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A SPECIAL K

While we won the battle of the infamous Form 1099 expansion repeal AND we won the battle of the government contractor withholding requirement repeal, you may recall the tax gap closing proponents did win one too (actually a couple). President Bush signed a housing stimulus bill into law as Public Law 110-289 on July 30, 2008. The law included a revenue offset to require credit and debit card payment settlement entities to report the gross receipts of the transactions they process each year for "participating payees." The effective date for the reporting was for years beginning after December 31, 2010. That means transactions in 2011 were covered. If you accept credit or debit cards for payment, your card processor will be sending you a Form 1099 K this month.

This new Form 1099-K will be issued to "participating payees." Basically, a participating payee is anyone who accepts credit or debit cards for payment. There is a de minimis threshold. The payment settlement entity must issue a report only if the participating payee has more than $20,000 in processed receipts and more than 200 transactions.

The law requires "payment settlement entities" to report to the IRS an annual dollar figure of the credit/debit receipts they process for any and each "participating payee." VISA and MasterCard are payment settlement entities but it appears the elaborate definitions of the new law cover just about every type of electronic payment system in existence.

The report will be issued in January for the previous calendar year transactions. To deal with the fact a payee may be on a different tax year, the new Form 1099-K requires the amounts to be reported for each month.

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 does not include fees, charge-back or other costs and refunded amounts.

As noted above, a copy of the report by the payment settlement entities will also be sent to the participating payee by January 31st. The obligation for the participating payee is the same as with other Form 1099s, to reconcile the taxpayer's records with the information report. As a result, generally, there is no immediate tax penalty consequence for the taxpayer. If the taxpayer is later audited and the amounts do not match, then the problems begin.

There is one other flash point with this new paperwork requirement. Before the payment settlement entities can report gross receipts they need the Tax Identification Numbers (TINs) of their "participating payees." Employer Identification Numbers and Social Security Numbers serve as TINs. In order to "facilitate" the collection of TINs, the new law invoked an existing withholding penalty provision that "encourages" businesses to provide their TINs when requested. In this case, it requires the payment settlement entities to withhold 28 percent of the gross receipts until they have obtained an accurate TIN. Needless to say, if a payment settlement entity with whom you do business asks for your TIN, you will want to provide it.

As noted above, the program takes effect for calendar year 2011 transactions. However, the backup withholding requirement takes effect for receipts received in 2013 so there is still time to make sure your card processor has your TIN, if they need it.

AND THE STORY IS NOT OVER

Let’s hope they have learned a lesson. The last time the Internal Revenue Service (IRS) released a report on the tax gap, we met with them and other proponents in Administrations (yep, plural) and on the Hill to explain to them the deficiencies in the report and the problems with the proposed solutions. Didn’t stop them from trying to implement their proposed solutions. Turns out we were spot on with most of our observations.

Guess what?

The IRS has issued a new tax gap report and they say it is growing. The original report was issued in 2001 and the new figures are for 2006. (Yes, as is ever the case, tax statistics lag mightily. Hard to believe we are trying to make tax policy in 2012 based on 2006 data). Under-reporting across taxpayer categories accounted for an estimated $376 billion of the gross tax gap in 2006, up from $285 billion in 2001. Tax non-filing accounted for $28 billion in 2006, up from $27 billion in 2001. Underpayment of tax increased to $46 billion, up from $33 billion in the previous study.

The good news is that while the “gap” increased, no more of us fell off the compliance bandwagon. The IRS concedes the voluntary compliance rate, the percentage of total tax revenues paid on a timely basis, for tax year 2006 is estimated to be 83.1 percent. In the words of the IRS, “The voluntary compliance rate for 2006 is statistically unchanged from the most recent prior estimate of 83.7 percent calculated for tax year 2001.” This has been one of our arguments all along, how realistic is to expect us to move the compliance needle. If memory serves me correctly, this percentage has been relatively stable for decades.

Business income underreported by individuals (primarily Schedule C filers) is one of the biggest chunks of the gap according to the IRS. At this point, we do not know of any new proposals to close the gap but we will mind the gap.