarious independent contractor work? And if a shift does occur, how should it be contextualized and evaluated? This Article investigates how the new tax changes are likely to affect and reshape work arrangements and lays a normative framework for evaluating any such shifts. It argues that although tax law in general has important and underappreciated effects on work arrangements, it is difficult to isolate § 199A as the driver of a workplace shift. While it is certainly the case that § 199A could make independent contractor classification more attractive than employee status for some workers, there are several factors that may limit the provision's effects. For example, § 199A's internal guardrails, agency interpretations, the need to satisfy classification tests, and the risk of legal challenges may help limit a wholesale shift. Cutting in the other direction, there are tax, legal, and economic factors that may exacerbate a workplace shift, including tax law reform; changes in agency and court interpretations; and economic shifts, such as increasing automation and offshoring of jobs. Section 199A is just one of the recent tax law changes that might affect work arrangements, and tax law is just one facet of the broader legal and economic conditions that are shaping work.

This Article also argues that even if § 199A were to trigger a widespread shift toward independent contractor arrangements, heterogeneity in jobs and workers would demand a nuanced evaluation of such a shift. Drawing on empirical research on the state of the contemporary workforce, this Article argues that depending on the industry, extent of workforce participation, and other factors (including whether the worker holds a primary-employee job), some workers may benefit from § 199A while others may be harmed. Still others may be relatively unaffected. For example, current survey and tax return data suggest that there has been an increase in workers with full-time employment doing employee work or independent contractor work as a side job. If such workers continue their full-time employee work and receive key benefits and protections through this primary employment, we might be less worried about the harms

⁸ See, e.g., Miranda Perry Fleischer & Daniel Hemel, *Atlas Nods: The Libertarian Case for a Basic Income*, 2017 WIS. L. REV. 1189, 1189 (analyzing and critiquing “fit” between libertarian theory and universal basic income); Miranda Perry Fleischer & Daniel Jacob Hemel, *The Architecture of a Basic Income*, 87 U. CHI. L. REV. (forthcoming 2020) (manuscript at 1), <https://ssrn.com/abstract=3346467> [<https://perma.cc/PGY6-3NW6>] (“We propose a UBI of \$6000 per person per year, paid to all citizens and lawful permanent residents via direct deposit in biweekly installments.”); Ari Glogower & Clint Wallace, Essay, *Shades of Basic Income 2* (Ohio State Pub. Law, Working Paper No. 443, 2017), <https://ssrn.com/abstract=3122146> [<https://perma.cc/52MU-XHP3>] (“The basic income concept, at this level of generality, has generated increasing interest among scholars, policymakers, and members of the public around the world and across the political spectrum.”).

caused by any increase in their independent contractor work prompted by § 199A. As another example, some research suggests that automation presents a threat to human work that is susceptible to such replacement.⁹ For these types of at-risk work, § 199A might make hiring workers more feasible by acting as a wage subsidy, potentially lessening automation's threat.¹⁰

In short, this Article's original contribution is to analyze how recent changes in tax law interact with other legal and economic drivers to ultimately shape contemporary work arrangements and to articulate a framework for normatively evaluating these effects. More broadly, this Article aims to shed light on the general phenomenon through which tax law interacts with labor law and other protections in shaping work. This Article's analysis thus provides a roadmap to guide ongoing academic and policy analysis of tax reform and its potential impacts on the future of work. Its insights are applicable not only with respect to the 2017 tax changes but also to evaluating any future tax changes that might occur. The 2017 tax changes themselves only became effective for the 2018 tax year, so their full impacts on workplace arrangements will likely take a few years to manifest.¹¹ Even at this early stage, however, it is important to map the key issues. Subsequent research can then build upon this analysis to model the effects of tax changes on work and test such models against future empirical data.

This Article proceeds as follows:

Part I provides the necessary background by explaining § 199A and summarizing commentator arguments regarding § 199A's impact on work arrangements—in particular, the claim that the new statute will incentivize a broad shift toward an independent contractor workforce.

Part II discusses what is at stake for labor, employment, tax, and other legal purposes in how a worker is classified; describes the evolving legal tests that must be satisfied; maps the trade-offs that firms and workers confront in determining their preferred classification; and explains how new § 199A might change that trade-off and lead to a shift. In doing so, Part II introduces tax considerations into a conversation that is usually dominated by concerns over labor- and employment-law protections.

Part III explores the tax, legal, and economic factors that might limit or exacerbate a workplace shift, thereby broadening the analysis beyond tax law and § 199A.

⁹ See *infra* notes 203-05 and accompanying text (discussing how automation may lead to destruction of work, further motivating employees to reclassify themselves and work as independent contractors).

¹⁰ But see Cynthia Estlund, *What Should We Do After Work? Automation and Employment Law*, 128 YALE L.J. 254, 303-05 (2018) (arguing that separating worker entitlements from employment relationships could reduce incentives to replace human labor with automation and to replace employees with “fissured” contractor relationships).

¹¹ See generally Tax Cuts and Jobs Act, Pub. L. No. 115-97, 131 Stat. 2054 (2017) (codified as amended at I.R.C. §§ 1-7702 (2018)) (repeating throughout that “amendments made by this section shall apply to taxable years beginning after December 31, 2017”).

Part IV turns to normative policy analysis. Drawing on currently available empirical research, it argues that because the contemporary workforce is heterogeneous, § 199A is likely to impact differently situated workers differently. Therefore, concerns about losing worker protections due to a tax-induced workplace shift may be more warranted for some workers than for others.

At the end of the day, the new tax law changes might not necessarily be good policy. But it is important to be clear about what exactly we are concerned about and for what reasons. By mapping how tax law changes interact with other legal and economic factors to affect work arrangements and by outlining how the risks of a shift differ as among differently situated workers, this Article lays a foundation for further empirical study of tax law's impact on the future of work.

I. THE NEW TAX LAW AND ITS CLAIMED WORKPLACE SHIFT

We first describe the new pass-through deduction that has generated the current debate.¹² We then describe the concerns raised by critics about the new provision's effects on the workplace.

A. *The New Pass-Through Deduction and Its Guardrails*

Among the most important domestic changes in the 2017 tax reform was the enactment of § 199A. This new provision sought to remedy a tax-rate inequity created by the new legislation¹³; as part of the overall tax reform, the corporate tax rate was reduced from 35% to 21%.¹⁴ However, businesses operating as pass-through entities (i.e., partnerships, S corporations, and sole proprietorships) were still taxed at the individual tax rates with a maximum marginal rate of 37%.

To provide tax-rate parity, Congress enacted § 199A. The new provision grants qualified partners, S-corporation shareholders, and individuals operating a trade or business as sole proprietors a deduction of up to 20% of a specifically calculated base of income (i.e., their QBI).¹⁵ The deduction is not available to

¹² See I.R.C. § 199A (establishing new deduction for independent contractors and other pass-through taxpayers but not employees or corporations).

¹³ See Letter from Orrin G. Hatch, Chairman, U.S. Senate Fin. Comm., to Bob Corker, Chairman, U.S. Senate Foreign Relations Comm. (Dec. 18, 2017), reprinted in *Hatch: Passthrough Provision Result of House-Senate Negotiations*, 2017 TAX NOTES TODAY FED. 242-14 (asserting that § 199A “provide[s] tax relief to pass-through businesses at a level similar to that provided to regular ‘C’ corporations”).

¹⁴ See I.R.C. § 11.

¹⁵ Whether and under what circumstances pass-throughs and C corporations have tax-rate parity under § 199A is fact specific. See James R. Repetti, *The Impact of the 2017 Act's Tax Rate Changes on Choice of Entity*, 21 FLA. TAX REV. 686, 714 (2018) (discussing how C corporation's retention of earnings, “qualified small business” status, and share sales may impact what tax rate corporation pays); Ruth Simon, *A Taxing Choice for Firms: S or C?*, WALL STREET J., Feb. 23, 2018, at B1 (“Many companies are taking longer to decide because

C corporations.¹⁶ The 20% deduction reduces the effective tax rate on pass-through taxpayers, bringing the rate more in line with the C-corporation rate. For example, in the case of a taxpayer facing the top 2018 marginal individual tax rate of 37%, the ability to take the full § 199A deduction would result in an effective marginal tax rate of 29.6%.¹⁷ The § 199A deduction is a below-the-line deduction taken after the calculation of adjusted gross income, meaning the deduction is available to both taxpayers who itemize deductions and those who do not.¹⁸ However, because tax rates are progressive, the deduction remains more valuable to higher-bracket taxpayers.¹⁹

Importantly for our purposes, the new deduction is not available to employees. To qualify for the deduction, the taxpayer's income must be from a "qualified trade or business,"²⁰ and the statute specifically excludes the performance of services as an employee from the definition of "qualified trade or business."²¹ This employee exclusion has prompted the criticism that § 199A could trigger a broad workplace shift from employee- to independent-contractor-based relationships, which would lead to a corresponding loss of employee benefits and protections.²² Critics have expressed concern that in remedying one

the calculations are complicated, said Milwaukee tax attorney Thomas Nichols, with the answers turning on the size of dividend payouts, when the owners expect to sell, expectations for what Congress might do down the road, and other factors."); Bradley T. Borden, *Choice-of-Entity Decisions Under the New Tax Act 1* (Brooklyn Law Sch. Legal Studies, Research Paper No. 550, 2018), <http://ssrn.com/abstract=3119829> [<https://perma.cc/TD85-W7CC>].

¹⁶ I.R.C. § 199A(a).

¹⁷ 80% of 37% = 29.6% (assuming that the net investment income tax in § 1411 does not apply).

¹⁸ I.R.C. § 63(b), (d) (making § 199A deduction available to both taxpayers who itemize deductions and those who do not).

¹⁹ See *id.* § 1 (demonstrating that tax rates increase as income increases).

²⁰ The income must be earned directly as a sole proprietor (which includes independent contractors) or through a pass-through entity (such as a partnership or S corporation). *Id.* § 199A(f)(1)(A). "Sole proprietor" describes a type of noncorporate business for tax filing purposes. "Independent contractor" is used to distinguish employees and nonemployees for payroll and Federal Unemployment Tax Act ("FUTA") purposes. An individual providing services as an independent contractor would file Schedule C (sole proprietor) with Form 1040 to report income from the activity and may have to file Schedule SE (self-employment tax) as well. See *Sole Proprietorships*, INTERNAL REVENUE SERV., <https://www.irs.gov/businesses/small-businesses-self-employed/sole-proprietorships> [<https://perma.cc/LH3H-CQ2S>] (last updated Jan. 16, 2020).

²¹ I.R.C. § 199A(d)(1)(B); Treas. Reg. § 1.199A-1(b)(14) (2019).

²² See, e.g., Andrew Velarde, *Passthrough Abandonment of Horizontal Equity Means It's Game On*, 159 TAX NOTES 1188, 1188 (2018) (discussing incentive created by new deduction to become independent contractor); Patricia Cohen, *Same Income, but Not Taxes, in G.O.P. Plans*, N.Y. TIMES, Dec. 10, 2017, at A1 (outlining several examples of inequitable outcomes that may arise as a result of this employee exclusion); Noam Scheiber, *New Tax Law Offers Carrot to Gig Workers, but It May Have Costs*, N.Y. TIMES, Jan. 1, 2018, at B1 ("The new

inequity—that between C corporations and pass-through entities—Congress might have inadvertently created another: a tax disparity between employees and independent contractors, with a clear tilt toward the latter.²³ These sentiments were widely circulated in the news, on blogs, and in other social media outlets in the aftermath of the 2017 tax reform, and we describe them in greater detail in Section I.B.

Regardless of the potential tax advantages of reporting as an independent contractor, a worker's status is not elective. Classification as an independent contractor must be supported by the facts. Emphasizing this point, the § 199A final regulations, issued in January 2019, provide a rebuttable presumption that former employees who switch to independent contractor status remain employees.²⁴ This rebuttable presumption shifts the burden to the taxpayer to demonstrate that her relationship with her former employer has changed sufficiently to merit the new classification as an independent contractor.

New § 199A contains a number of guardrails that limit the provision's application or curb tax-avoidance behavior, and these guardrails may constrain a taxpayer's ability to take the 20% deduction. The most important guardrails are (1) limitations based on the line of business, types of assets held, or employees hired by the pass-through business²⁵ and (2) the "reasonable compensation" carveout.²⁶

1. Line of Business, Assets, and Employees

Section 199A imposes a number of limitations on the deduction's availability, which apply to taxpayers above certain income levels.²⁷ Two major ones are based on (1) the nature of the trade or business and (2) the amount of Form W-2 wages paid by the pass-through taxpayer to its employees and the extent of the taxpayer's investment in qualified depreciable property.

tax law is likely to accelerate a hotly disputed trend in the American economy by rewarding workers who sever formal relationships with their employers and become contractors.”).

²³ See, e.g., Kamin et al., *supra* note 4, at 1459-61 (discussing employee incentives after § 199A); Tony Nitti, *Making Sense of the New '20% Qualified Business Income Deduction,'* FORBES (Dec. 26, 2017, 8:48 AM), <https://www.forbes.com/sites/anthonymitti/2017/12/26/tax-geek-tuesday-making-sense-of-the-new-20-qualified-business-income-deduction/> [<https://perma.cc/HVP7-QN97>] (noting potential disparity and whether statute's limitations remedy it).

²⁴ Treas. Reg. § 1.199A-5(d)(3)(i).

²⁵ I.R.C. § 199A(d)-(e).

²⁶ *Id.* § 199A(c)(4).

²⁷ *Id.* § 199A(e)(2) (adjusting for inflation). Taxable income thresholds are determined without regard to the § 199A deduction and are not limited to income from the qualified trade or business. *Id.* § 199A(b)(3)(A).

a. *Nature of Services*

First, if a taxpayer is in a specified service trade or business (“SSTB”) and has taxable income over certain statutory limits, her § 199A deduction will be reduced or even eliminated.²⁸ If taxable income is less than the statutory threshold, the taxpayer may take the full § 199A deduction regardless of her SSTB.²⁹ If the taxpayer earns above this threshold and is in an SSTB, then eligibility for the deduction is gradually reduced and eventually eliminated.³⁰

SSTB is defined to include the performance of services in a wide array of fields including health, law, financial services, accounting, actuarial science, performing arts, consulting, athletics, brokerage services, and “any trade or business where the principal asset of such trade or business is the reputation or skill of 1 or more of its employees.”³¹ In addition, § 199A adds investing; investment management; and trading or dealing in securities, partnership interests, or commodities to the list of prohibited businesses.³²

The bottom line is that for higher-income taxpayers, a business that constitutes the performance of services in one or more of a sweeping list of categories cannot benefit from § 199A—at least not without real planning.³³ The list of prohibited services also includes broad language encompassing any trade or business in which the principal asset is reputation or skill.³⁴ This language, which could have served as a significant limitation on the availability of the deduction, was defined narrowly in the final regulations.³⁵ In the case of lower-

²⁸ *Id.* § 199A(d)(1)(A) (clarifying that a “specified service trade or business” is not a “qualified trade or business”).

²⁹ *Id.* § 199A(b)(3)(A). The threshold was \$157,500 for individual filers and \$315,000 for joint return filers as enacted in 2017. *Id.* § 199A(e)(2). The inflation-adjusted amounts for 2020 are \$163,300 for individual filers and \$326,000 for joint returns. Rev. Proc. 2019-44, 2019-47 I.R.B. 1099.

³⁰ I.R.C. § 199A(d)(3)(A). If that taxpayer earns \$213,300 or more (\$426,000 for joint filers), she may not take the deduction at all. *Id.*

³¹ *Id.* §§ 199A(d)(2)(A), 1202(e)(3)(A). Although § 1202(e)(3)(A) includes “engineering” and “architecture,” § 199A(d)(2)(A) explicitly directs that § 1202(e)(3)(A) be applied without regard to those terms.

³² *Id.* § 199A(d)(2)(B).

³³ For businesses engaged in multiple activities including a specified service, the regulations provide a simplified approach for determining whether the specified services effectively taint the trade or business or are de minimis and can be ignored. *See* Prop. Treas. Reg. § 1.199A-5(c), 83 Fed. Reg. 40,895, 40,896 (Aug. 16, 2018).

³⁴ Although I.R.C. § 1202(e)(3)(A) speaks of the “reputation or skill of 1 or more of its employees,” § 199A modifies this for the 20% deduction. The limitation applies if the principal asset is the reputation or skill of “employees or owners.” I.R.C. § 199A(d)(2)(A). Thus, an owner who is not formally an employee could trigger the exclusion from qualified trade status or business status.

³⁵ *See* Treas. Reg. § 1.199A-5(b)(2)(xiv) (2019).

income taxpayers, for whom worker protections may be especially important, this nature-of-services guardrail poses no constraint.

b. *Wages and Investment in Qualified Depreciable Property*

The second restriction requires pass-through taxpayers with taxable income over certain thresholds³⁶ to either (1) pay a minimum amount of wages to employees or (2) pay a lesser amount of wages but also deploy a minimum amount of qualified depreciable assets in the business in order to secure the full 20% deduction.³⁷ This means that insufficient payment of W-2 wages or investment in qualified depreciable property will reduce the § 199A deduction for higher-income taxpayers. Businesses that have adequate employee payroll would likely satisfy the wage-only option.³⁸ And businesses with little labor but significant depreciable assets would likely satisfy the wage-plus-property option, preserving the full 20% deduction.³⁹

Both the nature-of-services limitation and the wage-only or investment-in-property limitation add significant complexity to § 199A and limit the deduction's availability. Neither of these provisions apply to taxpayers below the statutory taxable income thresholds, and they hence do not restrain lower-income taxpayers from taking the deduction. But with respect to workers above the thresholds, the additional restrictions could not only result in fewer of those taxpayers being eligible for the deduction but also lead to more behavioral distortions as taxpayers structure their enterprises to circumvent these limitations.

2. The "Reasonable Compensation" Carveout

As noted, the availability of the § 199A deduction depends in part on the amount of the taxpayer's QBI.⁴⁰ QBI generally refers to the net amount of income, gains, deductions, and losses with respect to the taxpayer's "qualified trade or business"⁴¹ if such items are effectively connected with a U.S. trade or

³⁶ The thresholds are the same as those for determining SSTB status. *See supra* note 29.

³⁷ I.R.C. § 199A(b)(2)(B). The taxpayer's allowable deduction is limited to the lesser of (1) 20% of QBI or (2) the greater of 50% of W-2 wages paid in the trade or business or 25% of W-2 wages plus 2.5% of the unadjusted basis immediately after acquisition of qualified property. *Id.* For 2020 taxpayers with taxable income below the \$163,300/\$326,000 threshold amount, the W-2 wage/depreciable property limitation will not apply. For taxpayers earning at or over the threshold amount, the application of the wage/depreciable property limitation is phased in, and it applies in full if the taxpayer earns \$213,300 or more (\$426,600 for joint filers). *Id.* § 199A(b)(3).

³⁸ *See Repetti, supra* note 15, at 694-95.

³⁹ *See id.* at 695.

⁴⁰ I.R.C. § 199A(a)-(c).

⁴¹ *Id.* § 199A(c)(1).

business of the taxpayer and are includible in taxable income for the tax year.⁴² In general, the higher the QBI, the better for the taxpayer.⁴³

The statute excludes from QBI the amount of “reasonable compensation paid to the taxpayer by any qualified trade or business of the taxpayer for services rendered with respect to the trade or business.”⁴⁴ Because high QBI maximizes the § 199A deduction, a reduction in QBI due to the “reasonable compensation” exclusion would limit the available deduction. The “reasonable compensation” language draws on terminology found in the tax law governing S corporations, which suggests that, at a minimum, compensation-like payments made to a taxpayer from a qualified trade or business conducted through an S corporation in which that taxpayer is a shareholder will not count as part of QBI in computing the deduction.⁴⁵ However, ambiguous statutory language left open the question of whether the reasonable-compensation limitation applied to independent contractors and partners as well. If the limitation applied, independent contractors filing as sole proprietors could have faced the risk that all their payments from the “trade or business” of offering their services would be treated as their reasonable compensation, leaving nothing to count as QBI and eliminating the § 199A deduction. The U.S. Department of the Treasury (“Treasury”) answered this question in the final regulations, concluding that the reasonable-compensation limitation applies only to S-corporation shareholders.⁴⁶ Accordingly, this guardrail should not limit independent contractors’ access to the § 199A deduction.

B. *The Logic and Limits of the Claimed Workplace Shift*

A frequent criticism in the immediate aftermath of the legislation’s enactment was that new § 199A created a significant incentive for workers to give up employee protections and become independent contractors.⁴⁷ In an article critiquing the new legislation, a group of thirteen law professors wrote:

⁴² *Id.* § 199A(c)(3)(A).

⁴³ More granularly, the statute provides for the deduction of the lesser of “combined qualified business income” of the taxpayer or 20% of taxable income other than net capital gain income plus 20% of qualified cooperative dividends of the taxpayer. *Id.* § 199A(a). “Combined qualified business income” is 20% of the taxpayer’s QBI for each of her qualified trades or businesses, subject to another limitation based on W-2 wages. *Id.* § 199A(b); see Treas. Reg. § 1.199A-2(c)(1)(iv), (d)(2) (2019) (antistuffing rule).

⁴⁴ I.R.C. § 199A(c)(4). Related carveouts exist for § 707(c) guaranteed payments, which are paid to partners “for services rendered with respect to the trade or business,” and for certain payments to partners by partnerships for services rendered with respect to the trade or business, to the extent provided for by regulations. *Id.* § 199A(c)(4)(A)-(B).

⁴⁵ H.R. REP. NO. 115-466, at 215 (2017) (Conf. Rep.).

⁴⁶ Treas. Reg. § 1.199A-3(b)(2)(ii)(H).

⁴⁷ See, e.g., Russell A. Hollrah & Patrick A. Hollrah, *New Passthrough Deduction Creates Tax Benefit for Self-Employed*, 158 TAX NOTES 1051, 1051 (2018) (noting that new § 199A “helps eliminate the financial consequences of this disparate [payroll tax] treatment” between

[The pass-through deduction] potentially remains good news for anyone who can quit their job and become either an independent contractor (and so be considered a sole proprietor) or a partner in a firm. The game is clear: do not be John Doe, employee. Be John Doe, independent contractor or partner in an LLC, receiving a profit share rather than wages.⁴⁸

As the article states, the risk is further heightened by the ongoing difficulty the Internal Revenue Service (“IRS”) has experienced in policing the line between employee and independent contractor even in the absence of such an explicit tax carrot.⁴⁹ The article’s authors individually repeated these concerns both in testimony before the Senate Committee on Finance in April 2018⁵⁰ and

independent contractors and employees); Velarde, *supra* note 22, at 1188; Batchelder & Kamin, *supra* note 4, at A18; Narendra Acharya & Jordan Faykus, *New Tax Law Could Incentivize Employees to Become Independent Contractors—Employers Should Proceed with Caution*, COMPENSATION CONNECTION (Jan. 23, 2018), <http://www.thecomensationconnection.com/2018/01/23/new-tax-law-could-incentivize-employees-to-become-independent-contractors-employers-should-proceed-with-caution/> [https://perma.cc/665P-8JGP].

