

Stealth IRS changes mean millions of new tax forms

By Neil deMause, contributing writer

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NEW YORK (CNNMoney.com) -- The [massive expansion of requirements](#) for businesses to file 1099 tax forms that was hidden in the 2,409-page health reform bill took many by surprise when it came to light last month. But it's just one piece of a years-long legislative stealth campaign to create ways for the federal government to track down unreported income.

The result: A blizzard of new tax forms that the Internal Revenue Service will begin rolling out next year.

"It was actually something that we were following back under the Bush administration under the 2008 budget -- we started to see these kinds of rumblings about the 'tax gap' and whether or not businesses were paying their fair share," says Tom Henschke, president of the Pennsylvania-based SMC Business Councils, which was one of the first organizations to [call attention](#) to the health care amendment when it was introduced last fall. "So two administrations can claim credit for this."

The first tax-reporting expansion was buried in a different bill, the Housing Assistance Tax Act introduced by House

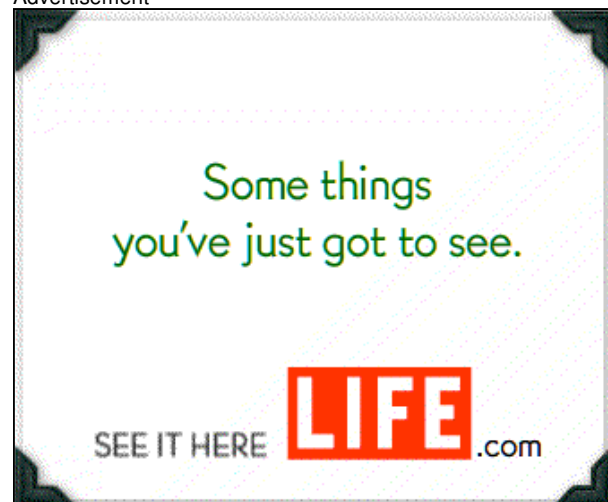
Speaker Nancy Pelosi and signed into law by President George W. Bush in July 2008. Best known for its first-time homebuyers' credit, the bill also created a new addition to the family of 1099 tax forms: the 1099-K.

The 1099 is a catch-all series of IRS documents used to report non-wage income from a variety of sources like contract work, dividends, earned interest and pension distributions. The new 1099-K aims to shine a light on a currently hard-to-track payment stream: credit cards. Starting in 2011, financial firms that process credit or debit card payments will be required to send their clients, and the IRS, an annual form documenting the year's transactions.

The rule comes with a floor to weed out the most casual retailers: The 1099-K is only required when a merchant has at least 200 payment transactions a year totaling more than \$20,000. But it applies to all payment processors, including Paypal, Amazon.com, and others that service very small businesses.

The goal of the new regulations is to catch

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income that is going unreported to the IRS. The federal government loses an estimated **\$300 billion each year** from the "tax gap" between what individuals and businesses owe and what they actually pay.

"Better information reporting helps the tax system work better by ensuring that everyone pays what they owe," IRS Commissioner Doug Shulman **explained last year** as his agency unveiled the 1099-K. "The new law gives us an important new tool for closing the tax gap and also provides business taxpayers better documentation to compute and report their income and expenses."

For companies that currently report all their credit card and Paypal sales to the IRS, the 1099-K requirement will have little impact. All the paperwork will be done by the bank or payment processing service, and business owners will simply receive a form at the end of the year listing their total receipts.

The 1099 changes attached to the health care reform bill are another kettle of fish. These massively expand the requirements for filing the "1099-Misc" form, which companies use for recording payments to freelance workers and other individual service providers. Until now, payments to corporations have been exempt from 1099 rules, as have payments for the purchase of goods.

Starting in 2012, that changes. All business payments or purchases that exceed \$600 in a calendar year will need to be accompanied by a 1099 filing. That means obtaining the taxpayer ID number of the individual or corporation you're making the payment to -- even if it's a giant retailer like Staples or

Best Buy -- at the time of the transaction, or else facing IRS penalties.

