Ready For Your Next Red Tape Nightmare?

Congress Created New Record-Keeping Requirements For Farms, Small Businesses

SARA WYANT

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A little-known provision tucked into the health care reform bill that President Obama signed into law this spring could have costly and confusing impacts on farmers and small business owners.

The new regulations, which kick in at the start of 2012, require any taxpayer with business income to issue 1099 forms to all vendors from whom they purchased more than $600 of goods and services that year and report on forms filed in 2013. That means supplies, parts, or any of the goods that you might purchase to run your farming operation or business.

"A laundromat that buys soap each week would now have to issue a 1099 to their supplier and the IRS at the end of the year. A landscaper who buys lawn fertilizer a couple of times a month will now be forced to issue 1099s to the companies they do business with, and no one is excluded," lamented Sen. Mike Johanns (R-NE) in a recent speech on the Senate floor where he argued for full repeal of the new regulations.

The Patient Protection and Affordable Care Act (PPACA) provision would apply to businesses of all sizes, charities and other tax-exempt organizations, and government entities. These would include two million farming businesses, 26 million non-farm sole proprietorships, four million S corporations, two million C corporations, three million partnerships, one million charities and other tax-exempt organizations, and probably more than 100,000 federal, state, and local government entities, according to a report released by National Taxpayer Advocate Nina Olson.

The provision has nothing to do with health care, other than to help generate more tax revenue to pay for the mammoth reform package by reducing the "tax gap." The federal government misses out on over $300 billion each year from tax underpayment, according to a report issued by the General Accountability Office in 2007. Requiring the additional 1099 paper trails are an attempt to help the Internal Revenue Service (IRS) find businesses that may not be paying their fair share of taxes.

But along with additional tax revenues, the new regulations will likely create a paperwork nightmare for farmers and small business owners and yes, even the IRS. Although the rules have not yet been finalized, Olson highlighted a number of the challenges in her report: "National Taxpayer Advocate's FY 2011 Objectives Report to Congress".

"First, vendors will have to furnish, and businesses will have to collect, TINs (Tax Identification Numbers). If the vendor is a sole proprietor who uses his or her Social Security number (SSN) as the TIN, there could be identity theft concerns, especially if TINs essentially become public through routine printing on receipts. Alternatively, such a vendor could obtain an Employer Identification Number (EIN). If a vendor fails to furnish a correct TIN, the business is required by law to impose back-up withholding at the rate of 28 percent of the purchase price."

"Second, businesses will now have to keep records of all purchases sorted by TIN. Under prior law, a business may have retained sufficient records to substantiate lump-sum expense deductions. Under the new law, the business will have to segregate its records by vendor TIN to determine whether the $600 annual threshold is met for each vendor.

"Third, businesses will have to produce and transmit information reports, including many not previously required. For this purpose, small businesses may have to acquire new software or pay for additional accounting services, incurring additional costs. Moreover, if a business makes qualifying purchases from at least 250 vendors during the calendar year, it will be required to file Forms 1099 electronically, which may require the business to pay a per-report fee charged by an e-file service provider.

"Fourth, the IRS will face challenges making productive use of this new volume of information reports. In general, the IRS's document-matching system (known as the Automated Underreporter (AUR) program) compares amounts shown on a taxpayer's tax return with amounts shown on third-party information reports like Forms W-2, Wage and Tax Statement, and Forms 1099.

For example, it matches wages shown on a Form W-2 with wages reported on a tax return and interest shown on a Form 1099-INT, Interest Income, with interest reported on a tax return.Under the expanded reporting regime, however, the amounts on the information reports and the tax returns will not match under the rules for at least two reasons. First, total annual payments under $600 will not be reported by the purchaser on Form 1099 but must be reported by the vendor. While the $600 threshold existed under prior law, if a significant proportion of a vendor's proceeds comes from small purchases, PPACA reporting would be underinclusive. Second, the goods market is subject to a high rate of returned items that result in refunds to the purchaser. If a business purchases and then returns goods, the vendor does not have any income. Yet depending on how the purchaser's record-keeping system is set up, a Form 1099 may be filed showing the purchase (particularly if the purchase occurs in one tax year and the return occurs in the following tax year)."

