The New 1099 Requirements for Businesses

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I. Section 9006 of the Patient Protection and Affordable Health Care Act – What Does It Mean?

Section 9006 of the bill amends Section 6041 of the Internal Revenue Code in the following way:

> **9006 -** ***Expansion of Information Reporting Requirements***
>
> **(a)** IN GENERAL.—Section 6041 of the Internal Revenue Code of 1986 is amended by adding at the end the following new subsections:
>
> > "**(h)** APPLICATION TO CORPORATIONS.—Notwithstanding any regulation prescribed by the Secretary before the date of the enactment of this subsection, for purposes of this section the term 'person' includes any corporation that is not an organization exempt from tax under section 501(a).
> >
> > "**(i)** REGULATIONS.—The Secretary may prescribe such regulations and other guidance as may be appropriate or necessary to carry out the purposes of this section, including rules to prevent duplicative reporting of transactions."
>
> **(b)** PAYMENTS FOR PROPERTY AND OTHER GROSS PROCEEDS.— Subsection (a) of section 6041 of the Internal Revenue Code of 1986 is amended—
>
> > **(1)** by inserting "amounts in consideration for property,"after "wages,",
> > **(2)** by inserting "gross proceeds," after "emoluments, or other", and
> > **(3)** by inserting "gross proceeds," after "setting forth the amount of such".
>
> **(c)** EFFECTIVE DATE.—The amendments made by this section shall apply to payments made after December 31, 2011.

The original section of the Internal Revenue Code reads:

> **6041 -** ***Information at source***
> **(a)** Payments of $600 or more
>
> > All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income (other than payments to which section 6042(a)(1), 6044(a)(1), 6047(e), 6049(a), or 6050N(a) applies, and other than payments with respect to which a statement is required under the authority of section 6042(a)(2), 6044(a)(2), or 6045), of $600 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such gains, profits, and income, and the name and address of the recipient of such payment.

Combined, the relevant edits produce:

> **6041 - *Information at source***
> **(a)** Payments of $600 or more
>
> All persons engaged in a trade or business and making payment in the course of such trade or business to another person, of rent, salaries, wages, **amounts in consideration for property**, premiums, annuities, compensations, remunerations, emoluments, **or other gross proceeds**, fixed or determinable gains, profits, and income (other than payments to which section 6042(a)(1),6044(a)(1), 6047(e), 6049(a), or 6050N(a) applies, and other than payments with respect to which a statement is required under the authority of section 6042(a)(2), 6044(a)(2), or 6045), of $600 or more in any taxable year, or, in the case of such payments made by the United States, the officers or employees of the United States having information as to such payments and required to make returns in regard thereto by the regulations hereinafter provided for, shall render a true and accurate return to the Secretary, under such regulations and in such form and manner and to such extent as may be prescribed by the Secretary, setting forth the amount of such **gross proceeds**, gains, profits, and income, and the name and address of the recipient of such payment. (*emphasis added*)

The amendments, in sum, broaden the 1099 reporting requirements to include not only payments for services over $600, but also goods and "other gross proceeds" over $600. They also remove an exemption for payments made to corporations. The exceptions within the Code section, listed in Appendix A for your reference, carve out the standard exemptions for 1099 reporting requirements – the $10 minimum for interest and dividend payments, etc. - and are unaffected by the amendments.

While there has been a small uproar over the increased paperwork load from these new requirements, remember that they only apply to transactions made while engaging in the trade or business in which the individual or company normally engages. These are transactions that the payer should already be claiming as business expenses and that the payee should already be claiming as business income. Thus, businesses should already be keeping track of these transactions and maintaining supporting documentation.

