

Merchant card and third-party payment network transaction reporting requirements



Contents

- 1 Introduction
- 2 Overview
- 6 Amount reported
- 7 Additional application to retailers, restaurants and hospitality industry taxpayers
- 8 Duplicate reporting
- 9 Action steps
- 10 Contact us

Introduction

In February 2011, the IRS issued the final version of Form 1099-K, *Merchant Card and Third Party Network Payments*. Form 1099-K and the Instructions implement the final regulations (T.D. 9496) under Section 6050W providing guidance on the reporting requirements for “payment settlement entities” that make payment in settlement of “payment card transactions” and “third-party network transactions.”

Section 6050W and the regulations apply to obvious payment settlement entities (PSEs) such as banks and third-party settlement organizations but also contain special rules that may be applicable to other types of entities that act as intermediaries for payment card, gift card or kiosk transactions for retail, restaurant or hospitality groups. Specifically, entities that receive payments from PSEs on behalf of independently owned or corporate owned stores, restaurants or hotels/motels may have a reporting obligation under these new rules. The regulations are very detailed with numerous cascading definitions. This article provides an overview of the provisions with an emphasis on how the regulations may apply to clients in the retail, restaurant and hospitality industries.

Form 1099-K and the Instructions implement the final regulations (T.D. 9496) under Section 6050W providing guidance on the reporting requirements for “payment settlement entities” that make payment in settlement of “payment card transactions” and “third-party network transactions.”

Overview

Section 6050W was enacted by the Housing Assistance Tax Act of 2008. It was proposed and crafted largely in response to estimates released by the IRS in 2006 on the annual tax gap — the difference between total federal taxes owed each year and what is actually paid on a timely basis. The IRS National Research Program study (IR-2006-28) found that compliance was lowest in areas with little third-party reporting and asserted that small businesses and self-employed taxpayers were responsible for the largest portion of the estimated \$345 billion tax gap.

The new reporting requirements were generally intended to provide the IRS with third-party reporting information on the aggregate gross receipts of all payment card transactions and third-party network transactions for any business or self-employed individual accepting such payments. The reporting burden itself does not fall on those receiving payments, but on the entities actually settling payments.

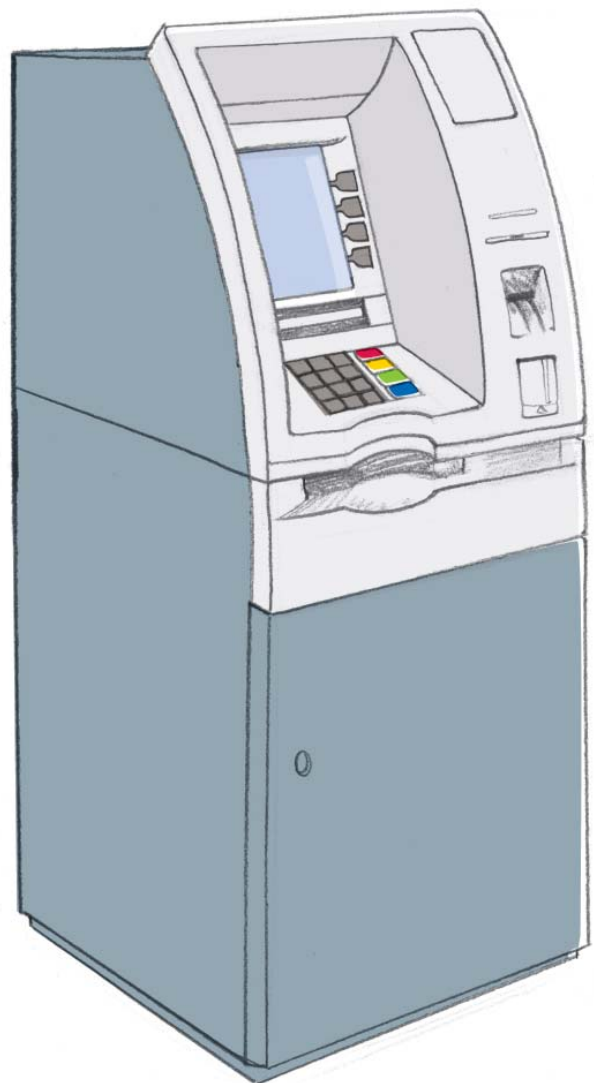
While the proposal was being considered by Congress in 2008, the Joint Committee on Taxation estimated it would raise over \$9.5 billion over 10 years, including about \$1.8 billion per year by the end of the 10-year budget window (JCX-64-08). There is no direct tax increase as a result of new Section 6050W, so the bulk of the revenue is estimated to come simply from improved compliance among those accepting a payment card as payment and/or accepting payment from a third-party settlement organization (though a nominal portion may be estimated to come from penalties imposed on reporting failures by PSEs).

