

1099 FORMS ARE NOT OPTIONAL - THEY ARE REQUIRED BY LAW

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We wanted to provide this reminder to ensure that you meet your obligation for all 2021 payments to unincorporated individuals and businesses of \$600 or more (rents, services, prizes, attorney fees, etc.). The IRS is increasingly focusing their attention in this area since it is the agency's main weapon against under reporting of income. Penalties for failing to file correct information returns have more than doubled in the last few years alone while employers, simple schedule Cs and even single property landlords, are facing intense new scrutiny of their 1099s to prevent under-reporting by independent contractors. Failure to file the form for 2021 or providing wrong information could cause a penalty that could be as much as \$820 per each 1099 omitted.

As you will learn in our attached memo, in 2020 the IRS introduced Form 1099-NEC, Nonemployee Compensation, as the new way to report self-employment income instead of Form 1099-MISC as traditionally had been used. While many states do not require 1099 submission since they get such from the IRS, the 1099-NEC is not so included.

We strongly encourage our business clients, nonprofit organizations, rental property owners, individuals filing a Schedule C as a sole proprietor or sole member LLC and other such friends of the firm to consider:

- First, you must determine if you have a trade or business. If you are operating to make a gain or profit, even solely as an independent contractor, you have a trade or business. If you run a nonprofit organization, a government agency, or a trust of a qualified pension or profit-sharing employer plan, such are trades or businesses for 1099. While the IRS might have previously abated or reduced the steep penalties, we're advised such may not be the case.
- Sending 1099 forms is not optional, it is the law. The Forms 1099 provide the means of reporting very specific income types from non-employment related sources that might not be captured elsewhere. If you or your trade or business paid someone (other than employees on payroll or for product purchases) the taxing authorities want to know about it. Business income tax returns (that includes the 1040 for a sole proprietor) even include a question asking if Forms 1099 were filed as required with your signature, under penalty of perjury, certifying your response to be true.
- In 2020 the IRS had introduced Form 1099-NEC, Nonemployee Compensation, as the new way to report self-employment income instead of Form 1099-MISC as traditionally had been used. While many states do not require 1099 submission since they get such from the IRS, the 1099-NEC is not so included. Thus, states like New Jersey, Pennsylvania, Delaware and several others are requiring such separate filing. You need to check current requirements for the states requiring a separate submission for compensation performed by its residents or when services are performed within that state by a non-resident.

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- Remember the "general rule" is that business owners (and, yes, "gig economy" and side income services are effectively "businesses") must issue a Form 1099-MISC or the 1099-NEC to each person to whom you have paid at least \$600 in rents, services (including parts and materials), prizes and awards or other income payments. Note you need not issue 1099s for payment for personal purposes.
- Do not send a 1099-MISC to an employee since that is what a W-2 is for (1099 NEC must be sent to the IRS by January 31, 2022 not like the 1099-MISC or others due to the IRS by February 28, 2022 or March 31, 2022 if filing electronically).
- If the recipient believes they are an employee, they should request you, as the payer, to correct this form. They can always report this amount on the line for "Wages, salaries, tips, etc." of their 1040 but should also complete Form 8919, attaching it to their return.
- If you must file 100 or more information returns during the year, you must file electronically. The 100-or-more requirement (this used to be 250) applies separately to each type of form. The electronic filing requirement does not apply if you apply for and receive a hardship waiver.
- If you must file electronically but fail to do so, and you do not have an approved waiver, you may be subject to a penalty of up to \$270 per return for failure to file electronically unless you can establish reasonable cause. However, you can file up to 99 returns in paper.
- Do not send a 1099-MISC to someone where you have personally paid to him or her. An independent contractor to whom you have made a personal payment unrelated to your "trade or business" doesn't receive a 1099.
- Do not send a 1099 to someone you've paid by credit card, debit card or by services like PayPal, Venmo or eBay. Such payments will be embodied in a 1099K that they will receive from their merchant services provider. Beginning in 2022, the new gross payment threshold for the 1099K will be \$600. Going forward, this new update means these companies must file a 1099-K form and report it to the IRS and the customer if they exceed \$600 a year. A big change from \$20,000 but a perceived need, given the rise of the gig economy and self-employment trends.
- The new instructions note that Forms 1099-MISC and 1099-NEC have become "continuous-use" forms, along with their instructions. This means that the forms will no longer be updated annually. Instead, IRS will revise them throughout the year. So be on the lookout for more frequent revisions. Also watch for a new box 13 on the latest edition of the forms. Box 13 will be designated for filing requirements of the Foreign Account Tax Compliance Act (FATCA).

