

## **Office of the State Controller**

### Self-Assessment of Internal Controls

## **Tax/Payroll Compliance Cycle**

### Compliance With IRS Information Return Reporting Requirements

## **INFORMATION RETURNS**

Information Returns are returns required by the Internal Revenue Service to carry out the Revenue Laws of the United States. Information Returns are procedural in nature and therefore do not normally require payment of any tax. While there may be no tax due with Information Returns, failure to file the required information returns can subject the non-reporting agency/college to substantial penalties. In addition, there are penalties for reporting payments in the incorrect amounts.

Good fiscal management requires that penalty exposure be kept at a minimum by an understanding of the applicable IRS reporting requirements and by being able to identify transactions of a reportable nature within the accounting system of the reporting entity.

## **CATEGORIES OF INFORMATION RETURNS**

There are four main categories of Information Returns:

1. Information Returns of persons subject to special provisions of the tax law. For example, returns showing income, deductions, and distributions of:
  - Partnerships
  - Exempt Organizations
  - S Corporations
2. Information Returns of employers reporting wages and other payments to employees.
3. Information Returns of employee benefit plans.
4. Information Returns for payments made to non-employees and transactions with other persons.

Items 2, 3, and 4 above apply to governmental agencies and universities. Returns for reporting wages and other payments and Information Returns of employee benefit plans are not discussed here. The next page summarizes the rules and regulations that relate to information returns for payments made to non-employees and transactions with other persons (item 4 above) and is followed by specific guidelines for completing certain informational returns that apply to governmental agencies and universities.

The guidelines for Information Returns Policy are as follows:

<b>Form</b>	<b>Title</b>	<b>What to Report</b>	<b>Amounts to Report</b>	<b>Due to Recipients</b>	<b>Due to IRS</b>
1042-S	Foreign Person's U.S. Source Income Subject to Withholding	Interest, dividends, royalties, pensions, and personal compensation.	All Amounts	March 15	March 15
1099-A	Acquisition or Abandonment of Secured Property	Acquisition or abandonment of secured property for which you are the lender.	All Amounts	January 31	February 28
1099-B	Proceeds from Broker and Barter Exchange Transactions	Sales or redemption of securities, commodities, or barter exchange transactions.	All Amounts	January 31	February 28
1099-DIV	Dividends and Distributions	Dividends, capital gains, nontaxable, and liquidation distributions.	\$10 or more except \$600 or more for liquidations	January 31	February 28
1099-G	Certain Government Payments	Unemployment compensation, state and local tax refunds, agriculture payments, and taxable grant payments.	\$10 or more except unemployment and tax refunds, \$600 for all others	January 31	February 28
1099-INT	Interest Income – Taxable and Tax Exempt	Interest Income	\$10 or more	January 31	February 28
1099-MISC	Miscellaneous Income	Rents, royalties, prizes, awards, payments to crew members of fishing boats, proceeds from the sale of catch, physicians, medical services, healthcare providers, crop insurance proceeds, and non-employee compensation. Also, payments to attorneys in connection with legal services. Gross payments to attorneys are reported if the service amount cannot be determined.	\$10 or more for royalties, and \$600 for all other	January 31	February 28

1099-R	Distributions From Pensions, Annuities, and Retirement	Distributions from Pensions, Annuities, and Retirements	All Amounts	January 31	February 28
1099-S	Proceeds From Real Estate Transactions	Proceeds from the sale or exchange of real estate. Form 1099-S is not required for sale or exchange of principal residence for \$250,000 or less (500,000) if married.	All Amounts	January 31	February 28
W-2G	Certain Gambling Winnings	Horseracing and State conducted lotteries.	\$600	January 31	February 28

### **Do not file information returns for:**

1. Payments for merchandise;
2. Rental payments paid to real estate agents;
3. Scholarship or fellowship grants that are taxable to the recipient because they are paid for teaching research or other services as a condition for receiving the grant. Such payments are considered as wages and must be reported on a Form W-2.
4. Payments made by governmental agencies to informants as an award, fee, or reward for information about criminal activity; and
5. Employee's wages, moving and relocation reimbursements, and travel reimbursements must be reported on a Form W-2.

### **FORM 1099-A, ACQUISITION OR ABANDONMENT OF SECURED PROPERTY**

You must complete Form 1099-A if, in connection with your trade or business, you lend money, and, in full or partial satisfaction of the debt, you:

1. Acquire an interest in the property that is secured for the debt; or
2. Have reason to know that the property has been abandoned.