At any rate,"it will be challenging for the IRS to sort these payments out," reports Olson in her report to Congress. "In our view, it is highly likely that the IRS will improperly assess penalties that it must abate later, after great expenditure of taxpayer and IRS time and effort."

Under a proposed regulation to streamline data collection, many business purchases made with credit or debit cards would be exempt from the new reporting requirement because they are already reported by banks and other payment processors. But even this proposed rule has come under attack from small business groups that want to pay with cash or check to avoid costly credit card fees. The IRS is accepting public comments on the new rule until Sept. 29, 2010.

Will Congress repeal?

Even before the new rules take effect, several lawmakers are trying to repeal this proposal altogether and a key Senate vote is scheduled for mid-Sept. Both Republicans and Democrats want to change the rule, but they differ in their approaches and methods of paying for them.

For example, Sen. Mike Johanns (R-NE) introduced S.3578, the Small Business Paperwork Mandate Elimination Act, which would totally repeal this provision and prevent what he describes as "a massive new paperwork requirement from being imposed on businesses." This is a companion legislation to H.R. 5141 introduced in May be Rep. Dan Lungren (R-CA).

"This mandate forces businesses to waste staff time and resources on paperwork that even the IRS says will likely be of little value," Johanns said. "One more mandate that stifles small businesses at the same time that Washington urges them to hire workers. For businesses already struggling to emerge from a recession this would be particularly burdensome, requiring government paperwork for common, everyday purchases. It is nothing more than a government-imposed obstacle to economic growth and job creation."

Co-sponsors include: Sen. Pat Roberts (R-KS), Sen. John Thune (R-SD), Sen. Christopher Bond (R-MO), Sen. Tom Coburn (R-OK), Sen James Inhofe (R-OK), Sen. Kay Bailey Hutchinson (R-TX), Sen. John Cornyn (R-TX), Sen. Mike Enzi (R-WY), Sen. John Barrasso (R-WY), Sen. Mike Crapo (R-ID),Sen. James Risch (R-ID), Saxby Chambliss (R-GA), Sen. Johny Isakson (R-GA), Sen. Richard Burr (R-NC), Sen. Lamar Alexander (R-TN), Sen. John McCain (R-AZ),Sen. Lindsey Graham (R-SC), Sen. Richard Lugar (R-IN), Sen. Lisa Murkowski (R-AR), Sen. John Ensign (R-NV), Sen. David Vitter (R-LA), Sen. George Voinovich (R-OH), and Sen. Scott Brown (R-MA). The lone Democrat to sign on this far is the chairman of the Senate Agriculture Committee: Sen. Blanche Lincoln (D-AR).

To pay for the change, Johanns lowers the affordability exemption for the new individual mandate from 8 percent to 5 percent, making fewer people subject to the individual health insurance mandate. The amendment also proposes that a $15 billion fund for wellness programs not be funded until 2018.

Sen. Bill Nelson (D-FL) plans to offer another amendment that would not repeal the record-keeping measure but would change the reporting threshold to from $600 to $5,000. His alternative is paid for by changing Section 199 of the tax code, which allows the nation's largest oil companies to deduct six percent of their income from oil and gas production from their tax liability, effective Dec. 31, 2010.

Some of the nation's largest small business groups and the American Farm Bureau Federation are lobbying for full repeal.

"The only option to address this widely-agreed upon onerous 1099 provision on small businesses is full repeal," emphasized Susan Eckerly, senior vice president at the National Federation of Independent Business in a statement. "Congress needs to stop speaking out of both sides of their mouth. If they are truly interested in helping small businesses – whatever their size – they will pass legislation that fully repeals this burdensome new requirement." Δ

SARA WYANT: Publisher weekly e-newsletter, AgriPulse.