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- Review all disbursements made from January 1, 2021 through December 31, 2021, summarizing all payments to unincorporated individuals and businesses where the accumulated total is \$600 or more. Nonprofit organizations are considered engaged in a trade or business and are subject to these reporting requirements. LLCs that elect to be treated as an S or C Corporation need not be issued 1099s, but most LLCs will probably require the issuance of 1099s. Have the correct name, employer identification or social security number and address. If you're unable to confirm a particular establishment is a corporation or not, issuing a 1099 might be a wise precaution. You can't go wrong sending more 1099s than required but you can be penalized if you don't file what you are required to.
- Beyond having to possibly face a government audit, if you fail to file the correct information by the deadline, fail to include all the required information on a return, or if you include incorrect information, you can be subjected to an array of steep penalties if you cannot show reasonable cause. If the payee fails to furnish his or her taxpayer identification number (TIN), they are subject to backup withholding at a 24% rate. If you do not collect and pay backup withholding from affected payees as required, you may become liable for any uncollected amount. An easy way to stave off penalties for name/TIN mismatches is to use the IRS' free online TIN matching program before completing 1099 forms. We understand you may verify up to 25 name/TIN combos on the screen but that you must register with the IRS to use this program.
- Do not use Form 1099-MISC to report employee business expense reimbursements. These payments made to employees under a non-accountable plan are reported as wages on Form W-2. A good accounting policy is to require every vendor to complete and provide a W-9 before you pay them. This is the best way to collect the information to determine, (a) if they need a 1099 and (b) how it should be issued. With the W-9 on file, you can eliminate the hassles of phone calls to individuals wary of giving you their social security number; avoid having to chase down independent contractors who moved (or don't return phone calls); or having to wait on hold while someone at a vendor's office tries to track down a federal identification number. (Sound familiar? We suggested doing this at the beginning of last year).
- You must report inside and outside Directors' Fees and other non-employee remuneration, including payments made after retirement. Other potential recipients you might overlook include outside accountants; lawyers; salespeople; auto mechanics or service stations that repair company autos; office cleaners; plumbers; electricians; painters; carpenters; IT consultants; repair people; equipment lessors; office/company auto lessors; inside and outside corporate directors and recipients of prizes and awards.
- If you pay rent to or through a real estate agent (typically property managers) you are an exception to filing a 1099. However, remember that you do need to issue a 1099 to a landlord you are paying rent unless you meet another exception.

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- Firms maintaining trust or escrow accounts must review all disbursements made in 2021. Payments frequently overlooked--where 1099s should be issued-- include payments out of these trust accounts and disbursements for interest, rentals, contracted services (other than for employees), part-timers where W-2s are not required or issued, commissions, individuals performing plant maintenance or cleaning services, etc. Forms 1099 are required for individuals, partnerships, LLCs, etc. Don't assume, just because a payment is made to a "company," that it is a corporation.
- Exempted from issuing a 1099 would be for sellers of merchandise, freight, storage or similar items.
- Involved with as many lawyers and law firms as we are, we've seen confusion abound in this arena. We're not trying to frighten you, but did you know that the IRS has a special manual which deals exclusively with auditing lawyers (call us separately to so discuss as we have lectured frequently on this)? Well, straight from the IRS audit guide specifically dealing with attorneys, is their focus on lawyers not issuing 1099s to independent contractors (like experts from Abo Cipolla Financial Forensics, LLC) out of an attorney's trust account. The argument that the funds belonged to the contractor will not relieve the attorney from this reporting responsibility. 1099s are also required to be filed for payments to recipients of lawsuits unless specifically exempt from taxation (another reason to call us).
- The exemption for payments to corporations does not apply to payments for legal services. Payments to attorneys for legal fees that amount to \$600 or more should be reported even if the attorney is incorporated in box 1 of Form 1099-NEC.
- Generally, do not report the claimant's attorney's fees. For example, an insurance company pays a claimant's attorney \$100,000 to settle a claim. The insurance company reports the payment as gross proceeds of \$100,000 in box 10 of the 1099-MISC. However, the insurance company does not have a reporting requirement for the claimant's attorney's fees paid from these funds. These rules apply whether:
 1. The legal services are provided to the payer.
 2. The attorney is the exclusive payee (for example, the attorney's and claimant's names are on one check); or
 3. Other information returns are required for some or all of a payment

- Another example, a person who, in a trade or business, pays \$600 of taxable damages to a claimant by paying that amount to a claimant's attorney is required to:

 1. Furnish Form 1099-MISC to the claimant, reporting damages, generally in box 3; and
 2. Furnish Form 1099-MISC to the claimant's attorney, reporting gross proceeds in box 10.

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- However, these rules do not apply to wages paid to attorneys reportable on Form W-2 or to profits distributed by a partnership to its partners reportable on Schedule K-1 (Form 1065, Partner's Share of Income, Deductions, Credits, etc.)

