

JOURNAL OF ACCOUNTANCY

TAX / BUSINESS & INDUSTRY

The Coming 1099 Revolution: Are You and Your Clients Ready?

Health care reform act provision vastly expands information reporting requirements.

BY DAVID LIFSON, CPA
AUGUST 2010



Revenue-raising provisions in the Patient Protection and Affordable Care Act, PL 111-148, and the Health Care and Education Reconciliation Act of 2010, PL 111-152, like their health care provisions, have far-reaching implications. One could even fundamentally change the way we do business and keep records in the United States—by dramatically increasing information reporting requirements for business transactions.

Under IRC §§ 6041(a) and (h) as amended by the Patient Protection Act, beginning Jan. 1, 2012, virtually all payments by a trade or business aggregating \$600 or more to any single vendor during any calendar year will have to be reported at the end of each calendar year to the vendor and to the IRS on Form 1099. Vendors include almost anyone a trade or business pays in the course of doing business, other than its employees whose compensation is already reported on Forms W-2.

Implementing this change will require collaboration among businesses and software vendors and likely the help of CPAs to correctly identify, characterize and report these transactions. Purchases affected could range from inventory to payments for advertising services to the electricity bill. IRS Commissioner Doug Shulman, however, said in a speech in May that the Service plans to administratively exempt business transactions conducted using payment cards such as credit and debit cards, because those transactions would already be reported by the payment processors.

WHAT'S NEW?

Reporting on Form 1099 currently applies only generally to certain financial transactions (for example, dividends, interest, sales of securities and loan transactions), targeted transactions (for example, bartering, prizes and qualified plan distributions) and amounts paid to unincorporated businesses—generally understood to be independent contractors—for services. Current law and regulation (Treas. Reg. § 1.6041-3) excludes reporting of most business payments to corporations and governments and for purchases of goods. Payments to tax-exempt organizations should also continue to be exempt from information reporting under the new law. With so much to keep track of, however, it may be easier for many businesses to simply accumulate and report these payments with other vendor transactions rather than identify and segregate them for nonreporting.

Depending on any relief granted through yet-to-be-published regulations, the new provisions will, as a practical matter, require businesses to track *all* payments made directly or through their employees or owners. Presumably, they could even include repeated business meals at the same restaurant, office supplies and equipment, or inventory for resale.

Now is not too soon to start thinking about the massive increase in record-keeping that will be required. Billions of transactions will have to be identified and re-sorted by vendor, summarized, and reported to the IRS by more than 30 million U.S. businesses. Unless the IRS administratively sets exceptions or a de minimis payment amount,

businesses will be required to record the taxpayer identification number (TIN) of the payee, or some other unique identifier, for each transaction during the year. Most businesses probably don't now routinely obtain a TIN for every party from which they make a purchase. The IRS' TIN matching program allows a payer to validate a TIN against a name electronically, but it's unclear how much help that will be with vastly more names and TINs to check.

CPAs can take the lead—both those who serve businesses internally and those who act as outside advisers on tax and accounting—in encouraging businesses that don't yet have them in place to develop or prepare their systems and procedures for routinely obtaining and recording this data for each transaction. Trying to do so after the fact would be extremely challenging. CPAs can suggest that their employer or clients plan for appropriate modifications to their payment vouchers, expense recording software, and systems for sorting and reporting on expense transactions to capture this information. The information can then be used to generate internal reports and will be readily transferrable to 1099s. Their systems for issuing 1099s will also need to be ready for what could be a many-fold increase in the number of forms issued.

And what about foreign vendors? It's unclear whether any relief will be granted with regard to obtaining TINs from overseas vendors that are not as likely as a U.S. vendor to have one. What happens when a traveling executive makes a business trip to Europe or China? Or when a clothing manufacturer imports goods from a dozen different factories in China, after the marketing executives purchased dozens of locally manufactured samples and brought them back to the U.S. for inspection? What's the most efficient way to uniquely identify the vendors?

