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March 17, 2009

Hon. Douglas Shulman
Commissioner of Internal Revenue
Internal Revenue Service
CC:PA:LPD:PR (Notice 2009-19)
Room 5203
PO Box 7604
Ben Franklin Station
Washington DC 20044

Re: Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions – Notice 2009-19

Dear Commissioner Shulman:

The IRS Information Reporting Program Advisory Committee (IRPAC)[1] is pleased to submit for your consideration the following comments on regulations to be developed under Internal Revenue Code (IRC) Section 6050W which was added to the Code by section 3091 of the Housing Assistance Tax Act of 2008[2]. On February 20, 2009, IRS released Notice 2009-19 in which the Service requested comments, particularly with regard to 10 stated questions. This letter addresses those issues.

1. Whether the Form 1099 series is appropriate for Section 6050W reporting and whether the time and manner of reporting to the Service should conform to existing practices for information reporting to the Service under other provisions of the Code?

   IRPAC recommends that IRS create a new form to be used solely for reporting under Section 6050W. This will minimize confusion between information returns received under Section 6050W and information returns that taxpayers may receive under Sections 6041, 6041A and 3402(t) which apply to card

[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges, and universities, and state taxing agencies.
[2] P.L. 110-289, 122 Stat. 2653.

transactions as well as cash and check transactions.[3] Although taxpayers are accustomed to receiving "1099s", the use of a separate form is more important than the name/title of that form.

With regard to conformance to existing practices, IRPAC suggests IRS generally adopt the existing practices for most other information returns in areas of, e.g., substitute forms, use of the FIRE system etc. We recommend that Section 6050W be added to Treas. Reg. 31.3406(d)-1(d), which specifies the method for providing a TIN under IRC sections 6041, 6041A, 6050A, and 6050N orally or in writing, rather than the rules for interest and dividends (certification), and that Treas. Reg. 301.6721-1 through 301.6724-1 as well as Publication 1586 be revised to include Section 6050W in the rules applicable to Section 6041.

In addition, IRS should embark on a comprehensive outreach campaign to educate the Payment Settlement Entity and Electronic Payment Facilitator (PSE/EPF) communities. While some PSE/EPFs are affiliated with banks that have extensive experience with information reporting, others are stand-alone third party processors which have no experience with any of the Code's other reporting requirements. Even those affiliated with banks tend to be separate departments or subsidiaries which have never before done information reporting, much less TIN Matching, backup withholding, depositing, B Notices, and Penalty Notices. IRS must bear some of the responsibility for educating these novices and for working with them as they implement systems, establish practices, and assemble a trained work force. During the first year or two of reporting under Section 6050W, we urge IRS to provide generous transition rules and penalty waivers. As forms and instructions are created or revised, the inexperience of the PSE/EPF community should be kept in mind.

2. Whether procedures for electronic reporting to payees, under Section 6050W(f), should conform to existing procedures for electronic reporting to payees under other provisions of the Code?

The IRS first provided for the electronic provision of payee statements and set forth standards for providing Forms 1099 to consumers electronically in T.D. 9144. The guidance sets up rules for consenting to electronic receipt of payee statements including a written communication from the institution explaining the option, and a written acceptance by the customer along with a demonstration that the individual was capable of receiving the documents electronically.

[3] Though in Question 8 we urge IRS to elimination duplication between and among various overlapping sections, even if that were done, merchants would continue to receive Forms 1099-MISC for non-electronic payments. Use of a separate form would serve to further define what is being reporting on what form.

[4] Fed. Reg., Vol. 69 No. 32, February 18, 2004 pages 7567-74. This document, in conjunction with section 401 of the Job Creation and Worker Assistance Act of 2002 (P. L. 107-147, March 9, 2002), authorizes payors to provide payees with electronic Forms 1099, etc., provided certain requirements are met including payee consent to receive such documents electronically.

These protections may have seemed appropriated at the time to ensure that the individual taxpayer would receive his/her payee statement without delay so that preparation and filing of individual tax returns would not be compromised in terms of time or accuracy. But the reporting under Section 6050W occurs in a strictly business-to-business relationship, and the business is electronic commerce. The payees range from Fortune 1000 businesses to government agencies, to institutions of higher learning to (a small minority) of sole proprietorships; all are part of a sophisticated electronic payments system.