II. Legislative Intent of the Section – Why Was It Included?

Reasoning: increased compliance = proper revenue stream

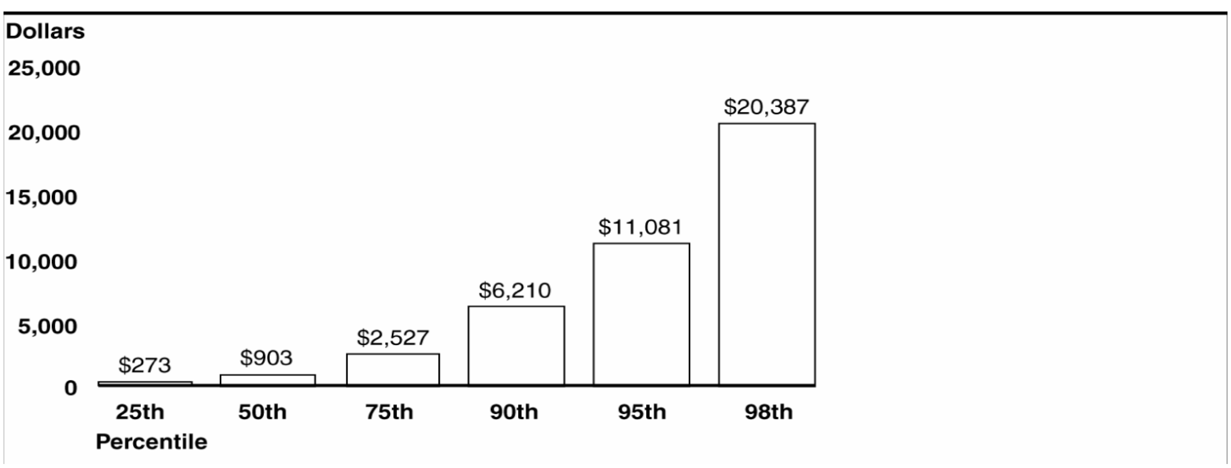
One may wonder, how did a technical modification of the Internal Revenue Code get into the Patient Protection and Affordable Care Act in the first place? We must take a quick trip through the legislative history of the bill. H.R. 3590, the base of the PPACA, began life in the House in September of 2009 as the Service Members Home Ownership Tax Act of 2009. Its original purpose was to extend the homebuyer's tax credit for soldiers who were on extended tours of duty and wouldn't return before the expiration of the credit. It also contained two, unrelated tax provisions: one increased the failure-to-file penalty for partnerships and S-corps and the other increased "the amount of any required installment of corporate estimated tax which is otherwise due in July, August, or September of 2014" from 100.25% to 100.75%. [1] The bill passed the House and shifted to the Senate, where it became the PPACA by a large Senate amendment.

Until §9006 of the PPACA, all payments to corporations and any payments for goods or property were exempt from 1099 reporting requirements. This exemption allowed many vendors to reduce their tax bills by under-reporting income. The Government Accountability Office, the Internal Revenue Service, and the Treasury Department, under both President Bush and President Obama, recommended strengthening the reporting requirement to increase compliance and revenue.

The IRS expects to increase compliance under the new 1099 requirements because it will have more information about money changing hands between vendors. Previously, any transactions between vendors and corporations and transactions between vendors and an individual involving goods did not require separate 1099s, but should have been included in the overall revenue reported on 1120s, 1065s, or 1040s (depending on the entity in question). The IRS had no way of reconciling a vendor's reported revenue with actual revenue. By compiling this new crop of 1099 information, the IRS expects to realize an increase in tax revenue of $17.1 billion over the next ten years. [2] These tax dollars are not an increase in taxes, but rather, money that is already supposed to be paid and has been hidden through under-reporting, whether fraudulent or unintentional.

This is not to say that Americans, in general, are tax cheats. In fact, when there is a paper trail to hold them accountable, W2-wage reports, for example, taxpayers are almost perfectly compliant. However, the IRS estimates that sole-proprietors under-report their income by 57% (eg. see Fig. 1). [3]

Fig. 1: Sole Proprietors' Estimated Understated Tax by Percentile for Tax Year 2001 [4]



1 U.S. House. 111th Congress, "H.R.3590 -- Service Members Home Ownership Tax Act of 2009" (Version: 1, Date: September 17, 2009) http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h3590ih.txt.pdf (retrieved 10/11/2010).

2 The Joint Committee on Taxation, "JCX-17-10 - . . . Estimated Revenue Effects of H.R. 3590. . ." March 20, 2010, available at: http://www.jct.gov/publications.html?func=startdown&id=3672 (retrieved 10/11/2010).

3 Internal Revenue Service, U.S. Treasury, "Reducing the Federal Tax Gap: A Report on Improving Voluntary Compliance," August 2, 2007, http://www.irs.gov/pub/irs-news/tax_gap_report_fi nal_080207_linked.pdf (retrieved 10/11/2010).

4 Government Accountability Office, " A Strategy for Reducing the Gap Should Include Options for Addressing Sole Proprietor Noncompliance, " July, 2007, http://www.gao.gov/new.items/d071014.pdf (retrieved 10/11/2010).

