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BENEFITS

Gig Workers Need to Prepare for Income Tax Surprise

Will the IRS find out if you don't report your income? This is the question everyone wants to ask, but tax professionals don't want to answer because of ethical or liability concerns.

Isaac M. O'Bannon • Mar. 03, 2022



Many people new to working in the gig economy experience a rough surprise the next time they file their income taxes. That's because income earned from driving Uber, Lyft, or GrubHub, or contracting services like professional writing or graphic arts, online sales through Amazon or other marketplaces, or even dog walking and house sitting services, are taxable. (Other examples: App-based jobs like Instacart and DoorDash, as well as handyman, lawn care, independent contractors.)

While almost all income earned from working "on the side" is taxable just like a regular job is, one big difference is that a traditional employer is required to proactively withhold the amount of taxes it is estimated a taxpayer will likely owe at the end of the year. With a gig economy job, those taxes are rarely withheld, which means the taxpayers, often regular workers with limited incomes, are responsible for holding back some of that income to pay their taxes at the end of the year.

- Be safe: Hire a CPA or Enrolled Agent (EA) to do your taxes.

How much will you owe in taxes on your side income?

This depends on your other income and withholdings, as well as tax credits and deductions you might be eligible for. While there is no easy answer, workers with income under \$50k should anticipate owing 20%-30% of their side income in taxes, which will be due by April 15 of the next year (sometimes as late as April 18 due to weekends or holidays). You can file an extension, but that only extends the time you have to file all your returns; the money you owe is due by the initial IRS deadline each year. It's important to keep receipts for the expenses you have to pay for when providing your service/business (car maintenance, miles, supplies, etc), because these business expenses reduce your net income, which reduces the taxes you will owe.

Penalties and Estimated Taxes

In many cases, even that might not be enough. If a taxpayer ends up owing more than \$1,000 when the tax return is filed, the IRS looks at that as intentionally under withholding and can add on a penalty. To avoid this, taxpayers who earn income that does not have taxes withheld from it are expected to pay the IRS an estimate of what their taxes will be, in quarterly installments, based on the prior year's income (with some exceptions).

- Learn more at this IRS site: <https://www.irs.gov/businesses/small-businesses-self-employed/estimated-taxes>

Self Employment Taxes

And don't forget about Social Security and Medicare. Traditional jobs also withhold taxes for these two items from paychecks. Part of that comes from the worker's pay, and some of it is a matching amount paid by the employer. Gig workers (freelancers and contractors) are expected to pay not only the employee share of the Social Security and Medicare taxes, but also the employer's share. This self-employment tax adds up to 15.3% of your net gig income (12.4% for Social Security and 2.9% for Medicare).

- Learn more at this IRS site: <https://www.irs.gov/businesses/small-businesses-self-employed/self-employment-tax-social-security-and-medicare-taxes>
- Self-employment tax calculator: <https://quickbooks.intuit.com/r/free-self-employment-tax-calculator/>

Will the IRS find out if you don't report your income?

This is the question everyone wants to ask, but tax professionals don't want to answer because of ethical or liability concerns. I can answer this, to some extent, since I am not a tax professional, but have worked around and with tax professionals for 20+ years.

The short answer is, if you work through or contract with a business that pays taxes, then **YES**, the IRS will likely find out pretty quickly if you don't report your side income. This is because the company that is paying you (whether an app-based company like food delivery, or a traditional business that you provide contract work for), is going to deduct the amount they paid you as an expense to their business. To do so, they will likely issue you a form 1099-NEC or other form 1099 – and a copy goes to the IRS. Even if you don't receive such a form at the end of the year, it is safest to assume they did, or will, report that they paid you to the IRS. These businesses are also legally required to report payments of at least \$600 in one year to any individual for contract work.

For workers who earned income in less organized activities, such as those who worked directly with customers where there is no paper trail (no business app or third-party business partner), or those who were paid in cash for their work, it's more difficult for the IRS to be aware of the income transaction. That doesn't mean there is no requirement to report the income. Intentionally failing to report taxable income is illegal. If the IRS has any reason to examine your taxes in the coming years, or the taxes of those who paid you, the agency could discover your omissions. In that

case, taxpayers can conceivably face criminal conviction for non-reporting of income, and the taxpayer would most likely owe back taxes, penalties and interest on any shortcomings. Negligence penalties can be assessed as well. It's also possible that government benefits could be garnished until payment is fulfilled.

What the IRS says:

“Generally, income earned from the gig economy is taxable and must be reported to the IRS. The gig economy is activity where people earn income providing on-demand work, services or goods. Often, it's through a digital platform like an app or website. Taxpayers must report income earned from the gig economy on a tax return, even if the income is:

- From part-time, temporary or side work,
- Not reported on an information return form – like a Form 1099-K, 1099-MISC, W-2 or other income statement or
- Paid in any form, including cash, property, goods or virtual currency.”

Visit the IRS gig economy tax center: <https://www.irs.gov/businesses/gig-economy-tax-center>

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Have a question about taxes? Ask it below (free registration required to comment.)

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