

All Things 1099: Understanding Your Tax Reporting Requirements



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Announcer:

Welcome to THRIVE a Paychex Business Podcast where you'll hear timely insights to help you navigate marketplace dynamics and propel your business forward. Here's your host Gene Marks.

Gene Marks:

Hey everybody. Welcome to another episode of THRIVE. Thank you so much for joining me. My name is Gene Marks. If you haven't figured out, for you guys looking at this. I am a CPA believer. I know that comes as very little surprise and I've got a... Debbie, first of all, before I formally introduce you, are you a CPA as well? I.

Debbie Pflieger:

I am not. I am an attorney by background.

Gene Marks:

Forget it. Let's cancel this whole thing. She's not a CPA, guys. I don't know if we could ... I'm just kidding, obviously. Debbie Pflieger is a principal at EY, Ernst & Young. And Debbie, you specialize in small business tax strategies, or in 1099 specific?

Debbie Pflieger:

Believe it or not I specialize in — not only do I specialize, but I lead an entire team that specializes on 1099 issues, information reporting, when you have to withhold from those payments, and similar payments that we make to non-U.S. vendors. So, that is what my team and I focus on exclusively, believe it or not.

Gene Marks:

It is unbelievable. It a statement of where we are in society right now, when we have a team of people at a Big Four accounting firm, that's like, literally devoted to a single tax point. Well, when you think about it ...

Debbie Pflieger:

The way I like to explain that to people ... Because, I get people who say to me all the time, "Really Deb, 1099 reporting?" My explanation is, "Look, I pay my fair share of taxes and I'd like to make sure everyone else

does too." That's what 1099s do. They make sure that we, that individuals and small businesses and the IRS all know the income that they've got and they pay their fair share of tax.

Gene Marks:

Listen, speaking about you, personally, if there was ever a zombie apocalypse and the world ever went down, there are some people that can fix cars, and other people that can make food and whatever. But, you know, I can fill out a tax return. You can fill out a 1099. We'll be fine. Right? It'll be good.

Debbie Pflieger:

Absolutely.

Gene Marks:

We'll survive about two days before we're eaten. But okay, so listen, we are talking about 1099s because it's a really important topic for small business owners. That's usually who is listening to this podcast, or watching this video, Debbie. You know, listen, you and I talked briefly before we start recording this, but I'm going to insult the intelligence of our audience and we're going to start from square one and just explain what 1099s are. Just so we get it down, what we need to know. So, go ahead, tell me what a 1099 is and what I need to know.

Debbie Pflieger:

Okay. So, 1099s, like I said, report income that a payee has received, just like W-2s report wage income. If you've got income that you've, you've received in any way other than as an employee, it's generally going to be reported to you on a 1099 and for tax purposes, persons, and when I say you, I don't just mean individuals. I mean partnerships, I mean LLCs. Depending upon the type of 1099, I mean corporations, they all receive 1099s reporting income. So, if you're a small business, you receive 1099s from the companies or the others with whom you do business. If you're doing business with other businesses, it's all B2B.

Debbie Pflieger:

Individuals in their private capacity are not required to issue 1099s although there's that nasty 1099-K. To the extent that I use a credit card to make a payment, let's say to a nail salon or a dry cleaner, even I would never issue them a 1099, because when it's a personal expenditure, you're not required to issue a 1099. But for about 10 years now, those credit card purchases have been reportable on the 1099-K by the bank that processes the payment on behalf of the merchant. So, the 1099 reporting is that broad.

Debbie Pflieger:

There's a 1099-NEC that stands for Non-Employee Compensation. Small businesses have to issue a lot of 1099 NECs to their consultants, their business advisors, their accountants, their lawyers, all should be getting 1099 NECs. Miscellaneous, report, rents received, or royalties received. You get 1099-INTs reporting interest income. Your broker or corporations that you own stock in have to issue 1099-DIVs to report dividend income. Again, brokers, if you sold stock, have to report the gross proceeds from the sale, as well as your basis in the stock. So that again, both you and the IRS know what your net gain or loss was from that capital transaction. Those are all 1099s that get issued and are coming in the mail this time of the year.

Gene Marks:

First of all, you did say, this time of the year, 1099s — as we're speaking right now, I actually don't know when this conversation is going to be published — but for the tax year ended 2021, they're actually due to be reported by February 28th of 2022, correct?

