

[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 31, and 301

[REG-139255-08]

RIN 1545-BI51

Information Reporting for Payments Made in Settlement of Payment Card and Third Party Network Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to information reporting requirements, information reporting penalties, and backup withholding requirements for payment card and third party network transactions. The proposed regulations reflect the enactment of section 6050W and related changes in the law made by the Housing Assistance Tax Act of 2008 that require payment settlement organizations to report payments in settlement of payment card and third party network transactions for each calendar year. The proposed regulations in this document will affect persons that make payment in settlement of payment card and third party network transactions and the payees of these transactions. The proposed regulations provide guidance to assist persons who will be required to make returns reporting payment card and third party network transactions and to the payees of those transactions. This document also provides notice of a public hearing on these proposed amendments to the regulations.

DATES: Written or electronic comments must be received by January 25, 2010.

Outlines of topics to be discussed at the public hearing scheduled for February 10, 2010 at 10 am must be received by January 27, 2010.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-139255-08), room 5205, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-139255-08), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov/> (IRS REG-139255-08).

FOR FURTHER INFORMATION CONTACT: Concerning these proposed regulations, Barbara Pettoni, (202) 622-4910; concerning submissions of comments or the public hearing, Regina Johnson, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

### **Background**

This document contains proposed amendments to 26 CFR Part 1 relating to information reporting under sections 6041, 6050W, and 6051 of the Internal Revenue Code (Code). This document also contains proposed amendments to 26 CFR Part 31 relating to backup withholding under section 3406, and to 26 CFR Part 301 relating to information reporting penalties under sections 6721 and 6722.

A new reporting requirement, section 6050W, was added to the Code by section 3091(a) of the Housing Assistance Tax Act of 2008, Div. C of Public Law No. 110-289, 122 Stat. 2654 (the Act), enacted on July 30, 2008. Section 6050W requires merchant

acquiring entities and third party settlement organizations to file an information return for each calendar year reporting all payment card transactions and third party network transactions with participating payees occurring in that calendar year. This requirement to file information returns applies to returns for calendar years beginning after December 31, 2010. This section also requires statements to be furnished to participating payees on or before January 31st of the year following the year for which the return is required.

The Act also amended section 3406(b)(3) to provide that amounts reportable under section 6050W are subject to backup withholding requirements. Section 3406(a)(1) requires certain payors to perform backup withholding by deducting and withholding income tax from a reportable payment (as defined in section 3406(b)(1)) if the payee fails to furnish the payee's taxpayer identification number (TIN) to the payor on a required return, or if the Secretary notifies the payor that the TIN furnished by the payee is incorrect. Backup withholding for amounts reportable under section 6050W applies to amounts paid after December 31, 2011.

Prior to making an information return, a payor may check the TIN furnished by the payee against the name/TIN combination contained in the IRS's database maintained for the program, and the IRS will inform the participant whether or not the name/TIN combination furnished by the payee matches a name/TIN combination in the database. The matching information provided to participants will help avoid TIN errors and reduce the number of backup withholding notices required under section 3406(a)(1)(B) of the Code. A verified TIN/name match will also provide participants with reasonable cause relief from penalties under section 6724(a). The Act further provides

that, solely for purposes of carrying out TIN matching under section 3406, section 6050W is effective on the date of enactment, July 30, 2008. The TIN matching program described in Rev. Proc. 2003-9, 2003-1 CB 516, permits program participants to verify the payee TINs required to be reported on information returns and payee statements. On February 6, 2009, the IRS announced that persons who will be required to make returns under section 6050W may match TINs under the procedures established by Rev. Proc. 2003-9. See Announcement 2009-6, "Taxpayer Identification Number ("TIN") Matching Program is Available to Persons Required to Make Returns Under New Section 6050W of the Internal Revenue Code" (Announcement 2009-6, 2009-9 IRB 643 (March 2, 2009)). See §601.601(d)(2)(ii)(b).

The Act also amended section 6724(d) by adding returns required by section 6050W to the definition of information return for purposes of penalties for failure to comply with certain information reporting requirements. The amendments to section 6724(d) apply to returns for calendar years beginning after December 31, 2010.

Notice 2009-19 invited public comments regarding guidance under section 6050W. See Notice 2009-19, "Information Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions" (Notice 2009-19, 2009-10 IRB 660 (March 9, 2009)). In particular, Notice 2009-19 requested comments on the interpretation of the statutory definitions of terms used in section 6050W, how to administer the reporting requirements so as to prevent reporting of the same transaction more than once, and whether the "gross amount" of the reportable payment transaction should be defined as "gross receipts or sales" or whether adjustments should be made for credits, cash equivalents, discounts, fees, refunds, or other amounts. Notice 2009-

19 also requested comments on how to address differences between section 6050W reporting and payee reporting on Form 1040, "U.S. Individual Income Tax Return," Form 1065, "U.S. Return of Partnership Income," or Form 1120, "U.S. Corporation Income Tax Return," and whether the time, form and manner of reporting should conform to existing practices for information reporting to the IRS under other provisions of the Code.

Comments were received in response to Notice 2009-19, and the comments were taken into consideration in developing these proposed regulations. The IRS and the Treasury Department invite any additional comments on the issues discussed in this preamble or on other issues relating to section 6050W. See §601.601(d)(2)(ii)(b).

## **Explanation of Provisions**

### In general

The proposed regulations provide guidance to interpret the definitions used in the statute and examples to illustrate the rules in the proposed regulations. The new law requires any payment settlement entity making payment to a participating payee in settlement of reportable payment transactions to make an annual return for each calendar year reporting the gross amount of the reportable transactions, and the name, address, and TIN of the participating payee. See section 6050W(a). The law also requires payment settlement entities to furnish written statements to persons with respect to whom such a return is required showing the name, address, and telephone number of the information contact of the person required to make the return and the gross amount of the reportable payment transactions with respect to the person required to be shown on the return. See section 6050W(f).

Section 6050W(b) provides that the term payment settlement entity means, in the case of a payment card transaction, a merchant acquiring entity; and in the case of a third party network transaction, a third party settlement organization. Section 6050W(b)(2) defines merchant acquiring entity as the bank or other organization with the contractual obligation to make payment to participating payees in settlement of payment card transactions, and section 6050W(b)(3) defines third party settlement organization as the central organization that has the contractual obligation to make payment to participating payees of third party network transactions. The proposed regulations clarify that a “payment settlement entity” may be a domestic or foreign entity.

A reportable payment transaction is any transaction in which a payment card is accepted as payment and any transaction that is settled through a third party payment network. See section 6050W(c). The proposed regulations provide guidance to interpret the meaning of this term in the context of both payment card transactions and third party network transactions, and to determine the gross amount of the transaction to be reported. Many commenters suggested meanings for the term “gross amount.” Some commenters suggested defining “gross amount” as the total amount of the transaction reduced by the fees deducted by the merchant acquiring entity. Other commenters suggested defining “gross amount” as the total amount of the transaction reduced by not only fees but also chargebacks and refunds. Commenters did not suggest, however, that reporting a gross amount with no reductions for any amounts would be burdensome for payment settlement entities. The proposed regulations provide that gross amount means 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.

The proposed regulations require reporting, with respect to each participating payee, of the gross amount of the aggregate reportable payment transactions for the calendar year and the gross amount of the aggregate reportable payment transactions for each month of the calendar year. The inclusion of monthly amounts on the return filed with the IRS and on the statement furnished to the payee will aid in reconciling payment card and third party network transaction receipts for fiscal year payees.