If the procedures for electronic payee statements were reasonable years ago for consumers who may not be tech-savvy, they are outdated today in the world of electronic commerce. Section 6050W applies to a market segment that is founded on use of electronic mechanisms to conduct business. IRS should adopt rules which provide that PSE/EPFs are able to supply any reports required under this section electronically in a manner consistent with that used to communicate business information.

IRPAC recommends: (1) any merchant already receiving business communications electronically be deemed to have consented to receiving the payee statement under Section 6050W electronically without further mailings or demonstrations of consent, subject to the right to request a paper statement if one is desired; (2) for merchants not currently receiving business communications electronically, a billing statement addendum, rather than a separate mailing should be sufficient with the specific format and content left to the PSE/EPF; and (3) a merchant electing to receive the payee statement electronically would show affirmative consent by logging onto the PSE/EPF web site and opting for electronic communications. No other written consent should be required beyond this clear demonstration of both intent and capability.

3. What foreign entities, if any, should be included in the definition of "payment settlement entity"?

For electronic payments to merchants doing business within the United States, the term PSE should include all entities that otherwise meet the definition without regard to their country of residence. An exception for a PSE just because it was not a US person would open a loophole for any US merchant seeking to escape reporting under this new provision. For example, if a foreign acquirer is excluded from the scope of Section 6050W, any US merchant currently doing business with a US bank (the "Acquirer") could switch to a foreign acquirer to avoid reporting. In addition, such an exception would provide a competitive disadvantage for US banks who would lose business to foreign acquirers who could offer this shield from IRS eyes. The rules should apply equally regardless of the identity of the PSE/EPF. We recommend that a PSE making payments to a US merchant be subject to the reporting requirements regardless of the national identity of the PSE.

In addition, the regulations should define who qualifies as an "Electronic payment facilitator" (EPF). In the payment card industry, the PSE normally will be a US bank. That bank, the "Acquirer", will have a contractual relationship with a merchant to process that merchant's transactions and pay according to the terms of the contract. Often that bank will out-source the actual processing to a third party processor. That out-sourcing relationship may be limited to the transaction processing, or may extend to performing all functions including paying the merchant. Sometimes the payment function may be performed by the processor but only at the direction and control of the acquirer, and sometimes the processor will have full authority to pay on its own initiative.

The regulations must define in which of these situations the processor rises to the level of an EPF. We recommend that the basic rules laid down in Treas. Reg. 1.6041-1(e) be applied here. If a processor performs mere ministerial functions such as paying when told to by the PSE, then the processor is not an EPF. But if the processor manages the payment function without the PSE having direct control over who to pay, when and how much, then that processor would be considered an EPF.

4. What persons with foreign addresses, if any, should be included in the definition of "participating payee"?

Each merchant in the payment card system has been investigated by the Acquirer during the application process. Acquirers will require evidence of a valid on-going business. Agents are routinely sent out to establish the merchant's stated address and the activities occurring there. Therefore, establishing the location of the merchant as being within the United States is easily done through the routine business practices of the application process. For purposes of Section 6050W, we believe that any merchant with a US address on record with the PSE/EPF be considered a participating payee. For merchants that have both US and non-US addresses, reporting should be required unless transactions can be specifically associated with the foreign address (such as when a merchant has separate foreign and US divisions with separate relationships with an acquirer.) We further recommend that any merchant with only a non-US address on file with the PSE/EPF should qualify for the foreign address exception without additional documentation, absent actual knowledge of a US presence on the part of the PSE/EPF.

For purposes of this foreign address exclusion under Section 6050W, IRPAC recommends that "US address" be defined as the fifty states and the District of Columbia, excluding Puerto Rico, Guam, the Virgin Islands, and other US territories since they generally are subject to different federal tax rules. In addition, merchants should be required to inform the PSE/EPF of any change in foreign/US address status.

