JANUARY 2021 PAYROLL TAX AND COMPENSATION REMINDERS

As we ring in the new year, we would like to remind you that this year many not be the same as 2020 when it comes to payroll taxes and compensation and benefit matters. This alert highlights various areas of change and what employers should be focusing on as they review year-end payroll.

NEW FORM FOR REPORTING NON-EMPLOYEE COMPENSATION

A new form (Form 1099-NEC) is to be used to report 2020 non-employee compensation, replacing Form 1099-MISC. Entities of all sizes and types that would typically provide a Form 1099-MISC to independent contractors and the IRS need to be aware of new IRS Form 1099-NEC. Persons who paid income to non-employees during 2020 must provide the income recipient with a Form 1099-NEC and the form must be submitted to the IRS no later than January 31, 2021. Form 1099-MISC will continue to be used to report payments of certain royalties, rents, prizes, and other payments of income (other than non-employee income). The form has been redesigned, so entities that use Form 1099-MISC should expect that reporting may differ somewhat from past years.

Note: The IRS imposes a penalty on taxpayers that fail to file correct information returns (Form 1099/1096) with the IRS. There is also an additional penalty for failure to provide the payee with a correct copy of the information return.

To whom should I send a 1099?

Any entity or individual engaged in a trade or business that makes certain payments of $600 or more during the calendar year, must file an information return. This includes payments made for rent, director's fees, prizes and awards, medical and health care payments, attorney fees, labor, commissions, and other outside services. Payments of interest, royalties, or dividends of $10 or more by entities other than individuals will also require the filing of an information return.
Payments for which a Form 1099 is not required include payments to governments or a corporation (including a limited liability company (LLC) that is treated as a C or S corporation), except for medical, health care, or law corporations. Payments for merchandise, telegrams, telephone, freight, storage, and similar charges are also not required. Payments made by credit or debit card, or through a payment processor (PayPal, Square, Stripe, etc.) are also not required to be reported on Form 1099.

Review your vendor information and Forms W-9

When your business onboards a new vendor, the process should include receipt of a W-9 prior to making any payments to them. The W-9 forms are used to prepare Form 1099's and to avoid backup withholding issues. The Form W-9 requires vendors to disclose whether they are set up to do business as an individual or some other type of entity (including whether or not they are a corporation, for which a Form 1099 will generally not be required), in addition to their address and taxpayer identification number (TIN). Persons or entities that have not furnished their correct tax identification number (TIN) to you are subject to backup withholding at 24%.*Caution: During some IRS audits, the IRS has assessed backup withholding even if the taxpayer identification number (TIN) was later obtained.*

Therefore, we highly recommend reviewing your vendor files to make sure you have a Form W-9 on file for every vendor you have paid for the calendar year, and if not, request them now! It's also a good policy for your business to have each vendor fill out a new W-9 form every year or two, as they can change. Form W-9 can be downloaded from the IRS here.

Rental real estate activities and the importance of filing Form 1099

The IRS has taken the position that if you take the 20% QBI deduction for your rental real estate activities, you should also be filing any required Form 1099's. Located in the Final 199A Regulations, the IRS states: "taxpayers should consider the appropriateness of treating a rental activity as a trade or business for purposes of Section 199A where the taxpayer does not comply with the information return filing requires under Section 6041." Failure to comply with 1099 filing requirements could result in the IRS denying the

QBI deduction – a severe penalty indeed! So, it is critical to determine whether your rental activities rise to the level of a trade or business, and if so, that you file Form 1099's when required.

Smith Leonard can help you with your 1099 and other information return filing requirements
If you would like Smith Leonard to assist in the preparation of your business' Form 1099's for 2020, please complete the *1099 Preparation Template* and submit it to us no later than **January 15**.

W-2 REPORTING OF FFCRA QUALIFIED SICK AND FAMILY LEAVE WAGES:

Employers with 500 or fewer employees may wish to review IRS Notice 2020-54 (issued in July 2020) regarding how to report on employees' 2020 Form W-2 the amount of mandatory, federal paid sick and family leave that the employer paid to employees under the Families First Coronavirus Response Act (FFCRA). Employers must report such wages on Form W-2 *or* on a separate statement, even though the employer's out-of-pocket cost is zero after the employer receives federal payroll tax credits. The reporting requirement can be satisfied via Form W-2, Box 14 or on a separate statement.

COVID-19 QUALIFIED DISASTER PAYMENTS TO EMPLOYEES:

Generally, anything of value that an employer provides to an employee is deemed to be taxable wages to the employee, unless an exception applies. Since COVID-19 was declared a national emergency on March 13, 2020, employers can use IRC Section 139 to make tax-free, tax-deductible "qualified disaster payments" to employees. Such payments can be made on tax-free basis until the national emergency is lifted.

With respect to COVID-19, employers can pay for, reimburse, or provide in-kind benefits reasonably believed by the employer to result from the COVID-19 national emergency that are not covered by insurance. For example, employers could pay for, reimburse, or provide employees with tax-free payments for over-the-counter medications, hand sanitizers, home disinfectant supplies, child care or tutoring due to school closings, work-from-home expenses (e.g. setting up a home office, increased utilities expenses, higher internet costs, printer, cell phone, etc.), increased costs from unreimbursed health-related expenses and increased transportation costs due to work relocation (such as taking a taxi or ride-sharing service from home instead of using public mass transit). There is no Form W-2 or Form 1099 reporting for IRC Section 139 payments.

EMPLOYER-PAID STUDENT LOAN DEBT:

During 2020, the CARES Act allows employers to pay up to $5,250 of their employees' student loan debt and not treat such payments as taxable wages. The payments can only be made under a non-discriminatory, written tuition assistance plan that complies with IRC Section 127.

REMINDER REGARDING NORTH CAROLINA'S CONTRACTOR INCOME TAX WITHHOLDING RULES:

Effective January 1, 2020, a payer must deduct and withhold 4% North Carolina income tax from nonwage compensation paid to a "payee" if the payer expects to pay more than $1,500 to the payee in that calendar year. Under the law, a payee is any of the following: a) a nonresident contractor (individuals or entities), b) An ITIN contractor (including those who have applied for an ITIN or have an expired ITIN), c) a person that fails to provide the payer with a taxpayer identification number (TIN), OR d) A person that fails to provide the payer a valid taxpayer identification number (TIN), subject to notification from the Department of Revenue that the TIN is invalid. There are certain exceptions to the new withholding rules. For example, tax is not required to be withheld from compensation paid to a non-resident entity if the entity is a corporation or limited liability company that has obtained a certificate of authority from the North Carolina Secretary of State. However, the payer must obtain from the entity, and retain in its records, the entity's identification number issued by the North Carolina Secretary of State.

Note: The new law imposes personal liability on responsible personal for unpaid income taxes required to be withheld by the business.