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KPMG report: Form 1099-NEC added to the combined federal-state filing program

The IRS on September 27, 2021, released a revised version of Publication 1220, *Specifications for Electronic Filing of Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G (Rev. 9-2021)*, containing several changes related to updates that the IRS issued over the 2021 calendar year.

- Notably, the IRS updated Section 12, *Combined Federal/State Filing (CF/SF) Program*, to include Form 1099-NEC, *Nonemployee Compensation*, on the list of information returns which may be filed under the CF/SF Program.
- In addition, Section 7, *Reporting Nonemployee Compensation (NEC) for Tax Year 2021*, was updated to note that the form is now part of the CF/SF Program, confirming that the IRS will accept submissions of the form for the 2021 tax year through the CF/SF Program.

Read [Publication 1220 \(Rev. 9-2021\)](#) [PDF 1.8 MB]

Background

Due to the “Protecting Americans from Tax Hikes Act of 2015” (PATH Act), the IRS accelerated the deadline for reporting nonemployee compensation, leading to a disparity between information returns submitted for other items on Form 1099-MISC, *Miscellaneous Income*. The issue was resolved for federal purposes in 2020, with the reinstatement of Form 1099-NEC, *Nonemployee Compensation*, which split out Form 1099-MISC, Box 7, reporting into its own form.

In September 2020, the IRS issued Publication 1220 for the 2020 tax year, leaving off Form 1099-NEC from the list of information returns which may be filed under the CF/SF Program. This caused confusion amongst taxpayers and state agencies.

State reporting issues

Many state agencies rely on the CF/SF Program to collect state specific data, particularly for information returns with no state withholding to report. In some cases, state revenue software systems were not setup to accept electronically submitted federal forms. Thus, many state agencies

were left scrambling to establish guidelines after the federal announcement that Form 1099-NEC would not be included in the CF/SF Program, leading to delayed, conflicting and missing guidance. In one instance, Wisconsin provided transitory relief, allowing taxpayers to continue submitting information on Form 1099-MISC; however, it was unclear from a practical perspective how to do that as Form 1099-MISC no longer contained the applicable fields.

In the rush to provide guidance, some states merely updated electronic filing specification manuals to state that Form 1099-NEC would be accepted but did not indicate whether direct reporting was required. California was particularly noteworthy, due to the volume of filers in that state, as it did not issue guidance until mere weeks prior to the filing deadline. Historically, the state of California has requested that taxpayers submit information returns through the CF/SF Program, so the delay was particularly painful for taxpayers attempting to get their due diligence processes in order. To the state's credit, it eventually issued an announcement stating that taxpayers would not be penalized for late filing due to direct reporting issues that arose.

Needless to say, the confusion at the state agency level certainly did not alleviate concerns at the taxpayer level. Many taxpayers that were unfamiliar with state reporting portals and processes were required to get up to speed in a short period of time. Those taxpayers which have historically relied on third-party providers and the CF/SF Program to handle their filing needs suddenly found themselves stuck with direct reporting obligations. The adjustment required additional resources and burdensome internal due-diligence updates.

2021 Form 1099-NEC reporting

Taxpayers can breathe a sigh of relief with the recent announcement that the IRS will direct eligible Forms 1099-NEC through the CF/SF Program. However, there are a number of issues that need to be addressed prior to filing season.

For starters, the IRS neglected to update the record layout position instructions in Publication 1220 for Form 1099-NEC. Note that the instructions for field positions 747-748, which trigger inclusion of the form in the program and help the IRS direct the form to the correct state agencies, are still instructing taxpayers to leave the fields blank. Some tax professionals believe this is an oversight and will be corrected.

It is also worth mentioning that the Publication 1220 list of states that participate in the CF/SF Program is not accurate for all forms, for all states. Although states may be listed as participants, the obligation ultimately rests with the taxpayer to determine if filing through the CF/SF Program is sufficient to satisfy their reporting needs. For example, both Massachusetts and Delaware are listed as participating states in Publication 1220, but both expressly report in their guidance that Forms 1099-MISC and 1099-NEC are required to be submitted directly to the respective state agencies.

In addition, taxpayers need to monitor for state updates after the recent federal announcement that the CF/SF Program will include Form 1099-NEC, as this does not guarantee that a state which previously accepted nonemployee reporting information through the program will still accept it. A handful of states previously noted that the CF/SF Program does not provide them with all of the information they require in a timely manner. Due to the one-off year which required direct reporting, it is possible that more states will seek to have this information reported directly to ensure they are capturing all possible revenue streams.

Read an [October 2021 report](#) prepared by KPMG LLP

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