

# Tax Trends

*By Mark A. Luscombe*

## The Tax Gap and the Growth of Third-Party Reporting

As Congress continues to press the IRS to close the tax gap (the amount of taxes owed to the government that are not being collected), the IRS continues to seek help from Congress to achieve this goal by expanding the scope of third-party reporting. It is fairly well documented that tax compliance is at its highest in areas where third-party reporting to the IRS already occurs. There is very little underreporting of wage income due to the W-2 reporting and withholding requirements. Information reporting on the various types of Form 1099 also tends to reduce underreporting of interest and dividend income and the proceeds of sale transactions.

Congress has taken several steps in recent tax legislation to expand third-party reporting. These provisions also provide sources of revenue to help pay for some of the tax breaks included in those pieces of legislation. Such provisions do typically face opposition. Third-party reporting does create a burden on the third party. We have already seen subsequent legislation delay the effective dates of some of these Congressional efforts. Typically Congress has initially provided delayed effective dates for these third-party reporting changes to give affected parties time to gear up to comply. These delayed effective dates also give lobbyists time to try to obtain further legislative changes.

### Withholding on Government Payments

The Tax Increase Prevention and Reconciliation Act of 2005<sup>1</sup> included a provision requiring that payments by government entities for goods or services



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after December 31, 2010, be subject to three-percent income tax withholding. The American Recovery and Reinvestment Act of 2009<sup>2</sup> delayed the withholding requirements for one year—now to apply to payments made after December 31, 2011.

The government entities included in the requirement are the entire federal government, all states and the District of Columbia (but excluding Native American tribal governments), and all political subdivisions of a state government or every instrumentality of a subdivision unless the annual payments of that instrumentality for property or services are less than \$100 million. Withholding is required on all payments to all persons providing property or services to the government, including individuals, trusts, estates, partnerships, associations and corporations. The proposed regulations create a payment threshold of \$10,000 before withholding is required. A number of exceptions also apply.

All amounts withheld must be reported by the government entity on Form 1099-MISC.

### **Information Reporting on Basis**

The Energy Improvement and Extension Act of 2008<sup>3</sup> requires that brokers, when reporting the sale of securities to the IRS, also include the customer's adjusted basis in the sold securities and classify any gain or loss as long- or short-term. A covered security is any specified security acquired on or after the applicable date if the security was acquired through a transaction in the account in which the security was held or was transferred to that account from an account in which the security was a covered security, but only if the broker receiving custody of the security receives a statutory statement with respect to the transfer.

A specified security includes any share of stock in a corporation; a note, bond, debenture or other evidence of indebtedness; a commodity, or a contract or a derivative with respect to a commodity; and other financial instruments as determined by the IRS.

The applicable date for a corporate stock is generally January 1, 2011. For stock in a RIC or stock acquired in connection with a dividend reinvestment plan, the applicable date is January 1, 2012. For other specified securities, the applicable date is January 1, 2013. Since the applicable date relates to when the security is purchased, there could be many sale transactions in the future of securities purchased before these dates that would not be subject to the new reporting requirements. The information is to be reported on Form 1099-B. Extensive proposed

regulations with respect to these broker reporting requirements were issued on December 16, 2009.

### **Credit/Debit Card Information Reporting**

The Housing and Economic Recovery Act of 2008<sup>4</sup> added a requirement for banks and other processors of merchant payment card transactions (credit and debit cards and internet payment systems) to report a merchant's annual gross payment card receipts to the IRS and to the merchant. The reporting is only required if the aggregate value of third-party network transactions for a merchant is \$20,000 or more for the calendar year and if the aggregate number of transactions is 200 or more.

This reporting requirement is effective for sales made on or after January 1, 2011. This information is to be reported on Form 1099-K.

### **Information Reporting Expanded to Payments to Corporations and for Property and Services**

The Patient Protection and Affordable Care Health Care Act,<sup>5</sup> as amended by the Health Care and Education Reconciliation Act of 2010,<sup>6</sup> added the most recent third-party reporting requirement. The general requirement for information reporting by all persons engaged in a trade or business who make payments in any tax year aggregating \$600 or more to a single payee had been expanded to include payments made to a corporation other than a corporation exempt from tax. The class of payments with respect to which reporting is required has also been expanded to include all amounts paid in consideration for property, and other gross proceeds for both property and services.

The change is effective for payments made after December 31, 2011. This information is to be reported of Form 1099-MISC.

In response to this legislation, small business groups are raising concerns about the significant burden that this new reporting requirement may impose on small business.

### **Summary**

As part of the continuing effort to reduce the tax gap, additional withholding and third-party information reporting obligations continue to be added to the tax

code. The withholding on government payments is, after a one-year delay, currently scheduled to apply to payments made after December 31, 2011. Information reporting of basis on corporate stock sales applies to corporate stock acquired after January 1, 2011, with the applicable date for other types of securities either January 1, 2012, or January 1, 2013. Information reporting of credit and debit card transactions is effective for sales made on or after January 1, 2011. Information reporting on payments to corporations and of gross proceeds for property and services is effective for payments made after December 31, 2011.

In the case of information reporting, in general the information returns will not be due until early in the year following the year in which the reporting obligation starts

to apply. For example, information reports on credit and debit card transactions for sales made on or after January 1, 2011, will not be due until 2012. Still, the number of additional reporting obligations coming into effect over the next few years is considerable. Practitioners will want to make sure that their clients are aware of and gearing up to comply with these new requirements.

#### ENDNOTES

- <sup>1</sup> Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222).
- <sup>2</sup> American Recovery and Reinvestment Act of 2009 (P.L. 111-5).
- <sup>3</sup> Energy Improvement and Extension Act of 2008 (Division B of P.L. 110-343).
- <sup>4</sup> Housing and Economic Recovery Act of 2008 (P.L. 110-289).
- <sup>5</sup> Patient Protection and Affordable Care Health Care Act (P.L. 111-148).
- <sup>6</sup> Health Care and Education Reconciliation Act of 2010 (P.L. 111-152).

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