SMALL BUSINESSES

Increased recordkeeping could weigh particularly heavily on small businesses. Users of small business software do not normally record transactions in a way that would include a re-sorting of all payments made during the year by vendor rather than by expense category, even when this capability is included in the software package. At a minimum, significant amounts of training and extra time to input additional data will be required to provide sift-and-sort capabilities necessary to comply with the new rules. In some cases, entirely new software will be required.

Ignoring the requirements could lead to expensive penalties for failure to provide information returns. Unless a waiver or other relief is granted, a business could face a \$50 penalty under section 6721 for each required information return it fails to file, or that it files with incomplete or incorrect information. For an intentional disregard of the requirement, the penalty could increase to \$100 per return or more. Meeting these requirements will, nevertheless, be a far less daunting task for those who plan ahead and who maintain a good expense database from which they can aggregate purchases by vendor and retrieve full vendor information.

Senate Finance Committee staff who drafted this legislation are reported as characterizing the requirement as a "pay for" to provide \$35 billion in tax cuts for small businesses (the Joint Committee on Taxation estimates it will raise \$17.1 billion in additional revenue through 2019), but how much will it cost to keep these records? Will the information be worth the cost of gathering it, and just what will the IRS do with it?

If called upon to identify all revenues by customer, small businesses might lack the resources to prove they did not receive income from customers that used the wrong identification number. The IRS has historically presumed that information reporting is correct and left the burden of proof to the identified recipient. Continuing that presumption in the face of 1099 proliferation could present quite a challenge for smaller businesses with fewer resources to identify all of their revenues by customer.

CPAs with small business clients have to be proactive to help those clients adapt to these requirements. They can check to make sure clients' business software has all the tools necessary—or will by 2012—to start accumulating this data and organizing it in real time. And CPAs are going to have to work with software designers to make sure that the required information will easily produce or at least populate government forms.

In fact, it may be helpful to think of this new reporting regime as similar to payroll accounting. In a sense, the whole world is going on a payroll system starting in 2012. Historically, CPAs have been at the forefront of helping businesses perform payroll processing and tax-related functions, and here is an opportunity for them to lead in providing a valuable service.

LARGE BUSINESSES

Large businesses generally maintain so-called vendor or accounts payable ledgers, so they often already track such payments. For them, information reporting could simply involve transferring this information to a Form 1099. Depending on any relief granted, payments to employees as vendors for expense reimbursements could minimize the added burden of accumulating this data for the vendors used by each employee.

For example, an employee on a business trip might purchase an airline ticket, stay in a hotel, and eat at several restaurants. Technically, the employee is simply a paying agent for the employer, and under the tax law the expenses reimbursed to the employee are expenses of the employer.

Assume that other employees also use the same airlines, the same hotel and the same restaurant. Literal interpretation of these laws would require the employer to keep track of each vendor used by each employee, aggregate all the payments made by all of its employees, and then report to that airline, hotel or restaurant the sum of all payments made by the company's employees. Imagine trying to reconcile that Form 1099 with the business records of the vendor, which presumably would also want to make sure the payments reported to the IRS as being made to that business are correct and correspond with gross income reported by the vendor on its income tax return. Business entities with fiscal years will have the added challenge of having to reconcile fiscal year data to calendar-year 1099 reporting. On the receiving end, for the vendor receiving its annual flurry of transaction-related Forms 1099, matching them to its records is another task that could require a CPA's help.

RELIEF ON THE HORIZON?

The trend toward enhanced business information reporting is not new and has drawn increasing attention in Congress over the past few years. Other recent legislation is scheduled to go into effect in 2011 (Housing Assistance Tax Act of 2008) requiring reporting of annual aggregate payment card and third-party network payments to merchants using the proposed Form 1099-K (see IRC § 6050W and REG-139255-08). The regulation writers could provide relief from reporting under section 6041 for transactions reported under the credit card payments provisions of section 6050W, as Shulman indicated in his May 27 speech the IRS plans to do.