Section 6050W(e) provides an exception for de minimis payments by third party settlement organizations to certain participating payees. Under the proposed regulations, a third party settlement organization must report payments made to a participating payee only if its aggregate payments to that payee from third party network transactions exceed \$20,000 and the aggregate number of those transactions with the payee exceeds 200. Several commenters requested that the exception for de minimis payments be extended to include payments in settlement of payment card transactions. The proposed regulations do not adopt this suggestion. Further comments are requested on the application of the de minimis rule exception, including whether the exception should be mandatory or voluntary.

Section 6050W(d)(1)(A) provides that participating payee means: (i) in the case of a payment card transaction, any person who accepts a payment card as payment; and (ii) in the case of a third party network transaction, any person who accepts payment from a third party settlement organization in settlement of such transaction.

Under section 6050W(d)(1)(B), the term participating payee excludes any person with a foreign address, except as the Secretary may provide. The proposed regulations provide that a payment settlement entity that is a person described as a U.S. payor or U.S. middleman in §1.6049-5(c)(5) is not required to report payments to participating payees with a foreign address as long as, prior to payment, the payee has provided the payment settlement entity with documentation upon which the payment settlement entity may rely to treat the payment as made to a foreign person in accordance with §1.1441-1(e)(1)(ii). By contrast, a payment settlement entity that is not a person described as a U.S. payor or U.S. middleman in §1.6049-5(c)(5) is not required to report payments to participating payees that do not have a United States address as long as the payment settlement entity neither knows nor has reason to know that the participating payee is a United States person. For purposes of this section, foreign address means any address that is not within the United States, as defined in section 7701(a)(9) (the States and the District of Columbia). United States address means any address that is within the United States. The IRS and the Treasury Department request comments on the treatment of payment settlement entities that are not U.S. payors or U.S. middlemen within the meaning of §1.6049-5(c)(5).

Under section 6050W(d)(1)(C), the term “participating payee” includes any governmental unit and any agency or instrumentality thereof. Accordingly, the proposed regulations do not provide for any exceptions to reporting for payments made to governmental units. Payments to governmental units that are made using transit cards and electronic toll collection systems are included within the scope of section 6050W if such payments meet the other requirements of section 6050W. Comments were not

received from governmental units regarding these issues. Therefore, the IRS and the Treasury Department request comments from governmental units and other interested parties regarding the impact of these proposed regulations on governmental units that accept payments made using transit cards, electronic toll collection systems, and similar electronic payment mechanisms.

### Payment Card Transactions

A payment card transaction is any transaction in which a payment card is accepted as payment. See section 6050W(c)(2). Under section 6050W(d)(2), a payment card is a card issued pursuant to an agreement or arrangement that provides for: (1) one or more issuers of such cards; (2) a network of persons unrelated to each other, and to the issuer, who agree to accept the cards as payment; and (3) standards and mechanisms for settling the transactions between the merchant acquiring entities and the persons who agree to accept the cards as payment.

Funds generally do not pass directly from the cardholder to the provider of goods or services for purchases made with a payment card. For example, in the case of a credit card transaction, a credit card organization may direct the transfer of funds from an issuing bank (the bank that issued the credit card) through the debit of the funds on account at an acceptable institution (such as a Federal Reserve Bank) and a credit of those funds to the merchant's bank (the merchant acquiring bank), which in turn pays the provider of goods or services. The cardholder frequently does not pay the issuing bank until after receipt of the payment card monthly billing statement. Thus, the merchant acquiring bank makes the payment to the provider of goods or services to settle the transaction, and the cardholder, who is the ultimate payor, generally does not

make payment until after the transaction occurs. The information reporting requirements under section 6050W reflect that the merchant acquiring bank is in the best position to file the information return reporting the payment to the provider of goods or services.

Commenters suggested adopting the definition of “payment card” in §31.3406(g)-1(f)(2)(i) for purposes of section 6050W. However, the definition of “payment card” in section 6050W(d)(2) is broader than in §31.3406(g)-1(f)(2)(i), which defines payment card as a card issued by a payment card organization (for example, a credit card organization). The proposed regulations reflect the broader statutory definition of “payment card” under section 6050W. Accordingly, a payment card is a card, issued to a cardholder, that a network of unrelated persons has agreed to accept as payment under an agreement that provides standards and mechanisms for settling the transactions between a merchant acquiring bank or similar entity and the providers who accept the cards. Under the proposed regulations, a payment card includes, but is not limited to, all credit cards, debit cards, and stored-value cards (including gift cards), and also includes the acceptance as payment of any account number or other indicia associated with a payment card.

#### Cards Issued in Connection with a Flexible Spending Account or a Health Reimbursement Arrangement

Several commenters requested that the definition of payment card be interpreted to exclude cards issued in connection with flexible spending arrangements (FSAs) (as defined in section 106(c)(2)) or health reimbursement arrangements (HRAs) that are treated as employer-provided coverage under an accident or health plan for purposes of

section 106. The commenters expressed concern that section 6050W may be interpreted to override the exception to information reporting under section 6041(f) for payments made for medical care (as defined in section 213(d)) under FSAs and HRAs. Other commenters indicated that it would be difficult for merchant acquiring entities to identify FSA and HRA card transactions and segregate them from other payment card transactions. In general, FSA and HRA cards have the imprint of a credit card association and function like credit or debit cards. Therefore, merchant acquiring entities may have difficulty distinguishing these transactions from typical credit or debit card transactions. In keeping with the broad interpretation of the definition of “payment card,” the proposed regulations do not except payments for medical care using an FSA or HRA card from reporting under section 6050W. Therefore, under the proposed regulations, the definition of payment card encompasses a card issued in connection with an FSA or HRA. Payments made for medical care under FSAs or HRAs will continue to be exempt from reporting under section 6041.

#### Stored-Value Cards and Gift Cards

The proposed regulations provide that the term “stored-value card” means any card with a prepaid value, including any gift card. Under the proposed regulations, a stored-value card is not a payment card within the meaning of section 6050W when the card is accepted as payment by a person who is related to the issuer of the card. Under these circumstances, the transaction is not a payment card transaction within the meaning of section 6050W and thus not a reportable transaction. However, if the stored-value card itself is purchased with a payment card issued by an unrelated entity, that purchase transaction is reportable under section 6050W.

In contrast, a stored-value card that a network of persons unrelated to the issuer has agreed to accept as payment (such as a stored-value card issued by a college that may be used at various local merchants unrelated to the college) is a payment card when it is accepted as payment in a transaction with an unrelated person. Under these circumstances, the transaction is a payment card transaction within the meaning of section 6050W that is reportable by the payment settlement entity. Use of a stored-value card within a network of both related persons and unrelated persons is a reportable transaction only when it is accepted as payment by an unrelated person. For purposes of this section, unrelated means any person who is not related within the meaning of section 267(b) (providing a list of relationships), including the application of section 267(c) and (e)(3) (providing rules relating to constructive ownership), or section 707(b)(1) (relationships with partnerships).

#### Third Party Network Transactions

Section 6050W(c)(3) provides that a third party network transaction means any transaction that is settled through a third party payment network. Section 6050W(d)(3) provides that third party payment network means any agreement or arrangement that: (A) involves the establishment of accounts with a central organization by a substantial number of persons who (i) are unrelated to such organization, (ii) provide goods or services, and (iii) have agreed to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement; (B) provides for standards and mechanisms for settling such transactions; and (C) guarantees persons providing goods or services pursuant to such agreement or arrangement that those persons will be paid for providing such goods or services. Section 6050W(d)(3) provides that a third party

payment network does not include any agreement or arrangement that provides for the issuance of payment cards.