- Many clients have followed our suggestion of having 1099s prepared by in-house staff or payroll service bureaus to keep our accounting fees at a minimum. Regardless, such individuals or enterprises should make sure that they still have someone (like us) review all 2021 expenditures since we have frequently noted many types of payments go undetected (and often well beyond the proper due date for reporting). We have seen all too many small businesses and self-employed individuals forget their January or February 1099 responsibilities just because they have not completed their accounting (often neglected just because income tax return filing was extended).
- Generally, amounts reported on 1099-NEC are subject to self-employment tax. If payments to individuals are not subject to this tax and are not reportable elsewhere on Form 1099-MISC, report such in Box 3.
- A canceled debt is not reportable on Form 1099-MISC. Report canceled debts on Form 1099-C
- If you hire a non-U.S. citizen who works remotely via the Internet from another country, generally, you need not file a 1099 for that person. However, if the foreign worker performs any work inside the United States, you will need to file the 1099. It is your responsibility to verify that the worker (1) is a non-U.S. citizen, and (2) performed all work outside the United States. For that purpose, have that foreign worker fill out, sign and return to you Form W-8BEN.
- A payer who later discovers an error should re-issue a corrected 1099 form to that payee and correct the filing with the IRS. If you are a payee, review every 1099 you receive against your own records. This is for a couple of reasons: The payer may have made a mistake, such as the wrong amount. If so, contact the payer and ask to have the 1099-MISC form corrected and reissued.
- Issuing a 1099 where the payee's name and TIN (Taxpayer Identification Number) don't match will likely garner extra IRS scrutiny. An easy way to stave off penalties for such may be to use the IRS' free online TIN matching program. You must register with the IRS to use this program and it is limited to match up to 25 name/TIN combos on the screen.
- You can truncate the first 5 digits of a payee's TIN on their 1099 but forms filed with the IRS must contain the full TIN and do not truncate your own TIN on those 1099's you issue (i.e. xxx-xx-1234 or xx-xxx1234).
- Make sure you, use the 2021 versions of the 1099-MISC and 1099-NEC for non-employee compensation.

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- Don't assume you're off the hook for reporting income if you don't receive a Form 1099. Even where you never receive a Form 1099, if you receive income, you must report it. You don't need a 1099 to report income. We suggest you update your address directly with payers and putting a forwarding order in with the U.S. Post Office if you've moved. Logic dictates you should see any forms the IRS sees.
- If you fail to file a correct 1099 information return by the due date and you cannot show reasonable cause, you may be subject to a penalty. Again, the penalty applies if you miss the filing deadline or fail to provide complete and / or correct information on the 1099. The 1099 penalty also applies if you file on paper when you had to file electronically, or your 1099 paper forms are not machine readable. And penalties may apply if you fail to report or include a correct TIN (Tax Identification Number). The 1099 deadline penalty is based on when you file the correct information return.
- If you fail to file your 1099 by the due date, you may be subject to a late filing penalty. The penalty applies if you fail to file timely, or did not include all the required information, or provided incorrect information. This penalty also applies if you were supposed to file electronically, but you filed on paper or reported incorrect TIN. The 1099 penalty increases with time. The penalties are:
 1. \$50 per 1099 if you correctly file within 30 days of the due date. The maximum penalty per year is \$571,000 (\$199,500 for small businesses).
 2. \$110 per 1099 if you correctly file over 30 days after the due date but by 8/1. The maximum penalty per year is \$1,713,000 (\$571,000 for small businesses).
 3. \$280 per 1099 if you file after 8/1, or you do not file the required 1099. The maximum penalty per year is \$3,426,000 (\$1,142,000 for small businesses).
- For this penalty, the IRS considers you a small business if you made \$5 million or less in average annual revenue for the previous three years.
- If any failure to file a correct information return is due to intentional disregard of the filing or correct information requirements, the penalty is at least \$570 per information return with no maximum penalty.
- You must provide payees statements (or recipient copies) by the due date. Different forms have different due dates. If you fail to provide copies to your payees by the due date, you may be subject to a penalty. The penalty applies if you fail to provide the statement or fail to include all required information, or you include incorrect information on the statement.

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- The penalty is based on when you furnish the correct payee statement. It is a separate penalty and is applied as the penalty for failure to file correct information returns by the due date. However, if the error or omission on the payee statement does not hinder the payee from using the 1099 information to file his or her tax returns, then the error is considered inconsequential, and the penalty can be waived. Errors and omissions considered unforgiving are wrong amounts, significant missing payee's address, unacceptable substitute form.
- If you must file electronically but fail to do so, and do not have an approved waiver or establish a reasonable cause, you may be subject to a penalty of up to \$280 per return for failure to file electronically. However, you can file up to 99 returns on paper; those returns will not be subject to a penalty for failure to file electronically. The penalty applies separately to original returns and corrected returns.
- If you willfully file a fraudulent 1099 for payments you claim you made to another person, that person may sue you for damages. You may have to pay \$5,000 or more.

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