

# Purchasing Cards and IRS Requirements

**A Look at the Issues**



# Executive Summary

Businesses that use purchasing cards must meet certain Internal Revenue Service (IRS) information reporting, withholding, and payee documentation requirements. These include:

- ▶ Obtaining a merchant's name, address, and Taxpayer Identification Number (TIN) before payment is made
- ▶ Backup withholding 31 percent if this information is not on hand
- ▶ Filing Forms 1099-MISC at year-end to report payments made to merchants for services.

These reporting requirements have been applied to check payment and invoice transactions for the past 50 years. In the 1980s, Congress added the TIN solicitation requirements, and three years ago Congress added the requirement that federal government agencies report payments made to all types of corporations.

These IRS regulations impose certain challenges to the client who has implemented a purchasing card program. For example, a cardholder cannot backup withhold on a credit card payment, and a credit card transaction does not contain all the information necessary to file a Form 1099-MISC.

Visa has been working with the IRS to develop less cumbersome rules for users of the Visa Purchasing card ("Visa Purchasing"). Visa's recommendations to the IRS include the following suggestions:

- ▶ Permit Visa to collect and maintain a database of merchant information (name, address, TIN, incorporation status code) which Visa would share with Visa Purchasing Issuers and their clients;
- ▶ Relieve Visa Purchasing clients of any penalties associated with possible incorrect information provided by Visa;
- ▶ Provide an exception from backup withholding rules for Visa Purchasing clients; and
- ▶ Permit Visa Purchasing clients to rely on the Merchant Category Code (MCC) to determine whether a Visa Purchasing card transaction is for merchandise or service.

The IRS is receptive to these recommendations and has taken initial steps to generate appropriate guidance to the credit card industry. Final action is not expected until 2001, at the earliest. Until the IRS officially rules, companies using purchasing cards may decide to:

- ▶ Rely on the Visa database (“Visa Merchant Profile Database”) to obtain data on most of its merchants;
- ▶ Independently seek merchant information where necessary; and
- ▶ Use the MCC to determine if the transaction pertains to merchandise or services.

The following is a more detailed look at IRS regulations, how they impact clients using purchasing cards, and how the Visa Merchant Profile Database can be a helpful tool in managing and meeting the IRS regulations.

## Introduction

Businesses that use purchasing cards to pay for services are subject to the same IRS information reporting requirements as those faced by businesses that use the traditional invoice and check method of payment. For the past several years, Visa has been leading a joint IRS/bankcard industry initiative to review and modify those requirements so they function more efficiently in a purchasing card environment. This paper discusses those requirements, Visa's efforts, and the choices available to purchasing card users today.

## Background

Since World War II, the IRS has required businesses to report amounts paid to workers for services provided. Under the law, if the individual is an employee, a Form W-2 must be filed; if the individual is an independent contractor, a Form 1099-MISC must be filed. The regulations provide some exceptions, such as for merchandise transactions and for payments to non-incorporated service providers (for non-federal government agencies). For the most part, regulations governing information reporting for non-employee payments have remained unchanged since the late 1950s through the mid-1980s. Since the mid-1980s, the IRS has added a few additional requirements to the Form 1099-MISC regulations. These requirements include an obligation to obtain and report the payee's TIN on Form 1099-MISC filings, and in certain situations to backup withhold and remit to the IRS 31 percent of the payments made.

Forms 1099-MISC are required to be filed by businesses of all types and sizes - from small independent operations to "Fortune 500" corporations. For 1995, over 4 million filers sent almost 95 million such forms.

The rules for filing apply equally to all transactions, regardless of the type of payment - cash, check, electronic funds transfer, or card. What follows is a discussion of the requirements to report payments on the Form 1099-MISC to independent contractors that are non-incorporated service providers. This discussion reviews the subject both generally and in the context of purchasing cards.

## Overview of IRS Requirements

Filing Form 1099-MISC is required when:

- ▶ A payment is made in the course of a "trade or business";
- ▶ The payment is made for any type of non-employee compensation, including services, commissions, director's fees, royalties, prizes and awards, and rent; and
- ▶ The total payments amount to at least \$600 in a calendar year.

Exceptions are provided for payments made to: 1) non-medical or non-health care service providers and 2) non-legal organizations.

### **Trade or Business Concept**

A purchasing card payment easily meets these requirements. Clients utilizing a purchasing card to make payments are clearly in a trade or business. This requirement is what saves the average individual from having to report. For example, a payment to a plumber who fixes an individual homeowner's water heater does not require a Form 1099-MISC filing. The homeowner who pays the plumber is not in a trade or business with respect to his home.

