



# Tax Compliance Has Entered the Spotlight

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# More Complex Models for Tax Reporting and Withholding Emerge

Businesses are changing rapidly, and their go-to-market strategies are evolving as well. All this change makes the act of tax compliance more difficult for both the companies and the tax authorities. Here are some of the fastest-growing areas receiving an increased focus for tax reporting, withholding, and compliance.



## Gig/Delivery Economy

**More than 50% of the U.S. workforce will participate in this segment by 2027.**

- The growth of the gig economy as measured by direct sellers was estimated to be over 40% in 2020.
- U.S. freelancers are expected to contribute more than \$1 trillion to the American economy in 2020.

Source: ADP Research Institute (<https://www.adp.com/-/media/adp/resourcehub/pdf/adpri/illuminating-the-shadow-workforce-by-adp-research-institute.ashx>)



## Multilevel Marketing (MLM)

**Direct selling is expected to represent over \$35 billion in U.S. retail sales in 2020.**

- Direct selling is expected to have nearly 7 million direct sellers in 2020.
- The majority (50%+) of direct sellers are in wellness and services.

Source: Direct Sellers Association ([www.dsa.org/statistics-insights](http://www.dsa.org/statistics-insights))



## Multinational Corporations


**Collectively, the Fortune 500 are expected to earn more than \$14 trillion in 2020.**

- Overall, the Fortune 500 represent two-thirds of the U.S. economy.



# Market Drivers for Tax Reporting and Withholding Growth of Non Traditional Workers

The market for gig workers is growing rapidly in response to specific business drivers including filling critical talent gaps, lowering labor costs, accelerating projects, and being able to access the talent pool from anywhere.



## Gig Worker

**Work often centers on a digital marketplace; such work is popular among service-based industries.**


- The share of gig workers at U.S. businesses swelled 15% since 2010.
- The U.S. had 1.6 million gig economy workers in 2020.
- Rapid growth in business services and software catered to both the payor and payee sides of the gig economy.



## Independent Contractor

**Work is task-centric; these workers are often self-employed with multiple clients.**

- Employment of independent contractors rose by about 30% from 2005 to 2015.
- Two-thirds of major companies are using freelance contracts to lower their labor costs.
- Downsized employees are often hired as independent contractors by their former employers.



## Statutory Employee

**Work is on commission and often home-based; such work is popular in financial services and MLM.**

- Worldwide, a new home-based business starts every 10 seconds.
- There were 6 million direct sellers in the U.S. in 2020.
- Pandemic has pushed further growth in this category as individuals look to augment lost income.

# Regulators Playing Catch-Up to Close the Gap

As business models change and grow, regulations must evolve as well. Tax authorities at the federal, state, and local levels are working to fill the gap between the current state of tax reporting law and the rapidly shifting business world.

## 1099-K and Third-Party Online Platforms

- Inconsistent treatment of payments through third-party online platforms can lead to underreporting and underpayment.
- Often third-parties do not provide information to the IRS. In those cases, **63% of income is misreported**, according to the IRS.
- The IRS last estimated the self-employment (gig) portion of the annual tax gap at **\$69 billion**.
- The tax gap isn't just a federal problem. The states are also looking to close the 1099-K reporting gap.

## Future Outlook for Tax Compliance

- More regulation (state and federal)
- Lower thresholds (state and federal)
- Stiffer penalties for noncompliance
- More stringent enforcement
- Exponential reporting obligations

## 1099-NEC and Independent Contractors

- Movement towards 1099 independent contractors will increase 1099-NEC form volumes.
- Updated language is likely to resolve conflict in these two sections by requiring the 1099-NEC over the 1099-K to improve payment visibility.
- IRS estimated **~70 million** 1099-NEC filings for the 2020 tax year.
- Many businesses will find themselves reporting a 1099-NEC and a 1099-MISC for the same recipient, doubling the reporting burden.
- Thirty+ states require direct reporting of critical 1099-NEC data.

# Growing Tax Gap Due to Lack of Backup Withholding

Regulators will begin to look at backup withholding with more scrutiny (based on the tax gap numbers provided), so businesses need to pay attention to having more proactive processes around non traditional worker onboarding and validation.