⁴⁸ Kamin et al., *supra* note 4, at 1463.

⁴⁹ “The bottom line is that these techniques will cover a wide swath of relatively high-income taxpayers who were previously employees. Employers already have some incentive to characterize workers as independent contractor[s], and the IRS has faced serious challenges enforcing the tax distinction between the two. This pressure will greatly increase with the added tax gaming incentives created by the new pass-through deduction. Moreover, for those employees who cannot easily recharacterize themselves as independent contractors, similar tax benefits can be achieved through the employees becoming partners in the relevant business.”

Id. at 1464 (footnote omitted).

⁵⁰ “If someone is an independent contractor, for instance, that person apparently gets the deduction, based on guidance so far. This is true even if the person were doing similar work as an employee—just without employee benefits and somewhat less supervision, for instance (some of the criteria that differentiate employees from independent contractors). There is no good reason to preference independent contractor status—but that is the result of this provision. And it sets up a complicated trade-off for workers to assess: weighing the now larger tax savings from being an independent contractor to the detriments of leaving behind employee benefits.”

Early Impressions of the New Tax Law: Hearing Before the S. Comm. on Fin., 115th Cong. 66-67 (2018) (statement of David Kamin, Professor of Law, New York University School of Law) (footnote omitted).

in a national op-ed.⁵¹ These types of concerns were echoed elsewhere in the popular press.⁵²

Thus, as expressed by these commentators and others, the concerns are that (1) workers may give up employee status (i.e., quit their jobs) and choose independent contractor jobs or (2) workers may attempt to reclassify employee positions (or be reclassified in those positions) as independent contractor positions, giving up benefits and protections.⁵³ While there is some reference to preexisting employer-side incentives to characterize workers as independent contractors, much of the concern being expressed centers on the effects of § 199A on *worker incentives* to either switch jobs or reclassify.

This focus makes apparent sense given that the worker takes the deduction, not the hiring firm, but it is incomplete in several key ways. The worker-incentive focus does not answer the empirical question of where the incidence of this new deduction will fall. Nor does it contain a nuanced account of how hiring firms might negotiate and bargain with workers in reconfiguring work arrangements. The question of whether workers or hiring firms will ultimately capture the benefit of the deduction is an important empirical question that must inform our normative evaluation of the new statute and its impact on the workforce.⁵⁴

Additionally, attention to § 199A's worker incentives ignores the power of other tax law changes to potentially affect work choices and arrangements. As discussed below, these include raising the standard deduction and repealing the individual mandate of the Patient Protection and Affordable Care Act's ("ACA").⁵⁵ Finally, overly focusing on § 199A fails to take into account the economic backdrop against which the tax law changes are occurring. Two contemporary trends—the increase in offshoring jobs to lower-cost locations and the rise of job-displacing automation—along with other legal and economic

⁵¹ "The new deduction could have profound effects on the American workplace over time. It essentially requires employees—most workers—to choose between benefits such as employer-based healthcare and the deduction. By creating a strong incentive for employees to give up these benefits and become independent contractors, it could further erode job, health and retirement security."

Batchelder & Kamin, *supra* note 4, at A18; see David Kamin, *Uncertainty, Perverse Incentives, and More*, MEDIUM (Jan. 11, 2018), <https://medium.com/whatever-source-derived/uncertainty-perverse-incentives-and-more-a7af2d143a70> [<https://perma.cc/H8AR-G9YP>].

⁵² See Cohen, *supra* note 22, at A1; Scheiber, *supra* note 22, at B1 ("The new tax law is likely to accelerate a hotly disputed trend in the American economy by rewarding workers who sever formal relationships with their employers and become contractors."); Acharya & Faykus, *supra* note 47.

⁵³ See *supra* note 23 and accompanying text.

⁵⁴ Some attention is also directed to higher-income taxpayers who are sophisticated tax planners and may play games with their classification in order to take advantage of the deduction. See *infra* Section IV.A.2.

⁵⁵ See *infra* Part III.

factors might either limit or exacerbate a workplace shift. Ultimately, § 199A is only one aspect of the 2017 tax law changes that might affect work arrangements, and tax law is only one aspect of the broader legal and economic environment that is shaping work.

The remainder of this Article explains the trade-offs between tax and labor considerations at stake in deciding how to structure work, broadens the inquiry by assessing the tax and other legal and economic factors that might limit or exacerbate workplace shifts, and articulates a normative framework for evaluating any shifts that might occur.

II. THE WORKER CLASSIFICATION TRADE-OFF

Will the new tax law prompt a shift toward independent contractor work? And if the predicted shift occurs, should it be regarded as problematic? To answer these questions, we first explain why worker classification matters for labor law, employment law, and tax purposes; how each field decides to classify workers; and what factors firms and workers consider in making decisions about workplace structures and worker classification. Parts III and IV of this Article will then explore the extent to which an independent contractor shift is likely to occur as a result of the intersection of tax law (including § 199A), nontax legal regimes, and economic factors and how such a shift ought to be evaluated in light of real-world data and contemporary trends.

A. *Why Classification Matters*

U.S. law generally groups workers into two categories—employee and independent contractor. It does so despite the fact that real-world work arrangements exist on a spectrum, with classic controlled-employee arrangements at one end and self-directed independent entrepreneurs at the other. The binary classification system of U.S. law demands that all real-life variations be placed into one of two legal boxes, thus shaping and distorting workplace arrangements.⁵⁶ One cannot just pick a classification; one also has to ensure that the work arrangement meets the legal tests supporting that classification. Parties might therefore incur costs to structure work arrangements

⁵⁶ The literature on the subject is voluminous. *See generally, e.g.*, Marc Linder, *Dependent and Independent Contractors in Recent U.S. Labor Law: An Ambiguous Dichotomy Rooted in Simulated Statutory Purposelessness*, 21 COMP. LAB. L. & POL'Y J. 187 (1999); Mitchell H. Rubinstein, *Employees, Employers, and Quasi-Employers: An Analysis of Employees and Employers Who Operate in the Borderland Between an Employer-and-Employee Relationship*, 14 U. PA. J. BUS. L. 605 (2012); Robert Sprague, *Worker (Mis)Classification in the Sharing Economy: Trying to Fit Square Pegs into Round Holes*, 31 A.B.A. J. LAB. & EMP. L. 53 (2015); Jenna Amato Moran, Note, *Independent Contractor or Employee? Misclassification of Workers and Its Effect on the State*, 28 BUFF. PUB. INT. L.J. 105 (2010).

to fit within a certain box and to reduce the risk of being penalized and reclassified into the other box.⁵⁷

So, why would workers and those hiring them prefer one box to another? Many legal regimes allocate rights, burdens, benefits, and responsibilities differently depending on whether workers are employees or independent contractors. Most pertinently, labor and employment law protections under the National Labor Relations Act (“NLRA”) and Fair Labor Standards Act (“FLSA”) are tied to worker classification.⁵⁸ However, worker classification matters in other legal areas as well (such as tax law, tort law, civil rights law, and the Employee Retirement Income Security Act (“ERISA”)).⁵⁹ The effects of worker classification are borne most directly by workers and those hiring them. But more broadly, society may also bear some externalized impacts of worker classification trends and may thus have an indirect interest in classification outcomes.⁶⁰

The following discussion highlights some of the main reasons worker classification matters, with particular emphasis on the less noticed tax and tax-related reasons it is significant.

1. Labor, Employment, and Other Legal Protections

Employee classification grants workers a number of crucial rights under federal law, perhaps the most important of which are labor and employment protections developed in the New Deal era. For labor law purposes, the right to collectively bargain under the NLRA belongs only to those classified as employees.⁶¹ Workers deemed to be independent contractors receive no such NLRA protections. Provisions of the FLSA establish overtime pay laws and minimum wage laws that apply to employees⁶² but not to independent

⁵⁷ See David Bauer, *The Misclassification of Independent Contractors: The Fifty-Four Billion Dollar Problem*, 12 RUTGERS J.L. & PUB. POL’Y 138, 141 (2015).

⁵⁸ See Shu-Yi Oei, *The Trouble with Gig Talk: Choice of Narrative and the Worker Classification Fights*, 81 LAW & CONTEMP. PROBS., no. 3, 2018, at 107, 120-21 (describing benefits available to employees under NLRA and FLSA).

⁵⁹ See Agnieszka A. McPeak, *Regulating Ridesharing Platforms Through Tort Law*, 39 U. HAW. L. REV. 357, 376-80 (2017) (exploring differences in tort liability between employees and independent contractors); Shu-Yi Oei & Diane M. Ring, *Tax Issues in the Sharing Economy: Implications for Workers*, in THE CAMBRIDGE HANDBOOK OF THE LAW OF THE SHARING ECONOMY 343, 345-46 (Nestor M. Davidson, Michèle Finck & John J. Infranca eds., 2018) (detailing tax implications of worker classification).

⁶⁰ See generally *Exploring the “Gig Economy” and the Future of Retirement Savings: Hearing Before the Subcomm. on Primary Health and Ret. Sec. of the S. Comm. on Health, Educ., Labor & Pensions*, 115th Cong. (2018) (studying impact of nonstandard work arrangements on retirement security and healthcare).

⁶¹ 29 U.S.C. §§ 152, 157 (2018) (defining “employee” to exclude “independent contractors” and granting employees right to collectively bargain).

⁶² *Id.* §§ 206-207 (establishing minimum-wage and maximum-hours laws for employees).

contractors.⁶³ Other federal laws guarantee unpaid leave and establish health-and-safety regulations for employees.⁶⁴ Employees also benefit from enhanced antidiscrimination protections⁶⁵ and retirement, disability, and medical benefits not comparable to those available to independent contractors.⁶⁶ In addition to federal-level protections, there are comparable provisions benefitting workers classified as employees at the state level.⁶⁷

However, the actual protective value of these multiple worker protections may be limited either through statutory parameters (e.g., the degree to which the NLRA does not offer protections to managers), through emerging legal trends (e.g., forced arbitration of worker claims), or through new forms of employment contracts (e.g., zero-hour or zero-benefits contracts). Still, given the scope of these protections and benefits, the definition of covered employees in these legal regimes carries tremendous weight. Securing employee status can be immensely attractive, particularly for workers who lack other means of self-protecting or insuring. From the perspective of hiring firms, on the other hand, employee status for workers is likely to impose greater costs than independent contractor status would.⁶⁸ For example, workers classified as employees must be paid

⁶³ See *id.* § 203 (defining “employee” for purposes of FLSA).

⁶⁴ E.g., Occupational Safety and Health Act of 1970, 29 U.S.C. §§ 651-678 (2018) (focusing on reduction of safety and health hazards at place of work); Family and Medical Leave Act of 1993, 29 U.S.C. § 2601 (2018) (entitling employees to “reasonable leave for medical reasons, for the birth or adoption of a child, and for the care of a child, spouse, or parent who has a serious health condition”); see Oei, *supra* note 58, at 120 (discussing federal protections for employees).

⁶⁵ See Civil Rights Act of 1964, Pub. L. No. 88-352, §§ 601-605, 78 Stat. 241, 252-53 (codified as amended in scattered sections of 42 U.S.C.). Protection under this Act does not extend to independent contractors. *Murray v. Principal Fin. Grp., Inc.*, 613 F.3d 943, 944 (9th Cir. 2010) (observing that Title VII protections cover employees but not independent contractors).

⁶⁶ E.g., Age Discrimination in Employment Act of 1967, 29 U.S.C. §§ 621-634 (2018) (prohibiting “arbitrary age discrimination in employment”); Americans with Disabilities Act of 1990, 42 U.S.C. §§ 12101-12213 (2018) (prohibiting discrimination on basis of disability); Civil Rights Act of 1964, Pub. L. No. 88-352, 78 Stat. at 252-53 (codified as amended in scattered sections of 42 U.S.C.) (prohibiting discrimination against employees on basis of sex, race, color, national origin, or religion).

⁶⁷ See, e.g., CAL. LAB. CODE § 226 (West 2019) (obligating employers to provide itemized statements to employees); *id.* § 351 (prohibiting employers from taking employee tips); *id.* § 2806 (obligating employers to reimburse employee mileage costs); *State Minimum Wage Laws*, U.S. DEP’T OF LABOR, <https://www.dol.gov/whd/minwage/america.htm#stateDetails> [https://perma.cc/ALT9-9DB7] (last updated Jan. 1, 2020) (listing each state’s minimum wage and its relationship to federal wage laws).

⁶⁸ See Press Release, U.S. Bureau of Labor Statistics, Employer Costs for Employee Compensation—September 2019 (Dec. 18, 2019), <https://www.bls.gov/news.release/pdf/ecec.pdf> [https://perma.cc/Z22X-AVG3] (finding that wages and salaries accounted for

minimum wage and overtime.⁶⁹ Collective bargaining may drive up wages and other costs, driving down profit margins.⁷⁰

The effects of worker classification on hiring firms and workers will partially depend on market dynamics and relative bargaining power.⁷¹ If labor supply is relatively elastic or qualified labor is in short supply, workers classified as independent contractors may be able to extract value from those hiring them, such that any loss of direct protections due to their nonemployee status are compensated for or are rendered less significant.⁷² For example, highly trained experts in certain fields may be well remunerated despite being independent contractors.⁷³ On the flip side, if workers are not in a position to effectively negotiate for increased compensation or benefits, loss of employee classification may be devastating.

2. Tax Consequences

Alongside the big-ticket labor and employment law regimes, tax law has exerted a relatively unnoticed parallel influence on worker classification choices. The primary tax implications of worker status aside from § 199A are (1) who bears unemployment and payroll (Social Security and Medicare) taxes,⁷⁴ (2) how wage withholding or information reporting are performed and

approximately 68.7% of employee compensation and that benefit costs accounted for remaining 31.3%).

⁶⁹ 29 U.S.C. §§ 201-219.

⁷⁰ See LAWRENCE MISHEL & MATTHEW WALTERS, ECON. POLICY INST., *HOW UNIONS HELP ALL WORKERS* 2 (2003), <https://www.epi.org/files/page/-/old/briefingpapers/143/bp143.pdf> [<https://perma.cc/6U6P-MHV5>] (arguing that unions raise wages by approximately 20% and compensation, including both wages and benefits, by approximately 28%).

⁷¹ See Paula B. Voos & Lawrence R. Mishel, *The Union Impact on Profits: Evidence from Industry Price-Cost Margin Data*, 4 J. LAB. ECON. 105, 106 (1986) (building upon prior studies showing that unions reduce profits); Verne Kopytoff, *How Amazon Crushed the Union Movement*, TIME (Jan. 16, 2014), <https://time.com/956/how-amazon-crushed-the-union-movement/> [<https://perma.cc/SG2Z-5QTX>] (noting relationship between Amazon's efforts to stop unionization and labor costs' impact on profit margins).

⁷² See, e.g., Robert McClelland & Shannon Mok, *A Review of Recent Research on Labor Supply Elasticities* (Cong. Budget Office, Working Paper No. 2012-12, 2012), https://www.cbo.gov/sites/default/files/cbofiles/attachments/10-25-2012-Recent_Research_on_Labor_Supply_Elasticities.pdf [<https://perma.cc/DR4J-UE7X>].

⁷³ See U.S. DEP'T OF THE TREASURY OFFICE OF ECON. POLICY, COUNCIL OF ECON. ADVISORS & U.S. DEP'T OF LABOR, OCCUPATIONAL LICENSING: A FRAMEWORK FOR POLICYMAKERS 12, 62 (2015), https://obamawhitehouse.archives.gov/sites/default/files/docs/licensing_report_final_nonembargo.pdf [<https://perma.cc/RGX9-C56N>] (“Licensed practitioners . . . might earn more than they would in an unlicensed market . . .”).

⁷⁴ See Federal Insurance Contribution Act of 1935, I.R.C. §§ 3101-3128 (2018) (establishing payroll tax obligations on employees and employers); Federal Unemployment Tax Act, *id.* §§ 3301-3311 (establishing unemployment tax obligations on employers).

whether estimated tax payments must be made,⁷⁵ (3) whether the worker is entitled to deductions for expenses she incurs in the performance of the work, and (4) what types of fringe benefits can be taken by the worker tax free.⁷⁶ With the introduction of § 199A, classification of a worker now plays a gatekeeping role in determining whether that worker is potentially eligible for the § 199A deduction. Finally, worker classification matters with respect to healthcare and retirement benefits—social insurance benefits that are delivered through the Tax Code.

a. *Social Security and Unemployment Taxes*

Federal tax law imposes a Social Security tax totaling 12.4% on worker wages up to \$137,700 for 2020 and a 2.9% Medicare tax with no salary cap, regardless of whether the worker is classified as an employee or an independent contractor.⁷⁷ For employees, these taxes are collectively known as Federal Insurance Contributions Act (“FICA”) taxes. For independent contractors, they are known as Self-Employment Contributions Act (“SECA”) taxes. Together, these taxes fund Social Security and Medicare. However, they are paid to the federal government differently depending on how the worker is classified.

Employers withhold half the Social Security tax (totaling 6.2%) from employees’ wages and pay it over to the IRS; the other half (6.2%) is an employer portion paid by the employer.⁷⁸ Similarly, employers withhold half the Medicare tax (totaling 1.45%) from employees’ wages and pay it over to the IRS; the other half (1.45%) is owed and paid by the employer.⁷⁹ Thus, for workers classified as employees, half the amount of payroll taxes is nominally imposed on the employer, who also handles all of the administrative reporting and payment obligations for both the employer portion and the employee portion. By contrast, for independent contractors the same total Social Security tax of 12.4% is due on self-employment income, but all of the tax is owed and

⁷⁵ See I.R.C. §§ 3401, 3402, 3501, 6041, 6050W; INTERNAL REVENUE SERV., EMPLOYER’S TAX GUIDE 21-25 (2019), <https://www.irs.gov/pub/irs-pdf/p15.pdf> [<https://perma.cc/M5TP-K6QD>] (discussing employer withholding obligations on employee wages).

⁷⁶ I.R.C. §§ 62, 67, 132.

⁷⁷ *Id.* § 3111(a); Press Release, U.S. Soc. Sec. Admin., Fact Sheet: 2020 Social Security Changes 1 (2020), <https://www.ssa.gov/news/press/factsheets/colafacts2020.pdf> [<https://perma.cc/5FWR-N3HU>]. A Medicare surtax is imposed on workers whose wages or self-employment income exceeds a certain threshold. *What Is the Additional Medicare Tax?*, INTERNAL REVENUE SERV. (Mar. 9, 2017), <https://www.irs.gov/newsroom/what-is-the-additional-medicare-tax> [<https://perma.cc/WXR4-WR43>].

⁷⁸ See sources cited *supra* note 77.

⁷⁹ INTERNAL REVENUE SERV., *supra* note 75, at 24. The incidence of the tax may not match legal liability.

paid by the worker.⁸⁰ Moreover, the independent contractor also bears the responsibility for reporting and paying the entire 2.9% Medicare tax to the IRS.⁸¹

Another difference between employees and independent contractors is that those who hire employees are responsible for the Federal Unemployment Tax Act ("FUTA") tax,⁸² a payroll tax equal to 6% of the first \$7000 of wages.⁸³ The unemployment insurance system is a unified federal-state system and unemployment taxes are paid at the state and federal levels.⁸⁴ Employers can claim a credit of up to 5.4% against their federal FUTA tax liability for amounts paid to state unemployment funds ("SUTA" taxes), thereby reducing their net federal FUTA tax to 0.6%.⁸⁵ The actual unemployment insurance regimes are administered at the state level under federal guidelines, and the federal taxes collected fund federal oversight of state programs as well as loans needed by states to cover insurance payouts.⁸⁶

Unlike employees, independent contractors are not generally covered by unemployment programs and do not have to pay FUTA taxes.⁸⁷ Correspondingly, they cannot claim unemployment benefits.

b. *Withholding, Information Reporting, and Estimated Taxes*

How wages and income are reported and income tax paid over to the IRS also differs for employees and independent contractors. Employers withhold state and federal income taxes and Social Security taxes from amounts paid to employees and transmit these amounts to the government.⁸⁸ Employers then

⁸⁰ I.R.C. § 1401(a); Press Release, U.S. Soc. Sec. Admin., *supra* note 77, at 1; *see* Kathleen DeLaney Thomas, *Taxing the Gig Economy*, 166 U. PA. L. REV. 1415, 1422-25 (2018) (noting onerous compliance obligations on independent contractors).

⁸¹ I.R.C. § 1401(b).

⁸² *Id.* §§ 3301-3311 (imposing tax on employers).

⁸³ *Id.* § 3301.

⁸⁴ *See generally* Peter J. Allman, *Withholding, Social Security and Unemployment Taxes on Compensation*, Tax Mgmt. Portfolio (BNA) No. 392-6th, at 38-39 (2018) (providing overview of FUTA taxes).

⁸⁵ *See, e.g.*, I.R.S. Info. Ltr. 2014-0022 (June 6, 2014) (explaining federal-state unemployment-compensation regime).

⁸⁶ *FUTA Credit Reduction*, INTERNAL REVENUE SERV., <https://www.irs.gov/businesses/small-businesses-self-employed/futa-credit-reduction> [<https://perma.cc/M7SR-3HFL>] (last updated Jan. 16, 2020) (explaining credit reduction state and its impact on employment taxes).

⁸⁷ Myra H. Barron, *Who's an Independent Contractor? Who's an Employee?*, 14 LAB. LAW. 457, 457 (1999). States use their own classification tests. *See, e.g.*, *UI and Independent Contractors*, N.Y. ST. DEP'T OF LAB., <https://www.labor.ny.gov/ui/claimantinfo/ui%20and%20independent%20contractors.shtm> [<https://perma.cc/8YJZ-2YUM>] (last visited Feb. 25, 2020) (outlining New York's test for determining worker status).

⁸⁸ I.R.C. §§ 3401, 3402, 3501.

report such amounts to both the IRS and the worker on a Form W-2.⁸⁹ Payments to independent contractors, by contrast, are not subject to withholding by payors. Instead, independent contractors generally receive a Form 1099 from the payor, which simply reports amounts paid, and the payor also sends a copy to the IRS (so-called “information reporting”).⁹⁰ Because there is no withholding on income as it is earned, the independent contractor is responsible for paying all taxes owed and for making quarterly estimated tax payments.⁹¹ The estimated tax obligation is not only for income tax but also for self-employment taxes (Social Security and Medicare) and the alternative minimum tax. Failure to pay the required quarterly estimated taxes over the course of the year can result in taxpayer penalties.⁹²

c. *Expense Recovery and Income Inclusion*

How a worker is classified also impacts her ability to deduct the expenses she incurs in performing the work. Prior to the 2017 tax reform, employees who incurred unreimbursed expenses in performing employment duties were theoretically permitted to deduct those employee expenses.⁹³ However, these and certain other costs (together called “miscellaneous itemized deductions”) were deductible only to the extent that they exceeded 2% of the taxpayer’s adjusted gross income.⁹⁴ This 2% floor meant that the deduction was realistically only available for taxpayers with high expenses relative to income. By contrast, workers classified as independent contractors were able to deduct their ordinary

⁸⁹ See INTERNAL REVENUE SERV., FORM W-2 WAGE AND TAX STATEMENT, <https://www.irs.gov/pub/irs-pdf/fw2.pdf> [<https://perma.cc/86MV-QTGP>] (last visited Feb. 25, 2020).