A **governmental unit** that lends money secured by property must also file Form 1099-A at the time an ownership interest is acquired. For governmental units this reporting requirement applies irrespective of the trade or business requirement. Property means real property such as a personal residence, or tangible personal property held for investment or used in a trade or business. For purposes of Form 1099-A reporting, property also includes **intangible** property.

Property is considered **abandoned** when the facts and circumstances show that the borrower intended to and has permanently discarded the property from use. If you expect to begin a foreclosure, execution, or similar sale within 3 months of the date you had reason to know the property was abandoned, the reporting requirement arises on the date you acquire an interest in the property or a third party purchases the property at such sale.

You are considered to have **acquired an interest** in the property at such time as you acquire title to the property or at the date of possession when the burdens and benefits of ownership are acquired. If an **objection period** is involved, use the date the objection period expires.

### **FORM 1099-A, MINIMUM FILING AMOUNTS**

Form 1099-A is required for all amounts. There is no minimum payment amount as there is with Form 1099-MISC. More than 250 in a calendar year must be reported on magnetic media.

## **AMOUNT TO REPORT ON FORM 1099-A**

In the case of full or partial satisfaction of any indebtedness, where you acquire an interest in any property that is security for such indebtedness, you should report:

1. The amount of such indebtedness at the time of such acquisition, and
2. The amount of indebtedness satisfied in such acquisition.

In the case in which you have reason to know the property in which you have a security interest has been abandoned, you will report the amount of indebtedness at the time of such abandonment.

## **FORM 1099-G, STATEMENT FOR RECIPIENTS OF CERTAIN GOVERNMENT PAYMENTS**

This form must be filed with the IRS if, as a unit of a federal, state, or local government, you:

1. Made certain payments such as unemployment compensation or state and local income tax refunds, in the amount of \$10 or more; or
2. Withheld federal income tax under the backup withholding rules; or
3. Made any taxable grants under a program administered by a federal, state, or local program to provide subsidized energy financing or grants for projects designed to conserve or produce energy. (This is required only for section 38 property, generally depreciable or amortizable or a dwelling unit located in the United States); or
4. **Also report amounts of any other taxable grant in the amount of \$600.00 or more, including amounts your agency or college is handling in a nominee capacity such as Department of Agriculture payments.**

No return is required for the following state tax credits:

1. Property tax credits
2. Farm preservation credits
3. Home heating credits
4. Solar energy credits

A federal grant is ordinarily taxable unless stated otherwise in the legislation authorizing the grant. **NOTE: Fellowship grants are not reportable.**

## **FORM 1099-INT, STATEMENT FOR RECIPIENTS OF INTEREST INCOME**

Form 1099-INT must be filed with the IRS if you are the payer of interest and you:

1. Paid or credited interest of \$10 or more on earnings from savings and loan associations, credit unions, bank deposits, corporate bonds, etc. (also, include interest of \$600 or more from sources other than the kinds listed if in the course of your trade or business);

2. Withheld foreign tax eligible for the recipient's foreign tax credit on interest;
3. Had original issue discount on short-term obligations of one year or less; or paid interest on bearer certificates of deposit; or
4. Withheld federal income tax on interest under the backup withholding rules.

Only report interest payments made during the conduct of your trade or business, including governmental and nonprofit organizations, or for which you are a **nominee or middleman**, for from which you withheld federal income tax or foreign tax.

The **nominee/middleman** provisions of Code Sec. 6049 are of special importance to governmental entities. Agencies and universities that have "pooled" funds held in a trustee capacity for students, inmates, patients, minors and others, and invested in interest bearing accounts, will need to issue Forms 1099-INT to show the correct owner of the beneficial interest in the account if the interest earned exceeds \$10. The nominee/middleman provisions do not apply if the actual owner's name appears on the interest information return prepared by the bank.

Tax exempt interest on installment purchases or capital leases and interest on government issued bonds must be reported as informational item on Form 1099-INT. As a general rule, interest on state and local bonds is tax exempt if the bonds are used exclusively for traditional governmental purposes. In the case of bonds issued after August 15, 1986, bond interest may not be tax-exempt when it is derived from:

- a) State or local bonds that have not been issued in registered form;
- b) Arbitrage bonds; or
- c) Private activity bonds that are not exempt as qualified bonds.

Do not report on Form 1099-INT any interest income paid or credited on a **long-term original issue discount obligation**. This interest, along with the original issue discount, is reported on Form 1099-OID.

