New IRS Reporting Requirement About to Kick In for Individuals and Small Businesses

October 26, 2011 - Every year businesses rush to get their IRS reporting paperwork mailed out. Employees of companies are used to getting a form W-2, showing their income for the year and the taxes they have already paid. Those who are self employed will frequently see 1099 forms from those that contract for their services. Other versions of the 1099 form are sent out to report bank interest, dividends, bank losses due to foreclosure or short sale, etcâ€¦ But this January, there will be a new form called at 1099-K that is likely to have widespread impact. This form will report credit card transactions. Whether you are selling dolls on eBay or run a large ecommerce website, this form is going to impact you and could cause a great deal of confusion for those who don't understand them.

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The 1099-K is designed to make it more difficult for anyone who accepts credit card payments, or electronic payments such as PayPal, to hide that income. The law requiring credit card companies to report these payments was signed in 2008 by President George W. Bush, but the first year of reporting will be for 2011 taxes.

The law doesn't make any distinction between businesses and individuals that accept electronic payments. Even if you are unincorporated and only conducting small sales on eBay to make ends meet, you are likely to receive a 1099-K if you accept any form of credit, debit or gift card form of payment.

But unlike other forms of income that require some form of 1099, the 1099-K doesn't necessarily report net income. It is a statement of gross income. And that is where the confusion is likely to arise.

For instance, if you receive a 1099 form from your bank for interest earned in 2011, there is no doubt that all of the

interest earned is a form of income. But with a 1099-K, let's say that you are selling dolls on eBay. The doll cost you $10. You charge $25 to the end buyer. That entire $25 is what gets reported to the IRS, and there is no way for the government to know that your initial cost was $10 or that you paid an additional $5 to ship it to the buyer. In this scenario, your net income is only $10.

What this means is that anyone collecting electronic payments will now need to keep clear records showing all of their costs. This could be especially cumbersome to anyone who only gets a small amount of income this way and who has not itemized their deductions in the past.

Since the reporting requirement is new, taxpayers should expect some confusion. The IRS hasn't even finalized the form design for the 1099-K yet. It is also likely that until the IRS has been able to put together several years of statistics, large differences in 1099-K income and reported income could bring additional scrutiny from the agency. That's nothing to be worried about if you have always kept good records, but it could be a matter of real concern for those who are less organized in their business approach.

byJim Malmberg
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