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# *Global IRW Newsbriefs*

Information reporting and withholding (IRW)

December 23, 2011

*The IRS issues a series of notices providing interim guidance regarding the implementation of information reporting obligations under Section 6050W*

## *Executive Summary*

The *Housing Assistance Tax Act of 2008* added Section 6050W to the Internal Revenue Code ("the Code") which requires annual information returns to be filed by merchant acquiring entities and third-party settlement organizations (referred to collectively as Payment Settlement Entities (PSEs)) to report payments made in settlement of payment card (*i.e.*, credit, debit, etc.) transactions and third-party network transactions for calendar years beginning after December 31, 2010.

Although the Treasury Department and IRS had published final regulations in August of 2010 to assist PSEs in the reporting of such transactions, the IRS recently issued a series of separate Notices which respond to comments received on the final regulations and provide:

- Relaxation in the Documentation Requirements for U.S. Payors Making Payment Outside the United States to an Offshore Account
- Relief to Insurance Companies that Administer Certain Insurance Arrangements
- Postponement of Backup Withholding Requirement for Payment Card and Third Party Network Payments
- Transitional Penalty Relief for information returns and payee statements to be filed for payments made in calendar year 2011 on Payment Card and Third Party Network Transactions.

PSEs may rely on the interim guidance provided in the notice until the regulations are amended.

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## Background

Section 6050W of the Code and the regulations thereunder provide that all payments made in settlement of payment card transactions must be reported. In addition, payments made in settlement of third party network transactions are required to be reported, only if the amount paid exceeds \$20,000 and the aggregate number of transactions exceeds 200 with respect to any payee within a calendar year.

The annual information returns which applies to payments made on and after January 1, 2011 must provide the gross amount of reportable payment transactions, as well as the name, address, and taxpayer identification number (TIN) of the payee. This information is to be reported to the IRS on Form 1099-K, *Merchant Card and Third-Party Payments*. A similar statement must also be furnished to the payee setting forth the gross amount of the reportable payment transactions, as well as the name, address, and phone number of the person required to make the return.

## Relaxation in the documentation requirements for U.S. payors making payments outside the U.S. to offshore accounts

The final regulations provided that U.S. payors making payments to participating payees are required to obtain proper documentation (Forms W-8) to classify the payee as a non-U.S. payee not subject to Form 1099-K reporting. A transitional rule was provided to ease the administrative burden for payments pursuant to a contractual obligation entered into before January 1, 2011, which allows a PSE that is a U.S. payor to rely on a foreign address and not obtain any additional documentation as long as the U.S. payor neither knows nor has reason to know that the payee is a U.S. person ("the address rule"). However, any substantial modification to the pre January 1, 2011 contract will require the U.S. payor to request documentation from non-U.S. payee to substantiate their non-U.S. status.

PSEs that are non-U.S. payors, are permitted to apply the address rule to both pre and post January 1, 2011 contracts and avoid reporting payments to participating payees with a non-U.S. address, so long as the PSE neither knows nor has reason to know that the payee is a U.S. person.

**PwC Observations:** U.S. payors can be non-U.S. entities with substantial U.S. ownership (greater than 50 percent) (i.e., Controlled Foreign Corporations). These entities claim to be at competitive disadvantage compared to foreign based companies with limited or few U.S. owned foreign entities given their more extensive documentation requirements.

In response to industry comments citing the administrative burdens associated with implementing the final regulations, [Notice 2011-71](#), which was published in August 2011, provided that a PSE that is a U.S. payor will be required to file Form 1099-K with respect to a payment made outside the United States to an offshore account, only if one of the following four indicia of U.S. status are present:

- There is a U.S. address associated with the participating payee (whether a residence or correspondence address);
- The PSE has standing instructions to direct the payment to a bank account maintained in the United States;
- The participating payee requests payment in U.S. dollars; or

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- The PSE knows or has reason to know that the participating payee is a U.S. person.

However, an information return is not required for a payment made outside the U.S. to an offshore account with any one of the four indicia or circumstances if the PSE obtains from the participating payee a valid Form W-8 (or substitute form described below) or documentary evidence establishing the participating payee's non-U.S. status. For this purpose, the Notice provides that Forms W-8 (or the substitute form described below) and documentary evidence must be collected by the PSE by the later of January 1, 2012, or 90 days after the date on which the PSE enters into contractual obligations with the participating payee; and Forms W-8 and documentary evidence may be relied upon only when the requirements set forth in the regulations under Section 1441 are satisfied.

In the case of a payment to a foreign payee of income that is effectively connected with the conduct of a trade or business in the United States, the appropriate withholding certificate is Form W-8ECI. For all other payments, the appropriate withholding certificate is Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding*.

**PwC Observations:** In the attempt to level the documentation standards between U.S. and non-U.S. payors, the Treasury and IRS have created a new burden. U.S. payors now must evaluate payees to determine if any indicia of U.S. status are present. This will require at a minimum changes to policies and procedures and or modifications to existing technology being utilized to manage the 6050W reporting obligations. Some U.S. payors may find it easier to simply obtain the Forms W-8 rather than establish procedures to determine if a particular payee has indicia of U.S. status and maintain support for the determinations made.

#### Substitute form in lieu of a Form W-8BEN

The Notice states that the Treasury Department and the IRS also intend to modify the regulations to allow a PSE to accept a substitute form in lieu of a Form W-8BEN in order for a participating payee to certify its non-U.S. status. Such substitute form will be acceptable provided that it contains:

- payee's name;
- country of incorporation (when applicable);
- type of entity;
- residence and mailing address (if different from residence address);
- certification of the payee's non-U.S. status made under penalties of perjury; and
- capacity of the individual providing the certification on behalf of the payee (in the case of a participating payee that is an entity).