As enacted, Section 6050W provides that any PSE making payment to a “participating payee” in settlement of a “reportable payment transaction” is required to file an information return for each calendar year with the IRS and furnish a statement to the participating payee with the gross amount of the reportable payment transactions.

The new reporting requirements were generally intended to provide the IRS with third-party reporting information on the aggregate gross receipts of all payment card transactions and third-party network transactions for any business or self-employed individual accepting such payments.

On Nov. 24, 2009, the IRS issued proposed regulations reflecting the new requirements under Section 6050W. These regulations were finalized on Aug. 16, 2010. The final regulations apply to returns for calendar years beginning after Dec. 31, 2010, and payments made in settlement of payment card and third-party network transactions subject to reporting in 2011 must be reported on information returns that will be due in 2012.¹ Form 1099-K requires PSE to report the aggregate gross amount of all reportable payment transactions for the year and for each month, as well as the name, address and taxpayer identification number (TIN) of the participating payee. If a payee does not provide a valid TIN, payments would be subject to backup withholding requirements beginning in 2012.² In connection with securing a valid TIN, on Feb. 9, 2009, the IRS announced that persons who will be required to report under Section 6050W may match TINs under procedures established in Rev. Proc. 2003-9.³ Under these procedures, prior to filing a Form 1099-K, a payor can check the TIN furnished by the payee against the name/TIN combination contained in the IRS database.

In general a reportable payment transaction means any transaction in which a payment card (or account number or other indicia associated with a payment card) is accepted as payment. A payment card includes, but is not limited to, credit, debit, gift or store-value cards. Reportable payment transactions also include any transaction that is settled through a third-party payment network.⁴ Third-party network transactions typically refer to online sales and purchases.



¹ Treas. Reg. Sec. 1.6050W-1(g) and -1(j).

² Section 3406(b)(3).

³ Announcement 2009-6, 2009-9 IRB 643.

⁴ Section 6050W(c)(1).

Basically, PSEs are those entities that are contractually liable to make payments to participating payees.⁵ A participating payee means any person who accepts a payment card as payment or, in the case of a third-party network transaction, any person who accepts payment from a third party.⁶ However, there are a number of exceptions involving foreign payees. For example, for contractual obligations entered into after Dec. 31, 2010, a U. S. payment settlement entity is not required to file a Form 1099-K for payments to a participating payee with a foreign address as long as the PSE has in its files documentation (Form W-8BEN) to treat the payment as being made to a foreign person.⁷ Additionally, a non-U.S. payment settlement entity is not required to file a Form 1099-K if the participating payee does not have a U.S. address and the PSE neither knows, nor has reason to know, that the participating payee is a U.S. person.

For payment card transactions and third-party network transactions to be reportable, there must be a network of persons or merchants who are unrelated to each other who agree to certain terms and conditions outlined in the regulations.⁸ Additionally, with respect to third-party network transactions, information reporting is necessary only if the amount to be reported exceeds \$20,000, and there are more than 200 transactions with respect to any payee (the “de minimis” exception).⁹ Moreover, in third-party network transactions, participating payees must provide goods or services.¹⁰

The general application of these provisions is illustrated by the following examples.

⁵ Section 6050W(b).

⁶ Section 6050W(d)(1).

⁷ Treas. Reg. Sec. 1.6050W-1(a)(5).

⁸ See Treas. Reg. Sec. 1.6050W-1.

⁹ Section 6050W(e).

¹⁰ Treas. Reg. Sec. 1.6050W-1(c)(3).

¹¹ Treas. Reg. Sec. 1.6050W-1(e) Example 1.

¹² Treas. Reg. Sec. 1.6050W-1(e) Example 2.

¹³ Treas. Reg. Sec. 1.6050W-1(e) Example 10.