## **FORM 1099-S, STATEMENT FOR RECIPIENTS OF PROCEEDS FROM REAL ESTATE TRANSACTIONS**

Generally, reporting is required if the transaction consists in whole or in part of the sale or exchange for money, indebtedness, property, or services, of any present or future ownership interest in any of the following:

1. Improved or unimproved land, including airspace.
2. Inherently permanent structures, including any residential, commercial, or industrial building.
3. A condominium unit and its appurtenant fixtures and common elements, including land.
4. Stock in a cooperative housing corporation.

5. Payments of timber royalties made under a “pay-as-cut” contract, reportable under section 6050N.

## **SALE OR EXCHANGE**

A sale or exchange includes any transaction properly treated as a sale or exchange for Federal income tax purposes, even if the transaction is not currently taxable. However, sales of personal residences are not reportable if the seller certifies that the profit will not exceed \$250,000 (\$500,000 if married).

## **OWNERSHIP INTEREST**

An ownership interest includes fee simple interest, life estates, reversions, remainders, and perpetual easements. It also includes any previously created rights to possession of use for all or part of any particular year. This includes a leasehold, easement, or timeshare, if such rights have a remaining term of at least 30 years, including any period for which the holder may renew such rights, determined on the date of closing. For example, a preexisting leasehold on a building with an original term of 99 years and a remaining term of 35 years on the closing date is an ownership interest; however, if the remaining term is 10 years, it is not an ownership interest. An ownership interest does not include any option to acquire real estate.

## **INVOLUNTARY CONVERSIONS AND THREAT OF IMMINENT DOMAIN**

A sale of real estate under threat of imminence of seizure, requisition, or condemnation is generally a reportable transaction. This is important to a governmental organization that under the law has the power of eminent domain.

## **EXCEPTIONS TO THE REPORTING REQUIREMENTS**

The following transactions are not reportable. However, you may choose to report them; but if you do, the return filed and the statement furnished to the transferor must comply with the reporting rules.

1. Any transactions in which the transferor (seller) is a corporation, a governmental unit, or an exempt volume transferor. If the transferee (buyer) is a state or political subdivision then the normal reporting rules apply.
2. A transfer in full or partial satisfaction of a debt secured by the property. This includes a foreclosure, a transfer in lieu of foreclosure, or an abandonment. Report on a Form 1099-A.
3. A de minimis transfer for less than \$600.
4. An interest in crops or surface or subsurface natural resources, i.e., timber, water, ores, and other natural deposits, whether or not such crops or natural resources are severed from the land.

## **PERSON REQUIRED TO REPORT**

The following explains who is required to file Form 1099-S

1. If you are the person responsible for closing the transaction, you must file Form 1099-S. If a Uniform Settlement Statement, prescribed under the Real Estate Settlement Procedures Act of 1974, is used, the person responsible for closing is the person listed as settlement agent on that statement.
2. If a Uniform Settlement Statement is not used, or if no settlement agent is listed, the person responsible for closing is the person who prepares the closing statement. This includes the settlement statement or other written document that identifies the transferor, transferee, and the real estate transferred, and describes how the proceeds are to be disbursed.
3. If no closing statement is used, or if two closing statements are used, the person responsible for closing is in the following order:
  - a) The transferee's (purchaser's) attorney if the attorney is present at the delivery of the transferee's note or a significant part of the cash proceeds to the transferor if the attorney prepares or reviews the preparation of the documents transferring legal or equitable ownership;
  - b) The transferor's attorney if the attorney is present at the delivery of the transferee's note or a significant part of the cash proceeds to the transferor or if the attorney prepares or reviews the preparation of the documents transferring legal or equitable ownership; or
  - c) The disbursing title or escrow company that is most significant in disbursing proceeds. If there is more than one attorney described in (a) or (b), the one whose involvement is most significant is the person responsible for filing.
4. If no one is responsible for closing the transaction as explained above, the person responsible for filing is, in order:
  - a) The mortgage lender;
  - b) The transferor's broker;
  - c) The transferee's broker; or
  - d) The transferee.

Under the Technical and Miscellaneous Revenue Act of 1988 (P.L. 100-647), real estate brokers were officially redesignated as "real estate reporting persons" for 1989 and subsequent years.

**NOTE:** If the person acting as broker in a real estate transaction is an employee of your agency/college and the exceptions to the reporting requirements listed here do not apply; then, your agency/college should prepare the 1099s for the transferor or should enter into a designation agreement to have another of the parties to the transaction prepare the Form 1099-S.

