What are payment settlement entities?

Payment settlement entities are the organizations responsible for reporting the payments made to participating payees. A payment settlement entity may be a domestic or foreign entity. For payment card transactions, merchant acquiring entities are the payment settlement entities, and for third party network transactions, third-party settlement organizations are the payment settlement entities.

What is a third-party settlement organization?

A third-party settlement organization is a central organization that has the contractual obligation to make payments to participating payees (generally, a merchant) in a third party payment network. Characteristics of a third party payment network include: (i) the existence of a central organization with whom providers of goods and services have established accounts, (ii) an agreement between the central organization and providers to settle transactions between the providers of goods and services and purchasers, (iii) the establishment of standards and mechanisms for settling such transactions and (iv) the guarantee of payment in settlement of such transactions. The most common example of a third-party settlement organization is an online auction-payment facilitator, which operates merely as an intermediary between buyer and seller by transferring funds between accounts in settlement of an auction/purchase. Third-party settlement organizations charge sellers a fee for facilitating the transaction. Under the reporting requirements, these entities must report the gross reportable transactions of the businesses to which they make payments provided the payee satisfies certain transaction volume and dollar thresholds.

What is a merchant acquiring entity?

Often called an “acquiring” or “merchant” bank, a merchant acquiring entity is the bank or other organization that processes credit card transactions on behalf of a merchant and ultimately transfers the funds received from the customer’s bank (called an “issuing bank”) to the merchant’s account. Initially, a merchant acquiring entity processes a request after a merchant swipes a customer’s card, and notifies a merchant when the card has been accepted. Merchant acquiring entities charge merchants a fee for facilitating their charge transactions. Merchant acquiring banks are responsible for reporting merchants’ reportable payment card transactions.
**What is a payee?**

A payee (or “participating payee”) is any person that accepts a payment card as payment, or in the case of a third party network transaction, any person that accepts payment made by a third party settlement organization on behalf of the purchaser or customer.

**Who is responsible for reporting merchant card payments?**

The merchant acquiring entity that transfers funds to the participating payee is responsible for reporting the gross amount of reportable transactions.

**Who is responsible for reporting third party network transactions?**

The third-party settlement organizations are responsible for reporting the gross amounts of reportable transactions paid to participating payees in their network.

**Whose merchant card payments must be reported?**

Merchant acquiring entities must report the gross amount of reportable transactions of any payee for whom they settle payment card transactions. A reportable payment card transaction is any payment in which a payment card or any indicia thereof (such as a credit card number) is accepted as payment.

**Whose third-party network transactions must be reported?**

Third-party settlement organizations must report the gross amounts of reportable transactions of any payee for whom they settle payments using their network provided that a payee’s reportable transactions exceed $20,000 and the aggregate number of those transactions exceeds 200.

**Why is this reporting necessary?**

The reporting is required by law. Third-party information reporting has been shown to increase voluntary tax compliance, improve collections and assessments within IRS, and thereby reduce the tax gap. With third-party reporting of payment card revenue and third party network transactions, the IRS has the means of instituting a robust business matching program, similar to the successful matching program already in use which verifies amounts reported on individual returns and identifies individual nonfilers.
How are reportable transactions to be reported? Will there be a new form?

Payment settlement entities will report gross transaction amounts on the new Form 1099-K, Merchant Card and Third-Party Payments.

What information must be reported?

The form requires reporting, with respect to any one payee, of the gross amount of reportable transactions for the calendar year and its corresponding months. The reporting of both annual and monthly amounts is necessary in order to reconcile differences between information returns and tax returns of fiscal year filers. The name, address, and taxpayer identification number of each participating payee must also be included on the form.

When are Forms 1099-K due?

Under the new law, information reporting for payment card and third party network transactions are due to the IRS by February 28 (March 31, if filed electronically), of the year following the transactions. The first 1099-Ks will be due for calendar year 2011, and must be submitted to the IRS by February 28, 2012 (March 31, 2012 if filed electronically).

Can Forms 1099-K be filed electronically?

Yes, there will be protocol for the electronic submission of Form 1099K. In fact, if a payment settlement entity must submit more than 250 individual information returns in any calendar year, all must be submitted electronically. Information about electronic filing of Form 1099-K can be found on the web at www.irs.gov.

What are payee statements and when are they due?

Payment settlement entities must furnish a “payee statement” showing the information reported to the IRS on Form 1099-K to each participating payee. The statements must be provided by the reporting entity to the payee by January 31 of the year following the calendar year for which the return was made. The first payee statements must be furnished by January 31, 2012.

Can payee statements be submitted electronically?

Yes, they may be provided electronically. Consent for receipt of electronic statements must first be provided by the payee. Consent can be granted electronically. See Treasury regulations
section 1.6050W-2 for instructions for receiving consent from payees. If a payee statement is submitted electronically, an email address for the reporting entity may be provided in lieu of a phone number.

**What is the de minimis standard for reporting? Does it apply to payment card transactions?**

The *de minimis* standard exempts the reporting of transactions settled by a third party settlement organization of a payee in a third party payment network if the aggregate payments to the payee do not exceed $20,000 or if the aggregate number of transactions does not exceed 200. This applies *only* to the payments settled by third-party settlement organizations. The *de minimis* standard does not apply to payment card transactions.

**What constitutes the “gross amount” of reportable transactions? Does the “gross amount” include fees, charge-backs or other costs and refunded amounts?**

The “gross amount” of reportable transactions means the total dollar amount of aggregate transactions without regard to any credits, charge-backs, fees, cash equivalents, discounts, refunds, or any other amounts. The “gross amount” is strictly the total dollar value paid to the participating payees before any fees, refunds, or any other amounts are considered.

