The U.S. Chamber of Commerce
The Impact of the New 1099 Reporting Provision

The 1099 reporting requirement is a non-health care provision that was passed as part of the massive health care bill to help identify businesses that are not reporting or underreporting income to avoid paying their fair share of taxes. Even though this provision was intended to raise $17 billion to help pay for the health care bill, it could cost government, nonprofits, and business much more, and, in the end, may serve to increase tax noncompliance.

The new 1099 reporting provision will impose a substantial burden on the backs of nonprofits, governments and businesses—especially small business. Starting in 2012, the new 1099 provision will:

- Cover 40 Million Entities—According to the National Taxpayer Advocate, the provision will impact 26 million sole proprietorships, 4 million S corporations, 2 million C corporations, 3 million partnerships, 2 million farming businesses, 1 million charities and other tax-exempt organizations, and more than 100,000 federal, state, and local government entities.

- Requires Numerous Additional IRS Filings—All 40 million covered entities will have to file form 1099 reports to the IRS for each business they purchase from whose non-credit card purchases total $600 or more for the year. It is unclear at this time if they will have to send a copy to the business vendor.

- Impose New Information Collection Burdens—All 40 million covered entities will have to collect Taxpayer Identification Numbers (TIN) as well as the company name and address from each business they make purchases from in which they anticipate that the non-credit card purchases will total $600 or more for the year.

- Subject the Self-Employed to Identity Theft—If the business vendor is a sole proprietorship, it will have to provide the purchaser with their Social Security number or apply for a separate Employer Identification Number (EIN) in order to protect itself from privacy and identity theft concerns.

- Compel More Backup Withholding Burdens—As the number of transactions that are covered under the provision greatly expands, so does the possibility for backup withholding. If the business vendor fails to furnish a correct TIN, then under certain circumstances the purchasing entity is required by law to withhold 28% of the purchase price. Failure to properly withhold an amount generally results in liability for that amount.

- Impose New Complex Record-Keeping Requirements—All 40 million covered entities will have to keep records on all their purchases from businesses for both goods and services that can be sorted by TIN and by payment method. Moreover, only the non-credit card purchases from businesses that total $600 or more for the year will have to be reported. Thus, complex and costly accounting changes will have to be made to their existing accounting systems.

- Subject Businesses to Costly Audits—IRS does not have the capability to create an adequate picture of a company's sales by matching the reported 1099 revenue to the company's reported revenue. This may result in many unnecessary and costly audits for the business vendor.

- Dramatically Increase Accounting Costs—IRS does not have the capability or systems to monitor the accuracy of the 1099s being filed. If mistakes are made by the 40 million covered entities filing 1099s on businesses, those businesses will have a difficult time proving why their reported sales do not match IRS figures. This will result in increased accounting costs due to costly and unnecessary audits.

- Requires Small Businesses to File Returns Electronically—If the number of 1099 filings exceeds 250, then the entity will have to file electronically, further increasing the cost burden of this provision, especially to small businesses.

- Heavily Penalizes Honest Taxpayers—The 1099 reporting provision will create an even more unlevel playing field between compliant and noncompliant business taxpayers. In reality, the heavy burden of the 1099 reporting provision will be paid for by compliant businesses. Those businesses attempting to avoid their tax obligations will continue to find creative ways to hide income.

The new 1099 reporting requirement will alter business behavior, which could have dramatic negative consequences for small businesses. The unintended consequences of the 1099 reporting provision will:

- Increase the Cost of Goods and Services—Many of the 40 million covered entities in an attempt to reduce their paperwork burdens, will simply require that the vendor take a credit card for the transaction since those transactions are exempt from reporting. The payment card transaction fees will be passed on to businesses and consumers through the cost of their products and services.

- Stifle Product Innovation—New products and services require a flexible marketplace in which vendors can easily overcome the reluctance of purchasers to try new items. The new paperwork and reporting requirements will serve to make the marketplace less hospitable for trials of new products and services.

- Swell the Need for Available Business Credit—It will be essential for businesses, especially smaller ones, to be able to obtain credit cards with sufficient credit limits in order to do business in the marketplace. This will be a catch-22 for many small businesses since they need a proven track record in business to qualify for ample credit limits.

- Lead to More Business Failures—The new 1099 requirements may result in a shift from more flexible and less costly vendor credit to less flexible and more expensive credit card financing. Contraction of credit to the business, for whatever reason, could have a major impact on survivability.

- Disadvantage New Businesses Relationships and Startups—Since there will be a heavy paperwork and record-keeping cost for establishing a new business relationship, many of the 40 million covered entities will be extremely reluctant to set up a relationship with a business, relying more heavily on established vendors.

- Drive Purchasing Away from Small Business—Many of the 40 million covered entities will be more apt to consolidate their business purchases with several large vendors with a broad geographic presence and a more diverse product line in order to reduce the paperwork burden. Additionally, larger vendors with sophisticated software may provide as a service much of the reporting for their business customers, providing further incentives to do business with bigger businesses over smaller ones.

- Drives Additional Tax Noncompliance—The 1099 reporting provision could undermine our voluntary tax compliance system, further frustrating tax collection efforts. Imposing vast and costly new data collection and reporting requirements on compliant taxpayers may be viewed by some businesses as unreasonable and overreaching by the government.

The IRS does not have the resources or the ability to use the new 1099 information to reconstruct an accurate picture of a company's revenues.

- The 1099 Reporting Does Not Capture Consumer Sales—For many businesses, a large volume of their sales are made directly by consumers whose cash purchases are not independently reported to the IRS.

- Sales Below the $600 Threshold Are Not Captured—There will be many transactions totaling under $600 in a year that will not be reported to the IRS.

- Returns, Rebates, and Discounts Are Reported Differently—Purchases of products and services are subject to returns, rebates, discounts, and other adjustments that are handled differently by the buyer and vendor. This will result in disparities between the amount reported as sales by the vendor and the amount reported to the IRS on the form 1099 by the purchaser.

- Many Companies Do Not Report Revenue on a Calendar Year Basis—Some businesses have different tax accounting years creating further discrepancies between a company's sales that would be reported to the IRS on a fiscal-year basis and the 1099 reporting that would be reported on a calendar-year basis. Additionally, some businesses use the accrual method of accounting, while others use the cash method.

- IRS Taxpayer Advocate Doubts the Usefulness—Even the IRS National Taxpayer Advocate indicated in her recent Fiscal Year 2011 Report to Congress, that "IRS will face challenges making productive use of this new volume of information reports."