5. How to interpret the statutory definition and scope of "payment card"

IRPAC recommends that IRS regulations under Section 6050W use the definition of "payment card" previously adopted by the IRS in Treas. Reg. 3406(g)-1(f)(2). This would include all credit and debit cards, both consumer and commercial, as well as any similar account or relationship which is not evidenced by an actual card. Gift cards purchased for spending at specific stores also should be included in "payment card" and reported as paid as of time of purchase as the merchant's right to payment attaches at that time. Pre-paid cards and stored value cards, on the other hand, may be used at multiple merchants. As a result, transactions paid with such a card should be reported only when the card is utilized at a specific merchant for it is only then that they are income to any particular taxpayer.

6. How to interpret the statutory definition and scope of "third party payment network"

It is commonly believed that the "third party network" (3PN) was directed at PayPal and similar entities where widely disparate "merchants" are paid for goods and services through a credit-card-like service. As a result of the broadly drafted text in the statute, some concern has arisen in various quarters that 3PN could extend to other situations inappropriately. For example, IRPAC has learned of at least two scenarios where existing reporting requirements may be duplicated by the same filers if the definition of "third party network" is broadly defined. (We discuss duplication by different filers in section 8 below.)

First, the health care industry is concerned with the broad definition of "third party network." Specifically, it is very common for health carriers to have contracts with a network of providers who provide services to the members under both insured and administrative service contract health plan arrangements. This hub networking facility collects premiums and other payments, as well as makes payments for many different insurance companies. The insurance company networks generally report these transactions already under Section 6041.

Second, some who run accounts payable departments are concerned whether they too may be swept into this reporting regime by a too broad definition of third party network. In this case, the AP department outsources the actual payment of vendors to a third party who also is paying AP invoices on behalf of other entities. The third party generally files any required returns under Section 6041.

In both of these cases, these payments are already being reported under existing law so there is no need to have the same parties generate a second information return to the same merchants. We recommend that IRS define "third party network" to exclude both of these, and similar, networks where reporting is already occurring.

IRPAC will continue to work toward providing specific wording to define third party networks to eliminate any confusion and establish that such payments are reportable only once by any party under existing provisions.

7. 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, discount amounts, fees, refunded amounts, or other amounts

There are many steps in the payment process for a card transaction. Funds are sent electronically from the issuing bank of the cardholder who purchased goods or services to an account maintained by the system for settlement purposes. This is done in response to a request for payment issued by the system after processing a day's worth of transactions for each participating acquirer; those transactions are the aggregate for the day for of all the merchants for which the acquirer processes and are not associated with any individual merchant or transaction. (In a separate processing stream, the issuer will receive the particulars of each transaction for each cardholder.) After the funds are wired to the system for settlement purposes, the system electronically sends the funds to each PSE/EPF which processes the transactions. Adjustments are made to the total for the day for any bank for any transaction that does not meet processing standards. The receiving bank adjusts its totals for each individual merchant to reflect these adjustments upstream, and also deducts from the amount due to a merchant its fee and any chargebacks registered but not for other items such as cashback which are due to the merchant. This number already has been adjusted for any returns. After all these procedures are observed the PSE/EPF initiates an electronic funds transfer to the merchant's account under standing instructions. The funds usually are sent to a bank account at the PSE/EPF or another financial institution. The amount of this electronic transfer of funds from the PSE/EPF to the merchant is the "gross proceeds" to be reported.

In other reporting sections of the Code, payors must report when the payee is "paid or credited," usually defined as when the funds leave the dominion and control of the payor and come within the dominion and control of the payee. It is this long-standing view of payment that we recommend to IRS under Section 6050W. The merchant has no access to the funds before they are electronically deposited into his account so reporting prior to this step would be inconsistent with long-standing IRS policy. After the funds are deposited in the merchant's account he has free access to them and therefore has been paid. Occasionally, the merchant may request that funds, which would otherwise be sent to his bank account, be retained in a security reserve required under the terms of his contract with the acquirer. These funds, diverted at the request of the merchant, to the reserve account maintained for his benefit, would also be considered paid to the merchant since he could have received the funds and then replenished his reserve but chose instead to cut out a step and send the funds directly to the reserve account. Whether deposited into his checking account or deposited to his reserve account, the funds have been "paid or credited" to the merchant.