The Joint Committee on Taxation (JCT) technical explanation of section 6050W explains that, in the case of a third party network transaction, the payment settlement entity is the third party settlement organization, defined as a central organization with the contractual obligation to make payment to participating payees of third party payment networks. According to the technical explanation, the central organization is a payment settlement entity required to report under section 6050W if it provides “a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payments through the network.” See “Technical Explanation of Division C of H.R. 3221, the ‘Housing Assistance Act of 2008’ as Scheduled for Consideration by the House of Representatives on July 23, 2008” (JCX-63-08), Joint Committee on Taxation, at 61 (July 23, 2008) (JCT Technical Explanation). Consistent with this explanation, the proposed regulations provide that the central organization of a third party settlement organization must provide a third party payment network that enables purchasers to transfer funds to providers of goods and services.

The JCT Technical Explanation also gives an example of “substantial number of persons” as that phrase is used in the definition of “third party payment network” in section 6050W(d)(3). The JCT Technical Explanation describes a “third party payment network” as any agreement or arrangement that, among other requirements, involves the establishment of accounts with a central organization by “a substantial number of persons (e.g., more than 50).” JCT Technical Explanation at 61. Comments are

requested on the interpretation of “substantial number of persons” as used in the definition of “third party payment network.”

Many comments were received requesting clarification on the meaning of third party payment network, in particular with respect to healthcare networks, accounts payable departments and “shared-service” organizations, and organizations that settle payment transactions on behalf of others.

### Healthcare Networks

Several commenters expressed concern that the broad definition of third party payment network will include health carriers that have contracts with a network of providers who provide services to covered persons under both insured and administrative service contract healthcare arrangements. A typical healthcare network (sometimes referred to as a “managed care” network) may include “covered persons” (policyholders, subscribers, enrollees or other individuals participating in a health benefit plan), a “health care provider” or “participating provider” (a healthcare professional or a facility that agrees under contract with a health carrier to provide services to covered persons with the expectation of receiving payment directly from the health carrier), and a “health carrier” (an entity that enters into an agreement to provide, deliver, arrange for, pay for, or reimburse any of the cost of health care services). Each of these parties may be a primary party with respect to its agreements with the other parties in the network.

Under the proposed regulations, health carriers operating a healthcare network are outside the scope of section 6050W because a healthcare network does not enable the transfer of funds from buyers to sellers. Health carriers do not facilitate the transfer

of payments from a covered person to a healthcare provider: the payments by covered persons to health carriers and the payments by health carriers to healthcare providers are separate and distinct. Health carriers collect premiums from covered persons pursuant to a plan agreement between the health carrier and the covered person for the cost of participation in the healthcare network. Separately, health carriers pay healthcare providers to compensate providers for services rendered to covered persons pursuant to provider agreements. Accordingly, because the purpose of a healthcare network is not to enable buyers to transfer funds to sellers, a healthcare network is not a “third party payment network” within the meaning of the proposed regulations.

#### Accounts Payable Departments and Shared-Service Organizations

Many comments were received requesting guidance on the interpretation of “third party payment network” with respect to accounts payable departments. Under the proposed regulations, an in-house accounts payable department is not a third party settlement organization of a third party payment network because an in-house accounts payable department is not a “third party.” Rather, an in-house accounts payable department is merely an accounting function of the purchaser of goods and services by which the purchaser makes payments directly to sellers on the purchaser’s own behalf.

In contrast, many purchasers outsource their accounts payable function to a third party organization, sometimes referred to as a “shared-service” organization. In a shared-service business model, the shared-service organization acts as an independent contractor with respect to the accounts payable of purchasers of goods and services. A shared-service arrangement allows purchasers to transfer funds to providers who have established accounts with the shared-service organization and have agreed to accept

payment for their goods and services from the shared-service organization. Thus, the shared-service business model consists of a central organization that provides “a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payments through the network.” JCT Technical Explanation at 61.

Accordingly, under the proposed regulations, a shared-service organization is a third party settlement organization of a third party payment network if: (1) a substantial number of unrelated providers of goods and services have established accounts with the shared-service organization, and (2) this arrangement enables purchasers of goods and services to transfer funds to these providers, who are obligated by contract to accept guaranteed payments from the shared-service organization in settlement of their transactions with the purchasers. The shared service organization must report these transactions as third party network transactions unless the de minimis exception applies (that is, the aggregate payments to each payee do not exceed \$20,000 or the aggregate number of transactions for each payee does not exceed 200).

#### Automated Clearing House (ACH) Networks

As stated previously, the JCT Technical Explanation states that an organization generally is required to report if it provides “a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payment through the network.” JCT Technical Explanation at 61. The JCT Technical Explanation further states: “However, an organization operating a network which merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers, but does not have

contractual agreements with sellers to use such network, is not required to report under the provision.” JCT Technical Explanation at 61.

Consistent with the JCT Technical Explanation, an example in the proposed regulations illustrates that payments settled through an automated clearing house (ACH) network are not settled through a third party payment network. An ACH merely processes electronic payments between payors and payees, and does not itself have contractual agreements with payees to use the ACH network. Accordingly, the proposed regulations reflect that an ACH network is not a third party payment network, and an ACH is therefore not required to report under section 6050W.

#### Aggregated Payees

Section 6050W(b)(4)(A) imposes special rules for persons who receive payments from a payment settlement entity on behalf of one or more participating payees and distribute such payments to one or more participating payees. Under section 6050W(b)(4)(A), such persons are treated (i) as participating payees with respect to the payment settlement entity, and (ii) as payment settlement entities with respect to the participating payees to whom the person distributes payments.

For example, in the case of a corporation that receives payment from a bank for credit card sales transacted at corporate independently-owned franchise stores, the bank is required to report the gross amount of the reportable transactions settled through the corporation even though the corporation does not accept credit cards and would not otherwise be treated as a participating payee under this section. In turn, the corporation is required to report the gross amount of reportable transactions allocable to each franchise store. The bank has no obligation to report the payments allocated by

the corporation to the franchise stores. See Technical Explanation at 61-62. The proposed regulations provide an example of persons that are aggregated payees for purposes of this section. This example is not meant to exclude other aggregated payee arrangements.

### Electronic Payment Facilitators

A payment settlement entity may contract with a third party to settle reportable payment transactions on behalf of the payment settlement entity. Section 6050W(b)(4)(B) provides a special rule for such arrangements. In any case where an “electronic payment facilitator” or other third party makes payments in settlement of reportable payment transactions on behalf of the payment settlement entity, the return under section 6050W must be filed by the electronic payment facilitator or other third party in lieu of the payment settlement entity.

Under the proposed regulations, any person that has contracted with a payment settlement entity to make payments on behalf of the payment settlement entity to a participating payee in settlement of reportable payment transactions is subject to the electronic payment facilitator rule. Because the electronic payment facilitator or other third party is required by statute to file the return if it makes the payment on behalf of the payment settlement entity, and because the electronic payment facilitator or other third party files in lieu of the payment settlement entity, the payment facilitator or other third party, not the payment settlement entity, is the party with the obligation to file the return under section 6050W in these cases. Therefore, the electronic payment facilitator or other third party that makes payment on behalf of the payment settlement entity is the

party that will be liable for any applicable penalties for failure to comply with the information reporting requirements under section 6050W.

