Part III - Administrative, Procedural, and Miscellaneous

Payments Subject to Backup Withholding in Payment Card and Third Party Network Transactions.

Notice 2011-42

PURPOSE

This notice provides interim guidance to third party settlement organizations (TPSO) (as defined under section 6050W of the Internal Revenue Code (Code) and its accompanying regulations) on backup withholding obligations under section 3406 of the Code and its accompanying regulations. Specifically, this notice establishes that a payment made by a TPSO is a reportable payment potentially subject to section 3406 backup withholding only if the payee has received payment from that TPSO in more than 200 transactions within a calendar year. Payments made in settlement of payment card transactions that are potentially subject to section 3406 backup withholding have no limiting threshold.

The Treasury Department and the Internal Revenue Service intend to amend the existing regulations under section 3406 to reflect the guidance provided in this notice. TPSOs may rely on the interim guidance in this notice until the regulations are amended.

BACKGROUND

Section 3406(a)(1) requires certain payors to perform backup withholding by deducting and withholding income tax from a reportable payment, regardless of any
threshold amount otherwise applicable to such payment, if the payee fails to furnish the payee’s taxpayer identification number (TIN) or furnishes an incorrect TIN to the payor. Section 6050W, added by section 3091 of the Housing Assistance Tax Act of 2008, Div. C of Pub. L. No. 110-289, 122 Stat. 2653 (the Act), requires information returns to be made by certain payors with respect to payments made in settlement of payment card transactions and third party payment network transactions. All payments made in settlement of payment card transactions are required to be reported under section 6050W. Payments made in settlement of third party network transactions, however, are required to be reported only if the amount to be reported exceeds $20,000 and the aggregate number of transactions exceeds 200 with respect to any payee within a calendar year.

The Act also amended section 3406(b)(3) by including as reportable payments potentially subject to backup withholding those payments required to be reported pursuant to section 6050W but without regard to the reporting minimum thresholds of that section. See Treas. Reg. § 31.3406(b)(3)-5(b). The withholding requirements under section 3406 will apply to section 6050W payments beginning January 1, 2012.

The regulations under section 3406 were amended to provide that whether payments made in settlement of third party network transactions were subject to withholding under section 3406 is determined without regard to the statutory monetary or transactional thresholds found in section 6050W. See Treas. Reg. § 31.3406(b)(3)-5. Those monetary and transactional thresholds are considered solely for determining whether a TPSO had an information reporting obligation under section 6050W for
payments made to a payee. Accordingly, under the regulations, TPSOs are required to obtain a TIN from every payee in a third party payment network, even the occasional small volume seller, to avoid backup withholding.

DISCUSSION

The Treasury Department and the Internal Revenue Service have determined that the section 6050W statutory transactional threshold for determining information reporting obligations should be met before any section 3406 withholding obligation arises with respect to TPSOs. The Treasury Department and the Internal Revenue Service intend to amend the regulations under section 3406 to provide that no backup withholding is required where the aggregate number of transactions between a TPSO and a payee do not exceed 200 within a calendar year. The monetary threshold of $20,000 found in section 6050W is not considered for purposes of determining backup withholding obligations.

Until the amended final regulations are published, TPSOs may rely on this notice to limit any backup withholding obligations to payees who have exceeded the 200 transaction threshold. The relief provided by this notice does not apply to payment card transactions.

DRAFTING INFORMATION

The principal author of this notice is Girish Prasad of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, please contact Girish Prasad at (202) 622-4910 (not a toll-free call).