**Why do the regulations require that merchant acquiring entities report the “gross amount” of transactions? Wouldn’t it make more sense to report the net amount without fees, charge-backs, etc.?**

The regulations require the reporting of the “gross amount” of transactions because the statute specifically requires reporting of the gross amount.

**Are foreign payment settlement entities subject to the reporting requirements?**

Yes, the statute and regulations establish that a “payment settlement entity” may be a domestic or foreign entity.
Are payment settlement entities required to report the transactions of governmental units, whether state or federal?

Yes. The term “participating payees” includes any governmental unit as well as any agency or instrumentality thereof.

What qualifies as a “payment card”?

Under the regulations, 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 as payment. The term “payment card” includes credit cards, debit cards, and stored-value cards, as well as payment through any indicia of a payment card (such as a credit card number).

Are purchases made with stored-value cards or gift cards reportable transactions?

It depends. Purchases made with store cards or gift cards are not reportable when the card is accepted as payment by someone who is related to the issuer of the card (such as a subsidiary company or the company itself). Under these circumstances, the stored-value cards do not fit the definition of a “payment card” and purchases made with such cards are therefore not reportable. However, purchases made with a stored-value card accepted by a network of persons unrelated to the issuer and each other are reportable transactions. “Unrelated” means any person who is not related within the meaning of §267(b) of the Internal Revenue Code, including the application of §267(b) and (e)(3), or §707(b)(1).

Do healthcare networks fit within the definition of a third-party settlement organization? What about accounts payable departments?

Health carriers operating a healthcare network do not fit within the definition of a third-party settlement organization because they do not transfer funds from buyers to sellers. Rather, health carriers accept payment, in the form of premiums, from buyers (employers or persons covered under the carrier’s plan) in order to give those buyers access to a network of healthcare providers; separately, health carriers then pay compensation to the medical professionals within their networks pursuant to predetermined rates. Accordingly, healthcare networks do not qualify as third-party settlement organizations.

Likewise, an in-house accounts-payable department is not a third-settlement organization. An in-house accounts-payable department is not a third-party settlement organization quite simply
because it is not a “third-party.” It is merely an internal processor of payments by the umbrella organization to outside parties.

**Does an automated-clearing house qualify as a third-party settlement organization?**

No. An automated-clearing house merely processes electronic payments between buyers and sellers through wire transfer, electronic checks, and direct deposit. Further, there is no contractual relationship between the automated-clearing house and payees. Thus, an automated-clearing house does not qualify as a third-party settlement organization and payments on its network are not reportable.

**How is reporting conducted when multiple payees receive allocable revenue from a person to whom payments are made by a payment settlement entity?**

The most common example of this situation is when a franchisor processes all of the merchant card transactions of multiple franchisees and distributes payments accordingly. For example, when a corporation receives payments from a bank on behalf of multiple payees, the corporation is treated a participating payee with respect to the bank and as a payment settlement entity with respect to the payees to whom the corporation distributes the payments. The bank is required to report the gross amount of reportable transactions settled through the corporation. In turn, the corporation is required to report the allocable transactions of the payees to whom the corporation distributes the payments. Under the statute and regulations, the corporation is an “aggregated payee.”

**Who reports when a payment settlement entity contracts with a third-party, such as an electronic payment facilitator, to settle reportable transactions?**

Whenever a payment settlement organization contracts with a third party to make payments in settlement of reportable payment transactions on behalf of the payment settlement entity, the return must be filed by the third party instead of the payment settlement entity.

**If transactions are already reported under other sections of the Internal Revenue Code, must they be reported again by payment settlement entities?**
Section 6050W explicitly grants the Secretary the power to draft regulations to prevent duplicative reporting of the same transaction. The final regulations under section 6050W (the new payment card reporting requirements) provide that payment card and third party network transactions that otherwise would be reportable both under section 6041 or 6041A(a) and under section 6050W must be reported under section 6050W and not under section 6041 or 6041A(a). Relief has not been granted for reporting under any other Internal Revenue Code section.

**How can payee TINs be verified? How soon?**

Verification of payee TINs is done through the “Taxpayer Identification Number (TIN) Matching Program.” See Revenue Procedure 2003-9, 2003-1 C.B. 516 for additional information. Verification of payee TINs in the IRS’ database is permitted as of the date of the legislation’s enactment (July 30, 2008).

**If another code provision already requires backup withholding of a reportable transaction, does the backup withholding provision under section 6050W still apply?**

The regulations do not eliminate the backup withholding requirements under section 6050W under any circumstances, even where the potential for duplicate withholding exists.

**Can the person required to make the information return under section 6050W and to secure the TIN necessary to make the return shift the economic burden to the participating payee?**

No. The Internal Revenue Code requires payment settlement entities or in some cases an electronic payment facilitator to file information returns and to furnish payee statements with respect to each participating payee to whom payments in settlement of reportable payment transactions are made. These statutory obligations apply regardless of whether the participating payee pays a fee. Moreover, if a payment settlement entity or an electronic payment facilitator fails to comply with these statutory obligations, it is subject to penalties under Internal Revenue Code sections 6721 and 6722. Because federal law requires payment settlement entities or electronic payment facilitators to file information returns and to furnish payee statements, such entities are precluded from collecting fees for costs incurred in fulfilling these requirements.