1099 Information Reporting Requirements and Penalties: Recent Legislative Activity

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Summary

Taxpayers are seen as more likely to report items of income on their tax returns if they know that a third party has reported it to the Internal Revenue Service (IRS); if follows, therefore, that expanding information reporting requirements under the Internal Revenue Code (IRC) can improve the collection of federal tax revenue. However, as those requirements are expanded, those who must comply with the requirements generally will face an increased administrative burden. This tension between the desire to improve tax compliance and the concomitant burden imposed on taxpayers was recently highlighted after expansions of the reporting requirements in IRC § 6041 were met by protests that the changes imposed too great a burden, particularly on small businesses. As a result of these objections, the expansions to the information reporting requirement were repealed shortly after they were enacted.

IRC § 6041 requires payments totaling at least $600 in a single calendar year to a single recipient to be reported to the IRS. The required return is generally a Form 1099, which is prepared by the entity making the payment and identifies to whom payment was made, the amount of the payment, and the general reason for the payment. The form is filed with the IRS and a copy is provided to the payee. The form is required only when the payer is considered to be engaged in a trade or business and has made the payment in connection with that trade or business.

The scope of IRC § 6041 was expanded by both the Patient Protection and Affordable Care Act (PPACA; P.L. 111-148) and the Small Business Jobs Act of 2010 (P.L. 111-240). Section 9006 of PPACA would have made payments to corporations and payments for goods or other property subject to reporting. Section 2101 of the Small Business Jobs Act would have made most landlords subject to the reporting requirements of IRC § 6041. The expansions made by both bills were subsequently repealed by the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011 (P.L. 112-9).

The Small Business Jobs Act also increased the penalties for failure to file an information return (IRC § 6721) and the penalties for failing to provide a copy of the information return to the payee (IRC § 6722). These changes have not been repealed and will apply to any information returns required to be filed after December 31, 2010.

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Taxpayers are seen as more likely to pay taxes on income if the realization of that income has been communicated to the Internal Revenue Service (IRS). To encourage compliance with tax laws, the Internal Revenue Code (IRC) includes a number of information reporting requirements regarding payments that may result in taxable income for the payee.

One such reporting requirement, contained in IRC § 6041(a), applies to certain payments made by persons in the course of a trade or business. Under IRC § 6041(a), if the total amount of payments made to a single payee over a year equals at least $600, the payer is required to file an information return with the IRS providing information identifying the payer, the payee, and the total amounts paid to that payee over the past calendar year. The information returns required to be filed under IRC § 6041 are typically versions of Form 1099.[1] A copy of this information return must also be provided to the payee. Although payees may receive copies of information returns, payees are not required to file any information returns under IRC § 6041.[2]

Section 6041 was amended twice in 2010: once by § 9006 of the Patient Protection and Affordable Care Act (PPACA)[3] and a second time by § 2101 of the Small Business Jobs Act of 2010.[4] Both amendments were subsequently repealed by the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011.[5] As a result, the information reporting requirements have been restored to their pre-PPACA scope. They may, however, be subject to stronger enforcement as a result of a surviving provision of the Small Business Jobs Act that revised the penalties for failing to file an accurate 1099 with the IRS or failing to provide an accurate copy of that form to the payee.

This report briefly discusses the procedures and penalties under current law applicable to the information reporting requirements under IRC § 6041, and also briefly describes recent amendments that have been repealed. For a more detailed discussion of the repealed amendments, including responses to them by various stakeholders, see CRS Report R41504, *1099 Information Reporting Requirements and Penalties as Modified by the Patient Protection and Affordable Care Act and the Small Business Jobs Act of 2010*, by (name redacted) and (name redacted).

Procedures

The procedures for filing information returns with the IRS were not changed by either PPACA or the Small Business Jobs Act; therefore, the repeal of the amendments to § 6041 has no effect on those procedures.

[1] Treas. Reg. § 1.6041-1(a)(2). Payments for trust distributions are made on Form 1096 and employee compensation is typically reported on Forms W-2 and W-3. *Id.*

[2] Payees, like most individuals, are required to report all income, whether reflected on a 1099 or not, on an annual federal income tax return if they have sufficient income to meet or exceed the filing threshold. Internal Revenue Code (IRC) § 6012(a).

[3] P.L. 111-148.

[4] P.L. 111-240.

[5] P.L. 112-9

Deadlines and Contents

The deadline for filing an information return with the IRS is February 28 of the year following the calendar year in which payments were made, or March 31 if filed electronically. Copies of information returns must be provided to payees no later than January 31 of the year following the calendar year in which the payments were made.

Information returns must accurately identify both the payer and the payee of the payments as well as the total amount paid. The payees are required to provide their names, addresses, and taxpayer identification numbers[6] to payers in order to facilitate information reporting. The information return must include all of these as well as the address and telephone number of the payer. It is the payer's obligation to request information from the payee, and the payee is required to provide it.[7] The payer may use Form W-9 to request the information from U.S. persons. If the payee does not provide a taxpayer identification number, the payer is generally required to collect backup withholding from payments due to the payee. For 2010-2012, the backup withholding rate is 28%.[8] A payee is subject to a penalty of $50 for each failure to provide the correct taxpayer identification number to a payer who has requested it.

