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Delayed Thresholds, Immediate Confusion: Form 1099-K Reporting Thresholds

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On December 23, 2022, Treasury and the IRS announced transitory relief for Form 1099-K reporting for Third Party Network Organizations (TPSOs), postponing the de minimis threshold of $600 for one year. Although the announcement came as welcome relief to many companies that are still working to align their compliance and reporting processes to the lower threshold, it has resulted in significant confusion for many payors, payees, and even state agencies. In *Delayed Thresholds, Immediate Confusion: Form 1099-K Reporting Thresholds*, we discuss how taxpayers are navigating compliance requirements in light of unclear guidance, and what payees can expect in the upcoming filing season.

Background

To address the subprime mortgage crisis that began in 2007, Congress enacted the Housing and Recovery Act of 2008 (HERA), here. Prior to enactment, Congress included section 6050W, a new provision pulled from legislation which had stalled in Congress, as a revenue offset to help fund HERA. Under section 6050W, Congress sought to capture underreported income, and increase revenue, by requiring certain intermediary payment settlement entities to report payments that were not previously subject to reporting. Congress included a de minimis threshold for Third Party Network Organizations (TPSOs), requiring reporting only for those payees that had conducted over 200 transactions where the aggregate amount of payments exceeded $20,000 in a year. Subsequently, Treasury and the IRS issued regulations, and Form 1099-K reporting began in 2012, for payments made in 2011. For further background, see *Evolving Form 1099-K* Thresholds, here.

2022 Form 1099-K Reporting Changes

In March 2021, President Biden signed the American Rescue Plan Act of 2021 (ARPA), here, in order to provide funding for Covid-19 relief. The legislation amended the section 6050W de minimis threshold amount, requiring reporting on payees at the much lower amount of $600, without regard to the number of transactions, for payments beginning on January 1, 2022. The expected reporting impact was significant, with some large payors estimating their annual form issuances to jump from the thousands to millions, in a single year. Notably, many smaller payors would be subjected to Form 1099-K reporting for the first time, with little time to process the rules, implement software system updates, and establish new reporting procedures.

In addition to reporting obligations, the lower threshold effectively deputized a new wave of payors as IRS collection agents. Payors are required to collect TINs under section 6050W but are not required to certify the TINs and, in practice, are unlikely to validate TINs for smaller payees where reporting is not required. The risk is relatively low, as the higher threshold means that these payees are unlikely to be identified by the IRS as payees subject to backup withholding. Under the lower threshold, payors may soon find that some (many?) of the TINs are invalid and may be subject to backup withholding, incurring additional reporting costs and effort. Thus, the new wave of reporting payors suddenly found themselves subject to significant due diligence and documentation requirements.

Concerned about the impact to taxpayers, bipartisan House and Senate members presented legislation that would have raised the threshold to $5,000 and provided for one year of transitional relief by retaining the de minimis 200 transaction reporting threshold for 2022. However, this bill failed to gain traction and ultimately stalled in Congress. See H.R. 7079, Cut Red Tape for Online Sales Act, here. It was widely expected that Congress would enact some form of transitory relief for Form 1099-K reporting under the Consolidated Appropriations Act, 2023 (Omnibus bill). To the dismay of many in industry, Congress spent the week leading up to the holiday recess resolving differences in the Omnibus bill without a single mention of the Form 1099-K threshold.

On December 23, 2022, the IRS issued an early release of Notice 2023-10, here, providing a year of transitory relief. Under the notice, payors that performed backup withholding on 2022 payments at the lower threshold amount would still be required to issue Forms 1099-K to report the amounts withheld. However, TPSOs would not be required to report payments at the lower de minimis threshold, and could instead rely on the prior threshold amounts of $20,000 across 200 transactions for 2022 payments. Though the relief was welcome news by taxpayers across the board, the short gap between the announcement and the recipient statement deadline leaves little time for payors to update their processes and inform their payees on the actions that they will be taking for 2022 reporting. In addition, the announcement was made immediately before the holidays, when most state revenue agencies are effectively shutdown, meaning there has been little to no official issuances to guide payors seeking to adhere to state reporting requirements.

From a logistical perspective, it may be easier for payors that had already established lower threshold process and system updates to simply report this information. However, as mentioned above, the number of forms skyrocketed for many large payors, which would result in significant filing fees. Alternatively, payors could revert to prior year reporting processes, as needed, in order to ensure accurate reporting. The challenge with this approach is ensuring consistent messaging for their payees, as many payors have likely spent time and effort during 2022 educating payees on the impact of the lower threshold. Indeed, on December 28, 2022, the IRS updated its Form 1099-K FAQs, here, to provide payees with additional information about their reporting obligations under the lower thresholds. The updates focused on those payees that have likely never received the form before and, although they may receive the form for 2022 payments, may still not be subject to taxation. Thus, it is clear that the increased reporting is a significant concern for payors and payees alike. Complicating matters, states have been slow to rollout guidance, leaving many payors guessing on their state reporting requirements and providing unclear information for payees.