The penalties that may be assessed relative to Form 1099-S reporting are:

1. Failure to file information return;
2. Failure to furnish a statement to the transferor;
3. Failure to include correct information;
4. Failure to supply identifying numbers
5. Willful failure to supply information

**Office of the State Controller**

Self-Assessment of Internal Controls

**Tax/Payroll Compliance Cycle**

Compliance With IRS Information Return Reporting and Backup Withholding Requirements

Objectives and Risks

Agency \_\_\_\_\_

Year-End \_\_\_\_\_

<u>Objectives</u>	<u>Risks</u>
<p>All transactions reportable for IRS Information Return reporting and Backup Withholding purposes are properly identified, accumulated, and reported to the proper taxing authorities.</p>	<ul style="list-style-type: none"> <li>• The tax system of the United States is one of voluntary compliance. If procedures designed to insure compliance are not being followed the fairness of the system could be compromised.</li> <li>• Agency may be subject to penalties for noncompliance with IRS information return reporting requirements.</li> <li>• Revenue properly reportable to the Internal Revenue Service could be underreported.</li> <li>• Revenue properly reportable to the North Carolina Department of Revenue could be underreported.</li> </ul>
<p>All calendar year-end Form 1099 Information Return reporting and Backup Withholding procedures are in written form. These procedures have been reviewed by authorized personnel and approved in accordance with established policies and procedures.</p>	<ul style="list-style-type: none"> <li>• Inadequate procedures for determining Form 1099 reportable payments and reportable payees.</li> <li>• Vendor files contain inadequate information for proper reporting.</li> <li>• Change in agency personnel could cause a failure to properly account for and report information returns as required by law.</li> </ul>

**Office of the State Controller**

Self-Assessment of Internal Controls

**Tax/Payroll Compliance Cycle**

Compliance With IRS Information Return Reporting Requirements

Control Policies and Procedures

Agency \_\_\_\_\_

Year-End \_\_\_\_\_

Note: The following documentation questions concern all Information Return Reporting Forms.

**A. Documentation**

Yes No N/A

\_\_\_ \_\_\_ \_\_\_ 1. Is there a formal plan of organization under which responsibilities are assigned for identifying Form 1099 reportable payments and reportable payees?

Name of person responsible: \_\_\_\_\_

Title: \_\_\_\_\_

\_\_\_ \_\_\_ \_\_\_ 2. Does the agency have written instructions available for responsible agency personnel to use as a guide for consistent, accurate, preparation of IRS Forms 1099 at calendar year-end?

\_\_\_ \_\_\_ \_\_\_ 3. Does the formal plan identify the specific individuals responsible for "flagging" transactions for subsequent Form 1099 reporting to the IRS?

\_\_\_ \_\_\_ \_\_\_ 4. Does the formal schedule have target dates for completing tasks associated with calendar year Form 1099 reporting?

\_\_\_ \_\_\_ \_\_\_ 5. Have policies and procedures been established concerning calendar year-end cutoff of 1099 accounting transactions?

\_\_\_ \_\_\_ \_\_\_ 6. Have policies and procedures been established concerning agency follow up on IRS Error Listings (CP2100 Notices)?

\_\_\_ \_\_\_ \_\_\_ 7. Do agency policies and procedures require that Backup Withholding take place as required by IRS regulations?

Note: The remaining questions concern individual Information Return Reporting Forms.

**C. Recording and Execution of Transaction and Events - 1099-A**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 1. Does the entity lend money secured by property? (Property meaning real, tangible or intangible.)
- \_\_\_ \_\_\_ \_\_\_ 2. Has your agency ever acquired an interest in property in full or partial satisfaction of debt on that property?
- \_\_\_ \_\_\_ \_\_\_ 3. Has your agency ever acquired an interest in loaned property for the reason that you had money on that property and the property was subsequently abandoned?
- \_\_\_ \_\_\_ \_\_\_ 4. If yes to 2 or 3 above, did you issue IRS Form 1099-A?
- \_\_\_ \_\_\_ \_\_\_ 5. If Form 1099-A is issued, did the entity report the amount of indebtedness at the time of acquisition and the amount of indebtedness satisfied in the acquisition?

