New tax form for retailers receiving credit card payments

By William A. Kastin and Mark A. Ziemba

Life's experiences all begin with a memorable "first." Remember, the first time you took the car out for a spin after receiving your driver's license? How about the first time you went to a music concert or ball game? Although less enjoyable, but equally as memorable, what about the first time you prepared or reviewed your first tax return? Arguably in an effort to build upon life's experiences, beginning in 2012, many merchants, restaurants, retailers and other businesses, including on-line sellers, each of whom accept payment by credit card or similar electronic payment, including Paypal, are about to enjoy a new "first" – the receipt of their first Internal Revenue Servvice Form 1099-K, Merchant Card and Third Party Network Payments.

Retailers who accept credit cards and similar electronic payments (collectively referred to as "credit card receivables") already have an established relationship with their "merchant acquirer" – that is, the bank or other organization that is contractually obligated to pay the retailer in settlement of the retailer's credit card receivables. Beginning in 2012, merchant acquirers will be required to issue a Form 1099-K with respect to each of their retailer-clients who, for the calendar year, have a gross amount of credit card receivables exceeding $20,000 and have over 200 transactions giving rise to credit card receivables.

The form will indicate how much the retailer has received in credit card receivables for both the calendar year and on a month-by-month basis. In preparation, retailers should be considering the following three issues:

First, if you don't already have one (and you probably do), you should obtain an employer identification number (EIN) from the IRS. Obtaining an EIN is as easy as filling out IRS Form SS-4 or applying online on the IRS' Web site. If you fail to provide your merchant acquirer with your EIN, then your merchant acquirer will be required to deduct and withhold an amount equal to 28 percent of the payments reportable on the Form 1099-K, commonly referred to as "backup withholding."

Second, if you don't already do so (and you probably do), you should maintain detailed and organized sales records, including information relating to your costs of goods sold, returns and charge backs, refunds, rebates and processing fees.

Third, upon receipt, carefully review the Form 1099-K to confirm that it is consistent with your records. It is best to identify any inconsistencies between your records and the information contained in the Form 1099-K as early as possible. During your review, keep in mind that the form sets forth the [gross] amount of all credit card receivables determined on the date of each transaction (i.e., the total dollar amount without regard to any adjustments for credits, discounts, rebates, fees, refunds or similar offsets). Thus, it is expected that the gross amount set forth in the form, which is determined on the date of the retailer's sales transaction, will [not] equal the retailer's net taxable income arising from credit card receivables for the year and may even differ from the amount determined on the date of the payment to the retailer from its merchant acquirer. The IRS has acknowledged that the information reported on the form is not intended to be an exact match of the net, taxable or even gross income of a retailer. Therefore, standing alone, any such discrepancy is not expected to result in an automatic audit.

Merchant acquirers responsible for issuing the Form 1099-K are similarly preparing to comply with their obligations under the new rules and are likely to be willing to work with their retailer-clients with respect to any questions that may arise. The new rules impose substantial reporting requirements on merchant acquirers. For example, merchant acquirers will be required to keep at least two sets of records: one identifying the amounts generated by their retailer-clients on the date of the respective transactions, which amounts are reported on the Form 1099-K, and another identifying the amounts actually payable to the retailer on the settlement date.

Also, merchant acquirers will need to deal with special procedures when dealing with retailer-clients that are commonly owned by a single franchisor. In such cases, the merchant acquirer must separately track the transactions of each independently-owned franchise store, and, depending on whether the franchise-owner or retailer are paid by the merchant acquirer, be prepared to adjust the manner in which the Forms 1099-K are issued.

In addition to giving retailers a new "first," the Form 1099-K will likely serve as an additional tool in tax audits by the IRS. Even though the gross amount reported on the form will not equal the retailer's net taxable income, the form will likely serve as a useful starting point from which the IRS can commence its investigation. As indicated above, in such a case, the retailer's comprehensive records detailing any offsets and charge backs will be critical.

From a technical perspective, retailers who already report to the IRS all of their taxable income arising from their credit card receivables will have few problems with receiving the new form – a copy of which will be sent by the merchant acquirer to the IRS, and a copy of which the retailer must include when filing its tax return. However, as a practical matter, retailers are bracing themselves for the inevitable increase in processing fees to cover the costs incurred by merchant acquirers as they begin to prepare for the massive endeavor of complying with these information reporting rules for all their retailer-clients.

If you are curious about how to best prepare for the new Form 1099-K reporting regime, or any potential audits in the future, then you should consult with a competent tax advisor.

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