

AACS LEGAL REPORT

1099 FORMS - "WHAT ARE THEY AND WHO DO WE SEND THEM TO?"

I. INTRODUCTION

At this time of year, school bookkeepers are busy preparing W-2 forms, which must be sent to each employee by January 31. Another record-keeping form that is sometimes overlooked, however, is the 1099 form. 1099 forms record payments that were made by the school to certain "non-employees" during the previous year.

Although there are different types of 1099 forms, the most common one is the 1099-MISC. As discussed in more detail below, a school must send a 1099-MISC form to most self-employed persons who received \$600 or more in compensation from the school during the previous calendar year.

In this Legal Report, we will look at some of the different 1099 forms in an effort to help your school determine whether it should be sending such forms to any "non-employees" and filing the forms with the Internal Revenue Service (the "IRS"). In addition, we will offer suggestions on how to complete these forms. Although this Report will address certain 1099 federal forms, it will not address any corresponding forms that your school may be required to file with various state agencies.

II. DISCUSSION

The different types of 1099 forms are used to record a variety of payments made to "non-employees" during the calendar year, i.e., compensation, interest payments, or payments resulting

from the sale of real estate. Although there are different types of 1099 forms, your school will be dealing with the **1099-MISC** form the majority of the time.

The **1099-MISC** is used to report disbursements made to non-employees in the form of compensation, rent, commissions and fees, prizes and awards, and other types of payments or reimbursements that equal or exceed \$600 in any one year. In most cases, these payments are made to self-employed, independent contractors who perform work for the church or the school.

Other types of 1099 forms that you may need to prepare from time to time include the **1099-INT** and the **1099-S**. Although these forms will be discussed briefly in this Report, we will focus mainly on the **1099-MISC** form.

A. Five general rules that apply to the 1099-MISC form.

As with most issues concerning the IRS, there are rules, exceptions to the rules, and exceptions to the exceptions. Nevertheless, in most cases, a school should issue a **1099-MISC** form to any self-employed individual who is paid compensation of at least \$600 during any calendar year. This form was designed to encourage self-employed persons to report their full taxable income.

When deciding whether to issue a **1099-MISC** form to a particular individual, the school should consider the five conditions listed below. If all five of these conditions are met, then the school should issue a **1099-MISC** form.

1. The individual receiving the payment is SELF-EMPLOYED and is not employed by a corporation.

The first rule to note in connection with **1099-MISC** forms is that such forms are not issued to individuals who are treated as employees of the school for income tax and payroll tax reporting

purposes. As noted above, school employees receive W-2 forms reflecting the compensation paid to them.

In addition, **1099-MISC** forms are not issued to employees of other corporations, if the corporation is the entity that is being paid by the school for the work. **Instead, 1099-MISC forms are issued only to individuals who are self-employed for income tax reporting purposes.**

For that reason, if the school hired a plumber, carpenter, or lawn maintenance person during the year, but that person was employed by a corporation, then the school is not required to issue a **1099-MISC** form to the corporation. Conversely, if such a person is not incorporated, then the school would be required to issue a **1099-MISC** form, assuming the other four requirements listed below have been met.¹

2. The self-employed individual has received \$600 or more in compensation from the school during the previous calendar year.

The **1099-MISC** requirement does not apply unless an individual has received \$600 or more from the school during the previous calendar year. Please note, however, that the \$600 rule applies to compensation - not to reimbursement of expenses. Therefore, in making a determination as to whether the \$600 rule has been met, the school is not required to include those amounts that are paid to an individual for the reimbursement of expenses that are "substantiated" as to amount, date, place, and business purpose. For that reason, the school should always retain those receipts that support a reimbursement of expenses.

Assume for purposes of example that a school pays a self-employed plumber \$645, of which \$50 represents reimbursement of substantiated expenses, i.e., reimbursement for travel and meals.

¹ Please note that a church generally will be required to issue a **1099-MISC** form to a pastor who is considered to be "self-employed" for income tax reporting purposes.

The school is not required to issue a **1099-MISC** form to the self-employed plumber because the school has paid the plumber only \$595 of reportable income. Please note, however, that the plumber's bill should include receipts for those expenses that have been reimbursed to him.