IRPAC recommends that the amount to be reported is the amount "paid or credited" to the merchant. That is, at some point, the PSE/EPF initiates an

electronic payment for the merchant's benefit under standing instructions. The amount of any such transfer to, or at the direction of, the merchant, is the "gross proceeds" to be reported.

8. How to administer the reporting requirements so as to prevent reporting of the same transaction more than once

IRPAC appreciates and supports the IRS' need for data to perform its compliance functions. But reporting a single transaction multiple times will not improve compliance. It will add burden to those reporting and confuse the taxpayers receiving the multiple returns. This confusion will also increase the burden on IRS as it tries to sort out what has been duplicated, and what has not. IRS will also have to deal with increased taxpayer calls with questions about this duplication, and with an increase in inaccurate tax returns and amended return processing. This unnecessary confusion and increase in burden on all parties can be simply solved with a regulation that eliminates the duplication.

Section 6041 and 6041A apply only to those in a trade or business, for transactions of at least $600 in a calendar year, with exemptions for payments for merchandise and most corporations. Section 3402(t) applies only to payments by Federal State and some larger local governments, but applies to both goods and services without an exemption for corporations. Section 6050W applies to transactions by governments, those in a trade or business, as well as the vast consumer sector of the economy, and contains no exceptions for payments to corporations or for governmental entities. Because the scope of the reporting under Section 6050W is vastly broader than the other sections combined, it should be the primarily reporting requirement.

Every payment card transaction reported under Sections 6041, 6041A, and 3402(t) will be reported a second time under Section 6050W. This will create obvious confusion for taxpayers who receive two returns for one transaction. This will be further compounded by the fact that the duplication is limited to transactions done by payment cards, and will not include payments done by check. Merchants generally do not keep track of who pays them by what method. It is important that the confusion potential be addressed by eliminating any duplication between and among the mentioned sections of the Code.

. In addition to confusion over duplicative reporting, the existence of Section 6050W on one side, and Sections 6041, 6041A, and 3402(t) on the other raises the possibility of double withholding. If the duplication is not removed, a single transaction could result in up to 56 percent being withheld.[5] Removing the overlap between the provisions is necessary to avoid this unjust result.

[5] The maximum may be up to 62 percent as the rate for backup withholding will revert to its previous level of 31% as of 2011 unless Congress extends the current tax cuts. Since the current Administration has announced its intention to let those provisions expire, it is highly likely that by the time 6050W goes into effect the backup withholding rate will be 31 percent

Examples:

Example 1 - G, a federal government agency, pays A, a corporation, $10,000 by purchase card for services. Sections 6041, 3402(t) and 6050W all apply. If no TIN is provided, backup withholding will need to be done twice, under Sections 6050W and 6041/3406. If G has a TIN for A, but the party reporting under Section 6050W does not, there will be backup withholding under Section 6050W, and 3% withholding under Section 3402(t).

Example 2 - Same facts as #1, but now P, a large corporation, is making the payment. Section 6041 does not apply because A is a corporation. Section 3402(t) does not apply because P is not a government agency. Section 6050W applies.

Example 3 - Same facts as in #1, but now the payment is for less than $10,000. Under proposed regulations, Section 3402(t) no longer applies. Sections 6041 and 6050W apply with the potential for double withholding if no TIN is present.

Example 4 - Same facts as #1 but now the agency pays for goods, not services. Section 6041 will not apply. Sections 3402(t) and 6050W still apply with the potential for 3% and 28% withholding, respectively.

Example 5 - Same facts as #1, but now the agency pays by check instead of by card. Section 6050W will not apply. Sections 3402(t) and 6041 apply with the potential for 3% and 28% withholding, respectively.

Example 6 - Same facts as #2, but now P pays S, a sole proprietor. Section 3402(t) does not apply because P is not a government agency. Section 6041 applies because S is not a corporation. Section 6050W applies because the payment was by payment card. There is the potential for double backup withholding.

Example 7 - C, a consumer, pays anyone any amount by cash or check. No reporting is required.

