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BY FACSIMILE

Ms. Emily S. McMahon
Acting Assistant Secretary (Tax Policy)
U.S. Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

The Honorable Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Dear Acting Assistant Secretary McMahon and Commissioner Shulman,

On behalf of the Retail Industry Leaders Association (RILA), I write to thank you for the relief that the Internal Revenue Service (Service) provided business taxpayers with respect to reporting of merchant-card and other third-party network reimbursements on their 2011 tax returns. The new Form 1099K required by § 6050W¹ has raised a number of concerns for recipients of these new information forms, and the changes to new Line 1a of the U.S. Corporation Income Tax Return (Form 1120) and U.S. Income Tax Return for an S Corporation (Form 1120S) will help ensure orderly filing for 2011.

By way of background, RILA is the trade association of the world's largest and most innovative retail companies. RILA members include more than 200 retailers, product manufacturers, and service suppliers, which together account for more than \$1.5 trillion in annual sales, millions of American jobs and more than 100,000 stores, manufacturing facilities and distribution centers domestically and abroad.

While the modification to the 2011 income tax returns is welcome relief, for the reasons set out below, we believe a permanent solution to this issue is essential for 2012 and future tax years. This letter explains our general concerns regarding the reconciliation of the reimbursement information reported on Form 1099K to the associated gross receipts and the accounting system and process changes that would be required for such an undertaking. Additionally, we outline the compliance concerns associated with the proposed change in reporting of merchant-card and third-party network payments as well as our recommendations for a permanent solution to this issue. Finally, we stress the need for a reasonable implementation period for any systems or processing changes in order for retailers to meet their tax filing obligations in a timely manner should the Service ultimately require separate reporting.

¹ Unless otherwise specified, all “§” references are to the Internal Revenue Code of 1986 and all “Treas. Reg. §” references are to the Treasury Regulations promulgated there under, both as amended through the date of this letter.

Form 1099K Reflects More than Gross Receipts

Reporting the portion of merchant-card and third-party network payments that relate to gross receipts is not a simple matter. The annual and monthly payment amounts to be reflected on Form 1099K will consist of far more than gross receipts from the sales of goods and services by a retailer. For example, a Form 1099K reflecting reimbursements for sales of merchandise purchased by credit card or debit card will also include a host of other items that do not constitute gross receipts, including:

- Sales taxes, which are collected on behalf of state and local governments and remitted to them.
- Deposits and fees mandated by state and/or local governments (e.g., bottle deposits, e-waste fees), which also are remitted to the respective jurisdiction;
- Cash-back transactions, where the amount is charged to the credit or debit card but the retailer gives the cash to the customer;
- Lottery and amusement park tickets and utility-collection services, which are paid to the service provider typically net of a commission retained by the retailer; and
- Charitable contributions made by a consumer at the point of sale and transferred to the charity by the retailer.

In addition, a Form 1099K may also include items on which the recognition of the gross receipts as income may be deferred, including gift cards, service plans, and warranty plans. In the case of gift cards, the merchant may be reimbursed for the purchase of a gift card via a credit card, for instance, in the current tax year but not recognize gross receipts associated with that gift card for up to two years.²

Similarly, many retailers typically require that customers who return merchandise without a receipt receive a gift card or merchandise credit representing the refunded value. Tracing the original purchase of the item, which may have occurred in a credit- or debit-card transaction, through the intervening gift card, to determine the associated gross receipts would challenge existing accounting systems and potentially span fiscal years.

An added complexity arises for retailers that do not follow the calendar year for tax accounting purposes. While we recognize that the current Form 1099K is designed to provide monthly amounts reimbursed by the merchant-card and third-party networks, many retailers employ the 52/53 week accounting method and end their accounting periods on a specific day of the month that may not align with the calendar month-end in many instances. Conceptually, reconciliation of Form 1099K information for these taxpayers would require daily data on the new form, although anomalous results are likely. Additionally, when the 52/53 week period ends on a weekend, credit- and debit-card transactions may not be processed until the following Monday. This can push the reimbursement shown on the Form 1099K into the following period, while the associated gross receipts would be recognized in the current period.

Many retailers also have international operations, and in some cases, those operations are reported as part of the consolidated U.S. tax return. Since the application of the new Form

² See e.g., Treas. Reg. § 1.451-5 and Rev. Proc. 2004-34, 2004-1 C.B. 991.