Debbie Pflieger:

Yeah. If you're filing on paper, they have to be filed with the IRS by February 28th. They're generally due to the payees by January 31st. So, you should have most of your 1099s by now. Broker statements were due last week.

Gene Marks:

I always get it, I always get it reversed. So, it's the end of January for 1099s. Then, it's the end of February for W-2s. Did I get that correct?

Debbie Pflieger:

No, even W-2s are due the end of January. Actually W-2s and the 1099-NECs are all due to the IRS by January 31st, because a few years ago, Congress sped that due date up, in an attempt to get the IRS more current information quickly, as they are processing tax returns now.

Gene Marks:

So, just to make sure, is there anything due by the end of February, or really has all the deadlines been moved up to January 31st?

Debbie Pflieger:

Well, all the other 1099s. The INT and the DIV and the B and the K, they are due to the IRS by February 28th, unless you're filing electronically. And then, it's March 31st. So, electronic files are a little bit later. Paper files are February 28th.

Gene Marks:

Got it. Okay. That makes sense. All right. Let me tell you a few steps back, Debbie. I'll ask you, in my business, I have 10 employees and I've got about a dozen contractors. Okay. I paid them with 1099s. I think I'm doing it the right way, but talk to me a little bit about some of the things I should be wary of or concerned about when I'm paying these outside people. Accountants, for example. I have a marketing person, part-time people, whatever. Tell me some of the things I should be aware of.

Debbie Pflieger:

The most important thing you need to be aware of is, you need to make sure that you get their tax identification number. For an individual, that's a social security number. For a business, it's an employer identification number. You want to be sure that you get that number before you make a payment to them. And the reason is because, if you make a payment without having their taxpayer identification number, what the tax law says is, you're supposed to withhold 24% from the payment and pay it over to the IRS. If you don't, then what the tax law says is, you become liable for the tax you should have withheld and didn't.

Debbie Pflieger:

So, you're supposed to have that number before you make the payment. Usually, you like to collect that on a W-9. That's the IRS's form for that. You're not required to collect it on a W-9, if you're talking about vendor payments. But, it is very much a common business practice to require it on a W-9, just because it's the easiest, quickest way to get it. But for example, any invoice that you receive, certainly from a large accounting firm is going to have our EIN already pre-printed on the invoice because we never want a client to have to withhold 24% of what they're paying to us, but getting a W-9, certainly common industry practice at this point. The other thing –

Gene Marks:

Sorry, I got to interrupt you and say, that's really, really good advice. If you're listening to this and you are a contractor, or you're a freelancer, or you're getting, or you know you're going to get a 1099 for somebody.

It's good practice that when you invoice your clients, if you've got an EIN, employer identification, in order to include that on your invoice. So, it just makes it that much easier for ... And like you said, it avoids having anything withheld that you know, a person might do for you.

Gene Marks:

Okay. Let's keep going on. There's with 1099 workers, a lot of businesses, they kind of push the lines as to whether or not a 1099 worker is an employee, or are they really a contractor? And this is becoming more and more of an issue, both politically, as well as from a worker classification issue. Give us your thoughts on that. What should we be aware of when we're classifying those workers?

Debbie Pflieger:

Worker classification is a world unto itself. And it's an area quite honestly — specialists who really focus on employment taxes are much better suited to answer that question. I will only tell you that you have to look carefully at whether or not you control what the worker is doing and how they're doing it. If you control them, they are your employee. For example, a childcare worker — you pretty much want to control how they're taking care of your kids and what they're doing, especially, if they're coming into your home. A cleaning service on the other hand, I know my personal attitude is just make sure the house is clean. I'm not going to spend a lot of time telling you what you should clean first or what product you should use, especially if you're using your own cleaning products. So, you have to look at whether or not you control what they are doing and how they are doing it.

Debbie Pflieger:

If they're an employee, you got to down the W-2 path, you're paying employment taxes, you're withholding income taxes. If you're not controlling them, then you're in the independent contractor world. You're on a 1099-NEC. You have to report that income, if it's \$600 or more in a year. You have to make sure you have the ITIN [Individual Taxpayer Identification Number]. The other critical piece of information I tell people to watch for all the time is, make sure you know the name of the person you're paying. That sounds so easy and flippant, but it's not. It's amazing how many payees, don't know their names. And for years, that used to be, "Oh yeah, a woman got married, didn't change her name with Social Security. As a result, there's a mismatch."