The \$600 requirement applies to payments made in the form of property as well as to payments made by cash or check. In other words, taking the example above, if the school gave the plumber a car as payment for his services, then the school may be required to issue a **1099-MISC** form to the plumber. The key is to look at the fair market value of the car at the time it was given to the plumber. If the car is worth \$600 or more, then the school would be required to issue a **1099-MISC** form to the plumber and list the fair market value of the car on the form.

3. The school is "engaged in a trade or business."

Only those organizations "engaged in a trade or business" are required to issue 1099 forms. Pursuant to the rules that apply to **1099-MISC** forms, however, churches and schools are considered to be "engaged in a trade or business." In particular, the regulations state that the term "engaged in a trade or business" applies to both for-profit and not-for-profit entities, including organizations exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code. For this reason, Christian schools and churches must issue **1099-MISC** forms, if the other requirements are satisfied.

4. The payment is made in the course of the school's "trade or business."

The regulations further state that 1099 forms must be issued by a school "with respect to payments made by [the school] in the course of [its] trade or business." Of course, school bookkeepers normally will be dealing only with payments made by the school in the course of its trade or business. Nevertheless, rare exceptions may exist, such as when a school pays for an

unusual personal expense incurred by a non-employee. If the payment is not made in connection with the school's "trade or business," then the **1099-MISC** requirement does not apply.

Regardless of this requirement, schools are not required to issue a **1099-MISC** form for the payment of certain services such as those related to the purchase of merchandise, telegrams, telephone, freight, or storage. Under this exception, a school is not required to issue a **1099-MISC** form to the telephone company, to UPS, or to vendors from which it purchased merchandise. Of course, most of these payments will be made to corporations, making the issuance of a **1099-MISC** form unnecessary.

5. No exception exists in connection with the requirement to issue a 1099-MISC form.

Most of the relevant exceptions have been discussed above, i.e., the exception that applies to reimbursement of expenses and the exception that applies to payments made to corporations. Nevertheless, you should be aware that a canceled debt is not reportable on a **1099-MISC** form. Therefore, even though a canceled debt does represent taxable income to the debtor, a school is not required to report this income on a **1099-MISC** form. The regulations clarify that only "financial institutions" are required to report a canceled debt as income, and this is done on Form 1099-C.

Of course, if the debtor is an employee, then the forgiven debt may represent taxable income, and such income should be reported on the W-2 form.

B. Other 1099 forms that your school may need to file.

Other types of **1099** forms include the following:

- **1099-INT** Used to report interest of \$600 or more that a school pays to an individual during any calendar year
- **1099-S** Used to report proceeds from the sale or exchange of certain real estate that a school pays to an individual during any calendar year

C. Additional guidelines that apply to 1099 forms.

For those schools that are required to file any of the **1099** forms, here are some additional things to remember:

- All **1099** forms should be filed along with **Form 1096**, *Annual Summary and Transmittal of U.S. Information Returns*; **Form 1096** simply lets the IRS know what you are sending them;
- **1099** forms should be filed with the IRS no later than February 28 of the year following the calendar year in which the payments were made; the payee's copy of the return should be furnished to him or her no later than January 31;
- Use **Form 8809** to request an extension of time to file **1099** forms;
- A school must have the social security number (or other tax identification number) of a self-employed person in order to complete the **1099-MISC** form; if the self-employed person who performed services for the school refuses to provide his or social security number, then the school may be required to apply "backup withholding" - (which is reported in Box 4 of the **1099-MISC**);
- The maximum penalty for failing to issue a **1099-MISC** is \$50 per occurrence, although the penalty can be higher in cases of intentional disregard of the rules;
- If you issue a **1099-MISC** form with incorrect information, you may issue a corrected **1099-MISC** entering an "X" in the box labeled "corrected" at the top of the form; you also will need to issue a new Form 1096 with a similar notation at the top of the form.

III. CONCLUSION

This Report has been designed to familiarize you with 1099 forms, and to offer some guidance on when such forms should be issued by the school. Of course, this Report cannot address all of the possible questions that may arise in connection with such forms, and if you have additional questions, you may want to contact your local accountant or tax attorney. If you need any of the 1099 forms, you can obtain them at a local IRS office, or by calling the IRS forms hotline number at **1-800-TAX-FORM**.

If you have questions or comments concerning the issues raised in this Legal Report, please feel free to contact Steve Cummings at the AACS Legal Hotline number in Atlanta, Georgia - (404) 479-4434.