#### Duplicate Reporting of the Same Transaction

Section 6050W(g) grants authority to the Secretary to issue guidance to implement the reporting requirement, including rules to prevent the reporting of the same transaction more than once. Numerous commenters requested relief from reporting the same transaction under more than one Code section, in particular with respect to transactions that will be subject to reporting under both sections 6041 (relating to information at source) and 6050W.

Depending on the circumstances, reporting of the same transaction more than once may be warranted for several reasons. First, the burden for reporting may fall on different persons. For example, under section 6041, the reporting person is the payor, whereas under section 6050W, the reporting person is the payment settlement entity. Requiring reporting from both reporters will help ensure that the transaction is reported even where one reporter fails to report.

Second, information reporting under other Code sections may provide different information that may be useful to the IRS. For example, section 6041 requires reporting of fixed or determinable gains, profits and income, whereas section 6050W requires reporting of gross amounts.

Third, exceptions to information reporting may apply under one Code section but not the other, which makes rules to avoid reporting the same transaction more than once difficult to coordinate. For example, §1.6041-3(p) provides that payments made to corporations are generally exempt from reporting under section 6041, whereas no

corporate payee exception exists under section 6050W. Conversely, for third party network transactions under section 6050W, a de minimis exception applies where the aggregate payments to each payee do not exceed \$20,000 or the aggregate number of transactions for each payee does not exceed 200, but no similar exception exists under section 6041. Thus, there are compelling reasons to require reporting under both Code sections.

Nevertheless, for payment card transactions, relief from reporting under section 6041 is warranted because section 6050W reporting covers all payment card transactions and thus effectively encompasses all payments subject to section 6041 reporting made by payment card. Accordingly, the proposed regulations amend section §1.6041-1 to provide that any payment card transaction that otherwise would be reportable under both sections 6041 and 6050W must be reported under section 6050W and not section 6041.

Relief from reporting under section 6041 is not warranted, however, for third party network transactions because such transactions are not subject to reporting unless the de minimis thresholds are met. The payor with the obligation to report under section 6041 cannot determine with certainty whether a third party network transaction is required to be reported under section 6050W. Additional comments are requested regarding the application of this rule to prevent the reporting of the same transaction more than once.

Commenters also requested relief from reporting the same transaction under both sections 3402(t) (relating to withholding on certain payments made by government entities) and 6050W. Government entities frequently use payment cards for payments

for property and services. Such payment card transactions will be subject both to information reporting under section 6050W and to withholding and information reporting under section 3402(t).

Information reporting under section 3402(t) and section 6050W serve different purposes, however. The purpose of information reporting under section 6050W is to encourage voluntary compliance in the reporting of gross receipts. In contrast, the purpose of information reporting under section 3402(t) is to report the amounts of tax withheld from payments and to furnish this information to payees and to the IRS. Both payees and the IRS must have mechanisms in place to account for the income tax that has been withheld from payments. Therefore, reporting under section 3402(t) cannot be eliminated for transactions that will also be required to be reported under section 6050W.

Further, an exception from reporting under section 6050W when the same transaction will be reported under section 3402(t) is not feasible because the payment settlement entity, such as a merchant acquiring entity in the case of a payment card transaction, may not have access to the identity of the actual card user. Thus, the payment settlement entity would not know whether the card user is a government entity required to withhold on payments pursuant to section 3402(t) and would not be able to determine whether reporting under section 6050W is excepted. Also, the proposed rules under section 3402(t) provide for a \$10,000 payment threshold amount, whereas section 6050W has no payment threshold amount for payment card transactions. See REG-158747-06, 2009-4 IRB 362 (73 FR 74,082) (Dec. 5, 2008). Accordingly, the

proposed regulations do not provide relief from reporting the same transaction under both sections 3402(t) and 6050W.

#### Time, Form and Manner for Reporting

Many commenters recommended that the IRS create a new form to be used solely for reporting under section 6050W. A draft form for this purpose, Form 1099-K, "Merchant card and third-party payments," is expected to be released contemporaneously with these proposed regulations. Draft Form 1099-K will be available for viewing and comment on the IRS web site at <http://www.irs.gov/pub/irs-dft/f1099k--dft.pdf>. Additional guidance regarding the proper form for reporting under this section will be issued in time for filing the first returns due under this section (returns for calendar year 2011 due in 2012).

The draft form is expected to require reporting, with respect to each participating payee, of the gross amount of the aggregate reportable payment transactions for the calendar year and the gross amount of the aggregate reportable payment transactions for each month of the calendar year. The inclusion of monthly amounts on the return filed with the IRS and on the statement furnished to the payee will aid in reconciling payment card and third party network transaction receipts for fiscal year payees. Additionally, the proposed regulations provide that the time and manner for reporting under section 6050W will follow the existing procedures for information reporting under other Code sections.

Section 6050W(f) provides that payee statements may be furnished electronically. Commenters requested that the existing procedures for payee statements be modified to eliminate the requirement for an affirmative consent to

receive the payee statement under section 6050W electronically. Instead, commenters requested that merchants already receiving business communications electronically be deemed to have consented to receive electronic payee statements under section 6050W. Commenters also suggested that reporting entities not be required to send a separate communication to payees to inform them of their option to receive payee statements electronically; rather, the communication may be included in another business communication. Commenters also suggested that merchants receiving paper communications who wish to receive electronic payee statements be allowed to consent to electronic payees statements by logging onto a website to indicate their consent, with no further written consent required. The proposed regulations do not adopt these suggestions to eliminate the existing consent procedures for furnishing electronic statements to payees. Additional comments are requested on whether the existing consent procedures should be modified.

#### Backup Withholding

The Act amended section 3406(b)(3) to provide that reportable payment transactions subject to information reporting under section 6050W generally are subject to backup withholding requirements. Section 3406 requires backup withholding in the case of any reportable payment if a condition for backup withholding, as set forth in section 3406(a)(1), exists. In the case of reportable payments, backup withholding generally applies if the payee fails to furnish his TIN to the payor or if the IRS notifies the payor that the TIN furnished by the payee is incorrect.

Section 3091(c) of the Act amended section 3406(b) by expanding the meaning of reportable payments subject to backup withholding to include payments required to

be shown on a return required under section 6050W, effective for amounts paid after December 31, 2011. Accordingly, the proposed regulations amend the regulations under section 3406 to provide that persons making information returns with respect to any reportable payment under section 6050W made after December 31, 2011 are included in the definition of “payors” obligated to backup withhold.

Several commenters expressed concern that when backup withholding for reportable payments reportable under section 6050W becomes effective, duplicate backup withholding on the same payment could potentially occur. The same reportable payment may be reportable under section 6050W and under another Code section, such as section 6041 or 6041A, thus potentially subjecting the payee to as much as 56-percent withholding for the same transaction.

Because the proposed regulations provide relief from reporting under section 6041 for payment card transactions that would otherwise be reportable under both sections 6041 and 6050W, the potential for duplicate backup withholding in such situations is eliminated. There continues, however, to be a potential for duplicate backup withholding for reportable payments made after December 31, 2011 that are reportable under section 6050W and another Code section. Also, in the case of a payment for services using a third party payment network after December 31, 2011, the payment potentially could be subject to backup withholding by the payor for these services as a reportable payment under section 6041, and by the third party settlement organization as a reportable payment under section 6050W.

A payment settlement entity reporting under section 6050W is in a better position to perform backup withholding for a third party network transaction than the payor

reporting under section 6041. Backup withholding compliance is difficult for payors in third party network transactions because an invoice may not be issued, and the payor in the transaction may not be in a position to backup withhold easily at the time of the transaction. Backup withholding may also be difficult because the payor does not make payment directly to the provider of services; rather, the third party settlement organization makes payment to the provider. However, relief from backup withholding for third party network transactions reportable under both section 6050W and section 6041 is not warranted because such transactions are not subject to reporting under section 6050W unless the de minimis thresholds are met. Thus, the payor with the obligation to report under section 6041 cannot determine with certainty whether a third party network transaction is required to be reported under section 6050W.

