

CLIENT ALERT

Relief for Payment Card Reporting Set to Expire Soon

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Many businesses became subject to new payment card reporting requirements (Form 1099-K) in early 2012 for payments made in 2011. Starting on January 1, 2013, those businesses will become subject to new backup withholding requirements and potential penalties for incorrect filing of Forms 1099-K.

The purpose of the new rules was to improve tax compliance among merchants that accept payment through payment cards (such as credit cards) and third party settlement organizations (such as PayPal or Google Wallet). These rules impact both the merchants that receive the Forms 1099-K as well as the payors (including merchant banks and settlement organizations) that have to issue the Forms 1099-K.

Background

Generally, the new payment card reporting requirements require certain "payment settlement entities" to file Forms 1099-K with respect to payments made to "participating payees." A participating payee is any merchant that accepts a payment card as payment or accepts payment made by a third party settlement organization on behalf of the customer. A participating payee might include a large or small business, or even a person selling items on eBay.

The payment settlement entity is the entity that submits the instructions to transfer amounts to the payee to settle the payment transaction. With respect to payment card transactions, the payment settlement entity is the entity (such as an acquiring or merchant bank) that is required to pay the participating payee in settlement of the transaction. For third party network transactions, the payment settlement entity is the third party settlement organization, which is the central organization with the contractual obligation to make payments to participating payees.

The gross amount of the transaction must be reported, without regard to credits, charge-backs, fees, cash equivalents, discounts, or refunds.

Third party settlement organization transactions are subject to a de minimis standard. Reporting is only required with respect to a particular payee if the aggregate payments to the payee exceed \$20,000 and the aggregate number of transactions exceed 200 within a particular calendar year. The de minimis standard does not apply to payment card transactions.

The payor must report the gross amount of reportable transactions for the calendar year, broken down by month. Forms 1099-K are due to the IRS by February 28 (or March 31, if filed electronically) of the year following the transactions. Statements must also be provided to the participating payees by January 31 of such year.

Backup withholding

Backup withholding generally applies to payments required to be reported on Forms 1099-K, and would apply, for example, if the payee does not provide a taxpayer identification number and certify that the payee is not subject to backup

withholding. Usually the payor obtains this information by having the payee complete a Form W-9 (indicating no backup withholding), or applicable W-8 in the case of a foreign payee. For payments subject to Form 1099-K reporting but made in 2012, the IRS granted relief from back-up withholding in Notice 2011-88. However, this relief expires for payments made after December 31, 2012. Therefore, backup withholding potentially applies to payments starting in 2013. Starting in January 1, 2013, where backup withholding applies, the rate will be 31% of the gross amount paid, assuming Congress does not change the rates.

Penalties

Generally, there are penalties for failure to timely file correct Forms 1099-K with the IRS and for failure to timely provide correct copies to payees. Those penalties are generally \$100 per information return, but can be lower if the information return is corrected quickly. Thus, for a payor with a large number of transactions, the penalties can add up quickly. However, in the case of intentional disregard, the penalty is 10% of the amount required to be shown on the return, with a minimum penalty of \$250 per information return. There are very limited exceptions to the penalties, including an exception for reasonable cause. For this purpose, the penalty is waived for reasonable cause only if the payor can establish either that there were significant mitigating factors with respect to the failure or that the failure arose from events beyond the filer's control. The payor must also establish that it acted in a responsible manner, for example by establishing a compliance system. Because of these conditions, the exceptions to the penalty may only be available in limited circumstances.

For Forms 1099-K to be filed in 2012, the IRS granted some relief from these penalties in Notice 2011-89. In 2012, the penalties would not apply if the payor made a good faith effort to accurately file the appropriate Form 1099-K and the accompanying payee statement. This relief will no longer apply for Forms 1099-K required to be filed in early 2013. Thus, going forward Forms 1099-K will be subject to the same penalties, and the same limited exceptions, as other Forms 1099.

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Charles C. Hwang

Partner – Washington, D.C.

Phone: +1 202.624.2626

Email: chwang@crowell.com