### **Services**

The IRS regulations narrow the very broad statute (Internal Revenue Code §6041) by eliminating any need to report payments for merchandise. However, to simplify things for the payor, if the payor makes a payment for both service and merchandise together, the IRS instructs the payor to report the gross amount. If the payor makes separate payments for service and merchandise, the IRS requires the payor to report the service amount but not the merchandise amount. These regulations also relieve the payor from reporting expense reimbursement payments made to independent contractors who properly account for such expenses.

### **Corporations**

The IRS regulations provide an exception from the reporting requirements for payments made to corporations (except medical and legal corporations). A "company" is not a corporation. A corporation is an entity that has contained in its name either "corporation", "incorporated", "Corp.", or "Inc.". A Limited Liability Company may be treated as a corporation if it makes that election. However, a business with just "company", "Co.", or "Ltd." in its name cannot be assumed to be a corporation unless it is an insurance or assurance company. Sole proprietorships and partnerships are not corporations, although they may use "Company" in their names. Payments to such sole proprietorships and partnerships are reportable.

Service payments to medical and legal corporations are reportable unless the payee is a governmental hospital or extended care facility. Beginning in 1998, federal agencies must report payments to all types of corporations. For other payors, the exception from reporting requirements for payments to non-legal and non-medical corporations continues in effect.

There is no reporting requirement if the total payments for all services for the entire calendar year are less than \$600. All service payments, regardless of the method of payment, should be aggregated to determine whether the minimum threshold for reporting has been reached. As a result, if a payor pays a merchant \$400 through

purchasing card transactions and another \$300 through a check/invoice payment, the total of \$700 must be reported on Form 1099-MISC.

## **Tax IDs**

If the total payments are reportable, the payor must obtain and report the payee's TIN on Form 1099-MISC. The payor must obtain the TIN before making the payment, or backup withholding applies (see Backup Withholding section). There are five types of TINs:

- ▶ A Social Security Number (SSN) for U.S. individuals and sole proprietorships
- ▶ An Employer Identification Number (EIN) for non-individuals, such as corporations, partnerships, and associations
- ▶ An Individual Taxpayer Identification Number (ITIN) for non-U.S. individuals who do not qualify for a Social Security Number
- ▶ An Adoption Taxpayer Identification Number (ATIN) for children in the process of being adopted
- ▶ A Preparer Taxpayer Identification Number (PTIN) for use by preparers of income tax returns

A merchant may provide a SSN or EIN, depending on the circumstances, but does not generally provide any of the other TIN types. For example, a merchant would not have an ATIN, because it is not a child, nor an ITIN, because if it were a business, the owner(s) would qualify for a SSN or EIN. Though a merchant may have a PTIN, in addition to an EIN or SSN, use of a PTIN is restricted and may not be used in the purchasing card reporting context.

In all cases except the PTIN, the TIN format consists of nine numbers with no alpha characters. A PTIN is recognizable because it consists of the letter "P" followed by eight numbers.

A sole proprietorship may have an EIN. The IRS prefers that the payor use the sole proprietor's SSN, but the EIN is acceptable. The sole proprietor's individual name—not the business name—needs to be reported on Form 1099-MISC, regardless of whether a SSN or EIN is used.

The payor may obtain the actual TIN orally or in writing. The IRS has defined rules that apply to either method of collection. The payor must use a TIN certification form, IRS Form W-9, only if the IRS informs the payor that the TIN previously reported for a payee on Form 1099-MISC is incorrect.

## **Backup Withholding**

The payor must withhold 31 percent of the payment amount if the payor does not have the payee's TIN at the time of payment. This process is called backup withholding. The same rules that govern the payor's payroll department for depositing withheld wages also govern deposits for backup withholding. However, backup withholding and wages should be deposited separately. The resulting backup withholding liabilities must be reported annually on IRS Form 945.

If a payor does not backup withhold when required, it is liable for the withholding unless it receives an affidavit (IRS Form 4669) from the payee that the payment was included in the payee's tax return for the year of payment. In addition, the IRS can impose penalties for failure to withhold. Deposit penalties can range from 2 to 15 percent of the required deposit amount, depending on how late the deposit is.