"These transactions will already be covered by reporting requirements on payment card processors, so there is no need for businesses to report them as well," Shulman said. "So, whenever a business uses a credit or debit card, there will be no new burden under the new law."

While exempting *all* credit or debit card payments is well intended, the relief provision could have a chilling, unintended impact on some small business owners, as also noted by the National Small Business Association. Many small businesses could see their customers vanish as those customers attempt to streamline and minimize the number of vendors requiring additional reporting. Furthermore, there are myriad small businesses that either do not accept credit or debit card payments, or are unable to do so on a competitive basis with larger companies. Balancing the interests of efficiency and all parties within the economy will be a challenging task for the regulation writers.

While the IRS is expected to provide guidance on the section 6041 requirements, the drafting, exposure and finalization of any regulation of this magnitude typically can take a year or more to complete. We can only hope there will be enough time for the business community to react. Businesses will certainly have a greater chance of making a timely transition if CPAs call their business clients' attention to the reporting requirements and recommend an immediate assessment of their readiness. Then CPAs also have an opportunity to help business clients implement compliance measures. This new transaction reporting regime looms as a new hurdle for business accounting. It's a real business-to-business challenge, but who does business better than CPAs?



Go to journalofaccountancy.com/Multimedia/Lifson.htm to see an interview with author David Lifson on the expanded information reporting requirements under IRC § 6041, as amended by the Patient Protection and Affordable Care Act.

EXECUTIVE SUMMARY

■ **Starting Jan. 1, 2012, businesses that may issue Forms 1099** currently only to report nonemployee compensation to independent contractors and certain other payments will be required to issue one to every

vendor to which they make payments totaling \$600 or more during the calendar year.

- **This provision represents a large expansion of information reporting** raising many questions of applicability that will likely require a massive increase in the number and types of records businesses must maintain. For every applicable vendor, for example, purchasers will need to obtain and match to purchases a taxpayer identification number (TIN) for use in filing the information return.
- **CPAs can encourage business clients** to begin preparing now for the new reporting regime. For large businesses, an important task may be instituting systems for tracking purchases by employees as agents of the business, and correctly aggregating them by vendor. Small businesses may not have the systems or procedures in place to capture the data required.
- **Vendors on the receiving end of purchase reporting Forms 1099** likewise will probably need CPAs' assistance in knowing how they will reconcile the reporting forms to their income reported for tax purposes.
- **Some relief could be forthcoming**, especially if the IRS allows another, similar information reporting initiative for transactions completed by payment card or third-party network under new IRC § 6050W to fulfill the requirement for purchase reporting.

David Lifson (david.lifson@crowehorwath.com) is a partner with Crowe Horwath LLP in New York City.

To comment on this article or to suggest an idea for another article, contact Paul Bonner, senior editor, at pbonner@aicpa.org or 919-402-4434.

AICPA RESOURCES

JofA article

"Health Care Reform Reshapes Tax Code," May 2010, page 60

Use journalofaccountancy.com to find past articles. In the search box, click "Open Advanced Search" and then search by title.

CPE self-study

- *2010 Health Care Reform Act: Critical Tax and Insurance Ramifications for You, Your Business, and Your Clients* (#745810)
- *AICPA's Tax Update for Financial Executives* (#745571)
- *Advanced Tax Issues for Federal Payroll Taxes, Benefits and Form 1099s* (#733114SNF)

For more information or to make a purchase, go to cpa2biz.com or call the Institute at 888-777-7077.

The Tax Adviser and Tax Section

The Tax Adviser is available at a reduced subscription price to members of the Tax Section, which provides tools, technologies and peer interaction to CPAs with tax practices. More than 23,000 CPAs are Tax Section members. The Section keeps members up to date on tax legislative and regulatory developments. Visit the Tax Center at aicpa.org/tax. The current issue of *The Tax Adviser* is available at aicpa.org/pubs/taxadv.

More from the JofA:

 Find us on Facebook |  Follow us on Twitter