Tax Insights

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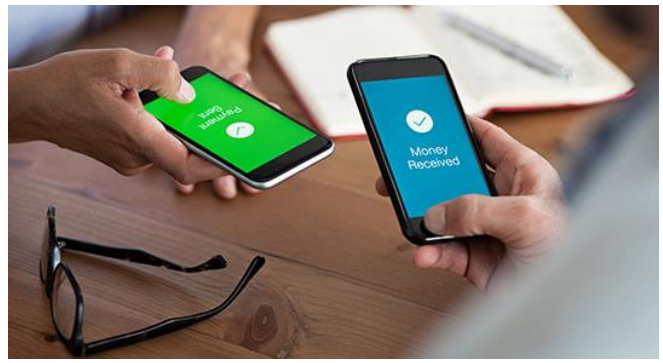
FEBRUARY 15, 2022

New tax reporting requirements for payment apps could affect you



If you run a business and accept payments through third-party networks such as Zelle, Venmo, Square or PayPal, you could be affected by new tax reporting requirements that take effect for 2022. They don’t alter your tax liability, but they could add to your record-keeping burden, as well as the number of tax-related documents you receive every January in anticipation of tax-filing season.

Form 1099-K primer

Form 1099-K, “Payment Card and Third-Party Network Transactions,” is an information return that reports certain payment transactions to the IRS and the taxpayer who receives the payments. Since it was first introduced in 2012, the form has been used to report payments:

- From payment card transactions (for example, debit, credit or stored-value cards), and
- In settlement of third-party network transactions, when above a certain minimum threshold amount.

For 2021 and prior years, the threshold was defined as gross payments that exceeded $20,000 and more than 200 such transactions. Note that no minimum threshold applies to payment card transactions — all such payments must be reported.

Taxpayers should receive a Form 1099-K from each “payment settlement entity” (PSE) from which they received payments in settlement of reportable payment transactions (that is, a payment card or third-party network transaction) during the tax year. Form 1099-K reports the gross amount of all reportable transactions for the year and by month. The dollar amount of each transaction is determined on the transaction date.

In the case of third-party network payments, the gross amount of a reportable payment doesn’t include any adjustments for credits, cash equivalents, discounts, fees, refunds or other amounts. In other words, the full amount reported might not represent the taxable amount.

Businesses (including independent contractors) should consider the amounts reported when calculating their gross receipts for income tax purposes. Depending on filing status, the amounts generally should be reported on Schedule C (Form 1040), “Profit or Loss From Business, Sole Proprietorship;” Schedule E (Form 1040), “Supplemental Income and Loss;” Schedule F (Form 1040), “Profit or Loss From Farming;” or the appropriate return for partnerships or corporations.

Understanding the new rules

The American Rescue Plan Act (ARPA), which was signed into law in March of 2021, brought significant changes to the requirements regarding Form 1099-K. The changes are intended to improve voluntary tax compliance.

Understanding the new rules (continued)

Beginning in 2022, the number of transactions component of the threshold for reporting third-party network transactions is eliminated, and the gross payments threshold drops to only $600. The change is expected to boost the number of Forms 1099-K many businesses receive in January 2023 for the 2022 tax year and going forward.

The ARPA also includes an important clarification. Since Form 1099-K was introduced, stakeholders have been uncertain about which types of third-party network transactions should be included. The ARPA makes clear that these transactions are reportable only if they're for goods and services. Payments for royalties, rent and other transactions settled through a third-party network are reported on Form 1099-MISC, "Miscellaneous Information."

The ARPA changes heighten only the reporting obligations of third-party payment networks; they don't affect individual taxpayer requirements. They might, however, reduce your odds of inadvertently underreporting income and paying the price down the road.

Taking steps toward accurate reporting

While the increased reporting doesn't require any specific changes of affected taxpayers, you'd be wise to institute some measures to ensure the reporting is accurate. For example, consider monitoring your payments and the amounts so you know whether you should receive a Form 1099-K from a particular PSE. Notably, you're required to report the associated income regardless of whether you receive the form.

You'll also want to step up your recordkeeping to allow you to reconcile any Forms 1099-K with the actual amounts received. If you have multiple sources of income, track and report each separately even if you receive a single Form 1099-K with gross payments for all of the businesses. For example, if you process both retail sales and rent payments on the same card terminal, your tax preparer would report the retail sales on Schedule C and the rent on Schedule E.

If you permit customers to get cash back when using debit cards for purchases, the cash back amounts will be included on Form 1099-K. Those amounts generally aren't included in your gross receipts or businesses expenses, though, making it critical that you track cash-back activity to prevent inclusion.

Amounts reported could be inaccurate if you share a credit card terminal with another person or business. Where required, consider filing and furnishing the appropriate information return (for example, Form 1099-K or Form 1099-MISC) for each party with whom you shared a card terminal. In addition, keep records of payments issued to every party sharing your terminal, including shared terminal written agreements and cancelled checks.

Other potential landmines include:

- Incorrect amounts due to mid-tax year changes in entity type (for example, from a sole proprietorship to a partnership),
- Forms issued to you as an individual, with your Social Security number, rather than to your C corporation, S corporation or partnership, with its taxpayer identification number,

- Incorrect amounts due to a mid-tax year sale or purchase of a business, and
- Duplicate payments that appear on both a Form 1099-K and either a Form 1099-MISC or a Form 1099-NEC, "Nonemployee Compensation."

If you receive a form with errors in your taxpayer identification number or payment amount, request a corrected form from the PSE and maintain records of all related correspondence.

Don't dawdle

It may seem tempting to put off the steps necessary to establish solid recordkeeping procedures for payments from third-party networks, but that would be a mistake. Act now to set up the necessary processes and procedures so you're in compliance and not scrambling at tax time.
