

New Tax Reporting Requirements for Landlords

Dear Client:

While January 1, 2011 ushers in a new year for all, it also brings with it new reporting requirements for landlords. New law enacted as part of the Small Business Jobs Act of 2010 (2010 Small Business Jobs Act), landlords receiving rental income from real property will be required to file information returns with the IRS, generally a Form 1099-MISC, when they pay any contractor or other service provider \$600 or more during the year for rental property expenses.

Information returns. An information return is generally required, under Tax Code Section 6041(a), to be made by a person (the payor) engaged in a trade or business that makes certain payments aggregating \$600 or more in any tax year to another person (payee) in the course of the payor's trade or business. This filing requirement is commonly known as the "\$600-or-more" rule. The information return must be filed with the IRS and corresponding statements must be sent to each payee. Form 1099-MISC, Miscellaneous Income, is generally used for this purpose.

New reporting requirement. Under the 2010 Small Business Act, a person receiving rental income from real estate is automatically considered to be engaged in a trade or business of renting property for information reporting purposes and is now subject to the "\$600 or more" reporting requirement. The new reporting requirement, effective for payments made after December 31, 2010, applies to landlords who make payments to plumbers and other maintenance individuals and service providers, landscaping services, accountants, and many other service providers (subject to some exceptions; for example, attorneys). The first information returns from landlords required under this new provision, therefore, will be due January 2012 for 2011 payments.

The \$600-or-more amount is an amount aggregated throughout the year, meaning that if you pay a particular service provider amounts that together total \$600 or more for their services throughout the year, you are subject to the reporting requirement.

Example. You are the landlord of a 25-unit apartment complex downtown. You have a landscaping service come every two weeks to trim the bushes, cut tree branches, and mow the grass outside of the complex. They charge \$200 per visit. Since your payments to them during the year will total well over \$600, you will be required to provide the IRS a Form 1099 reporting the payments you make, as well as furnish the landscaping company with a copy.

Exceptions. The new reporting rule does not apply to individuals who only receive rental income of only a minimal amount. The IRS has been given the authority to define "a minimal amount" as the term is used under the new law but has not yet done so. Small landlords and their advisors are lobbying for a high amount out of concern over the undue burdens placed on many landlords as the result of this new requirement.

The new reporting requirement also does not apply to any individual, including individuals who are active members of the uniformed services or an employee of the intelligence community, if substantially all rental income they derive is from renting their principal residence on a temporary basis. The new reporting requirement also does not apply if it would cause a hardship to the individual. The IRS will determine what a “hardship” is for purposes of this exception.

Corporations. The new reporting requirement does not apply to individuals who make payments totaling \$600 or more to any service provider that is an incorporated entity, at least for payments made during 2011. However, as the law stands now, beginning on January 1, 2012, payments of \$600 or more to corporations will be subject to more general information reporting requirements applicable to all business. The massive health care legislation passed in 2010 - the Patient Protection and Affordable Care Act (PPACA) - expanded the information return requirement for any trade or business – including that of a landlord “for information reporting purposes” – to include all payments made to corporations (other than tax-exempt corporations) after December 31, 2011, that aggregate \$600 or more during the course of any one year. The general business community has been calling for the repeal of this expanded reporting provision, which does not take effect for another year, on January 1, 2012. Our office will keep you posted on any developments.

Nevertheless, beginning this year if you receive rental income from real property and make payments of \$600 or more to any service provider who is not incorporated, and one of the above-mentioned exceptions does not apply, you will be required to report these rental property expenses to the IRS. You will also be required to furnish a copy of the Form 1099-MISC to the service provider.

Penalties. Failing to comply with the new reporting requirements may result in the imposition of penalties, which may include a penalty for failure to file the information return; a penalty for failure to furnish payee statements to the service provider; or a penalty for failure to comply with other various reporting requirements.

To more easily comply with the new requirements, if you have not already, you may want to implement new recordkeeping systems and maintain a database with the names, addresses, taxpayer identification numbers (TINs) or employer identification numbers (EINs), and other pertinent information, including payments and amount made to each throughout the year of your service providers. You will have to provide the IRS with the TIN or EIN of the service providers you engage. Maintaining these records also will help you prove the legitimate deductibility of these expenses from the rental income on which you otherwise need to pay income tax.

If you have any questions about these new reporting requirements, please contact our office.

Sincerely yours,

WALTHALL, DRAKE & WALLACE LLP