## Top Challenges for Backup Withholding

- Collecting accurate identity information
- Verifying identity information
- Maintaining an audit trail
- Managing communication with payees
- Reconciling backup withholding with Form 945



## Taxpayer Identification Number Problems

**~5.4 MILLION**

1099-MISC forms filed in tax year 2016  
with missing or incorrect TINs

Source: [www.treasury.gov/tigta/auditreports/2016reports/201640078fr.pdf](http://www.treasury.gov/tigta/auditreports/2016reports/201640078fr.pdf)

**\$9 BILLION**

Backup withholding tax not withheld on  
forms with missing or incorrect TINs

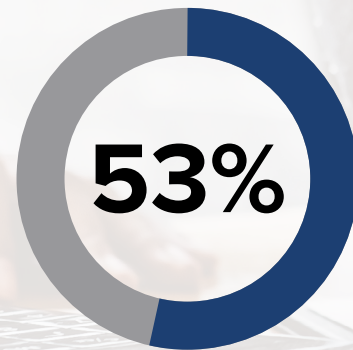
Source: [www.treasury.gov/tigta/auditreports/2016reports/201640078fr.pdf](http://www.treasury.gov/tigta/auditreports/2016reports/201640078fr.pdf)

New enhanced enforcement initiatives  
from the federal government directed at  
business include criminal prosecutions  
regarding backup withholding.

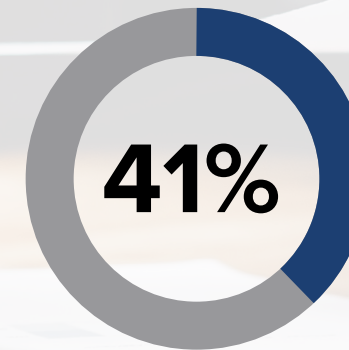


# Tax Compliance Enters the Spotlight

Given the uncertainty around the global pandemic, digital transactions have accelerated. The pressure to maintain compliance is tremendous as companies of all sizes quickly transition to support a rapidly expanding digital presence.



Number of survey respondents who are unhappy with their current tax management solution



Percentage of survey respondents planning to use a SaaS solution for tax management in the next 12 months (year over year change)

Source: SaaSPath 2020: Worldwide Banner Tables, IDC, June 2020 (#US46455420)

# External Adoption Drivers for Compliance



Many 1099-NEC and 1099-K federal and state changes went into effect for tax year 2020



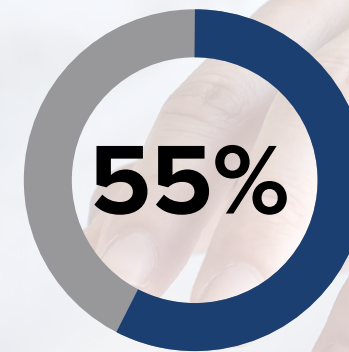
Enhanced enforcement on quality of tax identification information and backup withholding



Increasing regulatory requirements (new forms, changing thresholds, changing deadlines, new types of income)



New income types/workers (gig workers and independent contractors)



Percentage of customers who listed support for remote/external workforce as important driver for tax compliance investment

Source: SaaSPath 2020: Worldwide Banner Tables, IDC, June 2020 (#US46455420)



# Internal Tax Optimization Drivers



**Data security:** Security has become a multifaceted issue because of the rise of cybersecurity threats and the proliferation of data privacy regulations.



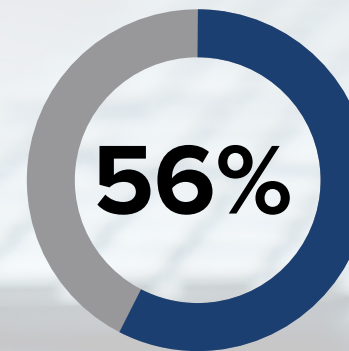
**Flexibility/adaptability:** The need for flexible solutions that can work with any IT ecosystem and easily adapt to business and regulatory changes.



**Limited IT resources:** Tax compliance departments often must contend with limited IT resources to deal with eventual technology challenges.