1099K reporting requirement to foreign merchant-card networks remains uncertain, a company's worldwide credit card transactions may not be entirely reflected on the Form 1099Ks it receives. Similarly, where a customer from outside the United States makes purchases within the United States through a credit card, the reimbursement from the merchant-card processor may come from outside the United States. In this case, the retailer would likely not receive a Form 1099K reflecting such transactions.

Reconciliation Implications for Existing Accounting Systems and Processes

The non-gross receipts items described above, along with sales of merchandise and services, are typically tracked through a company's sales audit system, which in many cases ultimately aggregates sales revenue and inventory sold for accounting and tax-filing purposes. Existing accounting systems, however, are typically not designed to reconcile these items to the particular tender type used by the consumer for the transaction. Credit and debit transactions are normally tracked on separate settlement systems to ensure appropriate reimbursements, but not to reconcile those amounts to the resulting gross receipts.³

The annual reconciliation of reimbursement amounts reported on Form 1099K to the associated gross receipts (and issues regarding varying accounting periods) will require substantial changes to existing accounting systems and/or burdensome manual processing of sales and payment data. For some RILA members, data connecting a sales record to the related credit- or debit-card transaction is only accessible for a short period, generally the period during which the product can be returned, often just a few months. Thereafter, the sales data is aggregated for the general ledger, separating it from the settlement system for credit- and debit-card transactions. For other RILA members, sales and tender-type data is available but significant new systems or software would have to be developed and implemented, or manual sorting of the data would be required, to parse credit- and debit-card transactions to determine the resulting gross receipts each year.

It is also important to stress that retailers generally seek to avoid system changes, especially those that could affect sales processing, unless they are absolutely essential. Accounting systems are an integral part of a retailer's overall operating infrastructure, both at the points of sale in its physical storefronts and also in its online shopping environment. Any change comes with the risk of destabilizing these systems, and a disruption can easily cost a retailer hundreds of thousands of dollars per hour and damage customer goodwill. Depending on the degree to which a retailer would have to modify its information systems to accomplish the proposed reconciled reporting for Form 1099Ks, such a change could pose major business risks as well as tax compliance burdens.

Reconciled reporting of Form 1099K information would also raise significant data retention issues. Maintaining entire databases of individual sales records and the corresponding credit- or debit-card transaction information, presumably for the three-year audit cycle, would well exceed current requirements for maintaining and substantiating accounting records.⁴ For many RILA

³ For most retailers, gift cards and other forms of prepaid access are managed over a separate system, which is also typically not designed to reconcile to the gross receipts associated with the gift-card transactions.

⁴ The retention requirement would likely exceed the three-year audit cycle as many audits do not start for several years following the filing of the tax return and can last for several years once initiated.

members, these databases consist of *billions* of transactions per year, and the storage and protection of such databases for an extended period would involve considerable costs. In addition, because credit- and debit card information may include certain personal information, posing risks for fraud and identify theft, contractual rules imposed by the card networks limit the extent to which and duration that retailers may retain specific credit- and debit-card transaction information, without incurring sizeable penalties. Accordingly, these cost and limitations on data retention create additional burdens with respect to complying with the proposed reconciled reporting of 1099K information.

Fundamental to this entire issue is the fact that current business operations do not necessitate that retailers determine gross receipts by tender type. Such information is not needed for inventory or financial management nor is it required for financial-statement reporting purposes. Moreover, retailers have long been able to meet their federal income tax responsibilities for reporting gross receipts without having to allocate them separately by tender type. And, retailers already reconcile the sales reported on their audited financial statements to the amount reported on the income tax return on the Part II of Schedule M-3, which is filed with their returns. Thus, mandating the reconciliation of reimbursement amounts reported on Form 1099K to the associated gross receipts would impose an extremely costly, burdensome, and unnecessary new reporting regime for no purpose other than supplying a single figure on an annual tax return.

Compliance Implications

We appreciate that the underlying intent of § 6050W was to improve tax compliance. It is our understanding, however, that the new reporting requirement was designed to provide the Service with information directly from the merchant-card and third-party networks that could be used for audit selection based on norms in particular industries for payments by cash versus credit and debit cards. In his testimony before the Senate Committee on Finance in April 2007, then-Commissioner Mark Everson described the proposal, which became § 6050W, in terms of its potential as an audit-selection resource for the Service and its deterrent effect on businesses that might otherwise not be reporting their income in full.⁵ We believe those objectives can be accomplished without retailers having to undertake complex and burdensome reporting of information from Form 1099Ks on their annual income tax return, especially given that the Service receives the corresponding copy of the information return.

