

The IRS Merchants' Transactions Reporting Requirements:

What Is Known Today—and What Merchant Acquiring Entities and Merchants Can Do Now to Prepare for Compliance

Executive Summary

This communication is the first in a series of regular updates to our clients and partners on the impact of new IRS reporting requirements to become effective January 1, 2011. This document will provide an overview of the legislation, its potential impact and how First Data will respond over the coming months to implement the requirements. These first steps are in anticipation of the regulations to be issued by the Secretary of the Treasury within the next few months to clarify the requirements.

Introduction

Within last July's 700-page Housing and Economic Recovery Act of 2008 is an important new measure that requires "merchant acquiring entities" to report the gross amounts of their merchant customers' payment card transactions to the IRS. A "merchant acquiring entity" is defined as the bank or other organization contractually obligated to make payment to merchants in settlement of payment card transactions. These new requirements, which will apply to transactions beginning on January 1, 2011 (with required reporting and tax withholding to begin in 2012), have created some confusion and anxiety among both merchants and financial institutions.

What Is a Merchant Acquiring Entity?

The statute defines a "merchant acquiring entity" as the bank or other organization contractually obligated to make payment to merchants in settlement of payment card transactions. These entities must report the gross amounts of their merchant customers' payment card transactions to the IRS.

Overview of the Legislation

The Housing and Economic Recovery Act of 2008 contains new payment transaction reporting requirements intended to help the IRS identify underreported sales. This is to be done through third-party corroboration of the amount of a merchant's credit card, debit card, gift card (open loop only) and eCommerce (such as PayPal or Bill Me Later) transactions. At the end of the year, the reporting entity (i.e., the "merchant acquiring entity") will file an information return with the IRS reporting the gross amount of that merchant's transactions for the year and will provide a corresponding written statement to the merchant.

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The new reporting law—which was vigorously opposed by business associations, banks, industry associations and First Data before it was ultimately signed into law—also requires the reporting entity to collect and verify the tax identification number (TIN) and the information (legal name and address) associated with that number for its merchant customers. If a merchant fails to provide its TIN or if there is a discrepancy between the merchant's TIN and the associated information in the reporting entity's records and the IRS' records, the reporting entity will be required to withhold 28 percent of the merchant's future payment card transactions until the issue is resolved. This withholding provision goes into effect for transactions starting in 2012 (unlike the reporting provisions of the legislation which apply to transactions beginning on January 1, 2011).

Resulting Requirements for Reporting Entities and Merchants

Reporting Entities

- Reporting entities must collect and verify the TINs and associated legal names and addresses of their merchant customers
- Beginning with the 2011 tax year, reporting entities are responsible for filing individual information returns (presumably a Form 1099) reporting the total annual dollar amount of payment card transactions for each of their merchant customers. In January 2012, reporting entities will file the information return with the IRS and distribute a corresponding statement for the 2011 tax year to each merchant
- Beginning in 2012, reporting entities must withhold 28 percent of payment card transactions for any merchant whose TIN/name combination used by the reporting entity does not match the merchant's information on file with the IRS

Merchants

- Merchants must ensure that their TIN/name combination on file with the IRS matches the information held by the reporting entity for their payment card transactions
- When merchants receive copies of the information returns filed by their reporting entities each year, merchants should compare that information with their own records to validate the accuracy of the information

Merchants: Advice on TINs

Depending on your situation, you will need either a TIN (Tax Identification Number) or an EIN (Employer Identification Number). To best determine which you will need or to confirm your TIN or EIN, visit the IRS Web site at <http://www.irs.gov/> and go to the section on TINs

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First Data Actions

A First Data team with members from all business units and operational areas is in place to manage the process of ensuring we are ready for all changes required by the new law. Ensuring our compliance is one of the first steps we can take to help our customers understand their needs and responsibilities. The team, which will report statuses to First Data's Executive Committee on a regular basis, is currently focusing on the following areas of the law:

Task	Targeted Completion of Task
TIN Matching and Validation	
→ Run Batch File Validation tests to assess Masterfile and TIN field validity	4/30/09 to 6/30/09
→ Finalize and implement an IRS Batch File validation process	1/31/10
→ Considering launch of a First Data Web-based tool for merchant TIN/name validation/attestation	1/31/10 to communicate a potential plan
→ Developing a toll-free voice response unit—a First Data Customer Service line—prompting for merchant validation/attestation	02/28/10
New Account Processes – TIN/name validation	TBD
Information return/statement creation and delivery to IRS/merchants and retention/retrieval requirements	TBD
Tax Withholding – process for reconciliation and handling of customer inquiries	TBD

As noted above, this is the first in our series of regular communications regarding timelines, expected milestones and client impact assessments. In addition, look for First Data-sponsored webinars and client Web sites for information.

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Conclusion

The new IRS reporting requirements will undoubtedly create apprehension and operational challenges for both merchants and reporting entities. Both parties can minimize frustrations by making the necessary preparations to comply with the law as its requirements are understood today, well in advance of the law's effective date.

First Data will continue to be a resource for merchants and financial institutions to help them understand responsibilities as details of the regulations become clearer. Additionally, we are committed to collaborating with our partners and customers in compliance implementation.

So, while the new IRS requirements may be intimidating, compliance will be manageable if all impacted parties make time to understand the provisions as they are outlined today, identify responsibilities and plan strategies. It's just as important to remain alert, through research and communications, for future clarifications regarding compliance.

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