

Testimony of

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**On Behalf of the
National Association of Home Builders**

**Before the
United States House of Representatives
House Committee on Small Business**

Hearing on

Buried in Paperwork: A 1099 Update

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Introduction

On behalf of the more than 160,000 members of the National Association of Home Builders, I appreciate the opportunity to submit this testimony to the House Committee on Small Business. My name is Mike Kegley, and I am a builder from Union, Kentucky, and the 2011 President of the Home Builders Association of Kentucky. I also serve as an alternate director on the National Association of Home Builders' Board.

I am a small business owner and Manager of The B.O.L.D Company. In 1986, my two brothers-in-law, my wife Janet, and I started our home building business in northern Kentucky. The company continues to be a family business, and six years ago my son joined the business. We have seven employees and built six homes in 2010.

Few industries have struggled more during this recession than the home building industry, and it has been no different with my company. Our business has seen a reduction from 16 homes built with 17 employees in 2007 to 6 homes in 2010 with 7 employees. We moved into remodeling work to make ends meet, and my wife had to leave the company to return to her field of speech therapy. We have struggled to keep our business, retain our employees, and maintain a minimum standard of living for the four families depending on the success of our company.

In this economic environment, any additional administrative costs imposed on me will greatly affect the future of my company—and the jobs of my employees. I am pleased that the Committee is focusing today on the impact of the new 1099 information reporting requirements on small businesses.

Information Reporting Requirements Prior to 2011

The Internal Revenue Service (IRS) requires businesses to issue a Form 1099 to any individual or unincorporated business paid in excess of \$600 per year for services rendered. This is required whether the payments are spread out over the course of the year or paid in one payment. Under current law, businesses are generally not required to issue a Form 1099 to incorporated businesses.

Changes to the Information Reporting Requirements

The *Patient Protection and Affordable Care Act* (P.L. 111-148) and the *Small Business Jobs Act of 2010* (P.L. 111-240) both expanded the tax code's information reporting requirements. Effective January 1, 2011, the *Small Business Jobs Act of 2010* expanded the requirements to so-called independent landlords. The *Patient Protection and Affordable Care Act* imposes additional reporting requirements beginning on January 1, 2012; the major changes are removing the exemption for payments to corporations and reporting on purchases of goods.

Independent Landlords

Prior to 2011, landlords who were not engaged in the trade or business of renting real property were exempted from the information reporting requirements. Typically, these landlords are referred to as "independent" landlords as they represent individual investors in rental properties. For example, a

homeowner who rents out a basement apartment or an investor in a vacation rental property were generally exempt from the information reporting requirements as they are not considered by the IRS to be engaged in the business of renting real property.

The *Small Business Jobs Act of 2010* removed the exemption for independent landlords, requiring them to comply with the information reporting requirements for payments made beginning in 2011. Individuals or firms that engage in real estate management services, owning and renting real property, were already required to comply with the information reporting requirements.

NAHB is concerned that many independent landlords remain unaware of this change in law and lack the technological ability to comply with it. Of note, the Act was signed into law on September 27, 2010, leaving landlords with little more than three months to implement accounting measures to comply with the reporting requirement. NAHB believes that this short time period is simply inadequate and unfair.

In most cases, the impacted landlords are not sophisticated investors. For example, a family who needs to relocate may choose to rent out their home rather than sell it. In other cases, individuals may rent out an apartment in their home to help make ends meet. They are now required to comply with complex information reporting requirements, including learning how to process and submit Form 1099, and to do so with only three months of advance warning. This will come at a significant cost and adds an unnecessary level of complexity to an already complex tax code.

The new law does contain several exemptions. The first exemption is for those who receive rental income from renting their principal residence on a temporary basis. This targets scenarios where a family may choose to rent out their home for a short period of time while they travel or during a special event in their home town. The second exemption excludes landlords receiving rental income of a minimal amount, as determined by regulation. Finally, the Secretary of Treasury may exempt individuals if compliance would cause a hardship. This potential impact of this final exemption is unclear as regulations have not yet been proposed.