This stems partially from fraudulent behavior and partially from ignorance. For example, under the current 1099 requirements, vendors must determine whether an entity falls under the corporate exemption or not, a determination that some are ill-equipped to make. The GAO has suggested, as far back as 1991, that the reporting requirements needed to extend to payments made to corporations. [5] For fiscal years 2008 and 2009, the Bush Administration requested legislative action to close reporting loopholes. [6]

III. Effective Date of the New 1099 Requirements – When Does it Begin?

As of 10/11/2010, no midifications have been made to the original language of the new 1099 requirements. "The amendments made by this section shall apply to payments made after December 31, 2011." Thus, even if a contract is signed or goods or services are delivered in 2011, so long as payment for those goods or services is made in 2012, the section is in effect.

There are no other dates of effectiveness for this section.

IV. Which Businesses are Affected – Are There Exemptions?

The new reporting requirements extend to all businesses, incorporated or not. This includes sole-proprietorships, partnerships, limited liability entities, and corporations who make payments to persons or companies in the amount of $600 or more during a single tax year.

This does not, however, mean that if you hire a contractor to fix the roof on your house that you will need to 1099 that contractor. In that case, as an individual, you are not engaged in a trade or business and are, thus, exempt from the new reporting requirements.

The new requirements do not, however, apply to non-profit organizations exempt from taxation under §501(a) of the Internal Revenue Code. Notice the code section uses the word "person" for both payer and payee. When combined with the new subsection (h), as added by §9006 of the PPACA, non-profits are not required to report payments for goods, services, etc. on a form 1099-MISC, nor are businesses that buy goods or services from non-profit organizations required to report those transactions on a form 1099-MISC.

V. Which Purchases are Affected – Are There Exemptions?

The new reporting requirements cover persons (and, by definition, corporations) engaging in trade or business. If, while engaged in that trade or business, you pay for goods, services, etc. in excess of $600 in value, you will be required to file a 1099-MISC with the IRS and provide a copy to the entity on the opposing end of the transaction. This will include purchases such as raw or processed materials, inventory, office supplies, and services such as utilities or phone lines. In a nutshell, anything that can be claimed as a business expense falls within the new reporting requirements. Purchases under $600 remain exempt.

5 Government Accountability Office, "IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements," January, 2009, http://www.gao.gov/new.items/d09238.pdf (retrieved 10/11/2010).

6 *Id.*

Again, however, only purchases made while engaged in the trade or business of the business entity fall under the new requirements. Thus, to elaborate on the prior example, even if the person contracting to have her roof repaired is herself a sole-proprietor roofing contractor, she is not acting in the course of her business or trade while having her own private roof repaired and does not need to file a 1099 for the transaction.

VI. Practical Procedures and Real Life Application – What Does This Mean for Businesses?

In effect, for the business receiving the goods or services, the amendments require taking payments normally appearing on various schedules attached to the business's tax return and creating a 1099 to back up each expense over $600. For the business providing the goods or services, the new 1099s will be treated the same as any other and included in the income section of the business's tax return.

1099s produced as a result of the new requirements are no different than 1099s generated for payment for services over $600 under the old reporting requirements. The IRS has not modified the 1099-MISC form to include any new fields for payment for goods or to distinguish payments to corporations from payments to individuals, nor does it seem necessary. [7] Any transactions or groups of transactions subject to new reporting requirements can be placed into Box 3 on the 1099-MISC unless it is already appropriate to list them elsewhere.

A few examples:

1. Business A purchases $400 worth of widgets from Vendor B in April of 2012 and pays upon receipt the next week. That Thanksgiving, out of widgets, Business A again places an order with Vendor B for another $400 worth of widgets. Vendor B, swamped with holiday orders, can't deliver the widgets until the last week of December. Business A, closed for the holidays, cuts a check to Vendor B on January 2nd of 2013. Business A places no other widget orders from Vendor B in either year. What are Business A's filing requirements with regards to Vendor B for 2012 and 2013?

   Business A is not required to file a 1099-MISC for either transaction. The date of payment is the important date. Business A paid only $400 in each year to Vendor B, under the $600 threshold.

2. On July 5th, 2011, Business X contracts with Vendor Y for telephone service for two years at a fixed rate of $50 per month to be billed monthly. Vendor Y sends out a technician to connect the service on the 7th, between 10 am and 2pm, and Business X begins utilizing the service that day. Vendor Y sends Business X the first bill on the 8th of August, due in thirty days, payment valid upon receipt. Business X pays the bill on August 31st and continues to pay the phone bill on the last business day of each month for the remainder of the contract. At the end of the contract, Business X decides to contract with Vendor Z for phone services (they charge less). What are Business X's filing requirements with regards to Vendors Y and Z for 2011, 2012, and

7 Internal Revenue Service, Treasury Dept., "Form 1099-MISC," 2010, http://www.irs.gov/pub/irs-pdf/f1099msc.pdf (retrieved 10/11/2010).