For payments that are subject to withholding under both sections 3402(t) and 6050W, the potential for duplicate withholding is complicated by the 3-percent withholding requirement contained within section 3402(t) itself. Section 3402(t) expressly provides exceptions to the 3-percent withholding requirement for payments that are subject to backup withholding under section 3406 if backup withholding is actually being deducted from the payment. Thus, where there is no 3-percent withholding on a government payment card transaction, the transaction will be subject to the higher 28-percent backup withholding under section 3406 instead of the 3-percent withholding under section 3402(t). However, a potential for duplicate backup withholding may arise if information reporting is required under both sections 3402(t) and 6050W but neither reporting requirement is satisfied.

The proposed regulations do not eliminate the requirement for backup withholding for transactions that are reportable under section 6050W and another Code section. Comments are requested on the circumstances under which relief for duplicate backup withholding is appropriate once backup withholding under section 6050W becomes effective.

**Proposed Effective/Applicability Dates:**

The amendments to the regulations as proposed will be effective on the date they are published as final regulations in the **Federal Register**.

With respect to the regulations under sections 6041, 6050W, 6051, 6721 and 6722, the regulations are proposed to apply to returns for calendar years beginning after December 31, 2010. With respect to the regulations under section 3406, the regulations are proposed to apply to amounts paid after December 31, 2011.

**Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Pursuant to the Regulatory Flexibility Act (5.U.S.C. chapter 6), it is hereby certified that the regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the persons required to report under section 6050W, payment settlement entities, will generally not be small businesses. Merchant acquiring entities, the payment settlement entities required to report payment card transactions, will primarily be banks with over \$175 million in

assets. Third party settlement organizations, the payment settlement entities required to report third party network transactions, will generally not be small entities by virtue of the definition of a third party payment network, which requires the establishment of accounts with a central organization (the third party settlement organization) by a substantial number of persons. Further, section 6050W(e) provides a de minimis exception that exempts third party settlement organizations from reporting transactions with respect to a payee if the aggregate amount of such transactions does not exceed \$20,000 or the aggregate number of such transactions does not exceed 200. The IRS and the Treasury Department also request comments on the accuracy of the statement that the regulations in this document will not have a significant economic impact on a substantial number of small entities. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed regulations and how they can be made easier to understand. Comments are requested on the examples in the proposed regulations, and commentators are specifically invited to suggest changes to these examples or to suggest new examples that they believe would better illustrate the principles that should be included in the final regulations. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 10, 2010 at 10 am in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by January 27, 2010. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### **Drafting Information**

The principal author of these proposed regulations is Barbara Pettoni, Office of Associate Chief Counsel (Procedure and Administration).

## List of Subjects

### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

### 26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

### 26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

## Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1, 31 and 301 are proposed to be amended as follows:

### PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.6041-1 is amended by adding a sentence at the end of paragraph (a)(1)(ii) and adding paragraphs (a)(1)(iv) and (a)(1)(v) to read as follows:

#### §1.6041-1 Return of information as to payments of \$600 or more.

(a) \* \* \*(1) \* \* \*(i) \* \* \*

(ii) \* \* \* For payment card transactions (as described in §1.6050W-1(b)) required to be reported on information returns required under section 6050W (relating to payment card and third party network transactions), see special rules in §1.6041-1(a)(1)(iv).

\* \* \* \* \*

(iv) Information returns required under section 6050W for calendar years beginning after December 31, 2010. For payments made by payment card after December 31, 2010, that are required to be reported on an information return under section 6050W (relating to payment card and third party network transactions), the following rule applies. Payment card transactions that are described in paragraph (a)(1)(ii) of this section that otherwise would be reportable under both sections 6041 and 6050W are reported under section 6050W and not section 6041. For provisions relating to information reporting for payment card transactions, see §1.6050W-1.

(v) Example. The provisions of paragraph (a)(1)(iv) are illustrated by the following example:

Example. 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 that has agreed to accept A's credit card as payment under an agreement that provides standards and mechanisms for settling the transaction between a merchant acquiring bank and the persons who accept the cards. Merchant acquiring bank Y is responsible for making the payment to B. Under paragraph (a)(1)(iv) of this section, A, as payor, is not required to file an information return under section 6041 with respect to the transaction because Y, as the payment settlement entity for the payment card transaction, is required to file an information return under section 6050W.

\* \* \* \* \*

Par. 3. Section §1.6050W-1 is added to read as follows:

§1.6050W-1 Information reporting for payments made in settlement of payment card and third party network transactions.

(a) In general--(1) General rule. Every payment settlement entity, as defined in paragraph (a)(3) of this section, must file an information return for each calendar year

with respect to payments made in settlement of reportable payment transactions, as defined in paragraph (a)(2) of this section, setting forth the following information:

(i) The name, address, and taxpayer identification number (TIN) of each participating payee, as defined in paragraph (a)(4) of this section, to whom one or more payments in settlement of reportable payment transactions are made.

(ii) With respect to each participating payee, the gross amount, as defined in paragraph (a)(5) of this section, of--

(A) The aggregate reportable payment transactions for the calendar year; and

(B) The aggregate reportable payment transactions for each month of the calendar year.

(iii) Any other information required by the form, instructions or current revenue procedures.

(2) Reportable payment transaction. The term reportable payment transaction means any payment card transaction (as defined in paragraph (b)(1) of this section) and any third party network transaction (as defined in paragraph (c)(1) of this section).

(3) Payment settlement entity. The term payment settlement entity means a domestic or foreign entity that is--

(i) In the case of a payment card transaction, a merchant acquiring entity (as defined in paragraph (b)(2) of this section); and

(ii) In the case of a third party network transaction, a third party settlement organization (as defined in paragraph (c)(2) of this section).

(4) Participating payee--(i) Definition. In general, the term participating payee means any person, including any governmental unit (and any agency or instrumentality thereof), who:

(A) In the case of a payment card transaction, accepts a payment card (as defined in paragraph (b)(3) of this section) as payment; and

(B) In the case of a third party network transaction, accepts payment from a third party settlement organization (as defined in paragraph (c)(2) of this section) in settlement of such transaction.

(ii) Foreign payees. For special rules relating to foreign payees, see paragraph (d)(3) of this section.

(5) Gross amount. For purposes of this section, gross amount means 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.

(b) Payment card transactions--(1) Definition. The term payment card transaction means any transaction in which a payment card, or any account number or other indicia associated with a payment card, is accepted as payment.

(2) Merchant acquiring entity. The term merchant acquiring entity means the bank or other organization that has the contractual obligation to make payment to participating payees (as defined in paragraph (a)(4)(i)(A) of this section) in settlement of payment card transactions.

(3) Payment card. (i) The term payment card means any card, including any stored-value card as defined in paragraph (b)(4) of this section, issued pursuant to an agreement or arrangement that provides for--

(A) One or more issuers of such cards;

(B) A network of persons unrelated to each other, and to the issuer, who agree to accept such cards as payment; and

(C) Standards and mechanisms for settling the transactions between the merchant acquiring entities and the persons who agree to accept the cards as payment.

(ii) Persons who agree to accept such cards as payment as described in this paragraph (b)(3) are participating payees within the meaning of paragraph (a)(4)(i)(A) of this section.