On top of the administrative burdens faced by independent landlords, the *Small Business Jobs Act of 2010* also increased penalties for failure to file an information return or failing to provide a copy of the information return to the payee. While NAHB lacks data suggesting the impact of this provision, it is reasonable to assume that most landlords, if they are even aware of this new requirement, will struggle to comply, and will now also face significantly higher penalties.

By imposing this change in law with less than three months notice, we believe it is reasonable to say that landlords have been set up for failure when it comes to compliance. NAHB urges Congress to reexamine the wisdom of imposing these burdensome requirements on independent landlords and, ultimately, to repeal them. Simply put, we do not believe that the cost imposed on independent landlords is commensurate with the additional tax revenue raised.

Repeal of the exemption for payments to corporations and expansion to goods

Beginning in 2012, the *Patient Protection and Affordable Care Act* requires all business to track and report additional payments that were previously excluded from the reporting requirements. Payments to corporations will no longer be exempt. The new requirement also expands the type of payments that will trigger reporting requirements beyond services to payment for goods or other property. Effectively, nearly every business-to-business transaction will be reported on Form 1099.

NAHB believes the new reporting requirements will impose significant paperwork burdens and costs on small businesses. Home builders are already familiar with reporting requirements as existing law has particularly focused on services. Nonetheless, the new requirement will substantially increase the reporting requirements on small home builders. In the January 2011 Builders' Economic Council Survey, NAHB surveyed builders to determine how many additional Form 1099s would be issued under the new law:

Number of Additional 1099s	Percent of Respondents
Fewer than 10	17%
10 to 24	17%
25 to 49	20%
50 to 74	14%
75 to 99	7%
100 or more	17%
Not sure/Don't know	7%
Median Number of Additional 1099s	40

The median result was 40 additional Form 1099s, but 38 percent of the respondents indicated they would issue 50 or more additional Form 1099s, and 17 percent would issue 100 or more additional forms.

A major reason for the increase in Form 1099s is not just the removal of the corporate exemption, but imposing reporting requirements on a host of new transactions, such as goods, utility payments, and freight. As an industry where businesses may be working on multiple building sites or managing multifamily rental properties, there will be significant costs involved to track, aggregate, and report all required transactions. In the home building industry, employees can be spread across multiple building sites. For example, the simple task of tracking fuel purchases from multiple gas stations, possibly in multiple states, is daunting. It is not as simple as collecting receipts. Businesses must determine the taxpayer identification numbers for each gas station, as they are likely owned by different franchise owners. Many businesses will be forced to hire additional staff to comply, and few home builders are in the position to do that.

For the B.O.L.D. Company, we issued in 2008 27 Form 1099s; in 2009 32 Form 1099s; and in 2010 29 Form 1099s. I employ a part-time bookkeeper, and according to her calculations, if the new law were in effect, I would have issued approximately 144 additional Form 1099s in 2008; 122 additional Form 1099s in 2009; and 173 additional Form 1099s in 2010. My bookkeeper further estimated that it would cost my company an additional \$6,400 in administrative costs for the first year the new law takes effect to obtain and catalog the required W-9 forms to track the necessary taxpayer identification numbers. Subsequent years would run about \$1,900 in W-9 upkeep costs. In addition, she estimated that the added administrative costs of generating the additional 1099s, had the law been in effect, would have been nearly \$2,200 in 2008, over \$1800 in 2009, and almost \$2,600 in 2010. To provide a rough estimate of total cost, had the law entered into effect in 2010, it would have cost my company \$6,400 to obtain and catalog the W-9 forms and \$2,600 to generate the additional Form 1099s, for an estimated total of \$9,000. And that does not include the software upgrades I would have to purchase or subsequent work to correct any errors. Currently, the IRS requires companies that file more than 250 Form 1099s to do so electronically. I do not anticipate that I would meet that threshold, but as a matter of efficiency, filing electronically may be the preferred option for many businesses. However, I note that most "off the shelf" accounting programs small businesses use are not able to file these forms electronically. The software my company uses does not have that ability.