⁹⁰ See I.R.C. §§ 6041, 6050W, 6654(c) and accompanying regulations. For tax literature on information reporting, see generally Leandra Lederman, Essay, *Reducing Information Gaps to Reduce the Tax Gap: When Is Information Reporting Warranted?*, 78 FORDHAM L. REV. 1733 (2010) (discussing information reporting laws and proposals); Leandra Lederman, *Statutory Speed Bumps: The Roles Third Parties Play in Tax Compliance*, 60 STAN. L. REV. 695 (2007) (arguing that federal income tax law can foster compliance using third-party structural incentives); Manoj Viswanathan, *Tax Compliance in a Decentralizing Economy*, 34 GA. ST. U. L. REV. 283 (2018) (discussing challenges to income reporting).

⁹¹ I.R.C. § 6654 (requiring payment of taxes in quarterly installments). See generally INTERNAL REVENUE SERV., TAX WITHHOLDING AND ESTIMATED TAX (2019), <https://www.irs.gov/pub/irs-pdf/p505.pdf> [<https://perma.cc/CY4B-ZCUV>] (discussing payment of estimated tax); Alan J. Tarr, *Estimated Tax*, Tax Mgmt. Portfolio (BNA) No. 581-3rd (2019) (discussing estimated taxes, obligations to pay, and penalties for failure to make payments); *Estimated Taxes*, INTERNAL REVENUE SERV., <https://www.irs.gov/businesses/small-businesses-self-employed/estimated-taxes> [<https://perma.cc/E4NZ-UM6W>] (last updated Jan. 16, 2020).

⁹² I.R.C. § 6654 (setting forth penalties for failure to pay estimated income tax).

⁹³ *Id.* § 162.

⁹⁴ *Id.* §§ 62, 67.

and necessary business expenses—commonly referred to as “above the line” deductions—without limitation on IRS Form 1040, Schedule C.⁹⁵ For workers classified as independent contractors who incur significant work-related costs (for example, Uber drivers who use their own cars), the ability to deduct these costs could dramatically reduce their effective tax rates.

The 2017 tax legislation suspended miscellaneous itemized deductions (including the deduction for employee expenses) starting in 2018 and effective for taxable years beginning before January 1, 2026. That is, rather than simply limiting employee business deductions, the tax reform completely bars any such deductions through 2025.⁹⁶ This is potentially significant for employees with high business expenses. Independent contractors continue to be able to deduct their trade or business expenses in full. Thus, § 199A aside, the 2017 tax reform also widened the gap between employees and independent contractors in terms of business-expense recovery.

d. *Fringe Benefits and Other Exclusions from Income*

Worker classification also affects the availability of exclusions from income. Building on a tradition of common law, industry practice, and IRS rulings, a number of tax statutes permit employees to exclude from income certain benefits received from their employers. Examples include employee discounts, de minimis fringe benefits, on-site gyms, and parking.⁹⁷ Independent contractors, by contrast, can receive many but not all of these types of benefits tax free. For example, under tax regulations, any individual receiving a de minimis fringe benefit (excludable under § 132(a)(4)) is deemed an employee for purposes of excluding that benefit, thus making the exclusion available to independent contractors as well as employees.⁹⁸ By contrast, independent contractors performing services for a business may not exclude the value of parking or of the use of consumer goods provided under a testing program.⁹⁹ While employees

⁹⁵ *Id.* § 162.

⁹⁶ *Id.* § 67(g); see Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11045, 131 Stat. 2054, 2088 (2017) (codified at I.R.C. § 67) (suspending itemized deductions under § 67 of Tax Code).

⁹⁷ I.R.C. § 132 (identifying employer-provided amenities that do not factor into employee's taxable gross income).

⁹⁸ Treas. Reg. § 1.132-1(b)(4) (2019) (“For purposes of section 132(a)(4) (relating to de minimis fringes), the term ‘employee’ means any recipient of a fringe benefit.”); INTERNAL REVENUE SERV., FRINGE BENEFIT GUIDE 14 (2014), <https://www.irs.gov/pub/irs-pdf/p5137.pdf> [<https://perma.cc/3F4S-C7DW>] (providing same definition of “employee” for purposes of fringe benefits).

⁹⁹ Treas. Reg. § 1.132-1(b)(2); William E. Elwood & Cynthia A. Moore, *Employee Fringe Benefits*, Tax Mgmt. Portfolio (BNA) No. 394-5th, at 150 (2018) (“[T]he regulations specifically deny independent contractors the special exclusion under § 132(a)(3) with respect to working condition parking benefits and the use of goods or for qualified consumer product testing.”).

can generally receive more fringe benefits tax free, independent contractors are nonetheless eligible for a notable number of these benefits.¹⁰⁰ Thus, the treatment of fringe benefits provides less tilt in favor of one category over the other than differences in business-expense deductibility.

e. *Section 199A*

Then, of course, there is § 199A. As a threshold matter, the new provision is only available to taxpayers who operate as independent contractors. Employees are barred from the deduction. While some independent contractors may be limited in their ability to take the deduction as a result of factors such as their line of business or income level, those classified as employees are denied the deduction outright. As discussed in Section I.B, it is for this reason that commentators have expressed concern that § 199A will create a significant shift toward independent contractor work.¹⁰¹

3. Tax-Delivered Social Welfare Benefits

A third category of tax-related consequences that hinges on how a worker is classified is social welfare benefits delivered through the Tax Code, sometimes referred to as tax expenditures.

a. *Healthcare Incentives*

Healthcare benefits delivered through the Tax Code are another way in which worker classification differences may matter, though the picture is muddy. Here, two topics are important: (1) benefits predating the 2010 ACA and (2) the changes that occurred upon enactment of the ACA.¹⁰²

¹⁰⁰ See Kurt L.P. Lawson, *Tax Status: Employee vs. Independent Contractor and Employee vs. Partner*, 62 WM. & MARY ANN. TAX. CONF., 2016, tab 15, at 8-10 (discussing fringe benefits for nonemployees).

¹⁰¹ Even prior to § 199A, the shift from employee to independent contractor could impact a worker's ability to secure the earned income tax credit ("EITC") or the size of that credit. I.R.C. § 32. The EITC is available to individuals based on their "earned income," whether wages or net self-employment income, assuming other requirements are met and that earned income and adjusted gross income ("AGI") thresholds are not exceeded. If the shift to independent contractor results in higher pay from the firm (and higher earned income) and/or an increased ability to deduct work-related expenses, the available EITC could either increase or decrease depending on the facts. New § 199A is taken below the line, and thus this deduction does not impact the two key calculations of earned income and AGI. See *id.* § 62(a). However, shifts in classifications resulting from § 199A might have the impacts described above (including increased pay and/or increased availability of work-related business deductions).

¹⁰² See generally *id.* § 4980H (describing payment due from certain employers not providing employee health coverage); Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended at 42 U.S.C. §§ 18001-18122 (2018)).

Even before the ACA, the Tax Code provided slightly different incentives for the provision of health insurance to employees than for independent contractors. Employers may take a tax deduction for the portion of employee health insurance premiums that they pay.¹⁰³ Employees may exclude the value of these employer-paid insurance premiums from income¹⁰⁴ and may exclude the receipt of medical benefits under their plans as well.¹⁰⁵ Additionally, the value of this benefit is excluded from the wage tax base for purposes of Social Security and Medicare taxes and from the employer's FUTA tax base.¹⁰⁶

Self-employed individuals (sole proprietors, qualified S-corporation shareholders, and partners) can deduct the health insurance premiums they pay for themselves, their spouses, and their covered dependents from gross income.¹⁰⁷ They can also exclude the receipt of medical benefits under their plans.¹⁰⁸ However, by contrast to employees, these health insurance premiums are not deductible in calculating the self-employment tax base (upon which Social Security and Medicare taxes are computed).¹⁰⁹

Thus, while there may have been some advantage to being classified as an employee with respect to healthcare incentives, independent contractors traditionally benefited from some tax-based healthcare incentives as well. The commonly held view that health insurance is a valuable benefit of employee status¹¹⁰ likely reflects employees' ability to obtain better and less-expensive

¹⁰³ I.R.C. § 162; Treas. Reg. § 1.162-10(a) (providing for deduction of such expenses).

¹⁰⁴ I.R.C. § 106.

¹⁰⁵ *Id.* § 105(b).

¹⁰⁶ INTERNAL REVENUE SERV., EMPLOYER'S TAX GUIDE TO FRINGE BENEFITS 6 (2019), <https://www.irs.gov/pub/irs-pdf/p15b.pdf> [<https://perma.cc/42FM-Q7QZ>] (displaying wage tax basis); *Employee Benefits: Fringe Benefits*, INTERNAL REVENUE SERV., <https://www.irs.gov/businesses/small-businesses-self-employed/employee-benefits> [<https://perma.cc/6ZV8-T3GW>] (last updated Jan. 16, 2020) (stating rules for calculating wage tax base).

¹⁰⁷ I.R.C. § 162(l); David Gamage, *Perverse Incentives Arising from the Tax Provisions of Healthcare Reform: Why Further Reforms Are Needed to Prevent Avoidable Costs to Low- and Moderate-Income Workers*, 65 TAX L. REV. 669, 681-83 (2012) (noting limitations on deductibility for self-employed taxpayers).

¹⁰⁸ I.R.C. § 104(a)(3).

¹⁰⁹ *Id.* § 162(l)(4).

¹¹⁰ See Paul Fronstin & Lisa Greenwald, *Value of Workplace Benefits: Findings from the 2016 Health and Voluntary Workplace Benefits Survey*, EBRI NOTES, Apr. 2017, at 2, 4 fig.2 (2017) (reporting that in survey of 1500 workers, health insurance was listed as most important employee benefit, with 64% ranking it as "extremely important" and 23% listing it as "very important"); Kerry Jones, *The Most Desirable Employee Benefits*, HARV. BUS. REV. (Feb. 15, 2017), <https://hbr.org/2017/02/the-most-desirable-employee-benefits> (listing health insurance as most highly prized employee benefit).

healthcare coverage through an employer's group plan than they could on their own.¹¹¹

The ACA's enactment in 2010 modified the landscape. The ACA required employers with fifty or more full-time employees to provide a certain level of affordable health insurance coverage to employees and penalized nonconforming employers.¹¹² The ACA also established state health insurance marketplaces where individuals could purchase their own health insurance, and it required all individuals to have health insurance unless exempted (though this "individual mandate" was effectively repealed starting in 2019).¹¹³ The ACA also provided subsidies in the form of (1) premium tax credits to lower-income individuals to subsidize insurance premiums and (2) cost-sharing subsidies paid directly from the federal government to insurers to help reduce out-of-pocket medical expenses for lower-income households.¹¹⁴ Thus, lower-income workers (whether employees or independent contractors) obtaining their own insurance from an ACA marketplace might benefit from these subsidies.

It is possible that the desirability of employer-provided health insurance may have declined for some taxpayers who are eligible to receive ACA subsidies.¹¹⁵ As Professor David Gamage has argued, employer-provided health insurance may cause taxpayers to lose ACA subsidies and be worse off as a result, a dynamic that may distort work choices as well as employer decisions to provide health insurance.¹¹⁶ For our purposes, it should be noted that the availability of ACA marketplace insurance plans and subsidies may mean that being an employee in order to receive health insurance may have become less important for some workers. It remains to be seen whether the repeal of the individual

¹¹¹ Historically, employers were not required to provide health insurance but might have done so to attract or retain workers. *See, e.g., Jones, supra* note 110 (reporting survey data showing potential employees base their decisions of where to work in part on benefits plans offered). Health care benefits can help ensure a healthy (and productive) workforce. *See Workplace Health Promotion: Increase Productivity*, CTRS. FOR DISEASE CONTROL & PREVENTION, <https://www.cdc.gov/workplacehealthpromotion/model/control-costs/benefits/productivity.html> [<https://perma.cc/EQP5-FX8J>] (last updated Dec. 4, 2015).

¹¹² I.R.C. § 4980H; *Employer Shared Responsibility Provisions*, INTERNAL REVENUE SERV., <https://www.irs.gov/affordable-care-act/employers/employer-shared-responsibility-provisions> [<https://perma.cc/6QUW-ZYEC>] (last updated Feb. 18, 2020).

¹¹³ I.R.C. § 5000A(c). The December 2017 repeal of the ACA individual mandate became effective in 2019 and may have reduced the number of individuals without employer-provided healthcare who sought out their own coverage. *See id.* (requiring applicable individuals to maintain minimum coverage or face penalty); Tax Cuts and Jobs Act, Pub. L. No. 115-97, § 11081, 131 Stat. 2054, 2092 (2017) (codified at I.R.C. § 5000A(c)) (repealing individual mandate); *infra* note 117 (presenting and discussing early empirical data on repeal).

¹¹⁴ I.R.C. § 36B (detailing tax credits); 42 U.S.C. § 18071 (detailing cost sharing).

¹¹⁵ *See Gamage, supra* note 107, at 702.

¹¹⁶ *Id.* at 701-08.

mandate will cause ACA-marketplaces to unravel and will diminish ACA health insurance availability and, correspondingly, work choices and preferences.¹¹⁷

b. *Retirement Benefits*

Another benefit often associated with employee status is the ability to participate in the employer's retirement plan.¹¹⁸ Both independent contractors and employees can access tax-favored retirement-savings vehicles, such as those that allow tax-free contributions.¹¹⁹ However, employer-based plans can be more attractive on a number of fronts. First, contribution limits for nonemployer retirement vehicles are lower than for employer-based plans.¹²⁰ However, these

¹¹⁷ Recent Census Bureau data show a drop in the percentage of insured individuals in 2018, but that drop seems primarily driven by a drop in the percentage of individuals covered by Medicaid. EDWARD R. BERTCHICK, JESSICA C. BARNETT & RACHEL D. UPTON, U.S. CENSUS BUREAU, *HEALTH INSURANCE COVERAGE IN THE UNITED STATES: 2018*, at 4-5 (2019), <https://www.census.gov/content/dam/Census/library/publications/2019/demo/p60-267.pdf> [<https://perma.cc/RP6H-BHEE>]. The effects of the repeal of the individual mandate remain unclear. An early assessment suggests that the repeal, which took effect January 1, 2019, resulted in a 5% decline in enrollment in the first quarter of 2019. Rachel Fehr, Cynthia Cox & Larry Levitt, *Data Note: Changes in Enrollment in the Individual Health Insurance Market Through Early 2019*, KAISER FAM. FOUND. (Aug. 21, 2019), <https://www.kff.org/private-insurance/issue-brief/data-note-changes-in-enrollment-in-the-individual-health-insurance-market-through-early-2019/> [<https://perma.cc/9GU5-VCZP>]; Press Release, Kaiser Family Found., Enrollment in Individual Market Dips Slightly in Early 2019 After Repeal of Individual Mandate Penalty (Aug. 21, 2019), <https://www.kff.org/private-insurance/press-release/enrollment-in-individual-market-dips-slightly-in-early-2019-after-repeal-of-individual-mandate-penalty/> [<https://perma.cc/UP42-P5YP>].

¹¹⁸ See U.S. BUREAU OF LABOR STATISTICS, *NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN THE UNITED STATES, MARCH 2017*, at 188 tbl.1 (2017), <https://www.bls.gov/ncs/ebs/benefits/2017/ebbl0061.pdf> [<https://perma.cc/2CKU-RSVR>] (reporting that 48% of private sector employers offered retirement plans). The same survey found that 66% of private sector workers reported that their employer offered such plans. *Id.* at 191 tbl.2. The 2019 survey reported that 71% of all private industry and state and local government workers had access to retirement benefits. U.S. BUREAU OF LABOR STATISTICS, *NATIONAL COMPENSATION SURVEY: EMPLOYEE BENEFITS IN THE UNITED STATES, MARCH 2019*, at 3 tbl.2 (2019), <https://www.bls.gov/ncs/ebs/benefits/2019/employee-benefits-in-the-united-states-march-2019.pdf> [<https://perma.cc/YTV9-2228>].

¹¹⁹ Options include I.R.C. § 401(a) qualified plans, § 401(k) plans, § 403(b) plans for tax-exempt and public-educational organizations, and §§ 219(a) and 408(e) individual retirement accounts ("IRAs"). Employer-based retirement plans are governed not only by tax law but also by ERISA, which sets minimum parameters on the structure and operation of the plans and the conduct of plan fiduciaries. See generally Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (codified as amended in scattered sections of 29 U.S.C.).

¹²⁰ For example, the 2020 maximum contribution to a traditional IRA is \$57,000. I.R.S. Notice 2019-59, 2019-47 I.R.B. 1091. Contributions are deductible by the taxpayer, but the

higher limits in employer plans may be less relevant for lower-wage employees unlikely to reach the contribution caps.

Second, employer-based retirement plans may feature lower fees, loan options, and, perhaps most significantly, matching employer contributions.¹²¹ While employers are not generally required to provide retirement plans to employees, if they do establish such plans and want tax-advantaged treatment, they must satisfy a series of nondiscrimination, contribution, and participation tests¹²² which are intended to ensure that the plan is available to lower-wage employees and is adequately used by such employees. Thus, retirement plan consultants advise firms to decrease the risk of failing the tests by making “plan participation more attractive to lower-paid employees” and increasing the plan’s matching formula “to encourage [lower-wage employees] to select higher payroll deduction rates.”¹²³ In this way, the leverage exercised by highly compensated employees who demand retirement benefits forces employers to provide these benefits to lower-wage employees as well in order to get the tax benefit.¹²⁴

deduction may be limited if the taxpayer or spouse is covered by an employer plan and their income exceeds certain thresholds. *IRA Deduction Limits*, INTERNAL REVENUE SERV., <https://www.irs.gov/retirement-plans/ira-deduction-limits> [https://perma.cc/2JLK-8ZNZ] (last updated Dec. 20, 2019); see *2020 IRA Contribution and Deduction Limits*, INTERNAL REVENUE SERV., <https://www.irs.gov/retirement-plans/plan-participant-employee/2018-ira-contribution-and-deduction-limits-effect-of-modified-agi-on-deductible-contributions-if-you-are-covered-by-a-retirement-plan-at-work> [https://perma.cc/9NFC-EG24] (last updated Dec. 4, 2019). The 2020 contribution limit for a 401(k) plan is \$19,500. I.R.S. Notice 2019-59, *supra*; see I.R.C. § 415 (2018).

¹²¹ For example, if the employee directs 1% of her salary into the retirement account, the employer might match that contribution, resulting in a total contribution equal to 2% of her salary. Employer contributions to qualified plans are deductible by the employer (and excluded from the employee’s current income). See *401(k) Plan Overview*, INTERNAL REVENUE SERV., <https://www.irs.gov/retirement-plans/plan-sponsor/401k-plan-overview> [https://perma.cc/JW8T-SMXV] (last updated Dec. 4, 2019); see also I.R.C. § 404(a).

¹²² See *401(k) Plan Fix-It Guide*, INTERNAL REVENUE SERV., <https://www.irs.gov/retirement-plans/401k-plan-fix-it-guide-the-plan-failed-the-401k-adp-and-acp-nondiscrimination-tests> [https://perma.cc/T3XU-SMYK] (last updated Dec. 19, 2019).

¹²³ Scott McCarthy, *What Is Non-Discrimination Testing?*, PENTEGRA (June 24, 2015), <https://www.pentegra.com/current-thinking/fee-disclosure/non-discrimination-testing/> [https://perma.cc/ND35-MRPV].

¹²⁴ Participation rates in employer-sponsored plans are considerably higher, primarily because the money is automatically taken out of one’s paycheck and because, under some circumstances, employers are also permitted to autoenroll employees with the option to opt out. See Barbara A. Butrica & Nadia S. Karamcheva, *Automatic Enrollment, Employer Match Rates, and Employee Compensation in 401(k) Plans*, MONTHLY LAB. REV., May 2015, at 1, 3. Some states have explored pilot projects to mimic the advantages of automatic employer plans through the introduction of “auto-IRAs.” See Elizabeth Bauer, *Should Poor People Save for Retirement?*, FORBES (July 21, 2018, 1:46 PM),

The above discussion illustrates that—even putting aside the 2017 tax changes—the tax consequences of worker classification are mixed, but likely tilted in favor of independent contractor classification for at least some workers. Independent contractors can take more generous above-the-line deductions for business expenses than employees and are not subject to FUTA taxes.¹²⁵ And the availability of ACA healthcare subsidies and exchange plans has arguably helped alleviate the burdens of obtaining health insurance for oneself. With the introduction of § 199A, the worry is that the incentive to prefer (or accept) independent contractor classification over employee classification has become even stronger.

Cutting the other way, independent contractors arguably have more onerous tax-compliance responsibilities, including being responsible for remitting income, Social Security, and Medicare tax payments; tracking expenses; and paying estimated taxes. Retirement benefits and incentives are likely less favorable for independent contractors as well. These downsides, together with the fact that employee status clearly provides more robust labor- and employment-law protections despite being more expensive for employers, might cause some to prefer employee status instead.

B. *The Legal Tests: A Contested Landscape*

Of course, it is not enough to simply prefer one classification to the other. This Section explains various fields' legal tests that hiring firms and workers must meet to qualify for their preferred statuses. In determining worker classification, different legal regimes utilize distinct tests set forth in case law, regulations, and rulings. The criteria and conclusions of one legal field are not generally dispositive for others.¹²⁶ Thus, the same work relationship may require multiple analyses across settings. For example, a Florida court considering the classification of workers under state labor law would not be bound by a federal tax-law conclusion that the same worker was an independent contractor.¹²⁷ Nor are conclusions in the same field even binding across jurisdictions. A California

<https://www.forbes.com/sites/ebauer/2018/07/21/should-poor-people-save-for-retirement/> [<https://perma.cc/YD68-MD2V>] (“Five states are launching plans to automatically enroll employees, predominantly lower-income workers, in state-administered individual retirement accounts.” (quoting Andrew G. Biggs, Opinion, *State-Run Retirement Plans Are the Wrong Way to Protect the Poor*, WASH. POST (July 18, 2018, 5:38 PM), https://www.washingtonpost.com/opinions/state-run-retirement-plans-are-the-wrong-way-to-protect-the-poor/2018/07/18/636b3eea-8a0c-11e8-a345-a1bf7847b375_story.html)).

¹²⁵ I.R.C. § 62.

¹²⁶ See, e.g., Clement L. Hyland & Laura A. Quigley, Note, *Determination of Employee Status: Right to Control v. Economic Reality—Is There a Difference?*, FLA. B.J., Jan. 1987, at 43, 44 (discussing differences).