¹⁴ Treas. Reg. Sec. 1.6050W-1(e) Example 6.

¹⁵ Treas. Reg. Sec. 1.6050W-1(e) Example 7.

Example 1: Payment card transaction

Customer A purchases goods from Merchant B using a credit card issued by Bank X. B is one of a network of unrelated persons who have agreed to accept credit cards issued by X as payment under an agreement that provides standards and mechanisms for settling transactions. Bank Z has the contractual obligation to make payment to B for the goods sold to A. In this case, Z as the PSE has the obligation to file Form 1099-K to report the payment made to settle the payment card transaction for the sale of goods from B to A.¹¹

Example 2: Third-party network transaction

Merchant B sells goods over the Internet. Merchant B, along with other merchants, has an account with X, an Internet payment service provider. None of these persons are related to X and all have agreed to settle transactions according to a contract they have entered into with X. X has guaranteed payment to all these merchants, including B for the sale of goods to customers. Customer A purchases goods from B and A pays X. In turn, X makes payment to B in settlement of the transaction for the sale of goods from B to A. X's arrangement constitutes a third-party network transaction and (assuming the de minimis exception does not apply), X would be required to issue a Form 1099-K to report the payment made to B.¹²

Example 3: Mall card

Customer B purchases a card that is issued by Shopping Mall A. Pursuant to an agreement, the card is accepted as payment by the mall merchants who are unrelated to the issuer and each other. B uses the card in the mall to purchase goods from Merchant C. In this situation, the mall card is a payment card and the use of the card by B to purchase goods from C is required to be reported on Form 1099-K.¹³

Example 4: Gift card

Customer A purchases a gift card from Merchant X that may be used only at X and its related network of stores. A purchases the gift card using cash. A gives the gift card to B, who uses the gift card to purchase goods at one of X's stores. The purchase of the gift card by A using cash is not a payment card transaction; thus, it is not required to be reported in a return of information required. Moreover, the gift card is not a payment card because the gift card is only accepted as payment by persons who are related to the issuer of the gift card and each other.¹⁴

Example 5: Private label card

Bank B issues a card imprinted with Retailer C's logo to cardholder A. The "C card" is accepted as payment only at C or at stores related to C. A uses the card at C to purchase electronics equipment. The C card is not a payment card because the card is accepted as payment only within a network of persons who are related to each other. Therefore, the use of the card by A at C is not required to be reported.¹⁵

Amount reported

PSEs must report the gross amount of payments made with respect to reportable payment transactions. For the purposes of Section 6050W, the gross amount is the total dollar amount of aggregate reportable payment transactions for each participating payee without regard to any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts or any other amounts.¹⁶ The dollar amount of each transaction must be determined on the date of the transaction.



Example 6: Gross amount

Customer A uses a payment card to purchase \$100 worth of goods from merchant B. Bank X is the party with the contractual obligation to make payment to B in settlement of the transaction. On Day 2, X, after deducting fees of \$2, makes payment of \$98 to settle the transaction for the sale of goods from B to A. X must report the amount of \$100, the amount of the transaction on Day 1, without any reduction for fees or any other amount, as the gross amount of this reportable payment transaction on the annual information return filed.¹⁷

¹⁶ Treas. Reg. Sec. 1.6050W-1(a)(6).

¹⁷ Treas. Reg. Sec. 1.6050W-1(e) Example 5.

Additional application to retailers, restaurants and hospitality industry taxpayers

Both the Code and regulations impose special rules for persons or entities that receive payments from a PSE on behalf of one or more participating payees and distribute such payments to one or more participating payees. Such persons or entities are treated as participating payees with respect to the PSE and as the PSE with respect to the participating payees to whom the person distributes payments.¹⁸

Example 7: Aggregated payees

Corporation A, acting on behalf of A's independently owned franchise stores or restaurants, receives payments from Bank X for credit card sales transacted at these stores or restaurants. X, the PSE, is required to report the gross amount of the reportable payment transactions distributed to A even though A does not accept credit cards and would not otherwise be treated as a participating payee. In turn, A, as the PSE, is required to report the gross amount of the reportable transactions allocable to each franchise store or restaurant.¹⁹

Example 8: Hotel kiosk

Under a "hotel kiosk" arrangement, Hotel B permits its customers to charge to their room account transactions for goods and services at sellers that are unrelated to B that operate on B's premises or on the premises of hotels related to B and that have established accounts in B's hotel kiosk system. B guarantees payment to the sellers for these transactions. Customers settle their room accounts with B when they check out and B, in turn, settles the hotel kiosk transactions with the unrelated sellers. B's hotel kiosk system constitutes a third-party payment network of which B is the third-party settlement organization. For each payee, B must file a Form 1099-K reporting the gross amount of the reportable transaction (subject to the de minimis exception).²⁰

¹⁸ Treas. Reg. Sec. 1.6050W-1(d)(1).