Many home builders depend on outside bookkeepers and accountants. I checked with three different services in Kentucky and came up with the following as an average cost of preparing a Form 1099: \$50 for the first form, and \$25 for each subsequent form. Additional volume discounts are available for more than 100 forms. Of course, this does not include the cost of obtaining and keeping current the W-9 forms and other administrative costs associated with compliance.

Home builders will face an additional level of complexity and higher compliance costs due to how most small builders must structure their businesses. As a result of insurance, licensing requirements, and liability issues, many small builders have multiple, very small companies performing several functions. For example, it is typical for a builder to operate their home building and remodeling company as separate entities. They may have different investors and will have separate bookkeeping. Each of these small entities would need to generate their individual 1099s increasing the complexity of managing a small home building business.

The burden on business stretches far beyond the scope of issuing additional 1099s. For the payees receiving the forms, they will face a substantial increase in forms that they will need to subsequently reconcile against their own records. And when errors occur—and there will certainly be errors—businesses will need to designate substantial time correcting the forms. As purchases of goods will begin to trigger the reporting requirements, matters become more complicated when product returns are factored in. Many goods face a high rate of returns, and tracking returns correctly will be essential to providing accurate Form 1099s. This will add another level of expense and complexity for small businesses—both for the buyer and the seller.

NAHB also believes that these reporting requirements will make small businesses less competitive relative to larger, corporate businesses. Small businesses will take steps to reduce their paperwork burdens by purchasing from fewer sources. Rather than purchasing nails from the local hardware store, lumber from the specialized dealer, and drywall from another supplier, builders may simply take all of their business to a larger retailer to reduce the resulting paperwork from each purchase. Small product suppliers will pay a price.

Exemption of Payments Made By Credit Card

The IRS has indicated that payments made by credit card will generally be exempt from the new information reporting requirements. This does provide a modest degree of relief, but NAHB believes the only solution is a full repeal of the provision.

According to the National Federation of Independent Business, only about half of all small businesses accept credit card payments¹. For many small businesses, they simply cannot afford to pay the fees associated with accepting credit cards. Small businesses should not be forced to accept credit card payments simply to remain competitive with larger corporate entities.

In addition, small businesses will need to continue to track all purchases made regardless of whether the credit card company or the business itself is required to report a payment. The business ultimately bears the responsibility to show that all payments were properly reported.

Lack of Index for Inflation

The \$600 threshold has not been adjusted since 1954. NAHB estimates that in 2010 dollars, \$600 in 1954 is worth the equivalent today of \$4,864. Because the threshold is not indexed for inflation, more and more transactions will trigger these reporting requirements over time. As a result, the burden and costs on small businesses complying with the new reporting requirements will continue to increase over time.

¹ Credit Cards – NFIB Small Business Poll, NFIB Research Foundation, Washington, DC, Volume 8; Issue 3; 2008.

Role of the Regulatory Flexibility Act

The Regulatory Flexibility Act (RFA), as amended by the Small Business Regulatory Enforcement Act (SBREFA), requires agencies, including the IRS, to consider the potential impact of regulations on small businesses and other small entities.² The IRS, like many agencies, can circumvent this requirement by issuing guidance. Issuing guidance—rather than a notice-and-comment rulemaking—avoids any serious analysis or consideration of the impact that the new reporting requirements will have on small businesses.

The RFA's mandate that agencies consider the impact of new regulations on small businesses is only required when an agency engages in the formal notice and comment rulemaking process, rather than to less formal guidance. Formal guidance is required by the Administrative Procedure Act (APA) whenever an agency seeks to impose new mandatory obligations.³ When agencies like the IRS fail to adequately consider the APA when issuing new rules, they are able to avoid the rulemaking process and their obligation under the RFA to consider impacts on small business. Although the *Patient Protection and Affordable Care Act* gave the IRS the option to either prescribe guidance or issue regulations, this does not obviate the agency's responsibility to apply the APA to their rulemaking decisions.