¹²⁷ See, e.g., Susan Schwochau, Note, *Identifying an Independent Contractor for Tax Purposes: Can Clarity and Fairness Be Achieved?*, 84 IOWA L. REV. 163, 174-85 (1998) (discussing tax test).

state-law determination will not bind those working for the same company in, say, New York.¹²⁸

1. Common Law Agency, Economic Realities, and ABC Tests

While the NLRA and the FLSA are both foundational pieces of worker-protection legislation, they apply different tests in determining worker status.¹²⁹

Under the NLRA, courts have applied the common law agency test in determining worker classification.¹³⁰ Based on common law respondeat superior claims currently found in the *Restatement (Third) of Agency*, the common law agency test examines the employer's control or right of control over the manner and means by which the work is accomplished.¹³¹ In applying this common law

¹²⁸ See, e.g., *Independent Contractor Versus Employee*, ST. CAL. DEP'T OF INDUS. REL., https://web.archive.org/web/20191206132018/https://www.dir.ca.gov/dlse/faq_independent_contractor.htm [<https://perma.cc/G5LL-4BR7>] (last visited Feb. 25, 2020) (“[I]n a wage claim where employment status is an issue, DLSE will often use the five-prong economic realities test to decide the issue. However, in a separate matter before a different state agency with the same parties and same facts, and employment status again being an issue, that agency may be required to use a different test, for example, the ‘control test,’ which may result in a different determination. Thus, it is possible that the same individual will be considered an employee for purposes of one law and an independent contractor under another.”).

¹²⁹ For example, the Acts have different statutory exclusions of certain employees. See *Rutherford Food Corp. v. McComb*, 331 U.S. 722, 728 & n.7 (1947) (noting FLSA's failure to provide explicit statutory definition of “employee”); *NLRB v. Hearst Publ'ns, Inc.*, 322 U.S. 111, 120 (1944) (commenting on Congress's failure to define “employee” in NLRA when enacted), *abrogated by* *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 325 (1992).

¹³⁰ The Supreme Court initially offered an NLRA test for worker classification that was broader than the common law agency test, but subsequent statutory reform clarified congressional intent to rely on the common law test. *Nationwide Mut.*, 503 U.S. at 324-25 (“In each case, the Court read ‘employee,’ which neither statute helpfully defined, to imply something broader than the common-law definition; after each opinion, Congress amended the statute so construed to demonstrate that the usual common-law principles were the keys to meaning.” (footnote omitted)).

¹³¹ See RESTATEMENT (THIRD) OF AGENCY § 7.07(3)(a) (AM. LAW INST. 2006) (“[A]n employee is an agent whose principal controls or has the right to control the manner and means of the agent's performance of work”); Oei, *supra* note 58, at 121-22 (discussing common law agency test); see also *Nationwide Mut.*, 503 U.S. at 323 (using common law right-to-control test for ERISA claims); *Alexander v. FedEx Ground Package Sys., Inc.*, 765 F.3d 981, 988 (9th Cir. 2014) (using control test and other factors to conclude that FedEx drivers were employees under California Labor Code); cf. *FedEx Home Delivery v. NLRB*, 563 F.3d 492, 498-500 (D.C. Cir. 2009) (applying “significant entrepreneurial opportunity” analysis to FedEx drivers); Robert L. Redfearn III, *Sharing Economy Misclassification: Employees and Independent Contractors in Transportation Network Companies*, 31 BERKELEY TECH. L.J. 1023, 1035 (2016) (“The primary question in determining if an employment relationship exists is ‘whether the person to whom service is rendered has the right to control the manner and means of accomplishing the result desired.’” (quoting S.G.

test, courts and tribunals have generally applied a list of eleven to thirteen factors to determine control, including the skill required; the location of the work; the individual or entity that provides the tools, instrumentalities, and place of work; the duration of the work relationship; the extent of the hired party's discretion over when and how long to work; and the inclusion of the work done by the worker in the regular business of the employer.¹³²

However, although it is generally acknowledged that the common law test applies for NLRA purposes, exactly what the test requires is contested. In particular, courts and the National Labor Relations Board ("NLRB") have sparred over how important it is that the worker has "significant entrepreneurial opportunity for gain or loss" (which suggests independent contractor status).¹³³ In 2009, the D.C. Circuit Court of Appeals held in *FedEx Home Delivery v. NLRB*¹³⁴ that FedEx drivers were independent contractors because of evidence of entrepreneurial opportunity.¹³⁵ But in 2014, the NLRB rejected the D.C. Circuit's interpretation and its focus on theoretical entrepreneurial opportunity as decisive. Instead, the NLRB emphasized control over the worker and actual entrepreneurial opportunity and applied a revised version of the test.¹³⁶ In 2019, the NLRB again revised its test in *SuperShuttle DFW, Inc.*,¹³⁷ ruling instead that the focus should be on theoretical entrepreneurial opportunity available to the worker.¹³⁸ This position makes it easier to classify workers as independent contractors.

To determine employee status under the FLSA, by contrast, the Department of Labor and courts have adopted an "economic realities" test that examines whether the worker is economically dependent on the business for which she works or is in reality in business herself.¹³⁹ Courts do not use the common law

Borello & Sons, Inc. v. Dep't of Indus. Relations, 769 P.2d 399, 404 (Cal. 1989) (in bank)); Brishen Rogers, *Employment Rights in the Platform Economy: Getting Back to Basics*, 10 HARV. L. & POL'Y REV. 479, 487 n.48 (2016) (describing factors under California multifactor test, which draws on both common law test and FLSA economic realities test).

¹³² *Lancaster Symphony Orchestra v. NLRB*, 822 F.3d 563, 565-66 (D.C. Cir. 2016) (describing multifactor employee-status test); *N. Am. Van Lines, Inc. v. NLRB*, 869 F.2d 596, 599-600 (D.C. Cir. 1989) (using multifactor right-to-control test to determine employee status).

¹³³ *FedEx Home Delivery*, 563 F.3d at 497 (quoting *Corp. Express Delivery Sys. v. NLRB*, 292 F.3d 777, 780 (D.C. Cir. 2002)).

¹³⁴ 563 F.3d 492 (D.C. Cir. 2009).

¹³⁵ *Id.* at 500.

¹³⁶ *FedEx Home Delivery*, 361 N.L.R.B. 610, 612 (2014) ("[W]e do not share the view of the District of Columbia Circuit that, over time, the Board has come to treat entrepreneurial opportunity as the decisive factor in its inquiry."), *enforcement denied*, 849 F.3d 1123 (D.C. Cir. 2017), and *overruled by* 367 N.L.R.B. No. 75 (Jan. 25, 2019).

¹³⁷ 367 N.L.R.B. No. 75 (Jan. 25, 2019).

¹³⁸ *See id.* at 9-10 (overruling *FedEx Home Delivery*).

¹³⁹ *See Schultz v. Capital Int'l Sec., Inc.*, 466 F.3d 298, 304-05 (4th Cir. 2006) (listing six factors of economic realities test); U.S. DEP'T OF LABOR, FACT SHEET #13: EMPLOYMENT

control test for FLSA purposes because the FLSA defines the term “employ” to “include[] to suffer or permit to work,” thus covering a broader set of relationships than the common law test.¹⁴⁰ Like the common law test, the economic realities test also weighs a list of factors, including whether the work is integral to the employer’s business, whether the worker’s managerial skill enhances her opportunity for profit, how the worker’s relative investment in facilities and equipment compares to the employer’s, the amount of special skill required for the work, the permanence of the relationship, and the degree of control exercised by the hiring firm over how the work is performed.¹⁴¹ And like the common law test, the boundaries of the FLSA economic realities test are contested, with administrative-level policy interpretive guidance making it easier or more difficult to classify workers in a certain way.¹⁴²

State unemployment insurance regimes have also developed and adopted their own classification tests. A majority of states apply the “ABC” test in their analyses.¹⁴³ The ABC test considers (A) whether the worker is free from control or direction in performing the work; (B) whether the work is conducted outside the ordinary course of the business’s activities and off the business’s premises; and (C) whether the worker is customarily engaged in an independent trade, profession, or business.¹⁴⁴ Other states use modifications of the ABC test, use the right-to-control test, or rely on state common law.

RELATIONSHIP UNDER THE FAIR LABOR STANDARDS ACT (FLSA) 1 (2008), <https://www.dol.gov/whd/regs/compliance/whdfs13.pdf> [https://perma.cc/S37X-QJR5] (defining employee as “one who, as a matter of economic reality, follows the usual path of an employee and is dependent on the business which he or she serves”); *see also* *Nationwide Mut. Ins. Co. v. Darden*, 503 U.S. 318, 326 (1992) (noting that FLSA meaning of “employee” might reach workers “who might not qualify as [employees] under a strict application of traditional agency law principles”); *United States v. Silk*, 331 U.S. 704, 716 (1947) (suggesting five factors to consider in assessing employee status under Social Security Act), *abrogated by Nationwide Mut.*, 503 U.S. at 325; Benjamin Means & Joseph A. Seiner, Essay, *Navigating the Uber Economy*, 49 U.C. DAVIS L. REV. 1511, 1528-32 (2016) (examining similarities between tests under FLSA and California Labor Code).

¹⁴⁰ 29 U.S.C. § 203(g) (2018).

¹⁴¹ *See Independent Contractor Versus Employee*, *supra* note 128; *supra* note 139 and accompanying sources.

¹⁴² On June 7, 2017, the U.S. Secretary of Labor withdrew the Department of Labor’s two-year-old, informal worker classification guidance documents that outlined the economic realities test and broadly interpreted it. Press Release, U.S. Dep’t of Labor, US Secretary of Labor Withdraws Joint Employment, Independent Contractor Informal Guidance (June 7, 2017), <https://www.dol.gov/newsroom/releases/opa/opa20170607> [https://perma.cc/M4PS-XER5]. This makes it easier to classify workers as independent contractors.

¹⁴³ Oei, *supra* note 58, at 122.

¹⁴⁴ *Id.*; *see Hargrove v. Sleepy’s, LLC*, 106 A.3d 449, 458-59 (N.J. 2015) (applying ABC test to New Jersey wage-payment and wage-and-hour claims).

The NLRA, the FLSA, and state unemployment insurance regimes are just three key examples of areas of law in which worker classification matters but different tests are used. Worker classification also matters in other legal regimes as well, including ERISA, the Americans with Disabilities Act, the Family and Medical Leave Act, the Occupational Safety and Health Act, and Title VII of the Civil Rights Act, among others.¹⁴⁵ These regimes all have to distinguish independent contractors from employees, and they all make their own determinations regarding which test to apply.¹⁴⁶ However, the differences in tests among regimes should not be overstated. In some cases, different tests might lead to different outcomes, but in many other cases the tests point in the same direction.

2. Tax Law's Twenty-Factor Test

Tax law employs a twenty-factor test set forth in IRS Revenue Ruling 87-41 to distinguish independent contractors from employees.¹⁴⁷ The test incorporates a mix of behavioral, financial, and relational factors.¹⁴⁸ Broadly speaking, the

¹⁴⁵ See *supra* Section II.A.

¹⁴⁶ See Dubal, *Wage Slave or Entrepreneur?*, *supra* note 5, at 74 fig.1 (charting tests across regimes).

¹⁴⁷ Rev. Rul. 87-41, 1987-1 C.B. 296, 298-99 (detailing test's twenty factors); Shu-Yi Oei & Diane M. Ring, *Can Sharing Be Taxed?*, 93 WASH. U. L. REV. 989, 1020 (2016) ("[C]ourts have considered a number of these factors in classifying workers."); see, e.g., Schramm v. Comm'r, 102 T.C.M. (CCH) 233, 234-35 (2011) (considering eight factors to determine worker status); Levine v. Comm'r, 89 T.C.M. (CCH) 1063, 1066-67 (2005) (listing factors used to determine worker status). The potential indeterminacy of the twenty-factor test led to reform proposals. See, e.g., William Hoffman, *Congress Presses IRS to Boost Gig Economy Compliance*, 160 TAX NOTES 740, 740-41 (2018) (outlining recommendations to lower third-party reporting thresholds); Calvin H. Johnson, *Settle Withholding by the Dollars, Not Control*, 136 TAX NOTES 949, 956-58 (2012) (advocating withholding income tax at source regardless of worker classification).

¹⁴⁸ Oei, *supra* note 58, at 122 ("The twenty factors focus on behavioral controls, financial aspects of the job, and the nature of the relationship between worker and hirer."); *Independent Contractor (Self-Employed) or Employee?*, INTERNAL REVENUE SERV., <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee> [<https://perma.cc/4LLH-78J4>] (last updated Jan. 16, 2020). The factors include (1) whether the person for whom the services are performed has the right to require compliance with that person's instructions; (2) whether there is worker training; (3) whether the worker's services are integrated into business operations; (4) whether services must be personally rendered; (5) whether the person for whom the services are performed hires assistants; (6) whether there is a continuing relationship; (7) whether set hours are established; (8) whether full-time work is required; (9) whether the work must be done on the employer's premises; (10) whether the work must be performed in a particular sequence; (11) whether the worker must submit regular reports; (12) whether the worker is paid by the hour, week, or month; (13) whether the person for whom the services are performed ordinarily pays for the worker's business or traveling expenses; (14) whether the person for whom the services are

factors are concerned with reporting structure, provision of training and guidance, level of investment, and client base. These twenty factors are actually a distillation of years of common law and reflect the adoption of the common law control test for federal employment tax purposes (and the rejection of the economic realities test).¹⁴⁹

Importantly, the multifactor tax test does not include any presumption in favor of either employee or independent contractor status.¹⁵⁰ Instead, the test aims to result in a neutral determination that reflects the totality of the factors.¹⁵¹ However, some factors are given more weight than others.¹⁵² On balance, a worker is typically classified as an independent contractor for tax law purposes if the person for whom the work is performed controls only the results of the work and not the details of its execution.¹⁵³

performed furnishes significant tools, materials, or equipment; (15) whether the worker invests in facilities used in performance of services that are not furnished by the employer (suggestive of independent contractor status); (16) whether the worker can realize profit or loss; (17) whether the worker works for more than one firm at the same time; (18) whether the worker makes her services available to the general public; (19) whether there is a right to discharge the worker; and (20) whether the worker can terminate the relationship at any time without incurring liability (indicating employee status). Rev. Rul. 87-41, 1987-1 C.B. 296, 298-99; see Diane M. Ring, *Silos and First Movers in the Sharing Economy Debates*, 13 LAW & ETHICS HUM. RTS. 61, 67 n.12 (2019) (summarizing factors).

¹⁴⁹ See generally WILLIAM HAYS WEISSMAN, NAT'L ASS'N OF TAX REPORTING & PROF'L MGMT., SECTION 530: ITS HISTORY AND APPLICATION IN LIGHT OF THE FEDERAL DEFINITION OF THE EMPLOYER-EMPLOYEE RELATIONSHIP FOR FEDERAL TAX PURPOSES (2009), https://www.irs.gov/pub/irs-utl/irpac-br_530_relief_-_appendix_natrm_paper_09032009.pdf [<https://perma.cc/QBD3-FG5W>].

¹⁵⁰ Ring, *supra* note 148, at 68.

¹⁵¹ *Id.* (“[T]he expectation is that the classification will be the result of direct application of the multiple factors, though in a fact-intensive and messy way.”).

¹⁵² WEISSMAN, *supra* note 149, at 4-5 (“While these 20 factors are commonly relied upon, it is not an exhaustive list and other factors may be relevant. Further, some factors may be given more weight than others in a particular case.”).

¹⁵³ See, e.g., *Schramm v. Comm’r*, 102 T.C.M. (CCH) 233, 235 (2011) (“The degree of control that the principal exercises over the worker has been referred to as the crucial test in making the determination.”); *Levine v. Comm’r*, 89 T.C.M. (CCH) 1063, 1067 (2005) (“If the person receiving the benefit of a service has the right to control the manner in which the service is performed, the person rendering the service may be an employee.”); Rev. Rul. 87-41, 1987-1 C.B. 296, 298 (“As an aid to determining whether an individual is an employee under the common law rules, twenty factors or elements have been identified as indicating whether sufficient control is present to establish an employer-employee relationship.”); Oei & Ring, *supra* note 147, at 1021 (“Very generally, a worker is an independent contractor if the business paying the worker has the right to control or direct only the result of the work and not what will be done and how.”); *Independent Contractor Defined*, INTERNAL REVENUE SERV., <https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-defined> [<https://perma.cc/V68X-YSE3>] (last updated Jan. 23, 2020) (“What

While, as a formal matter, each field makes its own worker classification determination, there are limits on whether a taxpayer can assert employee status for purposes of one legal regime and independent contractor status for another.¹⁵⁴ As we detail in other work, although the fields make nominally independent decisions, the choices and outcomes in one legal field are likely to influence outcomes in another legal field.¹⁵⁵ It is therefore uncommon to observe attempts at arbitrage between fields in classification matters—that is, attempts to argue that workers are, say, independent contractors for tax purposes but employees for labor-law purposes.

In summary, the above discussion yields two key insights:

First, a series of legal tests needs to be satisfied in each field in order to plausibly make the case that a worker is an independent contractor or an employee. Firms or workers cannot simply choose their preferred classification while meeting no requirements. Moreover, these legal tests are contested and evolving. Decisions by courts and administrative bodies may make it easier or more difficult in a particular field to classify workers as independent contractors and may change results in close cases.

Second, while these tests are distinct across fields, attempting cross-field arbitrage is risky and not a strategy usually observed. The more common dynamic is for firms and workers to pick a consistent classification in a relatively coordinated fashion across fields.

C. *Decisional Trade-Offs and the Mechanics of a Shift*

Thus, even prior to the 2017 tax reform, a decisional dynamic long existed whereby hiring firms and workers confronted trade-offs between independent contractor and employee status and sometimes held conflicting preferences. Assessing these trade-offs requires consideration of labor and employment protections as well as tax outcomes. Independent contractor status might be attractive for some workers due to some tax advantages and the flexibility of being one's own boss, and it is undoubtedly attractive for hiring firms due to lower costs. By contrast, employee status provides more direct protections and fewer tax-compliance costs for workers but might come with tax drawbacks and

matters is that the employer has the legal right to control the details of how the services are performed.”).

¹⁵⁴ See Oei, *supra* note 58, at 122; Ring, *supra* note 148, at 66 (“Thus, while the legal system is not bound to a universal standard across all fields, in practice the basic structure of the rules has generally converged.”); Shu-Yi Oei & Diane M. Ring, *The Senate Tax Bill and the Battles over Worker Classification*, TAXPROF BLOG (Nov. 11, 2017), https://taxprof.typepad.com/taxprof_blog/2017/11/the-senate-tax-bill-and-worker-classification.html [<https://perma.cc/MX74-4MAU>] (arguing that siloed approaches may have prevented tax scholars from fully appreciating risks of NEW GIG Act’s safe harbor).

¹⁵⁵ See Oei, *supra* note 58, at 122.

is likely more costly for firms. As a result, the decisional trade-off might look different for workers and firms.

Here, we map how the decisional trade-offs for workers and firms would generally look when considering the tax-, labor-, and employment-law consequences of choosing a certain classification.¹⁵⁶ We then examine the mechanisms by which the introduction of a new 20% deduction might change that trade-off and lead to a shift.

1. The Decisional Trade-Off: Workers vs. Firms

a. *Workers*

The key decision for workers is to weigh the possibility of more money upfront due to more generous tax deductions for independent contractors against direct labor and employment protections for employees. At first blush, this resembles a classic direct-versus-trickle-down decision: Should the worker take the direct protections of labor law, or should she “go it alone” and potentially receive more dollars, which she can use to self-insure?

But there are other layers to the trade-off. For example, another consideration is how to weigh the possibility that the job disappears (whether through automation or offshoring)¹⁵⁷ or that wages fall. Conversely, workers might weigh the possibility that remuneration may be higher for independent contractors due to lower costs for the hiring firms. The calculus may also vary based on whether the worker already holds another main job as an employee that provides benefits or is able to self-insure using other means.¹⁵⁸ A worker with other full-time employment (or with a spouse with full-time employment) may be more willing to risk the loss of the secondary job, thereby being willing to take the risk that employee classification makes that job disappear. But on the flip side, a worker may instead prefer independent contractor status for the secondary job on the theory that she already receives health, retirement, and other protections from her primary job.¹⁵⁹ Also, a worker who has ample wealth or other resources may be less interested in the direct protections of employee classification. Finally, for some, the expressive advantages of flexibility and “being your own boss” may make independent contractor status preferable despite forgone protections.

¹⁵⁶ Ultimately, the classification decision would depend on broader market and economic factors as well. *See infra* Part III.

¹⁵⁷ *See infra* notes 203-05 and accompanying text (discussing possibility of job elimination due to offshoring and increasing automation).

¹⁵⁸ *See infra* Section IV.B.2 (considering variously situated classes of workers and concluding that each class’s response to § 199A will vary based on divergent incentives and preferences).

¹⁵⁹ A worker with a full-time-employee job may have healthcare and retirement benefits through that job and may be able to increase tax withholding on wages from that job to cover any required quarterly filing and payment obligations on income earned from secondary independent contractor positions.

An important question here is the extent to which workers consciously appraise the costs and benefits of alternative choices. The monetary value of salary and benefits can certainly be estimated, though how this changes when classification shifts may be harder to divine. But the value of other benefits, such as worker independence or benefits under the NLRA, the FLSA, or state labor laws, may be hard to quantify. This is particularly so once on-the-ground enforcement considerations and worker bargaining power are taken into account. It is possible that some workers may cognitively discount the value of direct benefits—some of which may become salient only in the future—while overappreciating direct dollars received. But it is also possible that the tax advantages and disadvantages are not immediately obvious to workers either.

b. *Hiring Firms*

From the hiring firm's perspective, on the other hand, the traditional preference has been to classify workers as independent contractors if business structure and market conditions permit. This reflects the existence of significant tax and nontax costs of employee classification. On the tax side, businesses are obligated to pay the employer portion of FICA taxes and FUTA taxes, and they must also handle the administrative burdens of tax reporting and withholding for employees.¹⁶⁰ On the nontax side, employers must satisfy various requirements regarding permitted wages, hours, working conditions, and benefits that do not apply to independent contractors. Not surprisingly, many businesses would gladly eliminate these costs and burdens.

But to do so comes at a price. First, to support the claimed classification, the work relationship must satisfy the test in the relevant field. Broadly speaking, a business looking to embrace independent contractor classification for its workers must relinquish significant control over the workers. The more control the business exercises, the less likely it is that independent contractor classification will be respected. In fact, firms have historically undertaken measures to “lose” control over workers, at least on paper—for example, by engaging in subcontracting relationships that formally show diminished control.¹⁶¹

¹⁶⁰ See *supra* Section II.A.2 (discussing FICA and FUTA taxes).

¹⁶¹ “Subcontracting” denotes moving employees (e.g., a cleaning crew) off the company's payroll onto the payroll of a separate business and then outsourcing the cleaning contract to the separate business. The workers may still be employees but are now employees of the separate business. The advantages are that fewer benefits need to be offered to these workers (due to a reduced need to match benefits offered to other employees of the original firm) and that the liable employer in the event of disputes is less well-known and has shallower pockets. See Catherine K. Ruckelshaus, *Labor's Wage War*, 35 *FORDHAM URB. L.J.* 373, 379 (2008) (“Outsourcing employees to labor intermediaries such as temporary or leasing firms or labor brokers allows companies to argue that the intermediate entity is the sole employer responsible for pay rules, and allows them to dodge responsibility.”).

