

New IRS section 6050W: What it is, how it affects attorneys

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Editor's Note: The following article is reprinted courtesy of Law Pay Credit Card Processing and author Amy Porter. Originally published in 2011 for the 2012 tax year, it was submitted by the Office of Lawyers Professional Responsibility as a refresher course, and the office also emphasizes the content toward the end of the story, in the section "Painful Penalty," which addresses changes effective in 2013.

It is estimated there are over 10,000 credit card transactions made every second around the world. This astonishing number results in over \$7.5 trillion in credit card payments per year, according to the American Bankers Association. If you are one of the lucky businesses processing these transactions, congratulations: You are now subject to the newest IRS requirement — section 6050W.

What is 6050W?

Section 3091(a) of the Housing Assistance Tax Act of 2008 added section 6050W to the code requiring merchant acquiring entities and third-party settlement organizations to file an information return for each calendar year, reporting all payment card transactions and third-party network transactions with participating payees occurring in that calendar year. It was created in an effort to further reduce the estimated \$345 billion tax gap from the business sector by providing additional information to the IRS on aggregate credit card transactions.

Effective January 2012, all credit card processors (i.e., LawPay, First Data, TSYS, etc.) and third-party payment aggregators (PayPal & Square) will be required to report gross card transactions to the IRS. This means the gross dollar amount of all transactions will be reported on a special 1099-K, regardless of returns or any processing fee deductions.

The federal regulations state, "The amount to be reported to the IRS with respect to each lawyer is the total gross amount of all of the transactions made for that lawyer in the calendar year."

The preamble to the final regulations under section 6050W makes clear that the amount reported is to be the total gross amount "without regard to any adjustments for credits, cash equivalents, discount amounts, fees, refunded amounts or any other amounts."

The regs continue, “Commentators on the final regulations had suggested defining ‘gross amount’ as net sales, taking into account credit transactions, chargebacks and other adjustments, on the ground that gross amount is not a true indicator of revenue.” The Treasury rejected these suggestions because “the information reported on the return required under these regulations is not intended to be an exact match of the net, taxable or even the gross income of a payee.”

What about my IOLTA?

In the case of attorneys, section 6050W does not make a distinction between credit card transaction deposits made to a trust or IOLTA bank account and an attorney’s operating bank account. This has many attorneys concerned the IRS will view these transactions incorrectly as income. However, there are two important items to note:

1. The new 1099-K is only intended to be “informational.”
2. Your processor should include a merchant industry code on your 1099-K identifying you as a law firm or provider of legal services.

The reporting requirements under section 6050W require credit card processors to report to the IRS on Form 1099-K the total gross amount of payment card transactions processed for each client over the calendar year, without reduction to account for amounts deposited into IOLTAs.

Although there are few instructions from the IRS informing taxpayers on how to account for discrepancies between 1099-Ks issued to them and amounts reported on the taxpayer’s return, it is clear that the IRS does not intend the Form 1099-K to match net, taxable or even gross income. Thus, the amount shown on the Form 1099-K will not in all instances be required to be reported as income.

Match or Mis-Match?

In addition to the gross volume reporting, section 6050W also requires processors to verify and match your federal tax ID and legal name to IRS records. 6050W requires an exact match on both items to file your 1099-K correctly.

Due to technology limitations with most Visa & MasterCard processors, merchant statements are usually limited to only 25-35 characters. As such, many law firm merchants have either abbreviated their name or used an acronym for their merchant account. If this is the case, you will need to contact your processor to assure that your legal name on your merchant exactly matches the legal name you use to file your tax

returns (at least within the maximum number of characters provided by your merchant processor).

Painful Penalty

First, the good news: Originally set to begin January 2012, the IRS has decided to use the 2011 tax year as a “trial run” for reporting on 1099-Ks. Due to system and reporting limitations with both the IRS and virtually all card processors, the timeline for matching legal names and TINs has been extended until the 2012 tax year. The bad news however, is beginning January 2013, the IRS will impose a 28 percent withholding penalty on all credit card transactions if the merchant information on file is not an exact match with their records. It is still unclear what steps merchants will need to take to reclaim held funds, even if the legal name and TIN information is corrected.

Due to the steep withholding penalty, it is imperative that you confirm the information on your 1099-K this year. If you have not yet received a 1099-K from your processor, call and request a copy. All 1099-Ks should have been sent out in late January for a “trial run.” You will notice there is nothing further that needs to be done for the current 2011 tax year.

Fees for 6050W?

It seems anytime the IRS changes a policy or tax requirement, a new fee is created by the banking institutions to reclaim their own costs. As a merchant, you will be happy to know Section 6050W specifically states processors may not charge for implementing the 1099-K process. Beware of new 6050W charges disguised as “Government Fees” or “Tin-Matching Fees” that may have been recently added to your merchant account.

No Need for Alarm

The intent of Section 6050W is to assist the IRS in identifying businesses not filing accurate tax returns. In other words, the IRS appears to be targeting businesses most likely to omit or avoid reporting correct tax information.

Requiring a taxpayer to account for discrepancies between amounts reported on Form 1099-K and the taxpayer’s return would be consistent with reporting on Form 1099-Misc. In the case of Form 1099-Misc, a taxpayer reporting business income on Form 1040 reports only amounts that are “properly shown” on the 1099-Misc. In the case of deviations, the taxpayer is instructed to “attach a statement explaining the difference” (See 2010 Instructions for Schedule C: Profit or Loss From Business). Thus, it would be consistent with IRS policy in other areas to similarly require a taxpayer

reporting a return amount different from the amount shown on Form 1099-K to attach a statement showing the reason for the difference. In the case of a lawyer depositing amounts into an IOLTA, the statement would show the amount of such deposits over the year which is excludable from gross income.

Fortunately, the IRS has recently provided guidance for the 2011 tax filing year through a notice to Tax Filers dated January 31, 2012 entitled "Clarification to the instructions for Schedule C, E & F on Reporting 1099-K Amounts."

Not only has the requirement to report the amounts of Gross Credit Card Transactions been deferred for the tax Year 2011, there are other indications that the IRS may NOT require small business tax filers to reconcile the differences between 1099-K amount and income for future tax years.

Lastly, if come January 2013, you have still not matched your legal name and TIN with your processor, my advice is to stop accepting credit cards until you verify your legal name and federal Tax ID names match. There is no reason to risk a 28% withholding penalty when it is so easily avoidable. While LawPay is taking a very proactive approach to these new rules from the IRS by validating all Attorney Merchants, not every processor is following suit. Don't wait for your credit card processor to contact you! The IRS has assigned the reporting requirements on the credit card processors, but the ultimate liability lies squarely with you and your firm.