Debbie Pflieger:

But what we see much more often now are sole proprietors doing business as Al's Plumbing, but he gave you his social security number. So, if you make your 1099 in the name of Al's Plumbing, but his name is really Albert Smith, well, the IRS isn't going to be able to match that 1099 to Al's income, if you've got Al's Plumbing on the 1099, but his social security number. And if there's a mismatch like that, you're going to get a nasty thing the IRS calls a B notice. Which means that you've got to go collect a new name and TIN from Al and if you don't get a W-9 from him, you've got to start withholding 24% if he ever comes back. So make sure you know what their name is, and they you're using the proper legal name for the taxpayer identification number that they give you.

Gene Marks:

And I guess that's the reason why, if you're going to be working with somebody, you want them to fill out a W-9, correct?

Debbie Pflieger:

They're much more careful about what name they put on their W-9 than they are if you're just looking at the check you wrote. That's absolutely right.

Gene Marks:

Question for you, when somebody does fill out the W-9 and they provide an EIN. Does that necessarily mean you have to give them a 1099?

Debbie Pflieger:

Whether or not they give you an EIN is irrelevant. It comes down to whether you're making the payment in the course of a trade or business, your trade or business, and you've paid them \$600 or more during the course of the year.

Gene Marks:

But let me ask you, I pay a lot of people more. I pay our electric company PECO more than \$600 a year. I don't think we're sending them a 1099. Should we be?

Debbie Pflieger:

Well, no, because they're a corporation, and you don't have to issue 1099s to most corporations. There are two exceptions to that. Congress doesn't trust — so I'm not saying I don't trust them — Congress doesn't trust lawyers and doctors. So, even when you're paying an incorporated lawyer or you're paying an incorporated doctor, you still have to issue 1099s to them. But short of that, corporations don't receive most 1099s. An exception is for the 1099-K. But for 1099-NEC or miscellaneous, if you're paying rent to a corporation, you don't have to report the rent. If you're paying it to an LLC, you do.

Gene Marks:

Okay. By the way, you're right. My sister's a doctor. So you're perfectly right, not to trust any doctors out there. Be very careful, okay. Very nice woman, but I wouldn't let her cut my nails. You know, when you're doing 1099s, though, you say that you don't have to do this to a corporation. How do you know if they're a corporation? They have to tell you that they're a corporation. They literally have to have "Inc." after their names. You are relying on them to say to you, "I am a corporation." And by the way, not an S corporation I'm assuming you mean a C corporation? Am I also correct on that?

Debbie Pflieger:

Actually, S corporations are exempt from the basic 1099s, the 1099-NEC, the 1099 miscellaneous. Again, no corporation is exempt from 1099-K. They all get 1099 Ks. But, you can do one of two things. There's something called the eyeball test, where if you look at their name and it has "Inc." in the name, you can treat them as a corporation and exempt them. Or once again, another really good reason to collect a W-9, because the W-9, they can indicate to you on the W-9 that they are exempt. If you've got that W-9, you've got a perfect reason for the IRS. If they ever ask why you didn't issue a 1099, you've got the perfect answer right there.

Gene Marks:

Got it. Debbie, I have to tell you something. I don't get out much, and I don't have much of a social life, which is why I'm finding this conversation fascinating. I could talk about 1099 stuff, because the rules just, they intrigue me so much. There was a change that happened in 2021, that's going to affect 1099s for the 2022 tax year, the year that we're in right now. Talk to us about that change.

Debbie Pflieger:

It's a huge change. It's a huge change especially for anyone who's doing business on the internet. Because historically I said before, if you accept credit cards for payment, you receive a 1099-K from your bank, the bank that is processing your credit card payments on your behalf. And that rule has been around for plus or minus 10 years. I think everybody's gotten accustomed to getting those 1099-Ks. In addition to that, there's always been a rule that said, if you were a third party settlement organization — what that means is

basically a marketplace or a platform that connects buyers and sellers — if you were that intermediary and you connected buyers and sellers, you had an obligation to report on a 1099-K to any seller who received \$20,000 or more during a year and had 200 or more transactions. So those were really high thresholds, right?

