Treasury Inspector General for Tax Administration
Office of Audit

PLANS FOR THE IMPLEMENTATION OF MERCHANT CARD REPORTING COULD RESULT IN BURDEN FOR TAXPAYERS AND PROBLEMS FOR THE INTERNAL REVENUE SERVICE

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Highlights

Highlights of Report Number: 2011-40-065 to the Internal Revenue Service Deputy Commissioner for Services and Enforcement.

IMPACT ON TAXPAYERS

The merchant card reporting section of the Housing and Economic Recovery Act of 2008 was designed to assist the Internal Revenue Service (IRS) in matching income from sales paid with credit or debit cards to income claimed on a tax return. This is an effort to reduce the Tax Gap.

WHY TIGTA DID THE AUDIT

This review was initiated to determine whether the IRS has a complete and detailed plan in place to control and schedule the implementation of the merchant card reporting law as intended by Congress. The new law will add millions of additional information reporting documents to the IRS computer systems.

WHAT TIGTA FOUND

The new law requires payment settlement entities to report merchant card and third-party payments to the IRS on Merchant Card and Third Party Network Payments (Form 1099-K).

One of the stated goals of merchant card reporting is to assist the IRS in matching income from sales to income reported on tax returns. TIGTA found that the IRS's redesigning of Tax Year 2011 income tax forms may not facilitate a direct match between sales reported on Forms 1099-K and amounts reported on tax returns. Based on our finding, the IRS immediately made adjustments to one tax form and is reviewing the other affected forms to make similar improvements.

The law requires payment settlement entities to withhold a percentage of gross receipts (backup withholding) on those merchants who do not ultimately provide a valid Taxpayer Identification Number and name that match IRS records. Because of the increased volume of Forms 1099-K resulting from merchant card reporting requirements, there is a risk that mismatches might not be resolved before backup withholding becomes mandatory. The IRS's risk assessment and implementation plan did not contain adequate details regarding these risks as well as appropriate contingencies. TIGTA also found that the risk assessment and implementation plan prepared by the IRS lacked other details.

Finally, the IRS did not properly account for funds appropriated for merchant card reporting during the project's initial stages.

WHAT TIGTA RECOMMENDED

TIGTA recommended that the IRS monitor the amounts reported for merchant card and third-party payments to ensure there is no confusion about where to enter the amounts, the risk assessment and implementation plan adequately address mismatching names and Taxpayer Identification Numbers, sufficient detail is added to future risk assessments to address the full scope of the project, and future implementation plans indicate the full scope of the project and expected due dates. TIGTA also recommended that the IRS ensure financial reporting is added to the risk assessment and implementation plan so costs and schedules are tracked and reported timely, and costs are accumulated when resources are first used.

In their response to the report, IRS officials agreed with the recommendations and are planning appropriate corrective actions.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full IRS response, go to:

http://www.treas.gov/tigta/auditreports/2011reports/201140065fr.pdf.

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