## **Payee Statement**

Every January, by January 31, the payor must send the payee a statement reporting the service payments made during the previous calendar year and any backup withholding that was done. Forms sent to the payee may be either the official IRS Form 1099-MISC or a qualified substitute. Refer the IRS Publication 1179 for details about data and formatting requirements for substitute forms.

## **IRS Filing**

By February 28, the payor must send the same information to the IRS; however, if the filing with the IRS is done electronically (as opposed to on paper or by use of magnetic tape, diskette, or cartridge), then the file is due at the IRS by March 31.

The IRS permits the use of paper Forms 1099-MISC when filing with the agency if there are fewer than 250 returns. If filing is done on paper, the IRS requires the use of the official Form 1099-MISC. If a single payor needs to file more than 250 forms, the IRS requires that magnetic or electronic format (tape, diskette, cartridge, or electronic transmission) be used. See IRS Publication 1220 for the detailed requirements on how to file information returns with the IRS.

The IRS routinely grants a 30-day extension to file Form 1099-MISC with the government. To obtain an extension, the payor should submit IRS Form 8809 before the February 28 due date.

Extensions of time to file payee statements are also available. A payor can seek an extension by sending a letter to the IRS explaining the significant and uncontrollable factors that caused the delay. An extension of up to 30 days may be granted. The procedure for obtaining an extension of time for filing with the IRS or with the payee is described in IRS Publication 1220.

In order to qualify for a possible reduced penalty (see below), the IRS requires the payor to file corrections to any Forms 1099-MISC submitted in error within 30 days of discovering the error. The amount of the reduced penalty depends on when the corrections are filed.

## **Penalties**

The IRS may impose a \$50 per return penalty for any unintentional error in filing Forms 1099-MISC. The possible filing errors for Forms 1099-MISC include: filing late, filing with an incorrect TIN, filing in the incorrect format (paper versus electronic), filing with incorrect dollar amounts, or not filing at all. The maximum penalty is \$250,000 per year per payor for unintentional errors.

Filing errors corrected by August 1 may reduce the penalty to \$30 per return (\$150,000 maximum per year per payor).

Filing errors corrected before August 1 and within 30 days of the filing due date, including any extensions, may reduce the penalty to \$15 per return (\$75,000 maximum per year per payor).

Unintentional errors in filing the payee statements are separately punishable at a rate of \$50 per return (\$100,000 maximum per year per payor).

The IRS penalizes more severely any errors due to intentional disregard of the filing requirements by the payor. The penalties can be increased to either \$100 per return or 10 percent of the amount that the payor failed to properly report, whichever is greater, with no maximum. This standard applies to both the returns filed with the IRS and to the statement sent to the payee.

The IRS monitors errors committed by Forms 1099-MISC filers and sends penalty notices out each year. A payor receiving a penalty notice may dispute the assessment under the “reasonable cause” standard. See IRS Publication 1586 for details about the penalty program and the process to protest any assessed penalty.

## **B Notices**

The IRS matches the Forms 1099-MISC it receives against its master file. The IRS sends the payor a notice of invalid TIN if the name and TIN combination reported on the Form does not match the IRS records. The IRS calls this a “B Notice”.

When a payor receives a B Notice, it must contact the payee for correct information using IRS Form W-9 and a letter prescribed by the IRS. If the payee does not respond within 30 business days from the date on the original notice from the IRS to the payor, the payor must backup withhold on any future payments to that payee. Backup withholding continues until the payee sends the payor a completed Form W-9.

The IRS requires the sending of a different prescribed letter to the payee if the payor

receives two B Notices for a particular payee within three calendar years. At that time, the IRS does not require the sending of a Form W-9, but backup withholding must begin within 30 days and cannot stop until the IRS tells the payor to stop, even if new TIN information is provided by the payee.

For complete details about B Notice program requirements, please see IRS Publication 1281.

## Purchasing Cards

As noted in the introduction, all of these rules apply to both check and electronic payments including purchasing card transactions. Implementing the basic requirements entails:

- ▶ Determining if the transaction is reportable (services, not merchandise);
- ▶ Determining if the payee is reportable (non-incorporated) (for non-federal agency payors only);
- ▶ If reportable, obtaining a TIN from the payee;
- ▶ If no TIN is provided, backup withholding and depositing according to IRS rules; and
- ▶ Reporting on Form 1099-MISC to the IRS and the payee whenever payment for services totaled at least \$600, regardless of whether or not withholding was done; also, reporting all payments, regardless of the amount, if withholding was done.