(4) Stored-value cards. The term stored-value card means any card with a prepaid value, including any gift card.

(c) Third party network transactions--(1) Definition. The term third party network transaction means any transaction that is settled through a third party payment network.

(2) Third party settlement organization. The term third party settlement organization means the central organization that has the contractual obligation to make payments to participating payees (as defined in paragraph (a)(4)(i)(B) of this section) of third party network transactions. A central organization is a third party settlement organization if it provides a third party payment network (as defined in paragraph (c)(3)(i) of this section) that enables purchasers to transfer funds to providers of goods and services.

(3) Third party payment network. (i) The term third party payment network means any agreement or arrangement that--

(A) Involves the establishment of accounts with a central organization by a substantial number of providers of goods or services who are unrelated to the organization and who have agreed to settle transactions for the provision of the goods or services to purchasers according to the terms of the agreement or arrangement;

(B) Provides standards and mechanisms for settling the transactions; and

(C) Guarantees payment to the persons providing goods or services in settlement of transactions with purchasers pursuant to the agreement or arrangement.

(ii) Persons who are providers of goods and services as described in this paragraph (c)(3) are participating payees within the meaning of paragraph (a)(4)(i)(B) of this section.

(4) Exception for de minimis payments. A third party settlement organization is required to report any information under paragraph (a)(1) of this section with respect to third party network transactions of any participating payee only if--

(i) The amount that would otherwise be reported under paragraph (a)(1)(ii) of this section with respect to such transactions exceeds \$20,000; and

(ii) The aggregate number of such transactions exceeds 200.

(d) Special rules--(1) Aggregated payees. In any case where a person receives payments from a payment settlement entity (as defined in paragraph (a)(3) of this section) on behalf of one or more participating payees and distributes such payments to one or more participating payees (as defined in paragraph (a)(4) of this section), the person is treated as:

(i) The participating payee with respect to the payment settlement entity; and  
(ii) The payment settlement entity with respect to the participating payees to whom the person distributes payments.

(2) Electronic payment facilitator. If a payment settlement entity (as defined in paragraph (a)(3) of this section) contracts with an electronic payment facilitator or other third party to settle reportable payment transactions on behalf of the payment settlement entity, the electronic payment facilitator or other third party must file the annual information return under this section in lieu of the payment settlement entity. The electronic payment facilitator or other third party who makes payment on behalf of the payment settlement entity is the party that will be liable for any applicable penalties for failure to comply with the information reporting requirements of section 6050W.

(3) Foreign payees--(i) In general. A payment settlement entity that is a person described as a U.S. payor or U.S. middleman in §1.6049-5(c)(5) is not required to make a return of information for payments to a participating payee with a foreign address as long as, prior to payment, the payee has provided the payment settlement entity with documentation upon which the payment settlement entity may rely to treat the payment as made to a foreign person in accordance with §1.1441-1(e)(1)(ii). For purposes of this paragraph (d)(3)(i), the provisions of §1.1441-1 shall apply by substituting the term payor for the term withholding agent and without regard to the limitation to amounts subject to withholding under chapter 3 of the Internal Revenue Code and the regulations under that chapter.

(ii) Special rule. A payment settlement entity that is not a person described as a U.S. payor or U.S. middleman in §1.6049-5(c)(5) is not required to make a return of

information for a payment to a participating payee that does not have a United States address as long as the payment settlement entity neither knows nor has reason to know that the participating payee is a United States person.

(iii) Foreign address; United States address. For purposes of this section, foreign address means any address that is not within the United States, as defined in section 7701(a)(9) of the Internal Revenue Code (the States and the District of Columbia).

United States address means any address that is within the United States.

(4) Unrelated persons. For purposes of this section, unrelated means any person who is not related to another person within the meaning of section 267(b) (providing a list of relationships), including the application of section 267(c) and (e)(3) (providing rules relating to constructive ownership), and section 707(b)(1) (relationships with partnerships).

(e) Examples. The following examples illustrate the provisions of this section:

Example 1. Merchant acquiring entity. Customer A purchases goods from merchant B using a credit card issued by Bank X. B is one of a network of unrelated persons that has agreed to accept credit cards issued by X as payment under an agreement that provides standards and mechanisms for settling the transaction between a merchant acquiring bank and the persons who accept the cards. Bank Z is the bank with the contractual obligation to make payment to B for goods provided to A in the above transaction. As defined in paragraph (b)(2) of this section, Z is the merchant acquiring entity that must file the annual information return required under paragraph (a)(1) of this section to report the payment made to settle the transaction for the sale of goods from B to A.

Example 2. Third party settlement organization. (i) Merchant B is one of a substantial number of persons selling goods or services over the Internet that have an account with X, an Internet payment service provider. None of these persons, including B, are related to X, and all have agreed to settle transactions for the sale of goods or services to customers according to the terms of their contracts with X. X has guaranteed payment to all of these persons, including B, for the sale of goods or services to customers. Customer A purchases goods from B. A pays X for the goods purchased from B. X, in turn, makes payment to B in settlement of the transaction for the sale of goods from B to A.

(ii) X's arrangement constitutes a third party payment network as defined in paragraph (c)(3) of this section because a substantial number of persons that are unrelated to X, including B, have established accounts with X, and X is contractually obligated to settle transactions for the provision of goods or services by these persons to purchasers. Thus, under paragraph (c)(2) of this section, X is a third party settlement organization and the transaction discussed in this example is a third party network transaction under paragraph (c)(1) of this section. Therefore, X must file the annual information return required under paragraph (a)(1) of this section to report the payment made to B in settlement of the transaction with A provided that X's aggregate payments to B from third party network transactions exceed \$20,000 and the aggregate number of X's transactions with B exceeds 200 (as provided in paragraph (c)(4) of this section).

Example 3. Automated clearinghouse network. A operates an automated clearinghouse ("ACH") network that merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers. There are no contractual agreements between A and the sellers for the purpose of permitting the sellers to use the ACH network. Thus, A is not a third party settlement organization under paragraph (c)(2) of this section, the ACH network is not a third party payment network under paragraph (c)(3) of this section, and the electronic payment transactions are not third party network transactions under paragraph (c)(1) of this section. A is not required to file the annual information return required under paragraph (a)(1) of this section.

Example 4. Gross amount. Customer A uses a payment card to purchase \$100 worth of goods at merchant B. Bank X, the merchant acquiring entity for B, is the party with the contractual obligation to make payment to B in settlement of the transaction. X, after deducting fees of \$2, makes payment of \$98 to settle the transaction for the sale of goods from B to A. Under paragraph (a)(5) of this section, X must report the amount of \$100, without any reduction for fees or any other amount, as the gross amount of this reportable payment transaction on the annual information return filed under paragraph (a)(1) of this section.

Example 5. Gift card. (i) 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. B 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 described in paragraph (b)(1) of this section and, thus, is not required to be reported in a return of information required under paragraph (a)(1) of this section. Under paragraph (b)(3) of this section, the gift card is not a payment card because the gift card is accepted as payment by a person who is related to the issuer of the gift card. Therefore, the use of the gift card by B is not required to be reported in a return of information required under paragraph (a)(1) of this section.

(ii) The facts are the same as in paragraph (i), except that B adds value to the gift card using a credit card. The use of the credit card to add value to the gift card is a

reportable payment transaction (as defined in paragraph (a)(2) of this section) and must be reported in a return of information under this section by the bank or other organization that has the contractual obligation to make payment to X in settlement of the transaction.