Moreover, we do not see how the proposed reconciled reporting of Form 1099K information will provide the Service with meaningful information to improve compliance. At a minimum, the amount reported by a retailer on its Form 1120 will be an amount less than the figure reported on the Form 1099K once all of the non-gross receipts items discussed above are properly excluded. As a result, this reconciliation-reporting approach will not facilitate automatic matching of information returns as is currently done with other types of Form 1099s, such as those reporting interest or retirement account distributions, since the figure called for will never match the total of all Form 1099Ks issued to the taxpayer.

⁵ United States Senate, Committee on Finance, 110th Cong., 1st Sess., "Examining the Administration's Plan for Reducing the Tax Gap: What are the Goals, Benchmarks, and Timetables?" S. Hrg. 110-689, April, 18, 2007, at 28 – available at: <http://finance.senate.gov/hearings/hearing/download/?id=d2e64889-69f6-49f5-8272-d13dc3cf7173>.

In addition, the proposed reporting will add a new area of potential controversy on audit with taxpayers having to substantiate that the reconciled Form 1099K amount is accurate – even though that figure is not otherwise necessary to determine taxable income under current law or required for financial-statement reporting purposes. The result will be additional commitment of scarce audit resources by both taxpayers and the Service.

Recommendation

We believe that the compliance objectives underlying § 6050W can be achieved through the copies of Form 1099K that the Service receives from the merchant-card and third-party networks and the deterrent effect that the payee copy will have on recipients. As a result, we do not believe amounts from Form 1099Ks should be reflected on the annual income tax return.

To the extent that the Service believes such reporting will serve as an additional deterrent, we recommend that the relevant income tax returns be modified to require that only the aggregate of all Form 1099Ks be reported, without reconciliation of that aggregate amount to the associated gross receipts. Such reporting would still impose burdens on taxpayers to determine the universe of providers from which they should receive Form 1099Ks each year, which is likely to be difficult in the initial years of the new form and also for large businesses filing consolidated returns where multiple subsidiaries may receive Form 1099Ks from the same issuer. Additionally, it will require changes to tax preparation software to accommodate the new aggregate figure. Nevertheless, aggregate reporting would be significantly more feasible than reconciled reporting, both in terms of cost and additional compliance burdens.

Implementation Period

Should the Service determine that changes to the annual business income tax returns are necessary with respect to Form 1099K reporting, we urge you to provide a reasonable implementation period to ensure that system changes can be made before the new return requirements become effective. While accounting and payment systems vary among RILA members, we believe that reconciled reporting of Form 1099K information would require at least one full tax reporting cycle to develop, test and implement necessary software or other processing systems to determine the required figure. However, a longer period may be required for some retailers. Straight aggregate reporting of all Form 1099Ks received is expected to take less time, although a full reporting cycle would maximize the potential for success.

In either event, knowing the extent of any system changes prior to the start of the tax year is extremely important as most retailers have a system lock-down period beginning in the fall of each year and lasting through the following January. This period is designed to bar changes to accounting and payment systems that are not immediately critical in order to avoid disrupting the holiday shopping season. As a result, retailers typically must implement any system changes in the first part of a calendar year, which means that development and testing of such changes typically occurs during the prior year.

Ms. Emily S. McMahon
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Page 6

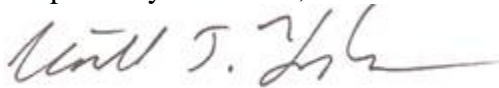
Conclusion

Given the enormous complexities that Form 1099K reporting raises and the potential for costly and time consuming accounting and other system changes that could be required, we respectfully request that this issue be addressed as soon as possible for the 2012 tax year and future years.

RILA and its members would be pleased to work with your staffs to reach a solution that retailers can reasonably implement and that furthers the Service's compliance-improvement objective. Please contact me at bill.hughes@rila.org or Mark Warren at mark.warren@rila.org with any questions or if you need additional information.

Thank you in advance for your consideration, and thank you again for the relief the Service has provided for tax year 2011.

Respectfully submitted,



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