

IRS is beginning to issue notices to small business taxpayers based on information reported on Form 1099-K

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In brief

The IRS is beginning to use information reported on Form 1099-K, *Payment Card and Third-Party Network Transactions*, received from credit card companies and certain third party network organizations (e.g., online payment companies), to identify under-reporting of gross receipts on previously filed tax returns. If the IRS believes a taxpayer has under-reported gross receipts, a notice may be issued requesting additional information. Taxpayers that receive a notice related to Form 1099-K should determine how best to respond by reviewing the information for accuracy and then consulting with their tax advisor. A prompt and appropriate response to the notice may help reduce future correspondence.

In detail

What type of information does Form 1099-K track and how is that information reported?

Under Section 6050W, entities that process payment card transactions or third-party network transactions, like credit card or online payment transactions, must track the gross receipts from those transactions and report them to both the IRS and the merchant on Form 1099-K (see also [FAQs on New Payment Card Reporting Requirements](#) and [Understanding Your 1099-K](#)). In turn, merchants that receive a Form 1099-K must make sure the reported amount is properly included in gross receipts on

their federal income tax return that is filed with the IRS. However, merchants should be aware that Form 1099-K reflects gross transaction amounts with no adjustments for things like returns, cash back, and sales tax.

How is the IRS planning to use information reported on Form 1099-K?

It is expected that the IRS will use the amount reported on Form 1099-K as a high-level indicator of whether taxpayers are reporting all of the gross receipts they should be reporting. In other words, the IRS will compare the gross receipts reported on Form 1099-K to the gross receipts reported on the taxpayer's tax return.

While this approach rarely will result in an exact match (because gross receipts reported on a tax return generally also include other payment amounts), the IRS believes the payments reported on Form 1099-K provide a point of reference for evaluating the reasonableness of a taxpayer's gross receipts.

When will the IRS issue a notice related to Form 1099-K?

The IRS recently announced on its website that it will issue notices to taxpayers that may have under-reported gross receipts (see [New Notices Related to Form 1099-K](#)).

This announcement states: "If you receive a letter or notice from the IRS, it will explain the reasons for the correspondence and provide instructions. The notice you receive covers a very specific issue about your account or tax return. Generally, the IRS will send a notice if it believes you owe additional tax or are due a larger refund, or if there is a question about your tax return." Taxpayers are most likely to receive a notice when there is an "unusually high portion of receipts from card payments and other Form 1099-K reportable transactions," or if the amount of gross receipts reported on their tax return is less than the gross receipts reported on Form 1099-K. While initial Form 1099-K enforcement efforts likely will be focused on small business taxpayers, large business taxpayers may be targeted in the near future.

What should taxpayers do if they receive a notice from the IRS related to Form 1099-K?

The IRS website also contains several sample notices (see link above). Each of the notices includes the taxpayer's reported gross receipts and gross receipts reported on Form(s) 1099-K. The notices request that the taxpayer simply review the information provided or provide a more detailed verification of the reported income. If the information is accurate, no further action is generally required. If the information is inaccurate, the taxpayer may be required to explain the discrepancies. In the worst case, the taxpayer may discover that certain gross receipts were unintentionally omitted from the tax return, which may require the filing of an amended return.

The takeaway

The IRS is beginning to issue notices to small business taxpayers based on information reported on Form 1099-K in an effort to identify under-reporting of gross receipts. Therefore, taxpayers should take extra care in making sure that amounts reported on Form 1099-K have been properly reflected on current and prior year federal income tax returns. Taxpayers that receive a notice from the IRS should not automatically assume that they have under-reported their gross receipts. In many instances, the IRS is just seeking additional, clarifying information. Regardless of the situation, taxpayers should determine how best to respond by reviewing the information contained in the notice for accuracy and then consulting with their tax advisor.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC Private Company Services representative, or one of the subject matter professionals shown on the next page:

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