Exception for Credit Card and Third Party Network Payments

The IRS recently promulgated regulations[9] governing the reporting of credit card and third party network transactions.[10] These regulations are not affected by the repeal described above, and create an exception to the information reporting requirements of § 6041. For payments made after December 31, 2010, Treasury Regulation § 1.6041-1(a)(1)(iv) states that any transaction that is subject to reporting under § 6050W, without regard to the third party network de minimus threshold, will not be reported under § 6041. Thus, if payments are made by credit card or through a third party network,[11] the payer generally will not be required to report them on an information return.

Penalties

Both the failure to submit an accurate information return to the IRS and the failure to provide a copy of the information return to the payee are subject to monetary penalties assessed by the IRS. As a unique information return is required with respect to each payee, penalties are assessed on each deficient information return. Both § 6721 (pertaining to failure to file accurate returns with

[6] For individuals, the taxpayer identification number (TIN) is generally their social security number.

[7] Section 6041(c) of the IRC requires the recipient to provide both name and address upon demand by the person paying the income. IRC § 6109(a)(1) requires the payer to report the TIN of the recipient. IRC § 6109(a)(2) requires the recipient to provide the TIN to the payer.

[8] The backup withholding rate is currently defined in IRC § 3406 as being the fourth lowest tax rate under IRC § 1(c), making it 28% for 2010. This definition was enacted in § 101(c)(10) of P.L. 107-16, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGGTRA). The provisions of EGTRRA, due to expire December 31, 2010, were extended by P.L. 111-312 through December 31, 2012. If allowed to expire at that time, on January 1, 2013, the backup withholding rate will revert to 31%—its pre-EGTRRA rate.

[9] Treas. Reg. § 1.6041-1(a)(1)(iv), (v), 75 *Federal Register* 49827, August 16, 2010.

[10] I.R.C. § 6050W (added by P.L. 110-289).

[11] *See* Treas. Reg. § 1.6050W-1((b)(3), (c)(3). One example of a third party network is PayPal.

the IRS) and § 6722 (pertaining to failure to provide payees with correct copies of the information returns) of the IRC have been amended by the Small Business Jobs Act to revise the amounts of the penalties. Section 6722 has been amended to change the structure of the penalty so that it is similar to the structure of the § 6721 penalty. In so doing, the effect is that the amended penalty may be lower than it previously would have been where corrective action is taken. The changes to both sections are scheduled to become effective for returns required to be filed after December 31, 2010. Thus, the new penalty amounts are expected to apply to returns that report payments made during calendar year 2010.

Civil Penalties for Information Returns Due Before 2011

For information returns that are due before the amendments take effect, the penalty for failing to file a correct and timely return with the IRS is $50 for each defective return not to exceed $250,000 for a single payer.[12] If the deficiency is corrected within 30 days of the due date, the penalty is reduced to $15 per return, not to exceed $75,000. If corrected later than 30 days, but before August 1, the penalty is $30 per return, not to exceed $150,000.[13] No penalty will be assessed against a person if defects are corrected by August 1, and the total number of defective returns does not exceed the greater of 10 or one-half percent of the total number of information returns required to be filed by the person.

Some small businesses may be able to take advantage of reduced ceilings on aggregate penalties for payers with gross receipts of less than $5 million. For these payers, the ceilings are $100,000 (for uncorrected violations), $25,000 (if corrected within 30 days), and $50,000 (if corrected after 30 days, but on or before August 1). Higher penalties may also be assessed where persons intentionally disregard their duty to file an information return. (See **Table 1**.)

Failure to provide a correct and timely statement to a payee is also subject to a $50 penalty per return, not to exceed $100,000 per payer. Higher penalties may also be assessed where persons intentionally disregard their duty to provide a payee with a copy of an information return. (See **Table 2**.)

Civil Penalties for Information Returns Due in 2011 or Later

Section 2102 of the Small Business Jobs Act modified the penalties for failing to provide information returns to the IRS or to the appropriate payee in a timely fashion. These amendments have not been repealed by the 112th Congress. The penalties for failing to file information returns with the IRS were increased across the board, as described in **Table 1**. These amounts will also be updated in 2017, and every five years after, to account for inflation.

[12] I.R.C. § 6721(a)(1).

[13] I.R.C. § 6721(b).

Table 1. Penalties for Failure to File Information Return with IRS

IRC § 6721

	Returns Due Before 2011	Returns Due in 2011 or Later
Base penalty	Lesser of $50/return or $250,000 ($100,000 for small businesses)	Lesser of $100/return or $1,500,000 ($500,000 for small businesses)
Corrected within 30 days	Lesser of $15/return or $75,000 ($25,000 for small businesses)	Lesser of $30/return or $250,000 ($75,000 for small businesses)
Corrected by August 1	Lesser of $30/return or $150,000 ($50,000 for small businesses)	Lesser of $60/return or $500,000 ($200,000 for small businesses)
Due to intentional disregard	$100/return without limit	$250/return without limit

Source: Compiled by CRS.