This is not the first time the IRS has avoided the RFA's requirements in this way. In fact, the agency's failure to comply with the RFA motivated this committee to amend the Act with SBREFA in the mid-nineties.⁴ SBREFA expressly expanded the scope of the RFA to include interpretive rules involving the internal revenue laws, so long as they are published in the federal register and impose a collection of information requirement on small entities.⁵ The new reporting requirements certainly qualify as collection of information requirements that should be subject to a regulatory flexibility determination.

When given the option to use informal guidance, however, the IRS can do an end run around the RFA. It is important to note that the RFA's requirements are quite minimal as a threshold matter, involving a certification that a rule will not have an impact on a significant number of small entities. Only when an impact is found does the RFA require the more demanding regulatory flexibility analysis. This avoidance is particularly vexing because the IRS has successfully worked through the RFA process in the past. For example, in 2006 the IRS partially withdrew regulations and submitted a revised regulatory flexibility

² Pub. L. No. 104-121, Title II, 110 Stat. 857 (1996).

³ 5 U.S.C.A. § 552(a)(1); "Rule making is agency action which regulates the future conduct of either groups or persons or a single person . . . [t]he object of the rule making proceeding is the implementation of prescription law or policy for the future, rather than the evaluation of a respondent's past conduct." *Attorney general's Manual on the Administrative Procedure Act* at 15 (1947).

⁴ The Impact of Regulation on Small Business, Joint Hearing Before the S. Comm. On Small Business and the H. Comm. on Small Business, 104th Cong. 13 (1995) (statement of Jere W. Glover, Chief Counsel for Advocacy, U.S. Small Bus. Admin.).

⁵ The legislative history associated with SBREFA explains: "One of the primary purposes of the RFA is to reduce the compliance burdens whenever possible under the statute. To accomplish this purpose, the IRS should take an expansive approach in interpreting the phrase 'collection of information' when considering whether to conduct a regulatory flexibility analysis." 142 Congr. Rec. S3242-02 (March 29, 1996) (Joint Managers' Statement of Legislative History and Congressional Intent).

analysis to proposed regulations that would change like-kind exchanges.⁶ These changes occurred following a slew of adverse comments from stakeholders after the initial regulatory flexibility analysis was conducted. The impacts would never have been meaningfully considered if the IRS had merely issued guidance, as is the case with their implementation of changes to the reporting requirements.

NAHB acknowledges that the IRS, when implementing tax provisions, often lacks the authority to exercise discretion and regulatory flexibility. In many cases, including the implementation of these new information reporting requirements, Congress may effectively tie the hands of the IRS. Of course, there are also circumstances where it is appropriate for the IRS to implement policy through informal guidance. However, if the IRS proceeded to issue regulations on the exemptions provided for independent landlords, for example, the RFA process may yield some relief to impacted parties. Even in cases where the IRS lacks discretion, NAHB believes that Congress and the Administration would benefit from RFA analyses in order to effectively determine the impact of tax changes on small businesses. NAHB would encourage the committee to look further into this issue.

Conclusion

These new information reporting requirements impose a substantial cost burden on small businesses. The collection of additional W-9 forms, monitoring of payments over the course of a year, and additional staff time will cost a small business thousands of dollars per year. Rather than hiring additional workers to expand and grow, small businesses will be hiring accountants and bookkeepers to keep up with these new requirements. The real burden of these new requirements does not only fall on businesses issuing the additional forms. For each small business that will now generate an additional 40, or 80, or 100 new Form 1099s, businesses that sell goods may receive thousands, if not tens of thousands, of additional Form 1099s that they will have to match against their records. Businesses will be overwhelmed.

I urge Congress to move swiftly to repeal the new information reporting requirements imposed by the *Small Business Jobs Act of 2010* and the *Patient Protection and Affordable Care Act*. I applaud the Senate's actions last week to adopt an amendment to the FAA Authorization bill (S. 223) to repeal the new reporting requirements in the *Patient Protection and Affordable Care Act* and urge the House to follow suit. Small businesses would be well served if the House passes H.R. 4, the *Small Business Paperwork Mandate Elimination Act of 2011*, introduced by Representative Dan Lungren.

⁶ 71 FR 6231.