INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

EMERGING COMPLIANCE ISSUES SUBGROUP REPORT

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A. IRC § 6050W and Form 1099-K Reporting

Recommendations

IRPAC continues to recommend this year that guidance (e.g., revenue rulings, notices, proposed regulations) is needed related to IRC § 6050W "Returns Relating to Payments Made in Settlement of Payment Card and Third Party Network Transactions."

1. Most importantly, IRPAC recommends that key terms integral to the meaning of “third party payment network” be defined because entities making payment with respect to third party payment network transactions (called third party settlement organizations or TPSOs) are not subject to reporting under IRC § 6050W unless the payments made to any given recipient exceed a de minimis threshold. Proper application of the de minimis rule is critical to the IRS's use of IRC § 6050W reporting data and without further clarification, some payers may incorrectly apply the de minimis rule to their payments, resulting in these payments not being reported to the recipients or the IRS. Understanding whether reporting is required on hundreds of thousands of transactions is critical to the usefulness of the reporting data that has been generated as a result of this provision.

2. IRPAC also recommends that the IRS issue guidance to clarify whether an aggregated payee (i.e., an intermediary who receives payments from a payment settlement entity (PSE) on behalf of one or more participating payees and distributes such payments to the participating payees) can retain its TPSO status.

3. IRPAC recommends that the IRS issue guidance with regard to how TPSOs are to apply the de minimis rules when the TPSO contracts mid-year with another entity (e.g., an electronic payment facilitator (EPF)) to make payment or when the product buyer directs a separate TPSO to make payment to the merchant participating in the first third party payment network.

4. To save mailing costs associated with very small payments, IRPAC recommends either implementing a minimum threshold below which reporting under IRC § 6050W would not need to be performed or issuing guidance to exclude from the definition of a "reportable payment transaction" wire transfers of funds that are equal to $.01, which are typically made by a PSE solely to check that it has the correct banking information for the merchant at the time the relationship is established.

Discussion

IRC § 6050W and the related Treasury Regulations require the reporting of payment card transactions and third party network transactions on Form 1099-K.

Payment card transactions are any transactions in which a payment card (or any account number or other indicia associated with a payment card) is accepted as payment. Third party network transactions are any transactions settled through a third party payment network. The definition of a third party payment network is critically important because payments by a TPSO settled through a third party payment network are not subject to reporting under IRC § 6050W unless they exceed a de minimis threshold (i.e., the amount otherwise reportable would exceed $20,000 AND the aggregate number of payment transactions exceeds 200).

Key terms integral to the meaning of "third party payment network" have still not been defined. These terms include "central organization," "guarantee," and "substantial number of providers of goods or services." The definitions to these terms are critical to determining whether the de minimis rules are applicable, and thus whether reporting is required in many cases. IRPAC's detailed recommendations related to the definition of these terms (as well as many other areas for needed guidance) can be found in its March 28, 2011 comment letter in Appendix D to the 2011 Report.

In addition, guidance is needed to clarify that aggregated payees can retain their TPSO status upon distributing payments (as a PSE) to one or more participating payees. An aggregated payee's retention of TPSO status should not vary based on the type of arrangement (i.e. payment card, debit card or bank account) or the source of the funds from which it receives payment. This is especially appropriate, for example, where the contractual terms between the intermediary and the credit card processing entity from which the intermediary receives payments are not identical to those between the intermediary and the merchant. (E.g., the credit card processing entity might not provide any fraud guarantees for transactions, but the intermediary might offer that service to its merchant customers.)Where the contractual terms differ and may give rise to different obligations for the intermediary, the classification of the arrangement between the intermediary and the merchant cannot be derived from the character of the arrangement between the intermediary and the credit card processing entity. Instead, given the potential for different obligations under the two arrangements, each arrangement should be evaluated independently. Accordingly, IRPAC recommends that the IRS issue guidance to clarify that an intermediary serving as an aggregated payee when it receives payment may be treated as a TPSO with respect to its payment of those funds to the merchant.

The current rules are also not clear with regard to how TPSOs are to apply the de minimis rules when the TPSO contracts mid-year with an EPF to make payment or when the product buyer directs a second TPSO to make payment to the merchant. For example, when one of these arrangements has been made, do the de minimis rules apply separately to the payments of both the initial TPSO and the EPF/second TPSO or must the two paying entities coordinate their respective payments to determine whether the de minimis rules apply to one or the other (or both)?

Finally, to minimize burden associated with the reporting of insignificant payments, IRPAC recommends implementing a minimum threshold below which reporting under IRC § 6050W would not need to be performed. We believe this threshold should be at least as high as the combined cost to the payer to print and mail the IRS Forms 1099-K, Payment Card and Third Party Network Transactions to the merchant. However, if the IRS does not believe it has the authority to implement a minimum threshold at this time, IRPAC alternatively recommends that the IRS issue guidance to exclude from the definition of a "reportable payment transaction" wire transfers of funds that are equal to $.01, which are made by PSEs solely to check that they have the correct banking information for the merchant-payees at the time the relationship is established ("Wire-Check Payments").Thousands of Form 1099-Ks are sent out each year reporting no more than $.01 because the account activity for the year only involved setting up the account. Defining reportable payment transactions to exclude these Wire-Check Payments would save both the IRS and the private sector significant resources. IRPAC believes the IRS has the authority to make this change since it relates to the definition of what is or is not a payment transaction.