State Form 1099-K Reporting

State treatment under the IRS 2022 transitory relief can be broken down into three rough groups: 1) those that follow the federal rules and will likely permit the IRS relief, 2) those that have established state de minimis thresholds specifically set at $600 or tied to section 6041 (i.e., $600 without regard to the number of transactions), and 3) those that have provided unclear rules. The first group seems relatively simple, as many states simply defer to the federal standard. For example, see the California FTB webpage *Guidance for reporting information returns*, here, which states, “If you file via paper or file electronically with the IRS following the IRS Combined Federal/State Filing Program (CFSF) guidelines as outlined in IRS Publication 1220, AND the amounts you are reporting to IRS and us are the same, do not file with us.” Unfortunately, the bulk of these states are also slow to issue state updates corresponding with federal changes. For example, the FTB webpage noted above links to another webpage, *1099 Guidance for recipients*, here, which still references the $600 threshold without any mention of the IRS transitory relief. Complicating matters, many of the states that have adopted the federal standard specifically reference the section 6050W threshold in state statutes. A strict interpretation of these states’ rules would lead one to believe that the IRS transitory relief does not apply. However, in practice, it is very unlikely that these states intend to enforce compliance at a stricter standard than the federal standard. Thus, they will almost certainly adhere to the transitory relief, whether they formally address it or not. But this distinction is still ripe for confusion.

The second group is relatively straightforward, in that these states have established statutory or regulatory rules that effectively align their threshold to match the Form 1099-MISC. This trend was essentially kickstarted in 2017 by Massachusetts and Vermont. Massachusetts amended its law, which originally required reporting at the federal thresholds, to permit the Commissioner to set the threshold. The Massachusetts Department of Revenue then issued TIR 17-11, here, which stated that the new threshold would be $600. Likewise, Vermont enacted legislation in 2017, here, amending its law to directly tie the threshold to section 6041. The move to reduce the threshold became a trend, as both Virginia (here) and Maryland (here) enacted legislation in 2020, tying their thresholds to the lower $600 amount. The result is clear, as these states require reporting at the $600 threshold without any regard to the IRS transitory relief.

Finally, there is a third group of states with unclear state reporting requirements, either due to poor drafting or outdated guidance following the IRS transitory relief. In the former category are states like Missouri, which provides very generic reporting requirements specifying that it may prescribe rules requiring information returns for any person making a payment of $1,200 or more that is subject to tax imposed under Missouri law. See the statute, here. Although the FAQs (here) do not specifically refer to Form 1099-K, the 2022 Missouri Employer Reporting of 1099 Instructions and Specifications Handbook (here) was updated to generally include Form 1099-K as a form that may be filed under the CF/SF Program, but not necessarily for Missouri. This led to understandable confusion on their intent, but the DOR has recently unofficially confirmed that it does not require Form 1099-K reporting.

In the latter category of the third group are more nuanced states that have issued updated guidance to accommodate the federal change, but have not yet officially addressed the transitory relief. Illinois enacted Form 1099-K reporting requirements under two separate bills over the course of 2019, at first matching the federal threshold for 2019, then requiring reporting for amounts exceeding $1,000 over four or more transactions, beginning in 2020 and going forward. The statute, here, remains unchanged following the second amendment; however, following ARPA, the Illinois DOR issued updated guidance (here) stating that Illinois would once again follow the federal threshold for reporting periods on or after January 1, 2022. The intent was clear, Illinois planned to piggyback off of the lower federal threshold; however, the DOR’s failure to provide further clarification following the issuance of the IRS transitory relief has led to confusion among taxpayers. Illinois has since unofficially confirmed that it will revert to the 2021 thresholds for 2022 reporting. Conversely, Montana has generally followed federal reporting thresholds, but also updated its guidance to note the lower threshold following ARPA (here). In a call with the Montana DOR, the representative confirmed that Montana generally follows federal guidelines and that the discrepancy was likely due to the agency being caught off guard by the IRS relief. However, Montana has yet to issue any additional guidance, official or otherwise.

Going Forward – Reporting in 2023 and Beyond

Taxpayers should view the late relief as an opportunity to get their processes up to speed for 2023 payments, and 2024 reporting. However, there has been speculation that the late relief may lead to permanent changes, as the additional year provides time for the industry to lobby Congress. There has already been some movement, as a 2021 bill was recently reintroduced to repeal the ARPA threshold amendments. See H.R. 190, Saving Gig Economy Taxpayers Act, here. There will likely be additional variations introduced in 2023, perhaps seeking to strike a middle point between the $20,000 and 200 transaction threshold and the $600 threshold. Taxpayers should keep an eye on these changes, but also keep in mind that state reporting thresholds will likely differ, regardless of federal transitory relief.

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