The question for many firms, then, is whether there is a segment of the workforce that can plausibly be moved out of employee status and into independent contractor status while still satisfying the core needs of the business.¹⁶² The answer will depend on the specifics of the work relationship, the hiring firm's willingness to risk misclassification penalties, and the relevant legal tests and their contested and evolving interpretations by courts and tribunals.

In some cases, firms have affirmatively concluded that their business model requires retention of control over workers and classification of workers as employees. For example, platform business Hello Alfred, which provides personal home managers who handle an assortment of household tasks, recently decided to rely exclusively on a workforce of employees despite the trend among platform firms to classify similar workers as independent contractors.¹⁶³ Notwithstanding the additional costs of employee classification, Hello Alfred concluded that exercising only limited control over its workforce in order to classify its workers as independent contractors was inconsistent with its business model, which was to provide carefully screened home managers to clients.

2. The Mechanics of a Workplace Shift

With the introduction of a 20% deduction for independent contractors, several outcomes are possible: (1) workers who are currently employees could abandon their employee jobs and do independent contractor jobs instead, (2) workers who are currently employees could try to recharacterize their current jobs as independent contractor work, or (3) firms could convert employee jobs into independent contractor jobs.¹⁶⁴ The first scenario lies in the hands of the worker. To accomplish the second scenario, hiring employers would have to cooperate because decisions such as choosing which tax form to issue, determining whether to withhold, and deciding how much control over workers to cede would rest with the hiring firm. The second scenario would also require that firms and workers satisfy the relevant legal tests¹⁶⁵ and avoid the rebuttable presumption in the § 199A regulations that former employees who shift to independent contractor status are still employees.¹⁶⁶

The third possible pathway envisions that hiring firms that had previously viewed the costs of reorganizing and reclassifying their workers as independent

¹⁶² A related question is whether alternative strategies, such as subcontracting, are available.

¹⁶³ Marcela Sapone, *Working on Work*, HELLO ALFRED (July 22, 2016), <https://blog.helloalfred.com/working-on-work-819e1e2aa6db> [https://perma.cc/9XJA-SZGX] ("When we launched last year, we decided to challenge the on-demand industry norm and W-2 our employees . . .").

¹⁶⁴ See *supra* Section I.B (noting concerns about these types of shifts).

¹⁶⁵ See *supra* Section II.B (describing legal tests that apply in various fields).

¹⁶⁶ Treas. Reg. § 1.199A-5(d)(3)(i) (2019).

contractors as too high could be enticed by the new § 199A deduction and decide to unilaterally shift workers to independent contractor status. This could cause workers to involuntarily shift to independent contractor status as employee positions disappear.

But it is the worker who takes the § 199A deduction, not the firm. Why, then, might a hiring firm decide to reclassify workers (or help workers reclassify themselves) after § 199A? One possible scenario is as follows: suppose that in a pre-§ 199A world, a firm would like to reclassify its current employees as independent contractors to reduce costs (including tax and nontax legal costs). However, doing so would place the full burden of paying payroll taxes on the worker,¹⁶⁷ and the firm is unwilling to fully compensate the worker for the “employer portion” of the payroll taxes that the worker would now have to pay herself (7.65% of self-employment income and 1.45% for the Medicare tax, in addition to the employee’s half).¹⁶⁸ Assume additionally that there is a nontrivial risk that the workforce might either quit or challenge the independent contractor classification. Moreover, the firm must incur some costs in rearranging operations to meet the legal tests for independent contractor status, lest it risk misclassification penalties. Given these factors, the firm concludes that shifting does not make sense.

Now comes § 199A, offering qualifying nonemployee workers a 20% deduction. That firm could now create a neutral or favorable tax outcome for workers by increasing worker pay by something *less than* the employer’s savings from independent contractor reclassification. This is possible because the 20% of QBI deduction serves as a subsidy from the government which allows the employer to provide a smaller pay increase. Under these facts, the marginal firm might now find reclassification worthwhile. Even if workers demand a pay bump equal to the full employer portion of the payroll taxes, the firm might still find the shift advantageous because workers (with the new deduction) are unlikely to challenge their new classifications.¹⁶⁹ In short, new § 199A may act as a monetary kicker and may serve a pacifying function on workers, thereby encouraging firms to make the shift even if the actual deduction goes to the worker.

Ultimately, of course, whether workers decide to seek or accept independent contractor classification and whether firms help facilitate such reclassification or foist it on workers will depend on factors such as the nature of the work, the elasticity of labor supply and demand in the industry, the relative bargaining power of workers and firms, the risk tolerance of firms, and other business

¹⁶⁷ See *supra* Section II.A.2 (discussing payroll taxes).

¹⁶⁸ This basic hypothetical assumes that the hiring firm does not offer healthcare or retirement benefits, so workers do not price in these factors.

¹⁶⁹ That is, if the employer increased worker pay by the full amount of the employer portion of payroll taxes, then this should make the worker neutral between the two statuses. With the addition of § 199A, that worker would also get the 20% deduction at no cost to the firm and might be even more satisfied.

realities. In addition, as Part III explains, there are a number of interlocking legal and economic considerations that may either limit or exacerbate a workplace shift.

III. BROADENING THE ANALYSIS ON A WORKPLACE SHIFT

We now broaden the analysis beyond tax law and § 199A to show how tax law interacts with other factors to ultimately shape contemporary work arrangements. The takeaways from our analysis are that (1) there are limiting factors—both internal and external to § 199A—that may reduce the extent of a workplace shift and that (2) there are other exacerbating factors that might make the shift more extreme. Tax is only one variable in this confluence of factors, so it is difficult to isolate the extent to which § 199A is a driver of a workplace shift.

A. *Factors That May Limit the Shift*

We first discuss the factors that might limit the extent of a § 199A-induced workplace shift.

1. The Limits of § 199A

Internal Statutory Guardrails. As discussed, § 199A comes with statutory limitations and guardrails. Most pertinently, the line-of-business and wage-and-investment limitations discussed above may reduce or eliminate the availability of the deduction for workers whose incomes are above certain statutory thresholds.¹⁷⁰ Businesses in prohibited fields or that lack sufficient W-2 wages paid and/or qualified depreciable property investments may be limited in their ability to take the deduction. Thus, certain higher-income taxpayers may not qualify for the benefits of § 199A unless they substantively reorganize their operations. While it is possible that § 199A may influence businesses to make organizational and structuring changes to become eligible for the deduction, such changes may be costly and deter classification shifts. On the other hand, final regulations confirm that the “reasonable compensation” guardrail will not apply to independent contractors and hence cannot be relied upon to constrain a workplace shift.¹⁷¹

Conflicting Incentives Within § 199A. There are also parts of § 199A that might make it more attractive to hire employees than independent contractors. For example, higher-income pass-through businesses (whose owners, either partners or S-corporation shareholders, are seeking their own § 199A deductions) must consider the 50%-of-W-2-wage limitation and/or the wage-

¹⁷⁰ I.R.C. § 199A(b)(2), (d) (2018). IRS regulations state that the reasonable-compensation guardrail applies only to S-corporation shareholders and not to independent contractors or partners. *See* Treas. Reg. § 1.199A-3(b)(2)(ii)(H).

¹⁷¹ Treas. Reg. § 1.199A-3(b)(2)(ii)(H).

and-qualified-property-investment limitation.¹⁷² If the business does not pay sufficient W-2 wages (or a sufficient combination of wages plus qualified property), the pass-through business owners' § 199A deduction may be limited. Thus, the traditional business preference for independent contractor classification must now compete with the need to pay adequate W-2 wages in order to take the § 199A deduction.

Relatedly, for pass-through businesses organized as partnerships, there may be conflicting incentives among partners. Strategies designed to ensure compliance with § 199A, such as a plan to hire sufficient employees (rather than subcontracting) to increase the amount of W-2 wages paid, may be appealing to owners who are concerned about the 50%-of-W-2-wages limitation. But other owners may weigh the need to pay W-2 wages differently (e.g., if they are below the income threshold triggering the W-2 rule, if they have losses from other qualified businesses that can be used to offset income, or if they are more worried about nontax risks and liabilities than are other owners). These types of conflicts can be difficult to navigate and predict, particularly in the case of existing entities whose owners have heterogeneous preferences.

Not a Safe Harbor. Another important point is that § 199A is not a risk-free safe harbor; it does not guarantee that the classification that the hiring firm asserts is the correct one if certain conditions are met. In this regard, § 199A differs in design from the NEW GIG Act, a piece of legislation originally proposed in 2017 (but ultimately not enacted) that would have almost guaranteed risk-free classification upon satisfying three easy statutory conditions.¹⁷³ While the purported goal was to provide workers clarity and "peace of mind" that the IRS would not later reclassify them as employees,¹⁷⁴ in actuality the safe harbor

¹⁷² I.R.C. § 199A(b)(2)(B).

¹⁷³ Representative Tom Rice (R-S.C.) introduced the NEW GIG Act in the House in October 2017. H.R. 4165, 115th Cong. (2017). Senator John Thune (R-S.D.) introduced the NEW GIG Act in the Senate in July 2017. S. 1549, 115th Cong. (2017). This language was included in the Chairman's Mark of the Senate version of the 2017 tax legislation. STAFF OF J. COMM. ON TAXATION, 115TH CONG., DESCRIPTION OF THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT" 155-59 (Comm. Print 2017). However, the Act was dropped from the final legislation. STAFF OF J. COMM. ON TAXATION, 115TH CONG., DESCRIPTION OF THE CHAIRMAN'S MODIFICATION TO THE CHAIRMAN'S MARK OF THE "TAX CUTS AND JOBS ACT" 2 (Comm. Print 2017). Both congressmen later reintroduced the legislation in their respective chambers in March 2019. Press Release, John Thune, Senator, U.S. Senate, Thune Reintroduces Bill to Add Certainty to Worker Classification Rules (Mar. 7, 2019), <https://www.thune.senate.gov/public/index.cfm/2019/3/thune-reintroduces-bill-to-add-certainty-to-worker-classification-rules> [<https://perma.cc/A92U-56YD>].

¹⁷⁴ Press Release, John Thune, Senator, U.S. Senate, Thune Introduces Bill to Add Certainty to Worker Classification Rules (July 13, 2017), <https://www.thune.senate.gov/public/index.cfm/2017/7/thune-introduces-bill-to-add-certainty-to-worker-classification-rules> [<https://perma.cc/YE86-4R72>] ("My legislation would provide clear rules so these

would have virtually eliminated tax-classification disputes brought by workers. The NEW GIG Act did not make independent contractor status more attractive to workers; it simply made it less risky for businesses.¹⁷⁵

By contrast, any influence exerted by § 199A will be through reduction in workers' taxes and not by risk reduction for hiring firms themselves. As we have argued elsewhere, "the Section 199A nudge to independent classification status is wrapped up in the carrot of a 20% deduction."¹⁷⁶ Section 199A is a complex carrot¹⁷⁷ and the question is whether and under what circumstances this carrot will prove sufficient to produce a notable worker classification shift. While the carrot may encourage additional shifts in worker classification, there is some evidence that many jobs that could be shifted already have been and, moreover, that misclassification is widespread.¹⁷⁸ Thus, it is also possible that only limited further shifts will occur.¹⁷⁹

Complexity and Compliance Costs. Section 199A's complexity may also influence its impact. The statute raises questions regarding the calculation of income, the exclusion of certain taxpayers, and the permissibility of strategic restructuring of partnerships and other businesses to qualify for the deduction.¹⁸⁰

freelance-style workers can work as independent contractors with the peace of mind that their tax status will be respected by the IRS.").

¹⁷⁵ See *supra* Section II.C (discussing decisional trade-offs between independent contractor status and employee status for hiring firms and workers).

¹⁷⁶ Shu-Yi Oei & Diane M. Ring, *Is New Code Section 199A Really Going to Turn Us All into Independent Contractors?* 2 (Jan. 12, 2018) (unpublished manuscript), <https://ssrn.com/abstract=3101180> [<https://perma.cc/MB7G-2U45>].

¹⁷⁷ See, e.g., Scheiber, *supra* note 22, at B1 (describing negative implications of being classified as independent contractor despite purported carrot offered by tax law).

¹⁷⁸ See AUGUSTA R. COOK ET AL., TREASURY INSPECTOR GEN. FOR TAX ADMIN., EMPLOYERS DO NOT ALWAYS FOLLOW INTERNAL REVENUE SERVICE WORKER DETERMINATION RULINGS 1 (2013), <https://www.treasury.gov/tigta/auditreports/2013reports/201330058fr.pdf> [<https://perma.cc/Z5KU-RR95>] ("The misclassification of employees as independent contractors is a nationwide problem affecting millions of workers that continues to grow and contribute to the Tax Gap."); Rubinstein, *supra* note 56, at 606 (discussing misclassification of workers and how courts deal with "quasi-employers"); Lalith de Silva et al., Planmatics, Inc., *Independent Contractors: Prevalence and Implications for Unemployment Insurance Programs* 38-51 (Feb. 2000) (unpublished manuscript), <https://wdr.doleta.gov/owsdrr/00-5/00-5.pdf> [<https://perma.cc/P35H-2XXS>] (profiling four industries with higher-than-average use of independent contractors).

¹⁷⁹ See Oei & Ring, *supra* note 176, at 7 (concluding that shifts in workplace arrangements and worker classifications already underway leave open question of § 199A's ability to accelerate shifts).

¹⁸⁰ E.g., Eric Yauch, *OMB Review of Passthrough Deduction Regs Is Underway*, 160 TAX NOTES 707, 707 (2018) ("[H]ow the IRS will implement the deduction has been a hot topic among practitioners."). The Joint Committee on Taxation's table on distribution of § 199A tax benefits reveals that while taxpayers earning from \$50,000 to \$100,000 will receive \$2.8 billion in benefits from § 199A in 2024, taxpayers with incomes from \$500,000 to \$1 million

This complexity introduces both planning opportunities¹⁸¹ and compliance costs. These compliance costs will likely vary by taxpayer.¹⁸² For taxpayers already classified as independent contractors with incomes below the threshold (and who are thus not subject to various statutory limitations), the deduction may be relatively straightforward.¹⁸³ For taxpayers currently classified as employees who are considering whether to shift, either at their own initiative or at the behest of their employer, the calculus requires them to compare their current tax position with that of an independent contractor under the new tax regime and assess the risks and costs of shifting.

For many businesses, the likely effects of § 199A may still be unknown. A National Federation of Independent Business survey of more than 2500 small businesses¹⁸⁴ conducted from February through April 2018 found that 33.4% of respondents reported being “not at all familiar” with the new deduction, while 39.9% reported being “somewhat familiar.”¹⁸⁵ Relatedly, 56.3% of respondents reported that they have not “talked with a tax professional or advisor to discuss

will receive \$36.9 billion in tax benefits. STAFF OF J. COMM. ON TAXATION, 115TH CONG., TABLES RELATED TO THE FEDERAL TAX SYSTEM AS IN EFFECT 2017 THROUGH 2026, at 4 (Comm. Print 2018).

¹⁸¹ Sophisticated taxpayers will strategize to secure or maximize their § 199A deduction. *See, e.g.,* Ruth Simon & Richard Rubin, *Crack and Pack: Companies Try to Master New Tax Law*, WALL STREET J., Apr. 4, 2018, at A1 (outlining strategies such as cleaving partnerships engaged in disqualified professions, like healthcare or law, into qualified and nonqualified activities). The IRS has begun responding to some of these strategies. *See, e.g.,* Treas. Reg. § 1.199A-5(c)(2) (2019) (limiting cleaving of businesses by treating businesses that provide services to 50%-related party as SSTBs).

¹⁸² *See* WILLIAM G. GALE ET AL., URBAN-BROOKINGS TAX POLICY CTR., EFFECTS OF THE TAX CUTS AND JOBS ACT: A PRELIMINARY ANALYSIS 17 (2018), https://www.brookings.edu/wp-content/uploads/2018/06/ES_20180608_tcja_summary_paper_final.pdf [<https://perma.cc/4K7C-T4N9>] (noting that 2017 tax reform “will end up making taxes more complicated on net for many taxpayers” due in part to taxpayer efforts to “figure out how to organize their employment status and business affairs to qualify for the 20 percent pass-through deduction”).

¹⁸³ *Cf.* Martin A. Sullivan, *A Dozen Ways to Increase the TCJA Passthrough Benefits*, 159 TAX NOTES 147, 148-53 (2018) (detailing complexities of § 199A for some taxpayers). *See* SCOTT GREENBERG & NICOLE KAEDING, TAX FOUND., REFORMING THE PASS-THROUGH DEDUCTION 13 (Rachel Shuster ed., 2018), <https://files.taxfoundation.org/20180621095652/Tax-Foundation-FF593.pdf> [<https://perma.cc/3CNM-L3VK>] (characterizing compliance for such taxpayers as “relatively simple”).

¹⁸⁴ Only 16.5% of survey respondents were C corporations, ineligible for the § 199A deduction. NAT'L FED'N OF INDEP. BUS. RESEARCH CTR., SMALL BUSINESS INTRODUCTION TO THE TAX CUTS AND JOBS ACT: PART 1, at 11 (2018), <https://www.nfib.com/assets/TCJA-Survey.pdf> [<https://perma.cc/JVR9-5BV4>]. In terms of firm size, 36.5% of respondents reported gross sales in the prior fiscal year of under \$500,000 and 54.4% reported gross sales under \$1 million. *Id.* at 23.

¹⁸⁵ *Id.* at 14.

how the new tax law will affect” their businesses.¹⁸⁶ Commentators have suggested that the opportunity for a deduction in 2018 may have been lost for those businesses that had not yet engaged with their tax professionals regarding § 199A.¹⁸⁷ Small businesses will presumably become more familiar with the new tax provision and may assess operational changes they could implement for the 2019 tax year.

Sunset. Another important feature of the 2017 tax reform was its extensive use of “sunset,” or expiration dates for various provisions.¹⁸⁸ Section 199A is among the new rules that are scheduled to sunset, applying only for tax years beginning after December 31, 2017, and before January 1, 2026. Once enacted, however, deductions tend to be difficult to reverse. However, while there has been talk about making the deduction permanent, lawmakers have yet to do so. In structuring their businesses, taxpayers must therefore not only weigh whether the tax benefits of § 199A are worth the costs but also consider what will happen in 2026 if the provision expires. The possibility that the deduction will disappear—and thus that firms will incur additional planning and restructuring costs at that time—might make the switch ill-advised.

2. Other Limiting Factors

Section 199A aside, there are other tax and nontax factors that might affect the magnitude of a workplace shift.

Need to Satisfy Classification Tests. The fact remains that to claim independent contractor status, one must satisfy the relevant classification tests. Otherwise, there is a risk that courts, tribunals, and the IRS will reclassify the worker. In particular, with respect to the common law control test and the tax law twenty-factor test, hiring firms may have to sacrifice some control over the worker in order to make a plausible claim for independent contractor status. In addition, other classification factors such as the entrepreneurial upside for the worker and whether the work done is an integral part of the hiring firm’s business impose constraints.

As discussed above, even though each legal regime theoretically makes its own classification determination, in practice there seems to be little appetite

¹⁸⁶ *Id.* at 15.

¹⁸⁷ Jamie Hopkins, *New Tax Deduction 199A Will Be Lost for Many in 2018*, FORBES (July 24, 2018, 2:33 PM), <https://www.forbes.com/sites/jamiehopkins/2018/07/24/new-tax-deduction-199a-will-be-lost-for-many-in-2018/> [<https://perma.cc/9T2M-665C>].

¹⁸⁸ To avoid a Democratic filibuster in the Senate, the tax legislation was passed pursuant to a process called budget reconciliation. Rebecca M. Kysar, *Tax Law and the Eroding Budget Process*, 81 LAW & CONTEMP. PROBS., no. 2, 2018, at 61, 62. Reconciliation facilitates passage but limits the legislation’s ability to increase the deficit. *Id.* at 70; Richard Rubin, *The New Tax Law: The Path to the Tax Overhaul*, WALL STREET J. (Feb. 13, 2018, 1:59 PM), <https://www.wsj.com/articles/the-new-tax-law-the-path-to-the-tax-overhaul-1518548345> (describing tax law’s path through Congress).

among businesses to arbitrage worker classification. In short, a firm's ability to shift workers to independent contractor status in order to take advantage of the new tax law remains limited by workplace realities. An important open question is whether most jobs that could plausibly satisfy the relevant legal tests have already shifted to independent contractor classification and whether those that remain are actually quite difficult to shift.

One significant caveat applies: there is evidence that worker misclassification is rampant and that some portion of it may be purposeful.¹⁸⁹ Likewise, some businesses looking to shift worker classification after the introduction of § 199A may similarly feel unconstrained by law. For example, some businesses may continue to conduct their operations as before (along lines that clearly fail to meet the independent contractor test) and yet shift the tax classification of the employees to independent contractor. Whether outright disregard of law defeats the effectiveness of the classification test will depend in part on IRS enforcement actions and resources.

IRS Enforcement Choices and the Limitations on Section 530 Protections. Enforcement choices and actions will also affect the extent of a worker classification shift. Penalties for misclassifying workers can be significant.¹⁹⁰ Depending on the degree and tenor of administrative-level enforcement and interpretation, enforcement choices could dampen or heighten businesses' willingness to push their employees into independent contractor status. If the IRS does not actively enforce against misclassifications—for example, due to prioritizing other areas, to underfunding, or to resource constraints—this could lead to more aggressive assertions of independent contractor classification.

Along these lines, it is important to note that the protections of Section 530 of the Revenue Act of 1978 will not be available to firms that move to reclassify as

¹⁸⁹ See sources cited *supra* note 178 (noting concerns about misclassification prior to 2017 tax reform); *infra* note 240 and accompanying text (discussing increase in self-employed individuals with relatively low business expenses, which might plausibly suggest worker misclassification or workers that resemble employees). See generally Katherine Lim et al., Independent Contractor or Employee? The Changing Relationship Between Firms and Their Workforce and Potential Consequences for the U.S. Income Tax (Nov. 12, 2018) (unpublished manuscript), <https://ssrn.com/abstract=3193225> [<https://perma.cc/L4YF-DQQ6>] (SSRN abstract) (noting increasing use of independent contractors by firms and that “independent contractor relationships increasingly resemble traditional employee relationships in their economic substance”).

¹⁹⁰ There is some evidence that many businesses have already been classifying their workers as independent contractors *inaccurately*, or at least in a way that may invite challenges. See COOK ET AL., *supra* note 178, at 2 (“The IRS estimates that employers misclassify millions of workers as independent contractors instead of employees.”); de Silva et al., *supra* note 178, at 91 (concluding that analysis of industry in five states found “high levels of misclassification” in several sectors).

independent contractors their workers currently classified as employees.¹⁹¹ Section 530 bars the application of retroactive taxes, penalties, and interest on an employer if the employer's classification of workers was both reasonable and consistently applied in prior years. The act of switching workers from employee to independent contractor status would not meet the "consistency" prong of the relief provision, which means that Section 530 would not protect firms that reclassify existing workers in light of § 199A. Consistent classification of new categories of workers as independent contractors going forward may, however, enjoy Section 530 protections.