Over the past several years and including 2015, IRPAC met and had phone calls with IRS personnel regarding these issues under IRC § 6050W and other practical reporting issues for the Form 1099-K.These discussions were substantive and productive, and IRPAC recognizes the thoughtfulness and seriousness with which the IRS approached these discussions. However, it has been over four years since IRPAC recommended that additional guidance be issued in this area and it appears that progress on this guidance project at the IRS has stalled. The IRS did advise IRPAC that "significant changes" are being made to the regulations under IRC § 6050W however the IRS is unable to share the changes with IRPAC. IRPAC respects that the IRS is unable to share all information but would also like to note that the purpose of IRPAC is to advise the IRS on industry impact when changes are made. IRPAC members are concerned that if the IRS does not consult with IRPAC on the open items, changes could be made that may negatively impact the payment card industry and taxpayers (merchants) or may not even be possible to implement. With no new guidance, merchants and processors continue to differ on interpretations and subsequently may not be reporting accurately. IRPAC urges the IRS to consider more discussions relating to the proposed changes.

While IRPAC understands that the IRS has had serious budget constraints placed on the organization, IRPAC believes that prioritizing the IRC § 6050W guidance project would not only help the tax reporting community, but also would help the IRS tax collection efforts. Indeed, now that there have been several years of reporting under IRC § 6050W, the IRS is working on pilot projects to utilize the reported information under IRC § 6050W as a tool for audit management. IRPAC believes that the IRS's statistics based on reported information under IRC § 6050W may not be complete (and therefore likely not accurate) due to unreported information as a result of the undefined terms discussed above. Accordingly, IRPAC believes it is in both the IRS's interest and the tax reporting community's interest to address these definitional issues as quickly as possible to ensure that only entities that are appropriately characterized as TPSOs are able to avail themselves of the de minimis rules.

B. Form1099-B Aggregate Reporting of Sales

Recommendation

1. Undertake a regulatory project for 2016 that would permit brokers to aggregate sales for trades from a single order executed on the same day in multiple fills on Form 1099-B irrespective of whether a single confirmation is issued that lists an aggregate price or average price per share.

Discussion

Over the past year, IRPAC met on a number of occasions with IRS personnel regarding our recommendation in Appendix A of the 2014 Public Report, that the IRS amend the instructions for Form 1099-B,Proceeds from Broker and Barter Exchange Transactions, to allow aggregate sales reporting for one trade order filled on the same day by multiple fills. IRS counsel advises that a regulation change is required prior to amending the instructions. IRPAC recommends the IRS undertake a regulatory project in 2016 that would permit brokers to aggregate sales for the same order that takes place on the same trade date for the same CUSIP or security identifier. Allowing aggregation would materially reduce the number of Forms 1099-B issued to the taxpayer and records transmitted to the service annually without a negative impact to revenue.

C. Transfers of Section 1256 Options

Recommendation

1. Amend Treasury Regulation §1.6045A–1T(e) to specify that if a covered Section 1256 contract is purchased in one tax year and then transferred to a receiving firm in another tax year that the receiving broker is responsible for all subsequent Form 1099-B reporting.

Discussion

IRPAC is appreciative that the IRS adopted our 2014 recommendation to require a transfer statement for covered Section 1256 options. Since then we have had several conversations with the IRS about the 1099-B reporting obligation for these options in the event a client purchases a section 1256 option contract in one tax year and then transfers it to another firm in a subsequent tax year. Firms are currently required to report on Form 1099-B a section 1256 holder’s unrealized profit or loss on all open contracts at the end of a preceding tax year. If a holder subsequently transfers the position to another firm it is unclear whether both the original firm and the new firm bear reporting responsibility for future years.

As an example, assume a client purchases a Section 1256 option contract from broker A in 2016 and then transfers it to broker B in 2017, where they subsequently sell the security. It is clear that broker A needs to report the unrealized profit or loss for 2016 on Form 1099-B. It is not clear under the temporary regulations that broker B bears the full reporting responsibility for the 2017 tax year.

For example:

- 2016 Section 1256 contract purchased at firm A client has unrealized profit of $5,000 at the end of 2016.
- 2017 client transfers the contract to firm B where they subsequently sell it for a $2,500 profit in 2017.

