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Cambyses Financial Advisors, LLC

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TCJA, The Gig Economy, and the Law of Unintended Consequences

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Working from Home – TCJA, the Gig Economy, and the Law of Unintended Consequences

As COVID spread a Work from Home (WFH) movement was born. Both employers and employees relocated to their kitchen tables, extra bedrooms, and den pool tables (Or in the case of one of our clients, a purpose built, secure bunker in a basement corner).

They soon discovered that technologies like Email, Facetime, Google Hangouts, Skype, Slack, Texting, and Zoom, when mated to authentication apps, and nestled in the cloud make full-time office work unnecessary.

Employees shed their onerous commutes, abandoned their oppressive cubicles, and worked in their bunny slippers with the dog resting peacefully at their feet.

Employers with work-from-anywhere policies boosted employee productivity and morale, reduced turnover, and reduced organizational costs,[1] Along the way, they discovered that even very complex jobs can performed as well or better in WFH than in the office, provided they don't require collaboration or social support.[2]

As a side benefit, both employers and employees realized that WFH made them a smaller target. In a natural or manmade disaster, a distributed workforce is better positioned to keep operations running, even if some of the group goes offline.

Seemingly overnight, long lists of "Work-From-Home-Friendly Firms" and "Top Work-From-Home Jobs" populated the internet.

It all sounded ever so win-win… like a Soviet Stakhanovite documentary – happily singing golden people harvesting endless fields of golden grain with nary a hint of sunburn or muscle ache.

Ah, but into every utopia some dystopia creeps – in this case the Tax Cuts and Jobs Act administered some Reality Therapy.

Under pre-TCJA rules employees who worked from home at the behest (or insistence) of their employer were entitled to either:

- Reimbursement of those expenses from their employer, or (to the extent the employer did not reimburse)
- An itemized deduction for Employee Business Expense (EBE)

[1] See studies by Harvard Business School. "How Companies Benefit When Employees Work Remotely." And Harvard Business School Faculty & Research. "Work-from-anywhere: The Productivity Effects of Geographic Flexibility."

[2] Journal of Business and Psychology. "Unpacking the Role of a Telecommuter's Job in Their Performance: Examining Job Complexity, Problem Solving, Interdependence, and Social Support."

The itemized deduction was one of a short list of "Miscellaneous Itemized Deductions" that were collectively subject to a deductibility floor: 2% of Adjusted Gross Income. Miscellaneous Itemized deductions included[3]

- Union Dues,
- Educator Expenses[4]
- Employee Business Expense (EBE)
- Investment Expenses (Account Maintenance Fees and Trade Commissions)[5]
- Payments for Tax Preparation
- Safe Deposit Rental Fees, and
- Several seldom seen but potentially large "other expenses"[6]

In the initial euphoria surrounding Work from Home, an awful lot of people[7] missed an important [8]point: The Tax Cuts and Jobs Act repealed every one of those Miscellaneous Itemized Deductions for Federal reporting purposes.[9] Thus, the only way for employees to recoup some or all of the employee expenses they incurred working from home was for the employer to reimburse them. Needless to say, most employers were not enthusiastic about this – though many employers did step up to the plate.

Just to make matters a bit more complicated. Many states (California among them) did not fully conform to TCJA – The most frequent departure was to preserve their own Miscellaneous Itemized Deduction provisions.[10] This introduced a state-federal reporting difference that was, for the most part, comprehensible only to tax professionals. Many of those who worked from home and were not reimbursed by their employer were forced to either pay a tax professional or forgo a potential state tax deduction. Our anecdotal impression: the verdict was about 50:50 on that choice.

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[3] For additional detail regarding the pre-TCJA rules, see IRS Publication 529 (12/2019), Miscellaneous Deductions – which is obsolete, but still available on the IRS Website. The Repealed Code and Regulations appear at IRC § 67.2-percent floor on miscellaneous itemized deductions and Regs. § 1.67-1T - 2-percent floor on miscellaneous itemized deductions, respectively.

[4] In excess of the $250 Educator Expense deduction for Adjusted Gross Income

[5] In excess of those used to offset investment income.

[6] Including losses incurred on complete liquidation of an IRA or other retirement plan balance (which we may see more of in the future), and several adjustments related to closing of your estate.

[7] Forbes Magazine, for example, didn't connect the dots or comment on this issue until late May or early June, 2020.

[8] One employer whose workforce was required to go WFH still adamantly refuses to reimburse EBE… But, enough about the IRS' policy! 😉

[9] There is an exception that permits Non-Grantor Trusts and Estates to claim the deductions. See Notice 2018-61

[10] Non-conforming states for EBE include Alabama , Arkansas , California , Hawaii , Minnesota , New York , and Pennsylvania. Those states still allow a deduction for unreimbursed employee expenses even though the federal government no longer does. Reporting methods differ among the states.

The Service and the states recently launched yet another campaign designed to eliminate "Misclassified Employees" (i.e. "employees" that the employer treats as "independent contractors"). Like previous campaigns – this one focuses on businesses that are already under examination and that have a disproportionate ratio of "contractors" vs. "employees." And, like previous campaigns, it involves ever more dire pronouncements about how-awful-it-is to misclassify employees, accompanied by ever more draconian and restrictive definitions of just exactly what "misclassification" entails.[11]

The campaign is, in part, a response to the evolution of the "Gig Economy." The ethos and logistics of the Gig Economy encourage employers and employees alike to impose or seek independent contractor status.

Inadvertently, Congress, TCJA, the IRS, and state agencies also aggravated a compliance problem they have been fighting for as long as anyone in our practice can remember (that's about 45 years in case it matters).

TCJA made the Gig Economy and independent contractor status an even more attractive option for a simple reason: Independent Contractors are unaffected by the repeal of the EBE deduction. Independent Contractor's "ordinary and necessary business expenses" are deductible under an entirely different set of rules, governed by different Internal Revenue Code provisions.[12]

The Gig Economy and the work-from-home movement will aggravate an already raw nerve. As a sea shift in the way America does business, they may force a re-evaluation of our basic notion of what it means to be "employed." Stay tuned as this melodrama unfolds!

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[11] See, for example, Dynamex v. Los Angeles and CA Assembly Bill AB5 (linked above). There are examples that involve nearly every US State.

[12] Miscellaneous Itemized Deductions were governed by IRC and Regulations Section 67; Independent Contractor deductions are governed (generally) by IRC and Regulations Section 162.