Repeal of the ACA Individual Mandate and the Availability of Health Insurance. In addition to introducing § 199A, the 2017 tax reform repealed the 2010 ACA's individual mandate.¹⁹² As discussed above, the ACA provided premium subsidies for lower-income individuals to help buy health insurance and may have made employer-provided health insurance less desirable to some of these individuals (who might prefer to take the premium subsidies and purchase their own insurance on the ACA exchanges).¹⁹³ There is concern, however, that repeal of the individual mandate penalty may cause the ACA health insurance marketplaces to unravel, which may cause nonemployer-provided health insurance plans to decline in quality, become more expensive, or disappear completely due to insurance market death spirals. Whether this will occur is an empirical question yet to be determined,¹⁹⁴ but if it does, this might cause workers to be less willing to accept independent contractor classification due to the increased difficulty of obtaining health insurance, thereby offsetting the incentive created by § 199A.

Worker Perceptions and Risk of Worker Challenges. Section 199A does not guarantee protection for firms against future misclassification challenges by workers. For example, if workers originally support a shift to independent contractor status but later conclude that the benefit of the deduction is outweighed by the downside of losing employee protections, they may challenge their classification. This outcome may be particularly likely if § 199A turns out to be more limited than expected due to strict regulatory interpretations and enforcement. Moreover, it is also possible that workers may not appreciate the benefit of § 199A, particularly relative to the other protections that are lost. If § 199A is not adequately salient to taxpayers taking the deduction, this may limit a hiring firm's ability to justify workplace shifts based on the deduction's existence.

¹⁹¹ *Worker Reclassification—Section 530 Relief*, INTERNAL REVENUE SERV., <https://www.irs.gov/government-entities/worker-reclassification-section-530-relief> [<https://perma.cc/7GSG-YL6M>] (last updated May 17, 2019).

¹⁹² See *supra* text accompanying note 113 (discussing repeal).

¹⁹³ See *supra* Section II.A.3.

¹⁹⁴ See *supra* note 117 and accompanying text.

State Law Shifts. Finally, there are state law shifts occurring that might cut against a shift toward independent contractor status. For example, in April 2018, the California Supreme Court decided *Dynamex Operations West, Inc. v. Superior Court*.¹⁹⁵ In that case, which applies only for purposes of California state wage orders, the court replaced the previously used multifactor common law test with a new ABC test which places the burden of establishing that a worker is an independent contractor on the hiring firm.¹⁹⁶ In September 2019, the California legislature followed up by enacting landmark legislation (known as AB 5) that makes the ABC test applicable not only for purposes of state wage orders but also for purposes of determining workers' compensation, unemployment insurance, state family leave, sick days, and other benefits.¹⁹⁷ The adoption of the ABC test likely makes it more difficult for businesses to classify workers as independent contractors, particularly in situations where the worker performs work that is in the ordinary course of the hiring firm's business (such as driving for a platform like Uber or Lyft). Two days before the California legislation took effect, Uber and Postmates filed a legal challenge to the new worker classification law.¹⁹⁸

California's legislation has reignited interest in other states to pursue legislative reform of worker classification standards and processes. In October 2019, for example, New York undertook consideration of similar worker classification reforms.¹⁹⁹ Should state law shifts like the one afoot in California take hold, companies may find it increasingly difficult to classify workers as independent contractors, potentially stemming a shift toward that classification.

¹⁹⁵ 416 P.3d 1, 1 (Cal. 2018); 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/> [https://perma.cc/X4GN-8BXH].

¹⁹⁶ *Dynamex*, 416 P.3d at 35 (listing ABC test's three factors); see *supra* note 144 and accompanying text (describing ABC test in detail).

¹⁹⁷ Assemb. B. 5, 2019-2020 Leg., Reg. Sess. (Cal. 2019), 2019 Cal. Legis. Serv. Ch. 296 (West), https://leginfo.ca.gov/faces/billTextClient.xhtml?bill_id=201920200AB5 [https://perma.cc/42GX-KUGR] (codifying *Dynamex* holding into law to ensure that workers—particularly misclassified independent contractors—have basic rights and protections, including workers' compensation, unemployment insurance, paid sick leave, and paid family leave).

¹⁹⁸ Complaint for Violation of Federal & California Constitutional Rights, Declaratory, Injunctive, & Other Relief & Demand for Jury Trial at 1-2, *Olson v. California*, No. 2:19-cv-10956 (C.D. Cal. filed Dec. 30, 2019), 2019 WL 7373427, at *1.

¹⁹⁹ Jimmy Vielkind, *Classifying Gig Workers Poses Challenge: Albany Lawmakers Cite Pushback California Law Has Faced as They Prepare Legislation*, WALL STREET J., Dec. 6, 2019, at A13A; Jimmy Vielkind, *Lawmakers Consider Reclassifying Gig Workers*, WALL STREET J., Oct. 17, 2019, at A12B.

B. *Factors That May Exacerbate a Shift*

Section 199A aside, there are other legal and economic factors that might contribute to or exacerbate a workplace shift. Many of these factors are gaining traction and exerting their influences simultaneously with § 199A. Thus, it may well be impossible to isolate § 199A's effects. The better approach is to understand that contemporary decisions about *how* to work and how to *classify* workers take place in a shifting and contested landscape of legal tussles and broader economic transformations.

1. Tax Factors

New § 199A is not the only 2017 tax law change that may affect worker classification choices. Another variable is the new tax law's suspension of miscellaneous itemized deductions, which essentially eliminates employees' ability to deduct trade or business expenses through 2025.²⁰⁰ For employees with high expenses—for example, employees that might use personal vehicles or other capital inputs to do their jobs—the effect of this suspension is potentially significant. This factor, as much as § 199A itself, may be instrumental in widening the gap between expense recovery for independent contractors and for employees, consequently encouraging a shift toward independent contractor status.

2. Nontax Legal Factors

Tax law changes aside, nontax legal factors may exacerbate a shift. For example, hiring firms have found ways to minimize the likelihood of classification challenges by requiring workers to sign mandatory arbitration clauses.²⁰¹ Such clauses have proven effective in stalling class action misclassification lawsuits, forcing workers (such as ridesharing drivers) to resort to piecemeal arbitrations and thereby reducing the likelihood of fundamental transformation of the business model through a single litigation.²⁰² As further explored in Part IV, § 199A may be a valuable financial benefit to workers who have little chance of overturning their classifications as independent contractors, but the section may not necessarily cause the shift itself.

²⁰⁰ See *supra* Section II.A.2.c (discussing such suspension).

²⁰¹ See Elizabeth C. Tippet & Bridget Schaaff, *How Concepcion and Italian Colors Affected Terms of Service Contracts in the Gig Economy*, 70 RUTGERS U. L. REV. 459, 461 (2018) (suggesting rapid growth of arbitration clauses in wake of *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011)); see also Jill I. Gross, *The Uberization of Arbitration Clauses*, 9 ARB. L. REV. 43, 43 (2017) ("These clauses often strip the weaker party of its right to pursue claims as class or collective actions (class action waivers)."). For example, Uber requires drivers to sign arbitration agreements waiving their rights to pursue class action challenges. See *infra* note 210.

²⁰² See Oei, *supra* note 58, at 130 (noting that Uber effectively stalls class action lawsuits by forcing its drivers to enter arbitration agreements and waive their rights to pursue class action challenges).

In addition, the changes wrought by the 2017 tax reforms are taking place at the same time as other legal changes. As discussed in Section II.B, the NLRB has recently interpreted the common law control test in a way that emphasizes entrepreneurial opportunities available to the worker (even if those opportunities are merely theoretical), and the Department of Labor withdrew informal guidance on application of the economic realities test. These moves make classifying workers as independent contractors easier for hiring firms and illustrate that the legal framework governing worker classification is deeply contested and constantly shifting, at least at the edges. This changing legal landscape operates alongside § 199A in shaping work and may contribute to and exacerbate shifts in worker classification that may arise.

3. Economic Factors

Finally, there are economic factors that may contribute to the acceleration of workplace changes. Offshoring jobs to lower-cost locations and the rising threat of automation displacing jobs previously done by humans stoke fears that work as presently conceived will soon fundamentally change and perhaps even disappear.²⁰³ An important current debate in both the legal and economics literature is the extent to which these threats to work are likely to be borne out and what responses society should take.²⁰⁴

²⁰³ SRIKANT DEVERAJ ET AL., CTR. FOR BUS. & ECON. RESEARCH, BALL STATE UNIV. & RURAL POLICY RESEARCH INST. CTR. FOR STATE POLICY, HOW VULNERABLE ARE AMERICAN COMMUNITIES TO AUTOMATION, TRADE, AND URBANIZATION? 15 (2017), <https://projects.cberdata.org/reports/Vulnerability-20170719.pdf> [<https://perma.cc/CD56-X4LG>] (synthesizing research that “increasingly points to the risks of large labor market shocks due to automation and trade”); Estlund, *supra* note 10, at 261-72 (discussing risks of automation); Katharine G. Abraham & Melissa S. Kearney, *Explaining the Decline in the U.S. Employment-to-Population Ratio: A Review of the Evidence* 13-16 (Nat’l Bureau of Econ. Research, Working Paper No. 24333, 2018), <https://www.nber.org/papers/w24333.pdf> [<https://perma.cc/4X7E-M56U>] (analyzing decline in employment and concluding that major factor has been rise of automation). A recent International Monetary Fund study looking at 11,000 workers across both advanced and emerging economies concluded that worker reactions to automation vary, with important factors being age, job volatility, and the level of “robot” penetration in the domestic market. Carlos Mulas-Granados et al., *Automation, Skills and the Future of Work: What Do Workers Think?* 27-28 (Int’l Monetary Fund, Working Paper No. 19/288, 2019), <https://www.imf.org/en/Publications/WP/Issues/2019/12/20/Automation-Skills-and-the-Future-of-Work-What-do-Workers-Think-48791> [<https://perma.cc/JFQ4-ZTVJ>].

²⁰⁴ See *supra* note 203 (discussing recent empirical studies on impacts and risks of automating U.S. workforce). See generally NIR JAIMOVICH ET AL., THE MACROECONOMICS OF AUTOMATION: DATA, THEORY, AND POLICY ANALYSIS (2020), <https://www.brookings.edu/research/a-tale-of-two-workers-the-macroeconomics-of-automation/> [<https://perma.cc/8TAN-QE2P>] (conducting empirical examination of which workers are subject to employment risks due to automation and what employment outcomes they experience).

With respect to automation, recent studies have examined how likely it is that current jobs will be lost to automation and what the time horizon for such replacement will be.²⁰⁵ While studies have come to varying conclusions, what is clear is that some researchers believe that there is a risk that automation and offshoring of jobs will lead to more and/or faster job destruction than job creation.

The threats to workers presented by automation and offshoring may make it easier to shift workers to independent contractor status. If workers have less real or perceived bargaining power, they may be more likely to accept independent contractor work and independent contractor classification.

In summary, new § 199A does not operate in a vacuum. There are legal, economic, and other tax changes brewing that will also affect the extent to which broad shifts in work and worker classification are likely to occur. In light of these factors, focusing only on § 199A risks framing the inquiry too narrowly. The more important question is how tax laws and tax law changes contribute to and interact with other legal and economic factors in ultimately shaping work arrangements.

IV. EVALUATING A WORKPLACE SHIFT

Having assessed why a shift might occur and the factors that might encourage or limit such a shift, we turn now to policy. If § 199A does cause a widespread shift toward independent contractor work, how should we evaluate that shift? Are the risks associated with such a shift real or overstated? We first outline the potential horrors as articulated by academics and other commentators and then evaluate these concerns in light of contemporary trends and empirical data.

²⁰⁵ See generally JAMES MANYIKA ET AL., MCKINSEY GLOB. INST., A FUTURE THAT WORKS: AUTOMATION, EMPLOYMENT, AND PRODUCTIVITY (2017), https://www.mckinsey.com/~media/McKinsey/Featured%20Insights/Digital%20Disruption/Harnessing%20automation%20for%20a%20future%20that%20works/MGI-A-future-that-works_Executive-summary.ashx [https://perma.cc/89WP-75AE] (analyzing automation potential of global economy, factors determining pace and extent of workplace adoption, and economic impact, suggesting that half of today's work activities could be automated by 2055); Daron Acemoglu & Pascual Restrepo, *Robots and Jobs: Evidence from US Labor Markets* 36-37 (Nat'l Bureau of Econ. Research, Working Paper No. 23285, 2017), <https://www.nber.org/papers/w23285.pdf> [https://perma.cc/8FBL-FGZP] (estimating that robots will have large and robust negative effects on employment and wages across commuting zones); James Bessen, *How Computer Automation Affects Occupations: Technology, Jobs, and Skills* 20-26 (Bos. Univ. Sch. of Law, Law & Econ. Working Paper No. 15-49, 2016), <http://www.bu.edu/law/files/2016/10/NewTech-Oct-2016.pdf> [https://perma.cc/R4XN-DXUE] (rejecting computer automation as source of significant overall job losses but finding that computers contribute to significant job displacement through shift of work from noncomputerized, low-paying occupations to higher-paying, computerized occupations).

A. *The Potential Horribles*

Close examination of academic and news commentary shows that when academics, journalists, and policymakers express concern regarding a potential worker classification shift, they are actually articulating two separate worries: First, there is a worry about widespread erosion of traditional worker protections and benefits and a rise in contingent and precarious work. Second, tax scholars in particular are concerned about “gaming”—that is, taxpayers structuring transactions to deliberately avoid or minimize taxes owed. We discuss each of these in turn.

1. Precarious Work and the Erosion of Worker Protections

A popular contemporary narrative is that there has been a decline in traditional employment with its stability and protections and a rise in freelance, temporary, contract, and similar work. Sociologists, economists, and other commentators refer to this type of work as “precarious work” and have coined terms like the “precariat” (a frankenword alluding to the precarious proletariat) and “contingent workforce” and “alternative work arrangements” (terms denoting the class of workers who lack job security, stability, employee protections, and benefits).²⁰⁶

A 2017 survey commissioned by Freelancers Union and Upwork found dramatic growth in freelancers and projected that freelancers would comprise the majority of the U.S. workforce within the next decade.²⁰⁷ The study specifically found that 57.3 million people freelanced in 2017, that the freelance workforce had grown at three times the rate of the overall U.S. workforce since 2014, and that almost half of millennials freelanced.²⁰⁸ The report claimed:

²⁰⁶ See SUSAN J. LAMBERT, PETER J. FUGIEL & JULIA R. HENLY, UNIV. OF CHI., *PRECARIOUS WORK SCHEDULES AMONG EARLY-CAREER EMPLOYEES IN THE US: A NATIONAL SNAPSHOT* 18 (2014), https://www.ssa.uchicago.edu/sites/default/files/uploads/lambert.fugiel.henly_precarious_work_schedules.august2014_0.pdf [<https://perma.cc/F3VU-9JX7>] (finding that many workers are “at considerable risk of unpredictable, unstable work hours over which they may have little control”); GUY STANDING, *THE PRECARIAT: THE NEW DANGEROUS CLASS* 7-11 (2011) (discussing origins, definitions, and interpretations of term “precariat”); Arne L. Kalleberg, *Precarious Work, Insecure Workers: Employment Relations in Transition*, 74 AM. SOC. REV. 1, 2-17 (2009) (referencing “nonstandard” work, “contingent” work, and “alternative employment opportunities” in analyzing job insecurity, economic insecurity, and inequality in the contemporary employment sphere); Daniel Schneider & Kristen Harknett, *Consequences of Routine Work-Schedule Instability for Worker Health and Well-Being*, 84 AM. SOC. REV. 82, 107-09 (2019) (examining how unpredictable schedules are negatively associated with household financial security, health, and parenting practices).

²⁰⁷ FREELANCERS UNION & UPWORK, *FREELANCING IN AMERICA: 2017*, at 2 (2017) <https://s3.amazonaws.com/fuwt-prod-storage/content/FreelancingInAmericaReport-2017.pdf> [<https://perma.cc/7WMT-5JVT>].

²⁰⁸ *Id.* at 3.

The traditional pillars of work in America—commuting, a 9-to-5 workday, a single long-term employer—have been eroding for decades. An increasing number of Americans are forgoing work with a single employer—and the access to benefits like health insurance and retirement plans that go with it—in favor of the autonomy and flexibility that comes with freelancing.²⁰⁹

Independent contractor work is not necessarily synonymous with precarious or contingent work. For example, architects, lawyers, and other professionals might be well-remunerated and nonprecarious independent contractors, while food service workers may well be precarious employees. However, the rise in precariousness in the labor market is often broadly associated with a shift toward independent contractor or self-employed status since those statuses often do not provide the benefits and protections traditionally associated with full-time employment.

Several high-profile litigations involving technology firms such as Uber, Lyft, and Grubhub have reinforced the association between independent contractor status and contingent work. In litigation, these firms have characterized their workers as independent contractors and have invoked arbitration clauses, challenges to class action certifications, and substantive arguments to fight worker challenges to independent contractor classification.²¹⁰ To date the firms have been quite successful in staving off reclassification of workers as employees. In February 2018, a California court ruled that the plaintiff, a Grubhub delivery driver, was an independent contractor under California law.²¹¹ And in April 2018, a federal court in Pennsylvania ruled in favor of Uber's motion for summary judgment, finding that the plaintiff driver was an independent contractor—not an employee—under the FLSA.²¹²

²⁰⁹ *Id.* at 5.

²¹⁰ *See, e.g.,* *Lawson v. Grubhub, Inc.*, 302 F. Supp. 3d 1071, 1093 (N.D. Cal. 2018) (classifying driver as independent contractor under California labor law); *Cotter v. Lyft, Inc.*, 176 F. Supp. 3d 930, 931-37 (N.D. Cal. 2016) (denying plaintiffs' motion for preliminary approval of Lyft's proposed class action settlement yet rejecting arguments that settlement should have contained terms reclassifying Lyft drivers as employees); *O'Connor v. Uber Techs., Inc.*, 82 F. Supp. 3d 1133, 1137 (N.D. Cal. 2015) (describing Uber's self-identification as platform for independent contractor drivers to connect with passengers desiring rides); *see also* *Mohamed v. Uber Techs., Inc.*, 848 F.3d 1201, 1207-08 (9th Cir. 2016) (reviewing order denying motion to compel arbitration and describing Uber's use of class action waivers and arbitration agreements in driver contracts); *Lamour v. Uber Techs., Inc.*, No. 1:16-cv-21449, 2017 WL 878712, at *12 (S.D. Fla. Mar. 1, 2017) (granting Uber's motion to strike collective action allegations and staying case pending arbitrator's resolution of Lamour's individual claim).

²¹¹ *Lawson*, 302 F. Supp. 3d at 1093.

²¹² *Razak v. Uber Techs., Inc.*, No. 2:16-cv-00573, 2016 WL 5874822, at *19 (E.D. Pa. Oct. 7, 2016).

It is true that workers have recently prevailed in state-level unemployment-insurance litigations. For example, in July 2018, New York's Unemployment Insurance Appeal Board concluded in a final determination that three Uber drivers were employees entitled to New York state unemployment insurance benefits.²¹³ Additionally, in April 2018, the California Supreme Court adopted a new classification test—the ABC test—that likely makes it more difficult for businesses to classify workers as independent contractors (a decision that was the basis for California's 2019 legislation).²¹⁴ However, the litigation landscape has by and large favored hiring firms.²¹⁵ These types of litigations have helped associate contingent, on-demand work with an independent contractor shift.

2. Games, Tax Planning, and Tax Base Erosion

At the other end of the spectrum, when tax scholars and policymakers have worried about an independent contractor shift, they have also worried about high-end gaming and tax planning and the resulting tax base erosion. The expectation is that it is too easy for sophisticated taxpayers with access to good tax advice to restructure their operations or make alternative work choices so that they can take advantage of the new pass-through deduction. So, for example, law firms may find ways to convert lawyers who are currently employees into independent contractors or partners, assuming they are below the § 199A income thresholds and otherwise qualify for the deduction.²¹⁶

In contrast to concerns over worker precariousness, the gaming worry centers on distortionary and inefficient tax planning, unfair tax avoidance, and erosion of the tax base, all of which may lead to a decline in revenues and a ballooning federal deficit.²¹⁷ The worry is not that the workers in question are vulnerable; rather, it is that they may be too good at reducing their taxes.

B. *Breaking Down the Risks*

How concerned should we be with these policy horrors and the risks they present? To answer this question, we evaluate the currently available data on workforce composition, collected prior to § 199A taking effect. This allows us

²¹³ Uber Techs., Inc., Appeal Bd. No. 596722, at 10 (State of N.Y. Unemployment Ins. Appeal Bd. July 12, 2018), <http://uiappeals.ny.gov/uiappeal-decisions/596722-appeal-decision.pdf> [<https://perma.cc/6HTB-69X2>].

²¹⁴ See *supra* note 195 and accompanying sources. For a discussion of the 2019 California worker classification legislation, see *supra* Section III.A.2.

²¹⁵ Oei, *supra* note 58, at 128-29; Ring, *supra* note 148, at 83.

²¹⁶ See Kamin et al., *supra* note 4, at 1462-64 (describing “gaming” as process of reclassifying lawyers or doctors from employees to independent contractors to qualify for § 199A deduction).

²¹⁷ See *id.* at 1442 (suggesting that “many of the new changes fundamentally undermine the integrity of the tax code” and enable “well-advised” taxpayers to engage in “strategic planning”).

to get a sense of the types of shifts that are already underway, how concerning they are, and what other shifts might unfold in the future. We then discuss, by analyzing differently situated hypothetical workers, how the risks associated with a § 199A-induced shift toward independent contractor work may differ depending on the type of work and workers.

1. Size and Composition of the Independent Contractor Workforce

It is difficult to get a complete picture of contemporary workplace shifts, including worker classification shifts, based on existing empirical work. Incomplete data, definitional and measurement issues, and vested interests of some of those conducting the analyses mean that evidence of a workplace shift is messy and inconclusive.²¹⁸ While some claim that there has been a significant shift toward independent work, recent government data suggest that the shift may be overstated or at least may be a more complex phenomenon than simply employee jobs turning into independent contractor jobs. It is also difficult to get a complete picture of which populations and demographics are affected by workplace shifts. Even researchers who previously reported a shift toward independent contractor work have revised their earlier claims.²¹⁹

An important point to note is that “contingent work,” “independent contracting,” “alternative work arrangements,” “independent workforce,” and “freelancers” are all terms frequently used to describe the claimed phenomenon of a workplace shift. However, they do not all mean the same thing and are not all defined the same way in existing survey-based studies.²²⁰ Moreover, these terms do not map perfectly onto research findings based on tax return data.