2013?

Business X doesn't need to file a 1099-MISC for Vendor Y in 2011 – the filing requirement has not yet kicked in and total payments were only $250. In 2012, Business X only paid $550 to Vendor Y for phone service – it mailed the last payment on Monday, 12/31, but payment is valid on receipt and Vendor Y didn't receive it until 1/2/2013 – so no filing is necessary. In 2013, the filing requirements are in place, but Business X switched phone service providers in the middle of the year, paying less than $600 to each. It does not have to file a 1099-MISC for either vendor in 2013.

3. In 2012, Business P signs an output contract with Vendor Q who produces red widgets, payment due on receipt of goods. During the course of the year, Vendor Q provides a total of 5000 red widgets to Business P at $.50 per widget. Business P pays Vendor Q promptly. Red widgets are a hot product in 2012 and Vendor Q simply can't produce enough to keep up with demand, so Business P orders and pays for another 800 widgets from Vendor R at $.75 per widget. What are Business P's filing requirements with regard to the two vendors?

Assuming all payments were made during tax year 2012, Business P must file a 1099-MISC for both vendors. It paid $2500 to Vendor Q for goods purchased. It also paid $600 to Vendor R for goods purchased.

VII. Tips and Strategies for Preparing Businesses for the Change – How Do I Prepare?

Beyond the snarky and obvious ploy of spreading transactions amongst enough vendors to keep every purchase under $600, there are some steps that businesses can take to reduce both the stress of dealing with the new requirements and the workload involved.

It is already good business practice to track expenses. If they aren't already tracking vendor payments, businesses should alter that tracking to include specific vendors within expense categories. Each vendor should provide necessary tax info upon contracting – name, address and TIN.

There are companies that have been providing volume 1099 filing services for years. They can be reasonably priced, for example, one company offers up to fifty 1099s for $45. Another offers unlimited client/filers and unlimited recipients for $199 startup and $99 annually. The IRS has a list of some of these providers on its website, many of which provide the ability to import from Microsoft Excel files or Quickbooks. [8] With normal bookkeeping practices and the ability to import data, most businesses can cover all 1099 requirements for less than $100 per year.

The date of effectiveness may have interesting consequences at the end of 2011. Remember, the new provisions only apply to payment dates, not to agreement dates or delivery dates. It makes sense for businesses who deal with a large number of vendors to reduce accounts payable to those vendors to under $600 before 2012 arrives. So, we may see businesses with cash available make a mad rush to pay off vendors on or before December 31st, 2011 in an attempt to reduce the number of 1099s they'll need to file for tax year 2012. Of course, if the businesses have ongoing relationships with their vendors, this becomes moot.

8 Internal Revenue Service, Treasury Dept. "Information Returns (Forms 1042-S, 1098, 1099, 5498, 8027 and W2G)" retrieved 10/11/2010, http://www.irs.gov/efile/lists/0,,id=100422,00.html (retrieved 10/11/2010).

VIII. Recent Legislative Developments Related to Section 9006 – What's Next?

Both of the following amendments were proposed as riders to an amendment to The Small Business Jobs and Credit Act of 2010 proposed by Sen. Reid of Nevada. [9]

Nelson amendment (S. Amdt. 4595 to the latest Senate substitute to H.R. 5297) [10] – Senator Bill Nelson of Florida offered an amendment , attached to The Small Business Jobs and Credit Act of 2010, to exempt businesses with under 25 employees from the new 1099 reporting requirements and to increase the threshold reporting amount to $5000, from $600. His amendment would have maintained the new requirement to report payments to corporations. To pay for any revenue shortfall, his amendment also proposed to deny a deduction for major oil and gas companies for income attributable to domestic production. Oil companies were understandably upset about this; the deduction averages $35 billion per year.

Johanns amendment (S. Amdt. 4596 to the latest Senate substitute to H.R. 5297) [11]– Senator Mike Johanns from Nebraska offered an amendment to Sen. Nelson's amendment which would have repealed the entire section and paid for the lost revenue by eliminating funding for the Prevention and Public Health Fund (part of the PPACA) from 2010 to 2017, to the tune of $11 billion. The amendment failed and with good reason. Preventative care has been shown to decrease medical costs by $3.27 and absenteeism costs by $2.73 for every dollar spent. [12] Thus, Senator Johanns' amendment was far from revenue neutral and could easily have cost businesses many times what they have to spend to comply with new reporting requirements.

There are no amendments or other legislative measures currently up for consideration that effect or alter the new 1099 requirements.