¹⁹ Treas. Reg. Sec. 1.6050W-1(e) Example 21.

²⁰ Treas. Reg. Sec. 1.6050W-1(e) Example 20.

Duplicate reporting

In certain situations, the same transaction may be subject to information reporting under more than one Code section. In such a situation, Congress authorized the IRS to issue guidance to prevent the reporting of the same transaction more than once.²¹ Accordingly, the final regulations provide that payments made after Dec. 31, 2010, by payment card or through a third-party payment network, which would be subject to reporting under both Section 6050W and Section 6041, are reportable only under Section 6050W.²² Solely for purposes of this exception, the de minimis threshold for third-party network transactions described above is disregarded in determining whether the transaction is subject to reporting under Section 6050W.

Example 9: Duplicate reporting

Restaurant owner A in the course of business pays \$600 of fixed or determinable income to B, a repairman, by credit card. B is one of a network of unrelated persons who have agreed to accept A's credit card as payment under an agreement that provides standards and mechanisms for settling transactions between a PSE and the persons who accept the cards. Bank Y is responsible for making the payment to B. As payor, A is not required to file an information return under Section 6041 (Form 1099-MISC) with respect to this transaction because Y, as the PSE for the payment card transaction, is required to file an information return under Section 6050W.²³



²¹ Section 6050W(g).

²² Treas. Reg. Sec. 1.6041-1(a)(1)(ii).

²³ Treas. Reg. Sec. 1.6041-1(a)(1)(v), Example 1.

Action steps

Companies should immediately determine whether the new information reporting regulations apply to their situation. If they do, it should be kept in mind that these requirements are currently in effect. Such efforts may involve coordination between tax and IT functions and outside service providers. It should also be noted that for calendar year 2011, taxpayers are required to file Forms 1099-K with the IRS on or before Feb. 28, 2012, (March 31 if filed electronically). Payee statements must be furnished to the payee on or before Jan. 31, 2012. Most businesses will also need to understand the procedures for furnishing payee statements electronically.

Compliance with the new rules will be important, because there are penalties for failing to file correct and timely information returns. The Small Business Jobs Act of 2010 enacted on Sept. 27, 2010, dramatically increases the penalties associated with failures to file timely and correct information returns and furnish payee statements. These penalties are tiered based on how late the information return is submitted. Beginning with information returns filed on or after Jan. 1, 2011, the penalty for an information return that is filed within 30 days

of the required due date is \$30 per return with a maximum penalty of \$250,000.²⁴ If a correct return is not filed within 30 days of the due date, but is filed before Aug. 1 of the year it is due, the penalty per return is \$60 with a maximum penalty of \$500,000.²⁵ Information returns filed after Aug. 1 are subject to a penalty of \$100 per return with a maximum of \$1.5 million.²⁶ If a failure to file is due to intentional disregard, the penalty is at a minimum \$250 per return with no ceiling.²⁷ There are lower penalties for businesses with average annual gross receipts not exceeding \$5 million for the most recent three taxable years.²⁸ Similar penalties can apply to the failure to furnish timely and correct payee statements.²⁹

In light of the heavy compliance burden that these new requirements impose on taxpayers, the IRS has offered one note of consolation with respect to penalties. The preamble to the final regulations provides that “the IRS will continue to work closely with stakeholders to ensure the smooth implementation of the provisions in these regulations, including, in general, the mitigation of penalties in the early stages of implementation, except for particularly egregious cases.”

²⁴ Section 6721(b)(1).

²⁵ Section 6721(b)(2).

²⁶ Section 6721(a)(1).

²⁷ Section 6721(e)(2).

²⁸ Section 6721(d).

²⁹ Section 6722(b).

