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KPMG report: Form 1099-K and state reporting issues

Reduced Form 1099-K thresholds for the 2022 tax year will result in increased information reporting. Unfortunately, the challenges extend beyond federal reporting, as state Form 1099 reporting requirements can be much more complex to navigate.

Some states do not require Forms 1099-K, particularly those states with no state income tax (for instance, Texas and Alaska). However, state legislatures in Florida and Tennessee have created two outliers—both for non-income tax reasons.

Background

Form 1099-K reporting thresholds were lowered under the [American Rescue Plan Act of 2021](#), as a revenue raiser to help provide funding for coronavirus (COVID-19) pandemic relief. The legislation amended section 6050W, dropping the de minimis threshold for reporting on third-party settlement organizations (TPSOs) from \$20,000 on 200 or more transactions to any qualifying transaction over \$600. The legislation went into effect beginning with payments made after December 31, 2021, meaning that all payments that occur throughout 2022 are subject to the lower requirement.

Roughly half of the states require Form 1099-K reporting in some capacity, with a number of these exempting reporting when withholding has not been required. In most cases, Form 1099-K can be submitted through the Combined Federal/State Filing (CF/SF) Program, making it much easier for taxpayers to comply. Although there are a few states that have set their own thresholds (such as New Jersey at \$1,000 and Arkansas at \$2,500), these would be captured under the new federal thresholds. Thus, taxpayers with no withholding that are using the CF/SF Program are largely covered for state purposes.

While many states tie their reporting requirements to section 6050W, others tie their Form 1099-K requirement to section 6041 (see [Virginia](#)) or have specifically set their threshold at \$600 (see [Massachusetts](#)). Practically speaking, this difference is inconsequential under current law, as most taxpayers' due diligence processes will capture all required reporting. Note that any changes to the federal law (note that a [proposed bill](#) would raise federal thresholds to \$5,000) would result in state reporting disparities.

Greater implications for taxpayers are those states that require direct reporting. For example, Connecticut permits filing under the CF/SF Program when there is no withholding to report, but specifically states that Forms 1099-K must be filed directly with the state. Similarly, Alabama permits filing of most Forms 1099 through the CF/SF Program, but specifically excludes Forms 1099-K. Thus, taxpayers need to be aware of each state's

individual requirements, as states being listed as participating in the CF/SF Program, and even permitting other Forms 1099 to be filed through the CF/SF Program, is not necessarily indicative of the state's filing requirements for Form 1099-K.

Tougher still, it would seem that states that do not assess income tax, and do not require Form 1099 reporting, would bypass Form 1099-K reporting. At its root, Form 1099-K reporting is essentially designed to capture taxable transactions that would otherwise not be caught because they occur through a third-party intermediary. Thus, no state income tax typically means that there is no reason to require taxpayers to report in those states. This is true for seven of the states with no income tax. However, Florida and Tennessee prove to be the exception, for similar reasons—sales tax.

Tennessee

Due in part to the lack of income tax revenue, and one of the lowest property tax rates in the United States, Tennessee is tied for the second highest sales tax rate (7.0%), behind only California.

In 2015, Tennessee sought to improve on a successful three-year old sales tax compliance program that primarily targeted tobacco and alcohol sales, through the introduction of [SB 0107](#). The bill expanded on the program by extending reporting to a wider range of wholesalers, specifically listing candy and cola wholesalers in the House Session. In addition, the bill sponsors expressed concerns that some payors were cheating the system under the prior sales tax compliance program and sought a way to even the playing field. Informally referred to as the “Trust, but Verify” Act by some sponsors, the bill included language requiring state reporting under section 6050W. Essentially, Tennessee wanted to leverage the federal reporting system in order to verify that sales reported, and sales tax remitted, by certain wholesalers were accurate. The bill was passed with near unanimous consent in both chambers.

KPMG observation

Although the Tennessee legislature passed the bill specifically to capture certain wholesalers of goods, the legislation requires that all payments subject to section 6050W reporting, made to a payee with a Tennessee address, are reported for state purposes. Unfortunately, section 6050W requires reporting on a fairly wide range of payments, including payments for services. This leads to an interesting result, as Tennessee does not require sales tax on most types of service payments, but payors may still be penalized for failure to report. This can be particularly burdensome, as Tennessee does not permit filing through the CF/SF Program and imposes a \$1,000 penalty for each month that the payor fails to file the return (capped at \$10,000 per entity). Thus, taxpayers may incur significant information reporting penalties if they are not aware of the rules.

Florida

Similarly, Florida has a disproportionately high sales tax rate (6%), tied at 16th highest in the United States, as a way to help offset the lack of income tax and ultimately fund state expenditures. However, the Florida Department of Revenue found that not all sales were being reported and taxed. To enforce reporting, Florida also decided to leverage the federal reporting system, particularly for the purpose of enforcing reporting on purchases being made with credit cards.

In early 2020, the Florida House introduced [HB 7097](#). Versions of the bill varied widely, and contained a number of sales tax cut provisions, ranging from back-to-school tax holidays to tax cuts on Formula 1 Grand Prix races. An early version of the bill was estimated to reduce revenue by \$126 million in the first year and up to \$160 million on a recurring basis. Ultimately the legislature settled on a version with a revenue impact of \$47.7 million in the first year and no recurring losses. No revenue raisers were ever included in the various versions of the bill. Interestingly, Form 1099-K reporting was included in all versions, but appears to have never been intended as a funding offset, as the Ways and Means Committee and Appropriations Committee merely listed the provision as having an indeterminate impact. The bill was enacted in April 2022, with an effective date of July 1, 2020.

Similar to Tennessee, Florida mirrored the federal language, and instituted a \$1,000 per month penalty for each failure to report, up to \$10,000 per entity. In its analysis, the Florida legislature specifically waived the option to

file through the CF/SF Program, noting that information from the IRS may be delayed, which would impact the ability for Florida to audit taxpayers within the three-year statute of limitations. Thus, direct reporting of the federal information return was established for the second no income tax state.

KPMG observation

State reporting can be complex, particularly as states adjust their provisions to align with (or differentiate from) federal reporting requirements. The recent Form 1099-K federal threshold modification, and ongoing reconciliation across the states, proves that taxpayers must be ever vigilant in their due diligence processes to recognize and adhere to reporting requirements. While the addition of no income tax states to the list of those requiring reporting is an outlier, it is likely other states will join in the future to meet state objectives.

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