Broker A will issue the following 1099B reporting for the 2016 Tax Year

2016 Tax Reporting from Firm A:

1099-B Reporting	
(8) Profit or (loss) realized in 2016 on closed contracts **$0**	(9) Unrealized profit or (loss) on open contracts – 12/31/2016 **$0**
(10) Unrealized profit or (loss) on open contracts –12/31/2015 **$5000**	(11) Aggregate profit or (loss) on contracts **$5000**

2017 Tax Reporting from Firm B:

1099-B Reporting	
(8) Profit or (loss) realized in 2017 on closed contracts **$2,500**	(9) Unrealized profit or (loss) on open contracts – 12/31/2017 **$0**
(10) Unrealized profit or (loss) on open contracts	(11) Aggregate profit or (loss) on contracts

–12/31/2016 **$5,000**	**$ (2,500)**

In order for Firm B to issue a 2017 Form 1099-B reporting the aggregate loss of ($2500) on the contract, they will need to account for the unrealized profit in box 10 that Firm A reported on their 2016 Form 1099-B. Lacking definitive guidance in the regulations that Firm A is no longer responsible for Form 1099-B reporting in subsequent tax years there is debate in the information reporting community on how to handle the reporting. IRPAC recommends that the IRS amend §1.6045A–1T(e) to specify that the receiving broker bears reporting responsibility for all years after the transfer. This will alleviate potential duplicative reporting being issued to the taxpayer.

D. Complex Debt Reporting Requirements

Recommendations

1. Permit brokers to calculate market discount on covered bonds purchased after 1/1/14 using the constant yield method as long as the security has not made any partial principal payments or a client has not elected that market discount be included in income currently with their broker.
2. Allow brokers to report Original Issue Discount on all covered tax-exempt obligations on Form 1099 OID rather than just those purchased after January 1, 2017.
3. Provide firms with guidance on how to calculate adjusted cost basis, market discount, and premium for bonds whose terms are not made available by the issuer or provide penalty relief to firms if they are unable to report this data on Forms 1099 for bonds that would otherwise be considered covered under the regulations.

Discussion

Treasury Regulation §1.6045-1T(n)(11)(i)(B) requires brokers to calculate market discount on a bond purchased after January 1, 2015 by assuming that a customer has made the election to accrue market discount based on a constant yield. This is favorable both to taxpayers and reduces the administrative burden on firms to collect written elections for this treatment. Brokers were required to calculate market discount on debt instruments purchased after January 1, 2014 using the straight-line method. Taxpayers may have purchased one lot of a bond at a market discount in March 2014 that is being calculated using straight-line and then purchased another lot at a market discount in March of 2015 which will be calculated using constant yield.

This disparate treatment of two lots of the same security has the potential to confuse clients or worse yet; clients may not even recognize the different treatment. IRPAC recommends that the IRS amend the regulation to allow for all covered bonds purchased after January 1, 2014 to be calculated using the constant yield method provided the security has not made any partial principal payments or that a client has not provided their broker with a written election to include market discount in income currently. This will allow for consistent tax treatment of lots and will not change any reporting that firms have previously sent to the IRS.

Treasury Regulation § 1.6049-10T requires brokers to report original issue discount and acquisition premium on tax-exempt bonds issued on or after January 1, 2017. Firms will have already been calculating original issue discount and acquisition premium for all covered tax-exempt bonds by this date in order to meet their basis reporting obligations on Form 1099-B. IRPAC recommends that the IRS allow brokers to report this information on all covered tax-exempt bonds beginning with the 2017 Tax Year. This will allow a consistent reporting experience for all covered debt instruments regardless of acquisition date and reduce the need to educate clients on another phase of cost basis reporting.

The final and temporary regulations relating to reporting by brokers for transactions involving debt instruments and options were released in TD 9616 in May of 2013.Those regulations specified that less complex debt instruments were covered if purchased after January 1, 2014, and that more complex debt instruments, including those “for which the terms of the instrument are not reasonably available to the broker within 90 days of the date the debt instrument was acquired by the customer” would be covered if purchased after January 1, 2016.

There are many securities for which the terms may not be reasonably available to brokers within 90 days of the date the security was acquired by the customer. Customers may be purchasing securities that were issued decades ago or foreign securities for which the issuer may never make the terms available. It is unclear under the current regulations what a broker is to do if they are unable to obtain these terms. How would firms calculate adjusted basis in the absence of these terms and what happens after the 90 day period passes? IRPAC recommends that the IRS provide firms with guidance on how to calculate adjusted cost basis, market discount, and premium for bonds in these cases or provide penalty relief to firms if they are unable to report this data on Forms 1099-B for bonds that would otherwise be considered covered under the regulations.

E. Form 1098-T

IRPAC partnered with the IRS on several initiatives related to the Form 1098-T. IRPAC provided suggested language for an IRS Frequently Asked Questions page that provided guidance to taxpayers in the event they received an education credit related IRS letter or were audited on education credits. Additionally, IRPAC worked with the IRS in support of university and college backed initiatives to encourage the IRS to waive penalties associated with the Notice 972CG proposed penalty program in relation to the Form 1098-T, because universities and colleges cannot require a student to submit a

TIN in order to register, and they have no mechanism to check if TINs provided by students are accurate. IRPAC applauds the steps the IRS took to provide relief to universities and college for tax years 2013 and 2014 that will save both taxpayers and the IRS time and money. In addition, for returns required after December 31, 2015, Congress enacted §6724(f), which provides that no penalty will be assessed for failing to provide the TIN of an individual on a Form 1098-T if the educational institution accurately certifies that it has complied with the standards promulgated by the Secretary for obtaining individuals' TINs. IRPAC thanks those involved with helping to bring about this positive resolution.