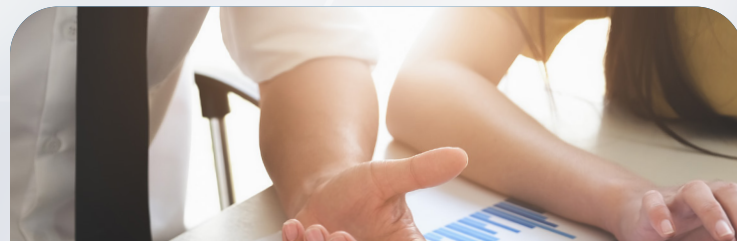
**Automation:** Organizations want to increase efficiency, reduce time spent entering information, and allow users to do more with less.



Percentage of customers who listed “limited IT resources” as an important driver for tax compliance investment

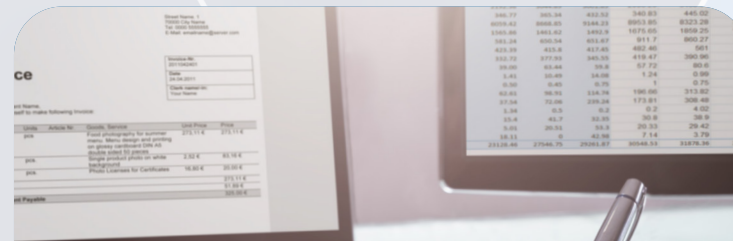
Source: SaaSPath 2020: Worldwide Banner Tables, IDC, June 2020 (#US46455420)

# How to Prepare for New Tax Reporting and Withholding Guidelines



## Invest in People

- Train staff on the nuances of tax reporting.
- Consider hiring a professional service provider.
- Establish a culture that embraces digital tax.



## Invest in Infrastructure

- Implement software suitable for new 1099 requirements.
- Find a software partner with deep tax reporting experience.
- Change IT infrastructure-related data management and access.



## Invest in Planning

- Review current reporting profile for potential adjustments.
- Assess impact of lower thresholds, state reporting and withholding on future 1099 reporting.
- Set specific goals for any process-related changes due to new 1099 reporting requirements.

# What to Consider in a Tax Reporting and Withholding Solution Provider

## User Experience

Tax and finance managers have a difficult time managing and analyzing data from multiple sources to ensure accurate and compliant reporting. Providers must be able to work with any source system and provide the tools to manage the validation, reporting, and withholding process.

## Data Security

Security has become a multifaceted issue because of the amount of sensitive data being stored and shared with payees and government agencies through varying delivery channels. Consider if simply outsourcing the compliance requirement is the best fit for you.

## Scalability/Flexibility as Company Grows

Software vendors in this market must demonstrate that they are building a secure, high-performance cloud to enable the workforce from anywhere and to facilitate constant regulatory changes.



## Regulatory Support and Expertise

The tax regulatory sands are constantly shifting for tax professionals. Tax reporting software providers must have the expertise to effectively manage IRS and state reporting regs. Consider managed services if simply outsourcing the compliance requirement is the best fit for you.

## Validation

The software must be able to proactively validate data with IRS TIN matching, which can help a company avoid downstream audits and penalties.

## Customer Support

Tax software vendors must be able to fill the role of software provider and guide when it comes to regulation. Look for an end-to-end solution from a provider with a strong track record of support to help manage the withholding and remittance process.



# About the Analyst



**Kevin Permenter**

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As a research manager with IDC's Enterprise Applications team, Kevin Permenter provides insights and intelligence across multiple areas including enterprise resource planning (ERP), order management, financial applications and project and portfolio management. He assesses the interplay, challenges, and trends regarding various enterprise application deployment models such as mobile enterprise applications and cloud models. He also develops and delivers his views, opinions, and analysis on the dynamics and evolution of this complex technology ecosystem.

[More about Kevin Permenter](#)

# Message from the Sponsor

## About Sovos

Sovos was built to solve the complexities of the digital transformation of tax, with complete, connected offerings for tax determination, continuous transaction control compliance, tax reporting and more. The company supports more than 12,000 customers, including half of the Fortune 500, operating in over 70 countries. Its SaaS products and proprietary Sovos S1 Platform integrate with a wide variety of business applications and government compliance processes. Sovos has employees throughout the Americas and Europe, and is owned by Hg and TA Associates. For more information visit [www.sovos.com](http://www.sovos.com) and follow us on LinkedIn and Twitter.

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