Because meeting these requirements when using a purchasing card can present some challenges, Visa has been working to make these requirements less burdensome on Visa Purchasing Issuers and clients compared to what those payors would face if using the invoice and check system for payments.

Specifically, Visa has worked with “IRPAC” (IRS Information Reporting Program Advisory Committee), an industry group that advises the IRS on information reporting matters. With Visa’s support and backing, IRPAC presented the IRS with several suggestions to make the reporting and withholding burden of the Visa Purchasing client less onerous. Those suggestions include:

- ▶ Authorize Visa and its Members to secure TINs from the payees. Visa has volunteered to take on this responsibility, which under the current law and regulations belongs to the purchasing card client. Visa has devoted considerable resources over the past five years to building a database of payee names, addresses, TINs, and incorporation status codes. It is Visa’s plan to build and maintain this database on behalf of its Members and their Visa Purchasing clients. Visa

Purchasing Issuers receive quarterly or annual reports from Visa with the name, address, TIN, and incorporation status of the merchants with which their cardholders did business. The Issuers (or their processors) forward this information to the cardholders, coupled with the information on the dollar amounts associated with those merchant transactions. Visa Purchasing clients then use this information to file the required Form 1099-MISC.

The IRS has indicated an initial agreement to permit Visa to take over this responsibility, thereby assisting Visa Purchasing Issuers and their clients in fulfilling this requirement. Visa Purchasing clients would still have the option to solicit and store merchant information on their own.

- ▶ Allow Visa and its Members to identify the corporate payees. Visa is securing not only merchant names and TINs, but also the merchant's incorporation status (as previously indicated) for the Visa Merchant Profile Database. Visa Purchasing Issuers can use the incorporation status to identify corporations not subject to reporting by non-federal agency payors. The resulting reports sent to purchasing card clients target only those transactions that could be reportable because the payee is an individual, sole proprietor, partnership, or other non-corporate entity.<sup>1</sup>
- ▶ Suspend backup withholding requirements. As a reminder, backup withholding can occur under the current regulations for two different reasons: first, the card accepting merchant did not provide a TIN, and second, the TIN provided by the card accepting merchant does not match IRS files. As for the first type, backup withholding cannot be effectively imposed because the merchant is paid within 48 hours by the acquiring financial institution ("Acquirer"), long before the TIN can be provided to the payor. To address this concern, Visa has changed its association by-laws to effectively require all Acquirers to obtain a TIN from all merchants that accept a Visa Purchasing card. The IRS is considering waiving backup withholding requirements for most Visa Purchasing card transactions because of this change. As for the second type, where the TIN does not match IRS files, alternative controls are being discussed.

Due to other business and budget priorities, the IRS has been unable to devote sufficient time and effort to developing the official guidance that would incorporate these recommendations and preliminary oral agreements. To expedite these matters, Visa has drafted and submitted regulation language to the IRS and has been working to have this project placed on the IRS business plan as soon as possible.

Once this project is on the IRS business plan, it will take IRS approximately one year to

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<sup>1</sup> With passage of the new statute that requires federal government agencies to report payments to corporations, the incorporation status code remains important. For non-federal government agency card users, the incorporation status code will enable them to limit the number of returns filed to those required by the regulations applicable to them. In addition, since Visa has always sought TINs from all merchants, not just non-corporations, the Visa Merchant Profile Database is able to service the needs of federal government agencies as well as the private sector.

develop and release preliminary guidance. After that, it usually takes 12 to 18 months for the guidance to become final. In the meantime, such guidance would usually be in effect, with any changes being prospective only.

If the IRS agrees to the Visa/IRPAC recommendations, Visa Purchasing clients may:

- ▶ Rely on the Visa Merchant Profile Database to provide critical merchant data;
- ▶ Rely on Visa and its Members to identify corporations and non-corporations; and
- ▶ Be relieved of the need to backup withhold.

Each Visa Purchasing client would receive information about the merchants it used from the Issuer. The Visa Purchasing client would then file any required Forms 1099-MISC either separately or together with returns reporting other types of payments. The Visa Purchasing client would have the option to prepare the filing in-house or hire an outside provider to file the required returns. Users of the traditional invoice and check system would continue to be subject to the same set of rules and would have to solicit TINs and identify corporations on their own.

## The Visa Merchant Profile Database

Visa has invested considerable resources in building Visa Merchant Profile Database, which contains names, addresses, incorporation status codes, and TINs of merchants that have accepted a Visa Purchasing card. Visa maintains a staff solely devoted to building and maintaining the database. Visa has revised its association by-laws to require all Acquirers to obtain and provide when requested the names, addresses, incorporation status codes, and TINs from any Visa Purchasing card-accepting merchants.