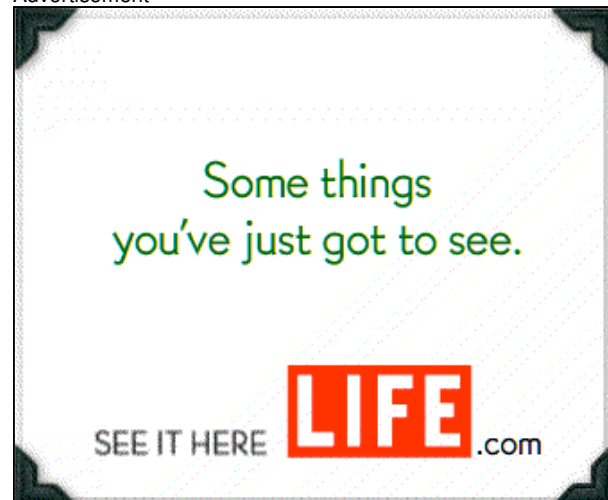
In essence, the 1099-Misc is having its role changed from a form for tracking off-payroll employment to one that must accompany virtually any sizeable business transaction.

"Just with business travel it would include hotels, rental cars," Henschke says. "Phone service: 1099. Computer service: 1099. Whoever does your postage meter: 1099. You do a little advertising, Yellow Pages: 1099. Your landlord: 1099. You might as well just keep them in your pocket and hand them out as you go around every day."

How did this sweeping provision end up hidden in the health reform bill? No one is willing to take credit for introducing the new legislation, which appeared in the Senate Finance Committee's version of the health bill last fall. Committee chairs Don Baucus, D-Mont., and Chuck Grassley, R-Iowa, both referred calls to committee staffers, who wouldn't comment on the record.

But the provision appears to be a long-in-

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the-works change that was just waiting for the right moment to be attached to legislation.

Back in 2007, the Senate Finance Committee asked the government's General Accountability Office to conduct a tax-gap study. The [resulting report](#) estimated that establishing additional 1099 paper trails for income could provide up to **\$345 billion annually** in new federal tax revenues.

Enter the health reform bill. Last fall, as the debate raged over its projected cost, Congressional supporters of the bill began a desperate search for "revenue enhancers" to bring the net cost down -- and eliminating the 1099 exceptions for corporations and goods was seen as an easy way to bring in more cash without raising tax rates.

House and Senate staffers "essentially have a cupboard full of convenient revenue raisers that they can put into bills when they need it," notes Chris Edwards, director of tax policy studies for the libertarian Cato Institute. In the case of the 1099 changes, he says, "this was sitting around, the IRS wanted it and had testified in favor of it, and they needed a revenue raiser. This was just a convenient thing."

Still, the form the new law took was surprising -- especially the requirement that businesses file 1099s when they purchase goods, which hardly anyone saw coming.

Henschke's group had previously surveyed its members and learned that they average 10 filings a year of 1099 forms, each of which takes about half an hour to prepare. That's in line with the GAO report, which found that a typical small business spent

between three and five hours per year filing 1099s.

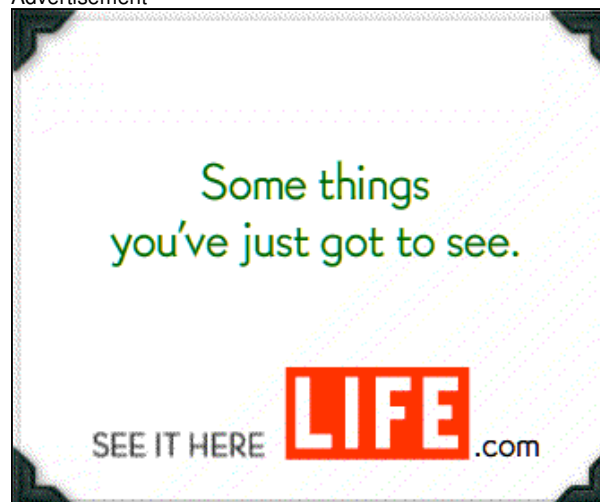
But SMC's survey found that extending 1099s just to services purchased from corporations would push that number to at least 200 filings per year for a typical small business -- adding an estimated \$6,000 to the cost of preparing the average tax return. And that's without even accounting for the requirement that 1099s be filed for purchases of goods, a provision that Henschke's group didn't see coming when it conducted its survey last year.

"These folks are doing their paperwork in the evenings and on the weekends already," he says. "This certainly adds to the burden substantially."

The IRS has a [draft version](#) of the 1099-K form available now for public feedback, and will begin requiring the form's use next year. The additional 1099 requirements take effect in 2012. The agency is in the process of drafting its guidance on them.

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