In lieu of the certification and penalties of perjury statement contained on the Form W-8BEN, a substitute form may contain the following statement:

Under penalties of perjury, I declare that the payee providing this certification is not a United States person (*i.e.*, a citizen or resident of the United States as determined for U.S. federal tax purposes, a corporation or partnership created or organized in the United States or under the law of the United States or of any State, any estate that

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would be subject to U.S. federal income tax on income from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, or any trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust), that the income to which this certification relates is not effectively connected with the conduct of a trade or business in the United States, and that the undersigned has examined the information on this form and to the best of my knowledge and belief it is true, correct, and complete. Furthermore, I authorize this form to be provided to any person that has control, receipt, or custody of the payment to which I am entitled or any person that can disburse or make the payments to which I am entitled.

***PwC Observation:*** The above language for a substitute Forms W-8BEN is only valid for purposes of Section 6050W. Substitute Forms W-8 for other purposes have different requirements.

#### No actual knowledge that a participating payee is a U.S. person

Notice 2011-71 states that the Treasury Department and the IRS intend to amend the regulations to clarify that a PSE that is a non-U.S. payor and that has reason to know, but no actual knowledge, that a participating payee is a U.S. person will not be required to file Form 1099-K if a Form W-8 (or a substitute form) or other documentary evidence is obtained from the participating payee.

#### Special rule for foreign per se corporations

The final regulations provide a presumption under which a PSE that is a U.S. payor making a payment outside the United States to an offshore account need not report payments to a participating payee with only a foreign address if the name of the participating payee indicates that it is a foreign *per se* corporation and the PSE neither knows nor has reason to know that the participating payee is a U.S. person. Notice 2011-71 states that this special rule will be retained in the amended regulations.

PSEs may rely on the interim guidance provided in the notice until the regulations are amended.

### *Relief to Insurance Companies that Administer Certain Insurance Arrangements*

Under the final regulations, a healthcare network is generally outside the scope of Section 6050W because a healthcare network does not enable the transfer of funds from buyers to sellers. The preamble to the final regulations indirectly acknowledges a comment to the effect that a self-insurance arrangement likewise should be treated as outside the scope of Section 6050W, however such an exclusion was not adopted "because this arrangement could create a third party payment network of which the health insurance entity is the [PSE] to the extent the health insurance entity effectively enables buyers (the self-insuring companies) to transfer funds to sellers of healthcare goods or services."

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On September 22, 2011, the IRS issued [Notice 2011-78](#) announcing its plan to amend the final regulations to exempt from Section 6050W reporting requirements certain insurance companies that administer some self-insured insurance policies. The Notice states that the Treasury Department and the IRS intend to amend the final regulations to expressly provide that an insurance company or an affiliate administering a self-insured arrangement on behalf of an employer or other entity on a cost-plus basis, or under an Administrative Services Only or Administrative Services Contract plan will not be treated as a PSE.

**PwC Observations:** Notice 2011-78 should be greeted as welcomed relief. Insurance entities that routinely issue Forms 1099-MISC to health care providers would have had to significantly modify their reporting systems. If Form 1099-K reporting would have been required the IRS would have ultimately received less information from these entities because the de minimus rule third party network transactions is significantly higher than the de minimus rule for Form 1099-MISC reporting.

PSEs may rely on the interim guidance provided in the notice until the regulations are amended.

### *Postponement of Backup Withholding Requirement for Payment Card and Third Party Network Payments*

Section 3406 requires certain payors to perform backup withholding by deducting and withholding income tax from a reportable payment (which includes Section 6050W payments), if a payee fails to timely furnish its TIN to the payor. The regulations under Section 3406 require that backup withholding applies to Section 6050W payments made after December 31, 2011 if a payee has not provided its TIN in the proper manner to a PSE.

A number of commentators have noted that the payors' unfamiliarity with procedures for backup withholding due to no prior withholding obligations, the need for additional time to develop systems to enable withholding, unfamiliarity with the TIN matching program used by the IRS, and general difficulties in matching TINs already obtained with the correct taxpayers have made compliance complex. In response, the IRS issued [Notice 2011-88](#) on October 27, 2011, which postpones until January 1, 2013 the effective date for potential backup withholding obligations imposed under Section 3406 for Section 6050W payments.

### *Transitional Penalty Relief for information returns and payee statements to be filed in 2012*

Prior to the enactment of Section 6050W, payors were not required to file any specific type of information return or to furnish the specific type of payee statement required by Form 1099-K. Penalties for failure to include all required information or including incorrect information on information returns or payee statements are provided in Code Sections 6721 and 6722, respectively.

In order to provide additional time to develop appropriate procedures for compliance with these new reporting requirements, the IRS issued [Notice 2011-89](#) on October 27, 2011 which provides transitional relief from penalties for PSEs reporting incorrect

information on Forms 1099-K and payee statements filed under Section 6050W by not imposing penalties under Sections 6721 and 6722 on payors that make good-faith efforts to file and furnish accurate Forms 1099-K.

This relief only applies to Forms 1099-K and payee statements filed in 2012 for reportable payments made in 2011.

**PwC Observations:** The penalty relief announced in Notice 2011-89 does not apply to PSEs that erroneously determine that Section 6050W does not apply to its payments. To access the relief in the Notice it is important that PSEs properly apply the rules under 6050W to determine if reporting is required. The IRS should provide additional guidance defining terms such as "substantial number of vendors" and "guarantee" to provide clarity to organizations that make payments and who potentially could be classified as a PSE.

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