9 U.S. Senate, 111th Congress, "S. Amdt. 4594 to the latest Senate substitute to H.R. 5297," Congressional Record pp. S6934-6961, August 5, 2010, http://thomas.loc.gov/cgi-bin/query/R?r111:FLD001:S56935 (retrieved 10/11/2010).
10 U.S. Senate, 111th Congress, "S. Amdt. 4595 to the latest Senate substitute to H.R. 5297," Congressional Record pp. S6961, August 5, 2010, http://thomas.loc.gov/cgi-bin/query/R?r111:FLD001:S56961 (retrieved 10/11/2010).
11 U.S. Senate, 111th Congress, "S. Amdt. 4596 to the latest Senate substitute to H.R. 5297," Congressional Record pp. S6961-6962, August 5, 2010, http://thomas.loc.gov/cgi-bin/query/R?r111:FLD001:S56962 (retrieved 10/11/2010).
12 Baicker, Katherine, et. al., "Workplace Wellness Programs Can Generate Savings," Health Affairs, 2010.

Appendix A – Internal Revenue Code Sections
(Current as of 10/11/2010)

501(a) - *Exemption from tax on corporations, certain trusts, etc.*
(a) Exemption from taxation

An organization described in subsection (c) or (d) or section 401 (a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

6042(a)(1) - *Returns regarding payments of dividends and corporate earnings and profits*
(a) Requirement of reporting

(1) In general

Every person—

(A) who makes payments of dividends aggregating $10 or more to any other person during any calendar year, or

(B) who receives payments of dividends as a nominee and who makes payments aggregating $10 or more during any calendar year to any other person with respect to the dividends so received,

shall make a return according to the forms or regulations prescribed by the Secretary, setting forth the aggregate amount of such payments and the name and address of the person to whom paid.

(2) Returns required by the Secretary

Every person who makes payments of dividends aggregating less than $10 to any other person during any calendar year shall, when required by the Secretary, make a return setting forth the aggregate amount of such payments, and the name and address of the person to whom paid.

6044(a)(1) - *Returns regarding payments of patronage dividends*
(a) Requirement of reporting

(1) In general

Except as otherwise provided in this section, every cooperative to which part I of subchapter T of chapter 1 applies, which makes payments of amounts described in subsection (b) aggregating $10 or more to any person during any calendar year, shall make a return according to the forms of regulations prescribed by the Secretary, setting forth the aggregate amount of such payments and the name and address of the person to whom paid.

(2) Returns required by the Secretary

Every such cooperative which makes payments of amounts described in subsection (b) aggregating less than $10 to any person during any calendar year shall, when required by the Secretary, make a return setting forth the aggregate amount of such payments and the name and address of the person to whom paid.

6045 - *Returns of brokers*
(a) General rule

Every person doing business as a broker shall, when required by the Secretary, make a return, in accordance with such regulations as the Secretary may prescribe, showing the name and address of each customer, with such details regarding gross proceeds and such other information as the Secretary may by forms or regulations require with respect to such business.

6047(e) - *Information relating to certain trusts and annuity plans*
(e) Employee stock ownership plans

The Secretary shall require—

(1) any employer maintaining, or the plan administrator (within the meaning of section 414(g)) of, an employee stock ownership plan which holds stock with respect to which section 404 (k) applies to dividends paid on such stock, or

(2) both such employer or plan administrator,

to make returns and reports regarding such plan, transaction, or loan to the Secretary and to such other persons as the Secretary may prescribe. Such returns and reports shall be made in such form, shall be made at such time, and shall contain such information as the Secretary may prescribe.

6049(a) - *Returns regarding payments of interest*
(a) Requirement of reporting

Every person—

(1) who makes payments of interest (as defined in subsection (b)) aggregating $10 or more to any other person during any calendar year, or

(2) who receives payments of interest (as so defined) as a nominee and who makes payments aggregating $10 or more during any calendar year to any other person with respect to the interest so received,

shall make a return according to the forms or regulations prescribed by the Secretary, setting forth the aggregate amount of such payments and the name and address of the person to whom paid.

6050N(a) - *Returns regarding payments of royalties*
(a) Requirement of reporting

Every person—

(1) who makes payments of royalties (or similar amounts) aggregating $10 or more to any other person during any calendar year, or

(2) who receives payments of royalties (or similar amounts) as a nominee and who makes payments aggregating $10 or more during any calendar year to any other person with respect to the royalties (or similar amounts) so received,

shall make a return according to the forms or regulations prescribed by the Secretary, setting forth the aggregate amount of such payments and the name and address of the person to whom paid.