To supplement data received from the merchant, either directly or indirectly through the Acquirer, Visa has contracted directly with reputable third party data providers.

The purpose of the Visa Merchant Profile Database is to collect merchant data in a central repository and share it among Visa Members. The Visa Merchant Profile Database enables reporting on all Visa Purchasing card-accepting merchants. It also positions Visa to respond to any future changes in IRS reporting requirements (see footnote 1, above).

The data elements being collected from Acquirers or third party data providers for the Visa Merchant Profile Database include:

- ▶ Merchant legal name (the “doing business as” (d.b.a.) name is included on the original Visa Purchasing card transaction);
- ▶ Full street address (city, state, and zip code are included on the original Visa Purchasing card transaction);

- ▶ TIN;
- ▶ Incorporation status; and
- ▶ Owner's full name, if merchant is a sole proprietor.

The current process for assembling Form 1099-MISC information requires the Visa Purchasing Issuer to extract merchant transaction activity for the calendar year and to match this activity to merchant information from the Visa Merchant Profile Database. The Issuer then provides this information to its Visa Purchasing clients to be used to complete Forms 1099-MISC for their merchants.

## Options for Visa Purchasing Clients

Once the IRS issues guidance in accordance with the list of Visa recommendations, Visa Purchasing clients will be able to fully realize the enormous savings the Visa Purchasing card affords them by relying on the Visa Merchant Profile Database. Until then, the information reporting requirements are no different from the current requirements for payments made by the traditional invoice and check method in today's environment. Visa Purchasing clients can approach this situation in several ways:

- ▶ Use the Visa Merchant Profile Database. Allow Visa and Visa Purchasing Issuers to provide Forms 1099-MISC information for all merchants that accepted a Visa Purchasing card. If the Visa Purchasing card was used late in the calendar year and there has not been time for Visa to gather the merchant's data, the client may need to follow up directly with the merchant to obtain the necessary information for Form-1099-MISC reporting. Therefore, it is recommended that Visa Purchasing clients establish procedures that ensure adequate year-end reporting.
- ▶ Be Conservative - Report on Everything and Everyone. This may increase the chances of filing of all required Forms 1099-MISC, but may greatly increase operation costs as well as risk additional filing penalties for incorrectly filed forms.
- ▶ Conduct Business as Usual. If the Visa Purchasing client has been doing business with a merchant under the invoice and check payment method, the client should already have that merchant's name and TIN in its files. It can file Forms 1099-MISC as usual by consolidating the purchasing card payment activity with any other electronic or check payments. For new merchants, it must continue to bear full responsibility for soliciting merchant information required for Form 1099-MISC reporting.

- ▶ **Prohibit Service Transactions.** Since merchandise transactions are not subject to Forms 1099-MISC reporting, Visa Purchasing clients may limit their employees to using purchasing cards for goods only. This strategy limits the beneficial cost savings the purchasing card provides. Also, it can be difficult to enforce this policy since some merchants provide both goods and services (for example, office supply stores sell photocopiers (goods) and machine maintenance contracts (services)).

### **Visa's Recommendations:**

The Visa Purchasing card can provide significant benefits to the client that uses it to streamline an otherwise labor intensive procurement process. It also presents challenges to meeting the IRS reporting requirements. Until the IRS issues definitive guidelines for the purchasing card environment, Visa Purchasing clients may choose to use the following approach to effectively manage Forms 1099-MISC filing requirements:

- ▶ Obtain necessary merchant data from the Visa Merchant Profile Database through your Visa Purchasing Issuer or processor.
- ▶ Use the Merchant Category Code to determine which transactions are reportable.
- ▶ If a transaction is reportable and the necessary merchant data is *not* available from the Visa Merchant Profile Database:
  - Search your own vendor database to obtain the necessary information, or
  - Perform your own research (mailing, phone call, etc.) to gather the information directly from the merchant.

When gathering data for Forms 1099-MISC reporting, it is important to take into account the time of year. If a merchant was recently added to the Visa Merchant Profile Database, Visa may not have had time to gather the merchant data needed for Forms 1099-MISC reporting. During the last quarter of the calendar year, Visa Purchasing clients may want to initiate their own research for merchant data, rather than depending on the Visa Merchant Profile Database, to ensure that the necessary information is available when needed.