Example 8 - Same facts but C now pays by payment card. Section 6050W applies along with backup withholding if no TIN is provided.

These examples demonstrate that all payment card transactions are reported under Section 6050W. Duplicate reporting occurs when either Section 6041 or 3402(t) also applies (or both apply). Duplicate withholding is also possible.

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once again. Because both 6041 and 650W could require the payor under Section 6041 and the PSE/EPF to withhold, the merchant could receive a mere 38 percent of the transaction.

We recommend that IRS provide in the regulations that any transaction reported under Section 6050W be exempt from reporting under all other Code sections. If Section 6050W does not apply to a transaction, then the payor would be required to report as under current law. The payor would easily know which transactions were conducted electronically versus those paid by check or cash as most, if not all, payors using cards for payments maintain separate systems for payments by check. A regulation excusing reporting under Sections 6041, 6041A, and 3402(t), where the transaction is reported under Section 6050W will ensure the broadest coverage without any duplication, thereby both providing IRS with the most expansive pool of information without confusing taxpayers with multiple reports of some transactions.

In addition to the above concern about overlapping provisions, there is concern in the health insurance industry about whether Section 6050W conflicts with the intent behind Section 6041(f) which was added in 2003 to override IRS Revenue Ruling 2003-43. Specifically, Section 6041(f) provides that no reporting is required under Section 6041 for payments for certain qualified medical services made through debit, credit and stored value cards. However, the same exclusion is not set forth in Section 6050W. The PSE/EPF has no way of knowing when a transaction is non-reportable under Section 6041(f) and can only report all transactions with a merchant. Therefore, IRS needs to clarify how these two provisions interact.

9. How to address differences between Section 6050W reporting and payee reporting on Forms 1040, 1065, or 1120, particularly when timing differences arise, for example, between calendar reporting years and fiscal taxable years, and the potential appropriateness of annual information returns from payment settlement entities that either segregate monthly "gross amounts" or reflect the taxable year of the participating payee.

Reporting on a cash/calendar year basis for all payees is a bedrock principle of information reporting. It has long been recognized both that individual payees may be using different fiscal years or the accrual method of accounting, and that the payor cannot know that information. It is impossible to maintain a system which would cater to each payee's tax return idiosyncrasies. Information reporting can be done only on a cash and calendar year basis. Federal government agencies have been reporting for over a decade payments to corporations; done on a cash/calendar year basis, these returns undoubtedly do not match to any line item on a corporate return filed on a fiscal/accrual basis. The terms for reporting under Section 6050W are similar and reporting should be the same, that is, on a cash and calendar year basis.

Section 6050W was adopted with the knowledge that such specific line item correlation with existing tax returns would not be possible given the current tax returns. If IRS desires to have line item correlation, they should revise the specific tax returns to provide for a line that reflects the amount reported under this section. That number then can be adjusted by the taxpayer for cashback paid

out to customers, chargebacks, returns, fees, as well as "normal" business expenses such as cost of goods sold, rent and other expenses, labor costs, etc. Congress intended that the reporting be of gross proceeds, and not taxable or other adjusted income.

10. What document retention and other verification requirements should apply to reporting entities and what information should be captured for purposes of substantiating the payments reported

    IRS should require of filers under Section 6050W only the same things required of other filers of other information returns: (1) retention of the information or the ability to re-create it for 3 years from later of the due date of the filing or actual filing date (4 years if any backup withholding is done.); and (2) voluntary, not mandatory, TIN matching. By adopting the suggested definition of gross proceeds, the PSE/EPF would "substantiate" any payments by showing records of the electronic funds transfers that occurred. No special recordkeeping should be required; PSE/EPFs should be held to a "normal business practice" standard of recordkeeping in computing and reporting the amount to the best of their ability.

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IRPAC appreciates this opportunity to provide these preliminary comments about the requirements and scope of information reporting with respect to new IRC section 6050W. We anticipate we will have additional comments to make over the new few months, and look forward to working with you on this important matter. If you have any questions, please contact the undersigned.

Sincerely,

Jon Lakritz
2009 Chairperson
IRPAC