Contact us

If you have questions or would like to discuss your specific situation, contact one of our Washington National Tax Office professionals:



Giles Sutton
Partner
T 704.632.6885
E giles.sutton@us.gt.com



Walter Goldberg
Executive Director
T 202.521.1510
E walter.goldberg@us.gt.com



Dustin Stamper
Manager
T 202.861.4144
E dustin.stamper@us.gt.com

Offices of Grant Thornton LLP

National Office

175 West Jackson Boulevard
Chicago, IL 60604
312.856.0200

Washington National Tax Office

1250 Connecticut Ave. NW, Suite 400
Washington, DC 20036-3531
202.296.7800

Arizona

Phoenix 602.474.3400

California

Irvine 949.553.1600
Los Angeles 213.627.1717
Sacramento 916.449.3991
San Diego 858.704.8000
San Francisco 415.986.3900
San Jose 408.275.9000
Woodland Hills 818.936.5100

Colorado

Denver 303.813.4000

Florida

Fort Lauderdale 954.768.9900
Miami 305.341.8040
Orlando 407.481.5100
Tampa 813.229.7201

Georgia

Atlanta 404.330.2000

Illinois

Chicago 312.856.0200
Oakbrook Terrace 630.873.2500

Kansas

Wichita 316.265.3231

Maryland

Baltimore 410.685.4000

Massachusetts

Boston 617.723.7900

Michigan

Detroit 248.262.1950

Minnesota

Minneapolis 612.332.0001

Missouri

Kansas City 816.412.2400
St. Louis 314.735.2200

Nevada

Reno 775.786.1520

New Jersey

Edison 732.516.5500

New York

Long Island 631.249.6001
Downtown 212.422.1000
Midtown 212.599.0100

North Carolina

Charlotte 704.632.3500
Raleigh 919.881.2700

Ohio

Cincinnati 513.762.5000
Cleveland 216.771.1400

Oklahoma

Oklahoma City 405.218.2800
Tulsa 918.877.0800

Oregon

Portland 503.222.3562

Pennsylvania

Philadelphia 215.561.4200

South Carolina

Columbia 803.231.3100

Texas

Austin 512.391.6821
Dallas 214.561.2300
Houston 832.476.3600
San Antonio 210.881.1800

Utah

Salt Lake City 801.415.1000

Virginia

Alexandria 703.837.4400
McLean 703.847.7500

Washington

Seattle 206.623.1121

Washington, D.C.

Washington, D.C. 202.296.7800

Wisconsin

Appleton 920.968.6700
Milwaukee 414.289.8200

Tax Professional Standards Statement

In accordance with certain professional standards, we inform you that this document supports Grant Thornton LLP's marketing of professional services, and is not written tax advice directed at the particular facts and circumstances of any person. If you are interested in the subject of this document, we encourage you to contact us or an independent tax advisor to discuss the potential application to your particular situation. Nothing herein shall be construed as imposing a limitation on any person from disclosing the tax treatment or tax structure of any matter addressed herein. To the extent this document may be considered to contain written tax advice, any written advice contained in, forwarded with, or attached to this document is not intended by Grant Thornton to be used, and cannot be used, by any person for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.

About Grant Thornton

The people in the independent firms of Grant Thornton International Ltd provide personalized attention and the highest quality service to public and private clients in more than 100 countries. Grant Thornton LLP is the U.S. member firm of Grant Thornton International Ltd, one of the six global audit, tax and advisory organizations. Grant Thornton International Ltd and its member firms are not a worldwide partnership, as each member firm is a separate and distinct legal entity.

The information contained herein is general in nature and based on authorities that are subject to change. It is not intended and should not be construed as legal, accounting or tax advice or opinion provided by Grant Thornton LLP to the reader. This material may not be applicable to or suitable for specific circumstances or needs and may require consideration of nontax and other tax factors. Contact Grant Thornton LLP or other tax professionals prior to taking any action based upon this information. Grant Thornton LLP assumes no obligation to inform the reader of any changes in tax laws or other factors that could affect information contained herein. No part of this document may be reproduced, retransmitted or otherwise redistributed in any form or by any means, electronic or mechanical, including by photocopying, facsimile transmission, recording, re-keying or using any information storage and retrieval system without written permission from Grant Thornton LLP.