Starting with the big picture, IRS tax return data show that in 2014, 190 million individuals filed a tax return with 146 million reporting positive earnings

²¹⁸ See, e.g., FREELANCERS UNION & UPWORK, *supra* note 207, at 1, 5 (reporting on “freelancers” (individuals who “perform[ed] supplemental, temporary, project- or contract-based work” in past twelve months) in study commissioned by independent contractor advocacy organization and gig-work employment platform); PAUL OYER, UPWORK, THE INDEPENDENT WORKFORCE IN AMERICA: THE ECONOMICS OF AN INCREASINGLY FLEXIBLE LABOR MARKET 1 (2016), https://s3-us-west-1.amazonaws.com/adquiro-content-prod/documents/paul_oyer_the_independent_workforce_in_america.pdf [<https://perma.cc/83N5-DXZP>] (study commissioned by gig-work employment platform).

²¹⁹ See Lawrence F. Katz & Alan B. Krueger, *Understanding Trends in Alternative Work Arrangements in the United States*, RSF, Dec. 2019, at 132, 133 [hereinafter Katz & Krueger, *Understanding Trends*] (reconciling results of authors’ 2015 study and BLS’s 2017 data, both cited *infra* note 224).

²²⁰ See CHARLES A. JESZECK ET AL., U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-15-168R, CONTINGENT WORKFORCE: SIZE, CHARACTERISTICS, EARNINGS, AND BENEFITS 3 (2015), <https://www.gao.gov/assets/670/669766.pdf> [<https://perma.cc/85LH-RATN>] (finding that proportional size of contingent workforce varies greatly depending on definitions and data source).

(including both wages and self-employment income).²²¹ Of those with positive earnings, 86.7% had solely W-2 income from an employer-employee relationship, 7.2% had income solely from self-employment, and 6.1% had both wage and employment income.²²² In the same year, 24.9 million individuals filed returns reporting nonfarm sole proprietorship (Schedule C) activity and almost 17 million individuals reported profit from self-employment earnings.²²³ These figures provide a sense of the raw numbers of self-employed taxpayers and the percentage of the workforce they represent.

But how has the share of self-employed taxpayers in the workforce changed over time? Here, findings from various studies must be pieced together to provide a clear picture. In June 2018, the U.S. Bureau of Labor Statistics (“BLS”) released preliminary 2017 survey data on contingent and alternative employment relationships.²²⁴ The last time BLS conducted such a survey was in 2005, before the financial crisis and the rise of the gig economy.²²⁵ While there has been much recent publicity about how the rise of the contingent workforce and nontraditional work arrangements is marking the end of traditional

²²¹ Emilie Jackson, Adam Looney & Shanthi Ramnath, *The Rise of Alternative Work Arrangements: Evidence and Implications for Tax Filing and Benefit Coverage* 10 (Office of Tax Analysis, Working Paper No. 114, 2017), <https://www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/WP-114.pdf> [<https://perma.cc/QB3X-76LG>].

²²² *Id.*

²²³ *Id.* at 3.

²²⁴ Press Release, U.S. Bureau of Labor Statistics, Contingent and Alternative Employment Arrangements—May 2017 (June 7, 2018), <https://www.bls.gov/news.release/pdf/conemp.pdf> [<https://perma.cc/S7KA-KDDF>] [hereinafter BLS 2017 Summary]. Prior to the release of this data, a National Bureau of Economic Research study sought to fill the 2005-2015 gap in BLS data collection on alternative work arrangements. See generally Lawrence F. Katz & Alan B. Krueger, *The Rise and Nature of Alternative Work Arrangements in the United States, 1995-2015* (Nat'l Bureau of Econ. Research, Working Paper No. 22667, 2016), <https://www.nber.org/papers/w22667.pdf> [<https://perma.cc/C2BN-6ZFZ>]. But that study was subsequently revised in light of updated BLS data. Lawrence F. Katz & Alan B. Krueger, *The Rise and Nature of Alternative Work Arrangements in the United States, 1995-2015*, 72 ILR REV. 382, 382-84 (2019) [hereinafter Katz & Krueger, *Rise and Nature*] (describing results of contingent worker survey with data from 2005 to 2015 and providing a short addendum reconciling BLS data); Katz & Krueger, *Understanding Trends*, *supra* note 219, at 133 (explaining timeline of 2015 study and release of BLS's 2017 study and reconciling discrepancy between them more fully).

²²⁵ ELKA TORPEY & ANDREW HOGAN, U.S. BUREAU OF LABOR STATISTICS, WORKING IN A GIG ECONOMY 3 (2016), <https://www.bls.gov/careeroutlook/2016/article/pdf/what-is-the-gig-economy.pdf> [<https://perma.cc/NG3M-FQGW>]. For the 2005 survey results, see generally Press Release, U.S. Bureau of Labor Statistics, Contingent and Alternative Employment Arrangements, February 2005 (July 27, 2005), https://www.bls.gov/news.release/archives/conemp_07272005.pdf [<https://perma.cc/4GET-J9YS>].

employment,²²⁶ the 2017 BLS data suggested that there had not been a dramatic shift toward alternative work arrangements.²²⁷ The BLS survey looked at two basic categories of nontraditional workers: those in “contingent work arrangements” (i.e., those reporting temporary jobs)²²⁸ and those in “alternative employment arrangements” (consisting of independent contractors, on-call workers, temporary help agency workers, and contract workers).²²⁹ The BLS preliminary data showed little or no shift in either contingent work or alternative employment arrangements. For example, under three different estimates, contingent workers accounted for between 1.3% and 3.8% of total employed workers in 2017, compared to between 1.8% and 4.1% in 2005.²³⁰ Similarly, 6.9% of workers under alternative work arrangements identified themselves as “independent contractors, independent consultants, or freelance workers, regardless of whether they are self-employed or wage and salary workers,” compared to 7.4% in February 2005.²³¹

²²⁶ See, e.g., INTUIT, INTUIT 2020 REPORT: TWENTY TRENDS THAT WILL SHAPE THE NEXT DECADE 20-21 (2010), https://http-download.intuit.com/http.intuit/CMO/intuit/futureofsmallbusiness/intuit_2020_report.pdf [<https://perma.cc/9X4T-UGNZ>] (predicting that percentage of contingent workers—freelancers, temps, part-time workers, and contractors—will rise from 25-30% of workforce to over 40% by 2020); Thogori Karago, *How the Freelance Generation Is Redefining Professional Norms*, LINKEDIN: OFFICIAL BLOG (Feb. 21, 2017), <https://blog.linkedin.com/2017/february/21/how-the-freelance-generation-is-redefining-professional-norms-linkedin> [<https://perma.cc/RU5U-ELWE>] (predicting that freelancers will comprise 43% of workforce in 2020, up from 6% in 1989); John White, *How the Rapid Rise of the Gig Economy Is Changing the Way We Work*, INC. (June 1, 2017), <https://www.inc.com/john-white/the-rapid-rise-of-the-gig-economy-is-changing-the-way-we-work.html> [<https://perma.cc/6H9Y-G8FH>] (contending that with gig economy, percentage of freelancers in United States will rise to 43% by 2020).

²²⁷ KAREN KOSANOVICH, U.S. BUREAU OF LABOR STATISTICS, WORKERS IN ALTERNATIVE EMPLOYMENT ARRANGEMENTS 2 (2018), <https://www.bls.gov/spotlight/2018/workers-in-alternative-employment-arrangements/pdf/workers-in-alternative-employment-arrangements.pdf> [<https://perma.cc/X4SK-8K4Y>]; BLS 2017 Summary, *supra* note 224, at 1. Other sources critique the claims that the number of gig workers is rising. See Ben Casselman, *The Exaggerated Gig Economy*, N.Y. TIMES, June 8, 2018, at B1 (identifying weaknesses in claimed growth in sector); Laura Gardiner, *Does the Gig Economy Revolutionise the World of Work, or Is It a Storm in a Teacup?*, ECONOMIST (Oct. 23, 2015), <https://www.economist.com/free-exchange/2015/10/23/does-the-gig-economy-revolutionise-the-world-of-work-or-is-it-a-storm-in-a-teacup> (analyzing limitations of current data).

²²⁸ Contingent workers provide their services without an implicit or explicit long-term contract. BLS 2017 Summary, *supra* note 224, at 2.

²²⁹ *Id.* The updated 2017 BLS survey added four new questions regarding the role of work found through mobile apps and websites. *Id.* at 1.

²³⁰ *Id.* at 2. Two of the three estimates include subsets of self-employed and of independent contractor workers. *Id.*

²³¹ *Id.*

Part of the reason the 2017 BLS data may have failed to reflect an increase in independent contractors was that the survey asked each respondent to report on her main job, a question that does not capture those respondents supplementing traditional work with nontraditional work as a side job.²³² As Annette Bernhardt has suggested, the BLS measurement consists mostly of “traditional independent contractors” (e.g., architects, real estate agents, and hair stylists) who do the independent contractor work as their main job.²³³ A 2019 IRS study supported this explanation, noting that among workers receiving Forms 1099 between 2000 and 2016, (1) the share of the workforce receiving income from nonemployee sources rose by 1.9%; (2) half of that increase developed from 2013 to 2016, primarily due to a rise in online platform workers; and (3) workers using online platforms for secondary or supplemental income drove the increase in platform work.²³⁴ Researchers at the Federal Reserve Bank of Boston (“Fed Bank”) have observed that the BLS statistics may not have captured those who engaged in informal work (including independent contractor work) to compensate for their inability to obtain full-time employment.²³⁵ This gap may be especially important given that Fed Bank’s own data indicated that the highest rates of participation in informal work were among workers designated “part-time for economic reasons”—those seeking full-time work but unable to find it—rather than those classified as unemployed or not in the workforce.²³⁶

The BLS data may have also failed to detect an increase in independent contractors due to inconsistent worker survey responses. A 2018 study compared

²³² For a useful review of the BLS release of preliminary data in June 2018, see Annette Bernhardt, *Making Sense of the New Government Data on Contingent Work*, U.C. BERKELEY LAB. CTR. (June 10, 2018), <http://laborcenter.berkeley.edu/making-sense-new-government-data-contingent-work/> [<https://perma.cc/9PSY-EH2H>].

²³³ *Id.* (“A lot of these workers are what I think of as traditional independent contractors—everything from real estate agents, architects, and entertainers to hair stylists, family child care providers, and plumbers.”).

²³⁴ Brett Collins et al., *Is Gig Work Replacing Traditional Employment? Evidence from Two Decades of Tax Returns 1, 8-9* (Mar. 25, 2019) (unpublished manuscript), <https://www.irs.gov/pub/irs-soi/19rpgigworkreplacingtraditionalemployment.pdf> [<https://perma.cc/JZ4C-UEPU>] (focusing on measuring taxpayers receiving Forms 1099, as opposed to Schedule SE filers, based on evidence that many workers receiving Form 1099 did not file Schedule SE even if it may have been required).

²³⁵ See Anat Bracha & Mary A. Burke, *Who Counts as Employed? Informal Work, Employment Status, and Labor Market Slack* 6 (Fed. Reserve Bank of Bos., Working Paper No. 16-29, 2016), <https://www.bostonfed.org/-/media/Documents/Workingpapers/PDF/wp1629.pdf> [<https://perma.cc/EDX5-FHPZ>] (explaining that many BLS measures would have been higher if they included informal workers).

²³⁶ *Id.*

census survey responses and tax data for the same individuals.²³⁷ Over the period from 1996 to 2012, the study found that although there was inconsistency in both directions, (1) self-employment reported through tax data grew “markedly” between 1996 and 2012²³⁸ and (2) there was a growing gap between self-employment numbers derived from tax data and self-employment numbers derived from survey data during this period.²³⁹ In short, some workers reported in surveys that they were employees despite filing a tax return reflecting self-employment.

A recent Treasury Office of Tax Analysis working paper that drew on tax return data helped to capture more detail on a possible rise in self-employment.²⁴⁰ The Treasury paper reported an increase in the number of individuals filing either Schedule SE (tax due on net self-employment earnings) or Schedule C (profit or loss from business) between 2000 and 2014, which suggests an increase in the number of independent contractors.²⁴¹ The share of the workforce reporting self-employment income on Schedule C rose from about 8.5% to 11% over that period.²⁴² The 2019 IRS study of 1099 workers offered further insight into this growth, finding that the rise in Schedule SE filing from 2007 to 2016 was due to workers without Forms 1099 who were EITC claimants.²⁴³

The Treasury paper attributed the shift largely to an increase in self-employed individuals with relatively low business expenses, which suggests that the

²³⁷ Katharine G. Abraham et al., *Measuring the Gig Economy: Current Knowledge and Open Issues* 17 (Nat’l Bureau of Econ. Research, Working Paper No. 24950, 2018), <https://www.nber.org/papers/w24950.pdf> [<https://perma.cc/83G4-M4B7>].

²³⁸ *Id.* at 19, 46 fig.2A (describing discrepancies between both data sources).

²³⁹ *Id.* at 19, 46 fig.2B. Of these tax-reported self-employed workers, some reported no employment income in the survey, some reported only wage income in the survey and both wage and employment income for tax, and some reported only wage income in the survey and only self-employment income for tax. *Id.*

²⁴⁰ See Jackson, Looney & Ramnath, *supra* note 221, at 9. The Treasury report details the shortcomings of survey data in capturing self-employment income and reviews the reasons for these deficits. *Id.* at 6-8.

²⁴¹ *Id.* at 16, 26 fig.3. The number of individuals filing Schedule C increased by 37% and those with self-employment income increased by 29%. *Id.*

²⁴² *Id.* In 2014, there were 19.3 million Schedule SE filers, of which 3.4 million were primarily wage earners, 3.5 million were filers with both wage and sole proprietorship income, and 10.3 million were primarily self-employed sole proprietors. *Id.* at 31 tbl.4. Treasury described filers with at least 85% of their earnings from wages as “primarily wage earners”; described filers with between 15% to 85% of their income from wages (but who also filed Schedule C with a profit) as filers with “earnings from both wages and sole proprietorship”; and described filers with less than 15% of income from wages (and who filed Schedule C with a profit) as “primarily self-employed sole proprietors.” *Id.* at 14.

²⁴³ See Collins et al., *supra* note 234, at 19.

income is earned largely from labor rather than capital inputs.²⁴⁴ For example, the study found a 70% increase in the number of Schedule SE filers with earnings from both wages and sole proprietorships with less than \$5000 of expenses, but only a 5% increase in filers with more than \$5000 of expenses.²⁴⁵ The share of the workforce with primarily sole proprietor earnings but less than five thousand dollars in expenses increased by 88%.²⁴⁶ There was also a 36% increase in filers who were primarily wage earners but also had sole proprietorship earnings.²⁴⁷ Thus, the Treasury data revealed an increase in self-employed individuals largely providing labor with low business expenses and showed that this increase happened with respect not only to those whose primary income source was wages but also to those whose primary source of income was self-employment.²⁴⁸

With respect to the gig economy, the Treasury study found that for 2014, only 109,700 individuals reported income from gig work.²⁴⁹ Of these, 39% were primarily wage earners who supplemented wages with gig work, 19.5% had income from both wages and self-employment, and 33% did gig work as their primary job.²⁵⁰ Consistent with other studies, Treasury found that only a small percentage of the total workforce (0.7%) had worked for an online platform in 2014, despite the fact that much of the public debate over work centers on the gig economy.²⁵¹

²⁴⁴ See Jackson, Looney & Ramnath, *supra* note 221, at 13, 17.

²⁴⁵ *Id.* at 17, 31 tbl.4.

²⁴⁶ *Id.*

²⁴⁷ See *id.* at 31 tbl.4.

²⁴⁸ *Id.* at 17. Others have suggested more strongly that the increase in self-employment is primarily due to individuals doing supplemental work. See, e.g., Lawrence Mishel, *Social Security Data Confirm Same Old Pattern: Self-Employment Headcount Has Risen but Economic Impact Remains Small*, ECON. POL'Y INST.: WORKING ECON. BLOG (June 28, 2018, 10:35 AM), <https://www.epi.org/blog/social-security-data-confirm-same-old-pattern-self-employment-headcount-has-risen-but-economic-impact-remains-small/> [<https://perma.cc/TVD6-ZM6N>] (extrapolating from Social Security data that 40% of self-employed taxpayers also had W-2 income and noting that “inflation adjusted self-employment earnings per filer actually declined 5.8 percent from 2000 to 2015 while W-2 wage earners saw their annual earnings grow by 8.5 percent”).

²⁴⁹ Jackson, Looney & Ramnath, *supra* note 221, at 16 (“In 2014, only a small group—about 109,700 individuals—file[d] a return reporting income from participating in a ‘gig economy’ or online platform based business . . .”). “Gig economy” refers to work performed as an independent contractor through platforms such as Airbnb and TaskRabbit. See Oei, *supra* note 58, at 109-11 (discussing evolving usage and impact of terms “sharing economy,” “gig economy,” “1099 economy,” and others).

²⁵⁰ Jackson, Looney & Ramnath, *supra* note 221, at 16 (quantifying primary income sources for gig economy participants).

²⁵¹ *Id.* at 7-8, 16. Studies suggest that the gig economy comprises 0.4% to 0.6% of workers, and one study found that within its survey pool, the percentage of adults who had worked in

Another recent paper based on tax return data supported and extended some of the findings of the Treasury study.²⁵² That paper found a 22% increase in workers with independent contractor income between 2001 and 2016, which corroborated the findings of the Treasury study.²⁵³ The paper found a steady increase in workers earning independent contractor income as their primary income source, as well as an increase in workers earning independent contractor income as supplemental income.²⁵⁴ Primary earners earning primarily independent contractor income exhibited the fastest growth, though the number of workers earning independent contractor income as a secondary income source had grown rapidly since 2013.²⁵⁵ However, the paper also found that the largest share of independent contractors received most of their income from wage employment and were in the top income quartile.²⁵⁶ These findings were also in line with the Treasury study's findings that increases in independent contractor work were occurring with respect to differently situated workers.

In addition, the paper found that the growth in independent contractors was disproportionately driven by increases in female independent contractors; that "the majority" of female independent contractors had independent contractor income that supplemented W-2 earnings; and that the largest growth in female independent contractors occurred for those for whom independent contractor earnings were the primary source of labor income, with these latter households being disproportionately in the bottom income-distribution quartile.²⁵⁷ The paper seems to suggest that some of this independent contractor growth stemmed from individuals transitioning from having no employment income to having independent contractor income.²⁵⁸

Together, BLS and Fed Bank survey data and the studies based on tax return data allow us to make some preliminary observations. First, the Treasury and Fed Bank studies suggest that notwithstanding the BLS data there has already been some increase in self-employment and independent contracting,

the gig economy within the previous thirty days rose from 0.1% in October 2012 to 1% in September 2015. *Id.* at 7; see DIANA FARRELL & FIONA GREIG, JPMORGAN CHASE INST., PAYCHECKS, PAYDAYS AND THE ONLINE PLATFORM ECONOMY 5 (2016), <https://www.jpmorganchase.com/corporate/institute/document/jpmc-institute-volatility-2-report.pdf> [<https://perma.cc/5YTR-GSN5>].

²⁵² Katherine Lim et al., Independent Contractors in the U.S.: New Trends from 15 Years of Administrative Tax Data 2 (July 2019) (unpublished manuscript), <https://www.irs.gov/pub/irs-soi/19rpindcontractorinus.pdf> [<https://perma.cc/7Y3W-8H4H>].

²⁵³ *Id.* at 2, 8. Lim et al. operationalize their study differently than the Treasury study (by excluding those with large deductions) in order to isolate individuals receiving compensation for their labor rather than capital investments. *Id.* at 10-11.

²⁵⁴ *Id.* at 17.

²⁵⁵ *Id.* at 18-19.

²⁵⁶ *Id.* at 19.

²⁵⁷ *Id.*

²⁵⁸ See *id.* at 22.

represented mostly by labor providers with low expenses rather than traditional small business work. The fact that Treasury and Katherine Lim and her coauthors uncovered an increase while BLS did not may be due to the fact that some of the increase was attributable to individuals earning a mix of wage and self-employment income. BLS, by focusing on main jobs, would not have picked this up.²⁵⁹ Interestingly, authors of a 2015 study finding a notable rise in alternative work arrangements recently restated their own findings.²⁶⁰ The original paper contended, based on an online survey, that alternative work arrangements in the United States (defined as including temporary, on-call, and contract workers as well as independent contractors and freelancers) rose from 10.7% in 2005 to 15.8% in 2015, with the largest rise (increasing from 1.4% to 3.1%) due to those working for contract companies.²⁶¹ However, the authors reassessed the work in light of the 2017 BLS data and IRS data through 2016, and they have now concluded that the growth in alternative work arrangements was more modest once adjusted for differences in survey methods, data reliability, and cyclical labor markets.²⁶²

Any numerical increase aside, the characteristics of the new self-employed filers are also important. Studies based on tax return data suggest that some nontrivial portion of self-employed taxpayers—and a nontrivial portion of the *increase* in such taxpayers—is attributable to workers with W-2 jobs who are more likely to have some protections and benefits from the W-2 jobs and who do self-employment work on the side.²⁶³ For such taxpayers, a shift toward independent contractor work may be less—or differently—concerning than if the shift was due to workers leaving (or losing) W-2 jobs altogether to do independent contractor jobs. As Bernhardt argued, much of the increase in independent contractor work that has been observed thus far might reflect a “privatization of the safety net”—in which workers supplement income or manage financial shocks by working a second job—rather than a shift away from W-2 work *per se*.²⁶⁴ The question, then, is how we feel about such privatization as a policy matter. For example, we might ask whether factors such as stagnant

²⁵⁹ See, e.g., Abraham et al., *supra* note 237, at 5 (seeking to reconcile current data); Bernhardt, *supra* note 232 (describing BLS survey’s objectives and data observed).

²⁶⁰ See generally Katz & Krueger, *Understanding Trends*, *supra* note 219.

²⁶¹ Katz & Krueger, *Rise and Nature*, *supra* note 224, at 383.

²⁶² Katz & Krueger, *Understanding Trends*, *supra* note 219, at 144.

²⁶³ See also Mishel, *supra* note 248 (drawing similar conclusions from Social Security data).

²⁶⁴ Bernhardt, *supra* note 232 (“If so, that would mean that independent contracting isn’t so much replacing W-2 jobs as making up for low wages, insufficient hours, or loss of earnings during spells of unemployment. At least for low-income workers, we may well be seeing the privatization of the safety net.”); Amanda Dixon, *The Average Side Hustler Earns over \$8K Annually*, BANKRATE (June 25, 2018), <https://www.bankrate.com/personal-finance/smart-money/side-hustles-survey-june-2018/> [https://perma.cc/B8PN-MBKJ] (reporting Bankrate survey that 37% of Americans have side jobs and 38% of them rely on additional income to fund ordinary living expenses).

wages have led to such privatization and whether tax law overly subsidizes this privatized safety net, entrenching it at the expense of other methods of delivering economic security, such as direct governmental support. We might also plausibly ask whether the new tax law will lead to a shift from wage work to independent contractor work that is fundamentally different than the part-time shifts that may have happened to date.