Example 6. Campus card. (i) Student A purchases a card issued by University Y that may be used on campus at various university-owned merchants and at various local merchants unrelated to Y. A uses the card in the university-owned cafeteria to purchase lunch. Under paragraph (b)(3) of this section, the campus card is not a payment card in this transaction because the card is accepted as payment by a person who is related to the issuer of the card. Therefore, the use of the campus-card by A in the university cafeteria is not required to be reported in a return of information required under paragraph (a)(1) of this section.

(ii) The facts are the same as in paragraph (i), except that A uses the campus card to purchase lunch at a local restaurant, unrelated to Y, that has agreed to accept the campus card as payment. Under paragraph (b)(3) of this section, the campus card is a payment card in this transaction because the card is accepted as payment by a person that is unrelated to this issuer of the card pursuant to an agreement. Therefore, the use of the card by A in the local restaurant for the purchase of lunch must be reported in a return of information required under paragraph (a)(1) of this section by the bank or other organization that has the contractual obligation to make payment to the restaurant in settlement of the transaction.

Example 7. Prepaid telephone card. A purchases a prepaid telephone card from Company X that may be used to make telephone calls using various long-distance providers unrelated to X that have agreed to accept the card as payment. A places a telephone call using the prepaid card as payment for the telephone call. Under paragraph (b)(3) of this section, the prepaid telephone card is a payment card because the card is accepted as payment by a person that is unrelated to the issuer of the card pursuant to an agreement. Therefore, the use of the prepaid card to make payment for the telephone call must be reported in a return of information required under paragraph (a)(1) of this section by the bank or other organization that has the contractual obligation to make payment to the long distance provider in settlement of the transaction.

Example 8. Transit card. City Z accepts a transit card as payment for use of its mass transit system. The transit card is issued by B, an organization unrelated to Z. A network of persons, including Z, who are unrelated to each other and to B, have agreed to accept the transit card issued by B as payment for transit and for other goods and services. Transit rider X purchases a transit card and uses the card to pay for travel on Z's mass transit system. Under paragraph (b)(3) of this section, the transit card is a payment card because the card is accepted as payment by a person who is one of a network of persons that are unrelated to the issuer of the card and that have agreed to accept the card as payment. Therefore, the use of the transit card by X to pay for transit on Z's mass transit system is a payment card transaction described in paragraph (b)(1) of this section that must be reported in a return of information required under

paragraph (a)(1) of this section by the bank or other organization that has the contractual obligation to make payment to Z. Z is the participating payee, described in paragraph (a)(4)(i)(A) of this section, of the payment card transaction.

Example 9. Healthcare network. Health carrier A operates healthcare network Y. A collects premiums from covered persons pursuant to a plan agreement between A and the covered persons for the cost of membership in Y. Separately, A pays healthcare providers pursuant to provider agreements to compensate these providers for services rendered to covered persons who are members of Y. A is not a third party settlement organization under paragraph (c)(2) of this section because A does not operate a third party payment network that enables purchasers to transfer funds to providers of goods and services. Therefore, A is not required to file the annual information return required under paragraph (a)(1) of this section.

Example 10. Third party accounts payable. X is a “shared-service” organization that performs accounts payable services for numerous purchasers that are unrelated to X. A substantial number of providers of goods and services have established accounts with X and have agreed to accept payment from X in settlement of their transactions with purchasers. The provider agreement with X includes standards and mechanisms for settling the transactions and guarantees payment to the providers, and the arrangement enables purchasers to transfer funds to providers. Under paragraph (c)(3) of this section, X’s accounts payable services constitute a third party payment network, of which X is the third party settlement organization (as defined in paragraph (c)(2) of this section). For each payee, X must file the annual information return required under paragraph (a)(1) of this section to report payments made by X in settlement of accounts payable to that payee if X’s aggregate payments to that payee exceed \$20,000 and the aggregate number of transactions with that payee exceeds 200 (as provided in paragraph (c)(4) of this section).

Example 11. Toll collection network. State A charges a toll to vehicles that travel its state highways. The tolling agency for A contracted with organization X to perform its toll collection. X provides an electronic toll collection system that allows the toll facility to record the passage of a vehicle with a transponder affixed to the vehicle. The customer account associated with the transponder is automatically debited for the amount of the toll. The customer funds a balance in the account, which is then depleted as the toll transactions occur. X periodically bills the customer to replenish the account. X then makes payment to A to settle the toll transactions that are recorded by the transponder. X also contracts with a substantial number of other entities unrelated to X that have established accounts with X and have agreed to accept payment using the electronic toll collection system provided by X. X guarantees payment to the entities for all toll transactions that are recorded by the transponders, and the arrangement enables customers to transfer funds to State A and other entities that charge tolls. Under paragraph (c)(3) of this section, X’s electronic toll collection system constitutes a third party payment network, of which X is the third party settlement organization (as defined in paragraph (c)(2) of this section). For each payee, including A, X must file the annual information return required under paragraph (a)(1) of this section to report payments

made by X in settlement of toll transactions if X's aggregate payments to that payee exceed \$20,000 and the aggregate number of transactions with that payee exceeds 200 (as provided in paragraph (c)(4) of this section).

Example 12. Hotel kiosk. Under a "hotel kiosk" arrangement, Hotel B permits its customers to charge, to their room account, transactions for goods and services at a substantial number of sellers unrelated to B that operate on B's premises and have established accounts in B's hotel kiosk system. Customers settle their room account with B when they check out, and B in turn settles the hotel kiosk transactions with the unrelated sellers. B guarantees payment to the sellers for these transactions and the arrangement enables customers to transfer funds to the sellers by means of one payment made to the hotel. Under paragraph (c)(3) of this section, B's hotel kiosk system constitutes a third party payment network, of which B is the third party settlement organization (as defined in paragraph (c)(2) of this section). For each payee, B must file the annual information return required under paragraph (a)(1) of this section to report payments made by B in settlement of the hotel kiosk transactions if B's aggregate payments to that payee exceed \$20,000 and the aggregate number of transactions with that payee exceeds 200 (as provided in paragraph (c)(4) of this section).

Example 13. Aggregated payee. Corporation A, acting on behalf of A's independently-owned franchise stores, receives payment from Bank X for credit card sales effectuated at these franchise stores. X, the payment settlement entity (as defined in paragraph (a)(3)(i) of this section), is required under paragraph (d)(1)(i) of this section to report the gross amount of the reportable payment transactions distributed to A (notwithstanding the fact that A does not accept payment cards and would not otherwise be treated as a participating payee). In turn, under paragraph (d)(1)(ii), A is required to report the gross amount of the reportable payment transactions allocable to each franchise store. X has no reporting obligation under this section with respect to payments made by A to its franchise stores.

Example 14. Electronic payment facilitator. Bank A is a merchant acquiring entity (as defined in paragraph (b)(2) of this section) with the contractual obligation to make payments to participating merchants to settle certain credit card transactions. X enters into a contract with A to settle these credit card transactions electronically on behalf of A. Under paragraph (d)(2) of this section, X is an electronic payment facilitator and must file the information return required under paragraph (a)(1) of this section with respect to A's credit card transactions settled by X. A has no reporting obligation with respect to payments made by X on A's behalf.

(f) Prescribed form. The return required by paragraph (a)(1) of this section must be made according to the forms and instructions published by the IRS.

(g) Time and place for filing. Returns made under this section for any calendar year must be filed on or before February 28th (March 31st if filing electronically) of the following year at the Internal Revenue Service Center location designated in the instructions to the relevant form.