Gene Marks:

Right. And by the way, these third party, PayPal, Squares, those are the examples ...

Debbie Pflieger:

Those types of things, you also have ride-sharing services. So, whether you're talking about Lyft or Uber or any of those, food delivery, same concept.

Gene Marks:

Before the rule, it was \$20,000, would you say?

Debbie Pflieger:

And 200 transactions.

Gene Marks:

Okay. So, you either had to be like a very overweight person with all the food delivery or you're going on a lot of taxi rides with Uber and Lyft to probably qualify for something like this. Right?

Debbie Pflieger:

Well, you had to be the driver or the deliverer to get the 1099-K, right? Yeah.

Gene Marks:

I see. Excuse me, it's the driver. Right. Okay. Got it. Ok.

Debbie Pflieger:

Another common one is landlords. If I have a vacation home and I rent it out through a platform, it would be, maybe I get to \$20,000 depending on how nice of a house it is. But, I probably won't rent it out 200 times during the course of a year. So, those are the platforms that as of 2022 — so not for the 1099s we've just received, but for the 1099s we're going to receive a year from now — they now have a \$600 threshold. Anything more than \$600, they have to report. So, we're going to see a huge increase in the number of 1099-Ks that those sellers, via all kinds of internet sites ... I've learned about a lot of different sites out there, small businesses. You can go online and through a website, find somebody to design your website for you, to tutor your kids, to provide all kinds of web-based services that are now going to be reportable that weren't reported in the past. So, 2022 is going to be a big reporting year.

Gene Marks:

Right. So, those services are now going to be reporting. Again, to tie this into, if I'm a small business and say, I'm a craft person on Etsy, for example. If I received more than \$600 during 2022 through PayPal payments, that's going to be reported by PayPal to the IRS. I'm going to get a 1099 from PayPal saying, "Hey, you received more than \$600 in payments from our services." It could have been from 2 customers or 200 customers. It doesn't make a difference. I was going to get that. What do I do with that, when I get that 1099? What do I care?

Debbie Pflieger:

You really care. That's why we're talking about it now, 11 months before you get that 1099-K, because it's going to be important that you capture all of your expenses associated with that income. Make sure that, if it's a crafter, save your receipts for all the supplies that you bought, all of the expenses you incur, all of

your shipping expenses. Anything else that you're spending to make that money. It's going to be all the more important that you're able to capture that, so that you're not paying more tax. Because the IRS is only going to get a 1099, that reports your gross income. It's going to be up to you to be able to document and claim the deductions associated with that income. So, really important for people now, in early 2022, to be focusing on what those expenses are that they are incurring, so that they can properly report their net income on their tax returns for 2022 next year.

Gene Marks:

Got it. I also heard that because of this change, a lot of the big payment services are going to be reaching out to their customers to get more information so they can file this. So, not to be surprised if you get an email or a phone call from PayPal saying, "Hey, we need your EIN or social security number or address," and things like that. Correct?

Debbie Pflieger:

That's right. A lot of platforms that did not collect social security numbers or EINs in the past are doing that now. Of course, everybody's concerned. That's private information. Worried about identity theft and all the rest. So, you want to feel confident that you're responding to an email, or to a request from the company you're really doing business with. Hopefully, they're having you go behind the screen and do that online after you've logged in. So, you're establishing who you are and that you are on the actual website that you use. Very important to make sure that you're giving that important information only to the people who really need it.

Gene Marks:

You actually bring up a really good point. I just made a note. I'm going to write about that. Because, I see the second half of 2022, lots of requests being made by a lot of financial services firms to get this information and a lot of nefarious people out there that are going to be doing phishing attacks and fake emails to fool users into thinking that they can give them that information. That could be a big problem this year. So, you're absolutely right, to be more diligent about that stuff.

Debbie Pflieger:

Let me just emphasize, it's going to be really important to make sure that platform has your EIN or social security number. Because if they don't, they're going to have to withhold 24%. That goes back to the backup withholding point that I raised a couple minutes ago. If they don't get it, they're going to have to withhold from you and you don't want them withholding 24% of your gross income.

Gene Marks:

Yeah. Good luck collecting that.

Debbie Pflieger:

Right.