Notes: As used in this chart, small businesses are those with gross receipts of not more than $500,000 in the calendar year for which an information return is required. I.R.C. § 6721(d).

Section 2102 of the Small Business Jobs Act also modified the penalty scheme for failures to provide copies of information returns to payees. As described in **Table 2**, the amended penalties mirror the amounts that would be assessed for a failure to file information returns with the IRS and are similarly indexed for inflation. In addition to raising the base penalty, the amendments also provide reduced penalties if corrective actions are taken. Because the prior penalty scheme did not take corrective action into account, penalties under the amended provision may actually be less than what would have been assessed under the old scheme if corrective action is taken.

Table 2. Penalties for Failure to Provide Information Return to Payee

IRC § 6722

	Returns Due Before 2011	Returns Due in 2011 or Later
Base penalty	Lesser of $50/return or $100,000	Lesser of $100/return or $1,500,000 ($500,000 for small businesses)
Corrected within 30 days	Same as base penalty	Lesser of $30/return or $250,000 ($75,000 for small businesses)
Corrected by August 1	Same as base penalty	Lesser of $60/return or $500,000 ($200,000 for small businesses)
Due to intentional disregard	$100/return	$250/return

Source: Compiled by CRS.

Notes: As used in this chart, small businesses are those with gross receipts of not more than $500,000 in the calendar year for which an information return is required. I.R.C. § 6722(d).

Criminal Penalties in Cases of Willful Violations

It is a misdemeanor for any person to willfully fail to make an information return as required by law.[14] Persons convicted of this offense may be punished by a fine of up to $25,000, imprisonment for up to one year, or both. A willful violation occurs when there is "a voluntary,

[14] I.R.C. § 7203.

intentional violation of a known legal duty."[15] However, a violation that results from a good-faith misunderstanding of the requirements of the IRC is not a willful violation, as that term has been interpreted by the courts.[16] Neither the Small Business Jobs Act nor PPACA changed the criminal penalties applicable to the willful failure to make an information return.

Repealed Amendments

Section 6041 was amended twice in 2010: once by § 9006 of PPACA[17] and a second time by § 2101 of the Small Business Jobs Act of 2010.[18] Both amendments were subsequently repealed by the Comprehensive 1099 Taxpayer Protection and Repayment of Exchange Subsidy Overpayments Act of 2011.[19] Each repealed amendment is described below. For a more detailed discussion of the repealed expansions, including responses to them by various stakeholders, see CRS Report R41504, *1099 Information Reporting Requirements and Penalties as Modified by the Patient Protection and Affordable Care Act and the Small Business Jobs Act of 2010*, by (name red acted) and (name redacted).

Section 9006 of the Patient Protection and Affordable Care Act

For payments made after December 31, 2011, § 9006 of PPACA amended the reporting requirement in IRC § 6041 in two principal ways. First, payments to corporations would no longer be automatically exempt from reporting requirements by virtue of the payee's corporate status, superseding existing regulations to the contrary.[20] Second, the types of payments that could trigger the reporting requirement were expanded to include amounts paid in consideration of property and other gross proceeds.[21] Although now repealed, the effect of this amendment would have been to require those engaged in a trade or business to report a broader range of payments made to a broader range of payees in order to encourage the voluntary reporting of taxable income and also to facilitate the enforcement and collection of taxes on income that is not voluntarily reported.[22]

Section 2101 of the Small Business Jobs Act of 2010

Section 2101 of the Small Business Jobs Act expanded the payers who would be required to comply with the section's reporting requirements to include landlords. Generally, those receiving

[15] Cheek v. U.S., 498 U.S. 192, 200 (1991).

[16] *Id.* at 202.

[17] P.L. 111-148.

[18] P.L. 111-240.

[19] P.L. 112-9

[20] I.R.C. § 6041(h), as added by P.L. 111-148 § 9006(a), the Patient Protection and Affordable Care Act (PPACA).

[21] PPACA § 9006(b).

[22] GAO-09-238, *IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Income Reporting Requirements* (January 2009). The Joint Committee on Tax has estimated that this provision would raise $17.1 billion between 2012 and 2019. JOINT COMM. ON TAX, *Estimated Revenue Effects Of The Amendment In The Nature Of A Substitute To H.R. 4872, The "Reconciliation Act Of 2010," As Amended, In Combination With The Revenue Effects Of H.R. 3590, The "Patient Protection And Affordable Care Act ('PPACA')," As Passed By The Senate, And Scheduled For Consideration By The House Committee On Rules On March 20, 2010* at 1 (March 20, 2010).

rental income from real estate have not been considered to be engaged in a trade or business; however, the recent amendment of § 6041 would have changed this. Solely for purposes of § 6041(a), most landlords would have been considered to be engaged in the trade or business of renting real estate and, therefore, might have been required to file Forms 1099 to report payments made in conjunction with their rental properties.

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