2. Heterogeneous Policy Concerns in a Heterogeneous Workforce

In light of the complexities revealed by the existing data, we now look at how the policy risks of an independent contractor shift induced by § 199A may vary depending on the type of work and workers. As the above discussion shows, workers and work arrangements are heterogeneous: workers may do primarily W-2 work and earn supplemental self-employed income, a mix of both types of work, or be primarily self-employed, and each worker's mix may change over time. The incentives and preferences of each type of worker vary and correspondingly their responses to § 199A will likely vary as well. The real impact of § 199A will turn on the specifics of each worker's situation.

To highlight the real-world variation, we now discuss some examples of differently situated workers, the potential impacts of § 199A on them, and the potential policy risks posed in each case. Our discussion shows that the policy concerns raised by any workplace shifts will vary depending on how a worker is situated and that it is difficult to make generalizations about the dangers and desirability of such shifts.

a. *Worker Currently Combining W-2 Work and Part-Time Independent Contractor Work*

The BLS, Treasury, and IRS data suggest that there is a nontrivial-sized group of workers who may work a main W-2 job and do independent contractor work on the side for supplemental income or who do a combination of W-2 and independent contractor work.²⁶⁵ Section 199A may cause such workers to work less. Thus, for example, a W-2 worker who drives for Uber on the weekends might drive less because the § 199A deduction enables her to achieve the same after-tax pay from fewer hours of driving. Alternatively, § 199A may lead the worker to either drive more hours and sacrifice leisure (because driving has become more financially attractive after taxes) or drive more and quit the W-2 job (because driving for Uber is now more financially rewarding than the W-2 work).

In some cases, workers who keep their W-2 positions and drive either more hours or fewer hours in response to § 199A may raise fewer concerns about

²⁶⁵ Bernhardt, *supra* note 232 (estimating, based on Treasury study, that 6% to 8% of workers supplement W-2 work with independent contractor work); see Collins et al., *supra* note 234, at 4 (finding that contractor work “typically supplements traditional W2 traditional jobs over the course of the year” for many workers); *supra* Section IV.B.1 (discussing size and composition of contractor workforce).

worker precariousness. Some of these workers may already derive healthcare, retirement, and other benefits from their W-2 work and may be less concerned about the limited protections of the independent contractor job. They might prioritize the flexibility of the side job over employee protections, especially if they believe that reclassification might reduce pay or make the side job disappear through automation or offshoring should firm costs (with employees) rise too high.²⁶⁶ For these workers, the § 199A deduction might act primarily as a subsidy that buttresses income security. This viewpoint is reflected in heterogeneous attitudes that have been expressed by Uber and Lyft drivers; despite high-profile litigations, it is clear that not all drivers want to be employees. Rather, some prefer the flexibility and independence of independent contractor status.²⁶⁷ Indeed, after California's recent *Dynamex* decision, one driver articulated the hope that the ruling would force Uber to allow drivers to be more independent and to set their own rates.²⁶⁸

Workers who quit their W-2 jobs or reduce W-2 work to take on more independent contractor work due to § 199A raise different and potentially more serious concerns. If such a shift occurs, that might cause us more worry about loss of benefits and protections from traditional employment. The degree of worry would depend on what type of independent contractor work is replacing the W-2 work. If workers switch from secure W-2 jobs to become well-remunerated, self-employed professionals, such as architects or engineers, and if we assume that these types of workers are sophisticated enough to self-insure against risks and shocks, this might raise concerns about gaming and tax-base erosion but perhaps not so much about worker precariousness. But if workers quit solid W-2 jobs to take on precarious independent contractor work in light of the new deduction, this would be more worrisome.

Likewise, if employers use the new § 199A deduction as an excuse to eliminate W-2 jobs and convert the workforce into reduced-security independent contractor jobs, this would raise concerns about workplace shifts and worker precariousness. As noted, however, the incentives for employers to initiate the shift are complex because the § 199A benefit nominally inures to the worker, and hiring firms must be able to make a plausible case under the various tests

²⁶⁶ See Shu-Yi Oei & Diane M. Ring, *The Tax Lives of Uber Drivers: Evidence from Internet Discussion Forums*, 8 COLUM. J. TAX L. 56, 88 (2017).

²⁶⁷ See *id.*; Tom Welsh, *The Uber Ruling Is Bad for Drivers and Customers—Self-Employment Is the Way Forward*, TELEGRAPH (Oct. 29, 2016, 10:27 PM), <https://www.telegraph.co.uk/news/2016/10/29/the-uber-ruling-is-bad-for-drivers-and-customers---self-employme/> [<https://perma.cc/599V-GZFR>] (offering U.K.-based view that employee classification could be undesirable for drivers due to likely effects on prices customers are charged and level of control exerted by Uber).

²⁶⁸ Andrew Khouri & Tracey Lien, *Work Rules Set to Change; Gig Jobs May Face a Shakeup After a Court Ruling on Classification of Contractors*, L.A. TIMES, May 2, 2018, at C1 (discussing possible responses to California decision).

that the workers are independent contractors, a factor that might prevent some shifts.²⁶⁹

b. *Existing Full-Time Independent Contractor*

Workers who are currently full-time independent contractors present different issues. The § 199A deduction may solidify such workers' independent contractor statuses. This outcome would pose no problem for those workers who genuinely belong in the category, such as professionals with their own client bases, as long as they otherwise meet the statutory line-of-business and income-threshold requirements.²⁷⁰

But for independent contractors who are improperly classified, there are two interconnected ways in which the deduction might cement the inappropriate classification: First, the deduction, which effectively increases the after-tax income of the worker at no cost to the business, may lower worker resistance to misclassification and dampen protests, reducing the likelihood of worker lawsuits and leaving the task of identifying misclassifications to government-initiated actions. Second, if workers increase labor supply due to the deduction, this would benefit employers, lowering costs and giving hiring firms leeway to weed out disgruntled workers.

For some workers, the question of whether they have been misclassified may be a close call. Assuming that in such borderline cases workers are less likely to prevail in a lawsuit, the new § 199A deduction could be viewed as a partial subsidy offsetting their loss of benefits due to a misclassification that is unlikely to be rectified in court.

c. *Worker Currently Combining Full-Time and Part-Time W-2 Work*

Not all workers seeking to supplement full-time W-2 work do so through independent contractor work. Some may do part-time W-2 work (e.g., evening or weekend shifts in food service or retail). For such workers, the § 199A deduction creates a potential inequity between their part-time W-2 work and the independent contractor work done by others. This might entice such workers to replace full- or part-time W-2 work with part-time independent contractor work.

Some workers might keep their main W-2 jobs for their protections and benefits while replacing their part-time W-2 jobs with independent contractor jobs to qualify for the § 199A deduction. Others may cut back on both their main W-2 work and their part-time W-2 work to take advantage of § 199A, either by switching jobs or by seeking to reclassify existing jobs. Again, the extent to which we find these moves concerning would depend on (1) the type of independent contractor work at issue and how precarious it is and (2) the extent to which the switch happens because hiring firms are successfully using § 199A

²⁶⁹ See Treas. Reg. § 1.199A-5(d)(3) (2019) (creating rebuttable presumption that former employees are still employees).

²⁷⁰ See I.R.C. § 199A(d)(2)-(3), (e)(2) (2018); *id.* § 1202(e)(3)(A) (describing those requirements).

as an impetus to eliminate W-2 jobs. Hiring firms' abilities and propensities to eliminate W-2 jobs will also depend on each firm's ability to meet the relevant legal tests and rebut the applicable regulatory presumptions; the elasticity in labor markets; and the availability of alternative cost-saving workforce solutions, such as subcontracting.

d. *Full-Time W-2 Employee Converting to Independent Contractor*

A final shift worth observing is the possibility that some current full-time W-2 workers will shift to full-time independent contractors. This could happen in two ways: First, these workers may remain at the same W-2 jobs but attempt to relabel themselves as independent contractors. Second, workers may quit or cut back on their W-2 jobs and take up independent contractor jobs instead.

For sophisticated employees, the first outcome may well fall into the gaming category.²⁷¹ For example, sophisticated employees may try to sever employment and come back as independent contractors doing substantially the same work, or those employees may combine with others to form partnerships that provide services to the businesses that previously employed them.²⁷² This may invite scrutiny regarding whether the new arrangement is sufficiently different from the old and whether the requirements for independent contractor classification are satisfied.²⁷³ As a policy matter, how problematic we find this planning behavior will partially depend on how aggressive and unethical such gaming is compared to the tax planning and gaming that already happens under current law. For other workers, relabeling may occur at the initiative of the employer and may succeed due to the workers' failure to appreciate the loss of protections or the workers' lack of negotiating power. For such workers, the concern would be less about gaming and more about a rise in precariousness.

With respect to the second strategy, our assessment of the risks will depend on the type of independent contractor job the employee has shifted to (i.e., precarious or not), the sophistication of the worker (i.e., whether she is able to self-insure), and the degree of compulsion the hiring firm exercises upon the worker.²⁷⁴ As noted, we might be less worried about higher-income workers becoming self-employed than we are about shifts happening with respect to precarious or poorly compensated workers.

²⁷¹ See Kamin et al., *supra* note 4, at 1442 n.5 (using "terms 'tax games' and 'tax gaming' to refer to both legal tax avoidance and illegal tax evasion, as well as to the large gray area of tax planning transactions that are neither clearly legal nor clearly illegal").

²⁷² See *id.* at 1463 (discussing potential reasons for switching from employee status to independent contractor status while doing similar work).

²⁷³ The regulations provide that employees who are subsequently treated as independent contractors will be presumed to be employees unless they can rebut such a presumption. Treas. Reg. § 1.199A-5(d)(3).

²⁷⁴ Some of the benefits of employee status may not be salient to workers. For example, various worker protections (including antidiscrimination protections) may not be appreciated until they are needed.

C. *Summary*

This Article's analysis has suggested a number of key takeaways.

First, this Article has described the process by which hiring firms and workers decide how to structure work arrangements and classify workers as a series of trade-offs among direct labor and employment protections; indirect, tax-delivered social insurance benefits; and tax consequences. Because arbitrage across fields is difficult, firms and workers will usually have to be consistent in making that trade-off. Therefore, we must take seriously any legal changes that tilt firm and worker choices, whether they be tax law changes or otherwise.

Second, this Article has argued that the nature and magnitude of an independent contractor shift will depend on a number of variables, not just § 199A. Factors such as whether the jobs in question can plausibly satisfy the classification tests, the risk of misclassification penalties and worker challenges, and IRS regulatory and enforcement choices may help limit a shift. With respect to § 199A itself, factors such as the statute's complexity, its line-of-business limitation, and the need to pay a minimum amount of W-2 wages to employees may mean that certain industries or income brackets will experience less of a shift. The contested legal landscape outside of the tax realm matters as well; shifting interpretations of the various control tests may make it easier or more difficult for employers to classify workers as independent contractors. And there are other legal and economic factors that may exacerbate a workplace shift such that it is difficult to isolate § 199A as the primary cause.

Third, this Article has demonstrated that the types of work and worker matters. For example, if a worker has a main W-2 job with solid benefits and is holding a part-time W-2 job or independent contractor position to buttress income security or to boost cash flow, we might find shifts pertaining to the part-time work less or differently troublesome than wholesale shifts that eliminate, erode, or cause abandonment of the main W-2 job. For this type of worker, the § 199A deduction might well act as a tax expenditure that boosts income security, either providing more income (if hours worked stay the same) or allowing more leisure time (because the worker has to work fewer hours at the second job). The question would then be whether boosting income security with this type of tax expenditure is good policy. Likewise, if a worker shifts from a W-2 job with solid benefits and protections to a highly skilled, well-remunerated independent contractor job (e.g., by becoming a self-employed sole proprietor), this might cause less (or at least different) concern than if the worker abandoned the W-2 job to do precarious work.

In summary, any independent contractor shift caused by § 199A could have one of several effects:

- (1) For some workers, including current independent contractors who are unlikely to prevail in misclassification litigation or those already doing

independent contractor work as a second job, § 199A could act as an income subsidy.²⁷⁵

- (2) More specifically, to the extent that such workers are doing the independent contractor job to supplement income or smooth economic shocks or risks, § 199A could be a tax expenditure that subsidizes this privately constructed social safety net.
- (3) For other workers, § 199A could cause an erosion of employee protections and an uptick in worker precariousness by causing a widespread shift toward independent contractor work, either by causing elimination of W-2 jobs (and conversion of such jobs into independent contractor jobs) or by incentivizing workers to substitute independent contractors work for W-2 jobs.
- (4) For more sophisticated taxpayers, § 199A might lead to gaming and tax structuring as taxpayers choose self-employment or other pass-through structures rather than employee status.
- (5) Section 199A might—by subsidizing worker wages or incentivizing independent contractor arrangements—help domestic labor be more attractive than offshoring or replacing jobs with automation and might thereby help preserve jobs or slow job loss.
- (6) Section 199A may have no economic benefits for workers and/or lead to no shifts. For example, if hiring firms capture the full economic benefits of § 199A (e.g., by reducing wages so workers' after-tax incomes do not change regardless of classification), workers may not enjoy any income subsidy even if they are nominally eligible for the deduction. Or, if hiring firms have already shifted all plausible jobs, § 199A may result in no further shifts.

The empirical questions going forward—which will drive our normative assessment of the outcomes—are the extent to which each of these outcomes will occur and which ones will be most dominant. For now, current empirical data on workplace trends suggest that the first and second effects could be nontrivial and should not be discounted.

Finally, whether § 199A will lead to a widespread independent contractor shift will depend on two factors: First, how valuable will workers perceive the § 199A deduction to be, and how valuable will it actually be, relative to the benefits and protections given up? This will likely vary by job and worker. Second, how many existing W-2 jobs can plausibly be reclassified, given the shifts that have already happened? Shifting would likely require a reduction in control that some businesses could not tolerate, which may be especially true for

²⁷⁵ As noted above, the size and availability of a worker's EITC could be impacted by the shift from employee to independent contractor regardless of any § 199A deduction. *See supra* note 101.

low-wage employee work. If so, this may mean that for at least some vulnerable workers, the difficulty of meeting the classification tests may forestall dramatic workplace shifts and the accompanying loss of benefits.

Stepping back, there are deeper questions at stake in the debate over § 199A's effects: How much economic security are citizens owed? And how much of this security should be attached to work? There are four potential providers of economic security and a social safety net: employers, citizens themselves, the government (and within this category, state or federal), and broader society (including family, friends, and broader communities).

Some of the concern regarding an independent contractor shift stems from the suspicion that society is moving away from a world where traditional employment relationships provided security to workers through a network of direct benefits and protections to a more precarious world in which work carries fewer protections and individuals are left to fend for themselves, perhaps with the help of friends, family, and broader communities. Although current data reveal that most work today remains W-2 work, there may be an increase in part-time independent contractor work to supplement W-2 work in light of stagnant wages and reduced benefits. This "privatization of the social safety net" may reflect a shift from having an economic safety net provided by employers and/or the government to one based on citizens' self-insuring through part-time work.²⁷⁶

There have, of course, been some countervailing shifts. For example, the ACA, with its premium tax credits and cost-sharing subsidies, arguably represented a shift in the locus of healthcare provision from employers to the government.²⁷⁷ This type of shift might alleviate pressure on employee-employer relationships to provide this aspect of the safety net. Along these same lines, the new § 199A deduction could potentially act as an indirect government subsidy that helps boost income or leisure consumption for some classes of workers. A separate but related workplace shift can be observed in proposed state-level initiatives to provide piecemeal protections to independent contractors. New York City, for example, passed legislation in August 2018 that allowed city regulators to set minimum pay rates for drivers.²⁷⁸ There have also

²⁷⁶ See Bernhardt, *supra* note 232 (noting that some independent contractor work supplements rather than replaces W-2 jobs); Dixon, *supra* note 264 (reporting Bankrate survey that 37% of Americans have side jobs and 38% of them rely on additional income to fund ordinary living expenses).

²⁷⁷ See generally Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended at 42 U.S.C. §§ 18001-18122 (2018)).

²⁷⁸ N.Y.C., N.Y., ADMIN. CODE § 19-549 (2018).

been initiatives in Seattle²⁷⁹ and California²⁸⁰ aimed at giving certain workers collective bargaining rights, regardless of their classification. Relatedly, bills have been proposed in New York and Washington state that would establish benefits frameworks for certain workers even if they are not employees.²⁸¹ While most of these initiatives have not been enacted so far, and while the protections they offer are piecemeal and limited, such initiatives offer an alternative vision of who should be providing the economic safety net (and how much) and whether eligibility should depend on one's job.

The important point is that how one feels about § 199A, the ACA, or any of the recent state-level initiatives will likely depend on how one answers the normative question of who should provide the safety net.²⁸² While some might

²⁷⁹ In May 2018, the Ninth Circuit ruled that a Seattle ordinance effectively allowing ridesharing drivers to “unionize” was not exempt from federal antitrust law (Sherman Act) preemption, thus keeping the law tied up in litigation. *See* Chamber of Commerce v. City of Seattle, 890 F.3d 769, 782 (9th Cir. 2018) (finding that Seattle ordinance did not qualify for protection under state-action immunity doctrine). The court also ruled that the ordinance did not violate the NLRA. *Id.* at 790. In its ruling, the court implied that it was possible for the state legislature to create an ordinance that was both Sherman Act and NLRA compliant (even though the contested ordinance did not satisfactorily do so). *See id.*

²⁸⁰ Reportedly, proposed California legislation was strategically withdrawn to let related litigation take priority (and due to concern over potential antitrust challenges). *See* Kate Conger, *California Bill to Give Gig Workers Organizing Rights Stalls over Antitrust Concerns*, TECHCRUNCH (Apr. 21, 2016, 6:14 PM), <https://techcrunch.com/2016/04/21/california-bill-to-give-gig-workers-organizing-rights-stalls-over-antitrust-concerns/> [<https://perma.cc/VVU6-39KG>] (considering whether collective bargaining rights for independent contractors would violate antitrust laws); *see also* Dubal, *Winning the Battle, Losing the War?*, *supra* note 5, at 744-45 (contending that California Assemblyperson Lorena Gonzalez was “not mov[ing] forward with [a] gig worker bill . . . because the labor community asked them to hold off until *O'Connor* went to trial”).

²⁸¹ Dan Levine & Kristina Cooke, *Unions, Gig-Economy Firms Gear Up for New York Benefits Battle*, REUTERS, Nov. 28, 2016, <https://www.reuters.com/article/us-labor-tech-benefits/unions-gig-economy-firms-gear-up-for-new-york-benefits-battle-idUSKBN13N0YL> [<https://perma.cc/5JHS-B86J>] (highlighting proposed New York legislation targeted toward improving worker benefits by increasing portability); *see* Josh Eidelson, *It's a New Game for Uber Drivers If New York Passes This Law*, BLOOMBERG (Jan. 10, 2017, 8:00 AM), <https://www.bloomberg.com/news/articles/2017-01-10/it-s-a-new-game-for-uber-drivers-if-new-york-passes-this-law> (describing upsides for Uber drivers resulting from New York's proposed portable benefits legislation). For Washington state's version of the legislation, *see* H.R. 2109, 65th Leg., Reg. Sess. (Wash. 2017); Maia Usui, *A Blueprint for Progressive Federalism: Washington State's Portable Benefits Bill*, ONLABOR (May 17, 2017), <https://onlabor.org/a-blueprint-for-progressive-federalism-washington-states-portable-benefits-bill/> [<https://perma.cc/B4CW-A9BM>].

²⁸² To the extent that the government provides some elements of the economic safety net, a secondary question is whether this should be done through the Tax Code, as both the ACA premium subsidies and § 199A are. Critics might well argue that even if the government should play a greater role in providing the safety net, this should be done directly (such as

rue a shift from a world in which hiring firms and traditional employer-employee relationships provided the bulk of economic security, others might argue that, to the extent that the government is playing a greater role in subsidizing healthcare and (possibly) secondary self-employment earnings through provisions like § 199A, this might not be a bad thing in some circumstances.²⁸³ Such observations do not obviate criticisms of § 199A's design. The actual statute could still prove distortionary, inequitable, and overly complicated despite reasonable underlying policies.²⁸⁴

CONCLUSION

This Article explored the relationship between tax law and decisions about workplace arrangements. Most pertinently, it investigated whether the 2017 tax reform is likely to give rise to a broad shift toward independent contractor work and, if such a shift does occur, how it should be normatively evaluated. We argued that while § 199A may create a greater tilt toward independent contractor classification for some workers, certain statutory features and other factors may help limit the shift. Still other factors may exacerbate it, such that it is difficult to isolate § 199A's effects.

We also demonstrated, drawing on empirical data on the state of the contemporary workplace, that even if § 199A were to prompt a shift, our evaluation of the shift should depend on the types of workers and work at issue. Different workers confront different realities. While a shift toward independent contractor classification may be problematic for some workers, empirical data suggests that for others it may be less troubling or troubling for different reasons. There are multiple possible dimensions to any workplace shift that might occur, so it is important to distinguish among different underlying policy concerns.

This Article by no means implies that today's workers do not face significant challenges. Today's workers are confronted with stagnant wages, loss of organizing power, decreasing workplace benefits, and increasing inequality.²⁸⁵

through a universal basic income or a single-payer healthcare system) rather than via an indirect tax expenditure. Resolving that debate is beyond the scope of this Article.

²⁸³ See Estlund, *supra* note 10, at 254 (arguing that separating worker entitlements from employment relationships might help reduce labor costs and slow replacement of jobs with automation and "fissuring"); cf. David Gamage, *How Should Governments Promote Distributive Justice?: A Framework for Analyzing the Optimal Choice of Tax Instruments*, 68 TAX L. REV. 1, 4 (2014) (discussing "double distortion").

²⁸⁴ See generally ANNIE LOWREY, GIVE PEOPLE MONEY (2018) (advocating universal basic income as remedy for poverty, inequality, and worker displacement by technology); Linda Sugin, *Tax Expenditures, Reform, and Distributive Justice*, 3 COLUM. J. TAX L. 1 (2011) (challenging critiques of tax expenditures as appropriate ways to achieve certain government goals).

²⁸⁵ See Jeff Stein & Andrew Van Dam, *For the Biggest Group of American Workers, Wages Are Falling*, WASH. POST, June 17, 2018, at A14 (discussing wages, weaker union rights, and distribution of growth in society).

Hiring firms have found other means to cut costs and limit liability, including by entering into cost-saving subcontracting relationships, offshoring, and relying on automation and technology.²⁸⁶ These factors have contributed to increasing work instability, wage inadequacy, and the need to work second jobs. But these types of concerns exist with respect to precarious and contingent *employee* jobs as well as independent contractor jobs. It is far from clear that an independent contractor shift is the factor that will lead to a huge uptick in contemporary worker precariousness. It is even less clear that § 199A will be a key driver of such a shift.

²⁸⁶ See Eduardo Porter, *The Workers Trump Forgot*, N.Y. TIMES, Mar. 1, 2017, at B1 (exploring rise of outsourcing); *supra* note 161 (explaining subcontracting).