**D. Recording and Execution of Transaction and Events - 1099-G**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 1. Has the entity made payments such as unemployment compensation or state and local tax refunds at \$10.00 or more?
- \_\_\_ \_\_\_ \_\_\_ 2. Has the entity withheld federal income tax under the backup withholding rules?
- \_\_\_ \_\_\_ \_\_\_ 3. Has the entity made any taxable grants under a program administered by a federal, state, or local program to provide subsidized energy financing or grants for projects designed to conserve energy?
- \_\_\_ \_\_\_ \_\_\_ 4. Has the entity made payments of taxable grants in the amount of \$600.00 or more? (Including amounts your agency or college handled a nominee capacity such as Department of Agriculture payments.)
- \_\_\_ \_\_\_ \_\_\_ 5. Are 1099-G's issued for any yes answers to the above questions?

**E. Recording and Execution of Transaction and Events - 1099-INT**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 1. Does the agency have "pooled" funds held in a trustee capacity for students, inmates, patients, minors and others, that are invested in interest bearing accounts?
- \_\_\_ \_\_\_ \_\_\_ 2. Does agency have capital leases or installment purchases in which it is paying tax exempt interest in excess of \$10.00 or more?
- \_\_\_ \_\_\_ \_\_\_ 3. Does the agency pay interest through the course of its trade or business in excess of \$600.00 that is taxable to the recipient?
- \_\_\_ \_\_\_ \_\_\_ 4. Did the pooled funds earn interest of \$10.00 or more for any individual payee?
- \_\_\_ \_\_\_ \_\_\_ 5. Does the actual owner's name appear on the interest information return prepared by the bank?
- \_\_\_ \_\_\_ \_\_\_ 6. If yes to questions 1, 2, 3, or 4 did the agency issue a 1099-Int?
- \_\_\_ \_\_\_ \_\_\_ 7. If yes to question 4, did the agency inquire with the bank whether or not the bank issued the appropriate 1099-INT?

**F. Recording and Execution of Transaction and Events - 1099-MISC**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 1. Did the entity make payments of \$10.00 or more for royalties?
- \_\_\_ \_\_\_ \_\_\_ 2. Did the entity make payments of \$600.00 or more for rent, including rent of office space, machine rentals, pasture rentals etc.? (Public housing agencies must report rental assistance payments made to owners of housing projects.)
- \_\_\_ \_\_\_ \_\_\_ 3. Did the entity make payments of \$600.00 or more for fees, commissions, or other forms of compensation to persons not treated as your employees for services rendered in your trade or business?
- \_\_\_ \_\_\_ \_\_\_ 4. In connection with medical assistance programs, or health, accident and sickness insurance programs, make payments of \$600.00 or more to physicians or other suppliers or providers of health care services?
- \_\_\_ \_\_\_ \_\_\_ 5. Did the entity withhold federal income tax on miscellaneous income under the backup withholding rules?
- \_\_\_ \_\_\_ \_\_\_ 6. If yes to the above questions, did the entity issue a 1099-MISC?

**G. Recording and Execution of Transaction and Events - 1099-S**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 1. Did the entity have a transaction that consisted in whole or in part of the sale or exchange for money, indebtedness, property, or services, or any present or future ownership interest in the following:
- Improved or unimproved land, including airspace;
  - Inherently permanent structures, including any residential, commercial, or industrial building;
  - A condominium unit and its appurtenant fixtures and common elements, including land;
  - Stock in a cooperative housing corporation; or
  - Payments of timber royalties made under a "pay-as-cut" contract, reportable under section 6050N.
- \_\_\_ \_\_\_ \_\_\_ 2. Did the entity purchase real estate under threat or imminence of seizure, requisition, or condemnation is generally a reportable transaction?
- \_\_\_ \_\_\_ \_\_\_ 3. Was the purchase generally a reportable transaction for a governmental entity?
- \_\_\_ \_\_\_ \_\_\_ 4. Was the entity or employees, responsible for closing any real estate transactions under the real estate reporting hierarchy?
- \_\_\_ \_\_\_ \_\_\_ 5. If yes to the above questions, did the entity issue a 1099-S?

**H. Recording and Execution of Transaction and Events - 1098**

Yes No N/A

- \_\_\_ \_\_\_ \_\_\_ 1. Did the entity receive mortgage interest of \$600.00 or more from an individual on any one mortgage during the year? (This includes a governmental unit and a cooperative housing corporation receiving mortgage interest of \$600.00 or more from an individual.)
- \_\_\_ \_\_\_ \_\_\_ 2. If yes to above, did the entity issue a form 1098?