

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

Whenever a payment settlement entity contracts with a third party, such as an electronic payment facilitator, to submit instructions to transfer funds to the account of the participating merchant in settlement of reportable payment transactions, reporting is required by the third party. The third-party need not have any agreement or arrangement with the participating merchant and the payment need not come from the third-party's account in order to trigger reporting. Two examples of entities that could be an electronic payment facilitator are:

- A processor who processes transactions for a merchant acquiring bank and submits instructions to transfer funds to payee's account but does not have a contractual obligation to pay the merchant.
- A sponsoring bank that submits the instructions to transfer funds to an ACH network on the processor's or merchant acquiring bank's behalf.

What is a Merchant Category Code (MCC)?

A Merchant Category Code (MCC) is a four-digit number used by the card payments industry to classify payees. The IRS reporting requirement specifies the reporting of MCC's according to bankcard industry standard definitions. There are approximately 600 MCCs representing different types of businesses (e.g. 4411 – Cruise Lines, 5462 – Bakeries, 5532 – Automotive Tire Stores). If a reporting entity or its processor employs an industry classification system other than or in addition to MCCs, the reporting entity should assign to each payee an MCC which most closely corresponds to the description of the payee's business.

What should be reported if a merchant has receipts classified under more than one MCC?

For 2011, if a merchant has receipts classified under more than one MCC, the reporting entity may either:

- File separate Forms 1099-K reporting the gross receipts attributable to each MCC, or
- File a single Form 1099-K reporting total gross receipts and the MCC which corresponds to the largest portion of total gross receipts.

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.

Does a third party settlement organization have to report MCC Codes?

No. Third-party settlement organizations do not use MCC codes to classify payees. Box 2 on the Form 1099-K should not be completed by third-party settlement organizations.

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, health-care networks do not qualify as third-party settlement organizations.

Likewise, an in-house accounts-payable department is not a third-party 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.

Can the entity responsible for filing Form 1099-K contract with a third-party to pre-prepare and file these returns?

Yes. However, the entity responsible for filing (i.e., the entity that submits the instructions to transfer funds) is liable for any applicable penalties under sections 6721 and 6722 if the reporting requirements are not met. In addition, the name, address, and Taxpayer Identification Number of the entity responsible for filing must be reported on the Form 1099-K in the box for Filer's.

Will the IRS assert penalties for inaccurate data submitted on the 1099-K?

The IRS is granting penalty relief. See IR Notice 2011-89 which will be published in Internal Revenue Bulletin 2011-46 dated Nov. 14, 2011. The Notice is also available on our website (www.irs.gov).

Is the IRS considering any relief from back-up withholding?

The IRS is providing relief from back-up withholding. See IR Notice 2011-88 which will be published in Internal Revenue Bulletin 2011-46 dated Nov. 14, 2011. The Notice is also available on this website.

For more information go to the Third Party Reporting Information Center.