(h) Time and place for furnishing statement--(1) In general. Every payment settlement entity required to file a return under this section must also furnish to each participating payee a written statement with the same information (as described in paragraph (h)(2) of this section). The statement must be furnished to the payee on or before January 31st of the year following the calendar year in which the reportable payment is made. If the return of information is not made on magnetic media, this requirement may be satisfied by furnishing to such person a copy of all Forms 1099-K, "Merchant card and third-party payments," or any successor form with respect to such person filed with the Internal Revenue Service Center. The statement will be considered furnished to the payee if it is mailed to the payee's last known address. The payment settlement entity may furnish the statement electronically with the prior consent of the payee.

(2) Information to be shown on statement furnished to payee. Each written statement furnished under paragraph (h)(1) of this section must include the following information--

(i) The name, address, and phone number (or email address if the statement is furnished electronically) of the information contact of the payment settlement entity.

(ii) With respect to the participating payee, the gross amount of--

(A) The aggregate reportable payment transactions for the calendar year; and

(B) The aggregate reportable payment transactions for each month of the calendar year.

(iii) Any other information required by the form, instructions, or current revenue procedures.

(i) Cross-reference to penalties. For provisions relating to the penalty for failure to file timely a correct information return required under section 6050W, see §301.6721-1 of this chapter (Procedure and Administration Regulations). For provisions relating to the penalty for failure to furnish timely a correct payee statement required under section 6050W(f), see §301.6722-1 of this chapter. See §301.6724-1 of this chapter for the waiver of a penalty if failure is due to reasonable cause and is not due to willful neglect.

(j) Effective/applicability date. The rules in this section apply to returns for calendar years beginning after December 31, 2010. The rules in this section are effective on the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

#### PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 4. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

Par. 5. Section 31.3406-0 is amended as follows:

1. Entries for §31.3406(b)(3)-5(a) and (b) are added.
2. Entry for §31.3406(g)-1 is amended by adding paragraphs (d), (e), and (f).

The additions read as follows:

§31.3406-0 Outline of the backup withholding regulations.

\* \* \* \* \*

§31.3406(b)(3)-5 Reportable payments of payment card and third party network transactions.

(a) Payment card and third party network transactions subject to backup withholding.

(b) Amount subject to backup withholding.

\* \* \* \* \*

§31.3406(g)-1 Exception for payments to certain payees and certain other payments.

\* \* \* \* \*

(d) Reportable payments made to Canadian nonresident alien individuals.

(e) Certain reportable payments made outside the United States by foreign persons, foreign offices of United States banks and brokers, and others.

(f) Special rule for certain payment card transactions.

\* \* \* \* \*

Par. 6. Section 31.3406(a)-2 is amended by revising paragraph (a) to read as follows:

§31.3406(a)-2 Definition of payors obligated to backup withhold.

(a) In general. Payor means the person that is required to make an information return under sections 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, 6050N, or 6050W with respect to any reportable payment (as described in section 3406(b)), or that is described in paragraph (b) of this section.

\* \* \* \* \*

Par. 7. Section 31.3406(b)(3)-5 is added to read as follows:

§31.3406(b)(3)-5 Reportable payments of payment card and third party network transactions.

(a) Payment card and third party network transactions subject to backup withholding. A payment of a kind, and to a payee, that is required to be reported under section 6050W (relating to information reporting for payment card and third party network transactions) is a reportable payment for purposes of section 3406. See

§31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) Amount subject to backup withholding. In general, the amount described in paragraph (a) of this section that is subject to withholding under section 3406 is the amount subject to reporting under section 6050W.

(c) Effective/applicability date. The provisions of this section apply to amounts paid after December 31, 2011.

Par. 8. Section 31.3406(d)-1 is amended by revising paragraph (d) to read as follows:

§31.3406(d)-1 Manner required for furnishing a taxpayer identification number.

\* \* \* \* \*

(d) Rents, commissions, nonemployee compensation, certain fishing boat operators, and payment card and third party network transactions, etc.--Manner required for furnishing a taxpayer identification number. For accounts, contracts, or relationships subject to information reporting under section 6041 (relating to information reporting at source on rents, royalties, salaries, etc.), section 6041A(a) (relating to information reporting of payments for nonemployee services), section 6050A (relating to information reporting by certain fishing boat operators), section 6050N (relating to information reporting of payments of royalties), or section 6050W (relating to information reporting for payment card and third party network transactions), the payee must furnish the payee's taxpayer identification number to the payor either orally or in writing. Except as provided in §31.3406(d)-5, the payee is not required to certify under penalties of

perjury that the taxpayer identification number is correct regardless of when the account, contract, or relationship is established.

Par. 9. Section 31.6051-4 is amended by revising paragraph (c)(2) to read as follows:

§31.6051-4 Statement required in case of backup withholding.

\* \* \* \* \*

(c) \* \* \*

(2) The amount subject to reporting under sections 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, 6050N, or 6050W whether or not the amount of the reportable payment is less than the amount for which an information return is required. If tax is withheld under section 3406, the statement must show the amount of the payment withheld upon;

\* \* \* \* \*

PART 301--PROCEDURE AND ADMINISTRATION

Par. 10. Section 301.6721-1(g) is amended by:

1. Removing the language “or” at the end of paragraphs (g)(2)(vi) and (g)(3)(xii).
2. Redesignating paragraph (g)(2)(vii) as (g)(2)(viii).
3. Adding new paragraph (g)(2)(vii).
4. Redesignating paragraphs (g)(3)(viii), (g)(3)(ix), (g)(3)(x), (g)(3)(xi), (g)(3)(xii) and (g)(3)(xiii) as (g)(3)(ix), (g)(3)(x), (g)(3)(xi), (g)(3)(xii), (g)(3)(xiii) and (g)(3)(xiv).
5. Adding the language “or” at the end of newly designated paragraph (g)(3)(xiii).
6. Adding new paragraph (g)(3)(viii).

The revisions and additions read as follows:

§301.6721-1 Failure to file correct information returns.

\* \* \* \* \*

(g) \* \* \* (2) \* \* \*

(vii) Section 6050W (relating to information returns with respect to payments made in settlement of payment card and third party network transactions (effective for information returns required to be filed for calendar years beginning after December 31, 2010)), or

\* \* \* \* \*

(3) \* \* \*

(viii) Section 6050W (relating to information returns with respect to payments made in settlement of payment card and third party network transactions (effective for information returns required to be filed for calendar years beginning after December 31, 2010)),

\* \* \* \* \*

Par. 11. Section 301.6722-1 is amended by:

1. Removing the language “and” at the end of paragraph (d)(2)(xviii).
2. Redesignating paragraphs (d)(2)(xvi), (d)(2)(xvii), (d)(2)(xviii) and (d)(2)(xix) as (d)(2)(xvii), (d)(2)(xviii), (d)(2)(xix) and (d)(2)(xx).
3. Adding new paragraph (d)(2)(xvi).
4. Adding the language “and” at the end of the newly designated paragraph (d)(2)(xix).

5. Adding new paragraph (f).

The revisions and additions read as follows:

§301.6722-1 Failure to furnish correct payee statements.

\* \* \* \* \*

(d)\* \* \* (2)\* \* \*

(xvi) Section 6050W (relating to information returns with respect to payments made in settlement of payment card and third party network transactions, generally the recipient copy),

\* \* \* \* \*

(f) Effective/Applicability date. The provisions of paragraph (d)(2)(xvi) of this section apply to information returns required to be filed for calendar years beginning after December 31, 2010.

\* \* \* \* \*

Linda E. Stiff  
Deputy Commissioner for Services and Enforcement.