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eBay sellers face tax issues

Payment card reporting under the American Housing Rescue and Foreclosure Prevention Act of 2008

The American Housing Rescue and Foreclosure Prevention Act of 2008 (Act) was signed into law on July 30, 2008, as part of a comprehensive response to the U.S. mortgage crisis. A section of the Act requires that, beginning in 2011, merchant acquiring banks as well as third-party payment card processors and certain other settlement organizations must annually report the total amount of debit and/or credit card transactions of individual merchants to the Internal Revenue Service (IRS) and to the merchants. In certain cases, the reporting entity will also have to impose backup withholding on settlements with merchants.

Smart Business asked Zahara Alarakhia, a partner of the Corporate Transactions and Securities Practice Group at Munck Carter, LLP, about the effects that the Act will have on the acquiring industry.



Zahara Alarakhia

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Who is subject to the reporting requirement?

The new law requires information reporting of merchants that accept debit and/or credit card transactions or that accept payments from a third-party settlement organization (PayPal, Google Checkout, etc.). The requirement will not apply to those merchants selling less than \$20,000 and effecting less than 200 transactions per year. The purpose of including all third-party settlement organizations was primarily designed to target online sales players. For instance, if an eBay power seller makes more than \$20,000 in a given year through 200 or more transactions, the IRS will receive information about their sales. The IRS intends to use this information to investigate the possible underreporting of the merchant's income.

Who must report?

The payment settlement entity will bear the burden of this reporting requirement. In most cases involving debit or credit card transactions, this entity will be a bank that is a member of the Visa/MasterCard association and that also contracts with merchants to act as an acquiring institution for their debit and credit card transactions. However, many banks outsource the actual processing function to third-party entities. These third-party payment card processors are also now responsible for payment reporting. With

respect to third-party network transactions, the third-party settlement organization that facilitates these transactions would be responsible for payment reporting. For example, eBay would be a third-party payment network and PayPal would be a third-party settlement organization with the reporting requirement.

What merchant information must be reported?

The payment settlement entity must report the gross amount of each reportable transaction paid to a merchant, along with the name, address and taxpayer identification number (TIN) of the merchant. A reportable transaction includes any payment card transaction (debit/credit card), regardless of whether the card is physically present, and any third-party network transaction.

What are some of the potential compliance problems with the new law?

One potential compliance problem is linking the merchant's TIN to its merchant

identification number (MID). Currently, most acquiring banks and payment card processors verify the TIN of a merchant when an account is established. The TIN is then deleted and an internal merchant identifier is assigned to the account. However, multiple MIDs are often issued for merchants with multiple locations or branches. The new law requires that these many MIDs be linked to a single TIN. This not only increases the complexity and cost of compliance for acquiring banks and third-party card processors, but it also raises the likelihood of errors caused by mismatched merchant transactions with TINs.

Another potential compliance problem would be matching merchant payments with the correct TINs. Some business entities have legal names but operate and advertise under different names. For example, taxpaying sole proprietor 'John Smith' has a business called 'ABC Landscaping.' Reconciling the merchant payment to the correct name and TIN could result in inaccurate reporting and subsequent legal and bookkeeping problems for both the acquiring bank or card processor and the merchant.

What actions should the acquiring industry consider before the reporting requirement goes into effect on December 31, 2010?

There are many details not clearly spelled out in the new law, such as how the law will be enforced and what penalties will apply in cases of noncompliance. The Treasury Department will probably address these and other issues in a set of regulations. In the meantime, acquiring banks and card processors will need to train staff on the new reporting requirements, modify or replace technology systems in order to accurately reconcile annual electronic receipts figures calculated by the bank or processor and the merchants, verify correct TINs, and consider merging separately stored TINs and MIDs, especially in the case of multiple locations or franchises. <<

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