Gene Marks:

Good luck collecting that. And in fact, that situation happened. I'm a treasurer for a nonprofit here, in Philadelphia. A few years ago, there were some payments where we had not given our tax identification number to a payment service. They had withheld the 24%, which they shouldn't have. We're still trying to collect the money from the IRS. I'm not sure if you've heard this Debbie, but they're kind of behind in their work, the IRS. [Laughter.] So, we're still working on doing it. So yeah, your advice is very well taken. You do not want to be in a situation where you're getting this amount of money withheld, because it will be a headache to go and collect it.

Gene Marks:

Okay. So, the final couple minutes that we have.

Gene Marks:

We've talked about 1099s and the basics, what the filing rules are, when you should do a 1099, all the different types of 1099s. We have talked about the changes that have happened this tax year that's going to affect us with these new 1099s, 1099-Ks, that's due now, that expanded the rules, that we're all going to be getting more of these 1099s.

Gene Marks:

How about ...? One final question has to do with foreign vendors. Again, some of us do make payments to people. I have a development team in Mexico. How am I going to report my payments to those guys?

Debbie Pflieger:

When you're making a payment to a foreign vendor, what you have to ask yourself is, first of all, what am I paying them for? If you're paying them for goods or merchandise or equipment, it's not subject to these rules. You can go ahead and pay them, no problem. If you're paying them something that you would have to report on a 1099, if it was to a U.S. person, then you've got to think about these rules. You have to say, "Okay, if its income that is fixed or determinable," is the technical language, but that means, again, services, royalties, licensing fees. Be careful of software purchases, software licenses, especially. Then what you have to do is you have to ask yourself, "Where did they earn it? Did they earn it in the U.S.? Or did they earn it abroad?"

Debbie Pflieger:

If they're providing services to you, if it's a lawyer in Mexico, who's helping you with a Mexican contract, as long as they stay south of the border, not subject to U.S. tax, the IRS doesn't want to know about it. You can go ahead and pay it. But, if they are coming to the U.S. To provide those services, to meet with you, to talk to you about what you need. Or, if you're paying a royalty for the use of someone's software in the United States, then that's U.S. Source income. When you pay that you have to withhold 30% from it, unless you get a treaty claim or some other exception, and you always have to report it on a 1042-S. It's different. The 1099s go to U.S. People, 1042-Ss go to foreign persons. There's a W-8, there are a series of W-8s. There are multiple W-8s that you can collect from a foreign vendor.

Debbie Pflieger:

A lot of people make the mistake of thinking, "Well, look, if I get a W-9 from a US vendor, I don't have to withhold. So, I'll just get one of these W-8s from a foreign vendor and I'll be done. That's the worst mistake you can make. Just because you have a W-8 does not mean you don't have to withhold and you always have to report if you're paying U.S. source income. So, you always have to ask the question, "Is it potentially subject to U.S. tax? Where did they earn it?" If they earned it in the US, that's when you need a W-8 to figure out whether or not you have to withhold and you always have to report it on that 1042-S.

Gene Marks:

Debbie, anything else you want to share with us on 1099s? Or, have you frightened us enough?

Debbie Pflieger:

You know, you can be the ultimate judge of that. [Chuckles.] I think, we could talk for an entire web podcast on foreign vendors someday, if you'd like.

Gene Marks:

Oh, no doubt. We have lots more tax topics to cover. I personally find this information really fascinating. Without little, the jokes aside, it's critical stuff that you have to know if you're a small business owner. And so many of my clients like myself, Debbie, we use contractors all the time. Like I said, I've got people over in, a group of guys in Mexico that I pay for services. They do development services, outsource services for me there. So, it sounds like I don't have to send them a 1099. But you know what? They did come to Philadelphia for a big lunch that I paid for, a couple months ago. So, I'll think about what I'm going to do about that. Anyway, Debbie Pflieger is a principal at Ernst & Young, EY. Thank you very much. Deb, where are you based? What office?

Debbie Pflieger:

New York.

Gene Marks:

You're in New York. Okay.

Debbie Pflieger:

Although I'm ... in Manhattan.

Gene Marks:

You're in Manhattan, but you're not in your office now though, I can tell, correct?

Debbie Pflieger:

I am not. I'm out on Long Island.

Gene Marks:

Good for you. Hope you stay there. Never go to Manhattan again. It's a dangerous place. Thank you very much.

Gene Marks:

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Announcer:

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