



## **Electronic Transactions Association**

### **The Electronic Transactions Association's Comments re: The U.S. House of Representatives Small Business Committee Hearing on the Merchant Card Information Reporting Proposal**

The Electronic Transactions Association<sup>1</sup> (ETA) is pleased to submit comments to the House Small Business Committee for the written record of its hearing on the Merchant Card Information Reporting Proposal currently being considered by Congress. ETA is strongly opposed to this proposal and appreciates the Committee's continued interest in this subject.

#### **ETA Position Summary**

ETA strongly recommends that this Committee and Congress consider the anticipated adverse effects this reporting requirement would have on small businesses, merchant acquiring banks, and individual consumers. The Reporting Proposal is likely to add additional burdens on all parties involved in the electronic payment process, most significantly on small businesses, which often lack the resources or know-how to develop and implement automated systems of unique record-keeping for this purpose alone. In addition, the Proposal itself is vague and will lead to misleading information being reported to the IRS, and its economic benefit is unsubstantiated.

If the Proposal is to be truly effective, it will require an exhaustive amount of information, which would be virtually impossible for merchant acquiring banks to produce. Therefore, any proposal of this nature would either be inadequate or too costly, and any additional burdens on small businesses and merchant acquiring banks would not have a significant revenue benefit to the Federal Government. In short, any burden placed on small businesses and merchant acquiring banks via this Proposal would outweigh any estimated revenue.

While the costs of compliance with such a Federal mandate would initially be borne by the merchant acquiring banks, ultimately the increased costs of complying with these burdensome reporting requirements would be pushed down to small businesses whose only choice would be to pass them on to consumers, further increasing the relative economic power of large multinational retailers whose individual financial power can absorb greater increased costs.

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<sup>1</sup> ETA, founded in 1990, is the nation's oldest and largest organization of businesses representing the merchant acquiring industry that enables merchants to offer electronic payment services to consumers. With over 500 member companies, ETA's diverse membership, including state/federal chartered financial institutions, merchant service providers (also known as independent sales organizations), and credit card companies, is part of the backbone of the American economy that facilitates electronic payments.

A final point to consider regarding this Proposal is whether or not it is appropriate to impose huge new costs and burdens on small businesses and the merchant acquiring banks, as well as their merchants' customers, during a time of looming uncertainty in our economy. This problematic provision would heap new expenses and additional uncertainties at a difficult time, adding new strains to the current economic situation.

### **Reporting Requirements Specifically Unfair to Small Businesses**

Over the past several years, credit and debit cards have become the preferred payment method for purchases in the everyday world. As a result of these spending methods, the Department of the Treasury believes that by obtaining reports of merchant credit and debit card sales from merchant acquiring banks it will be able to ascertain gross revenue information, which it believes small businesses have been under reporting, by matching their credit and debit card reports with their tax returns. There is an apparent belief that after reviewing merchant credit and debit card sales, the IRS will be able to extrapolate what the small businesses' cash transactions should be. ETA believes that the unfair burden this reporting requirement will place on the merchant card industry, and on the small businesses that will need to reconcile multiple reporting mechanisms to the IRS, will vastly outweigh any benefits gained from such reports. Furthermore, as this extrapolation exercise would purely be a system of guessing, it is ripe for abuse. There are millions of businesses currently operating in the U.S. and this system would require the IRS to become an expert overnight on the spending habits of individual consumers at commercially and geographically diverse business enterprises. Both the payment mix of a given business type and consumers' payment behavior vary widely across the country. Trying to determine consumers' preferences for payment type at specific merchant locations, in order to come up with a ratio of cards-to-cash sales based on a merchant's card receipts, would be an impossible endeavor.

While ETA supports increased compliance by small businesses when filing their tax returns, it is not a simple process for merchant processing entities to send credit and debit card processing information to the IRS. It will require the gathering of millions of reports each year covering trillions of electronic transactions. Furthermore, it will place the burden on merchant processing entities to differentiate between small businesses, individuals, and individual proprietors. Gathering, compiling, and transmitting this information will cost the industry millions of dollars each year in order to comply with a requirement whose intent is fundamentally flawed. While, in theory, matching credit and debit card reports with business filings would provide the IRS with data related to underreported income by businesses that had credit and debit card receipts, and would automatically trigger to the IRS the identification of small businesses that did not file a return, we question whether this benefit alone justifies the enormity of this effort. We ask whether this single benefit could be accomplished in a simpler and more economical way.

In addition, this reporting requirement does not take into account that certain merchant organizations accept debit and credit card payments on an aggregated basis for other related but separately owned and operated businesses. For example, it is common for

franchisors to provide aggregated payment processing services on behalf of franchisees and to withhold franchise fees or service payments from credit card funds. To the merchant provider, these separately owned businesses look like one large account, rather than many small businesses. This type of processing arrangement is also prevalent in the petroleum industry where integrated technology for all locations is used for processing all card types, including private label petroleum cards used at individual-owned, branded gas stations. These types of reporting complexities would be ripe for the occurrence of errors in reporting to the IRS, as well as possibly allowing for loopholes in the system.

Additionally, many of the merchant banks involved in providing credit and debit payment services do so only by complete reliance on the services of third-party processors who perform account reconciliation, data processing, and payment services. These third-party entities are the repository for the data that would ultimately be the source of the information that the IRS wants. This Proposal will have far-reaching effects and unintended consequences since, based on the versions currently put forth by the House and the Senate, multiple entities could potentially be responsible for delivering information on the same businesses. However, based on their purview, their reports might contain differing data. For example, a processor might provide processing services for bank-issued and cleared cards, such as MasterCard and Visa, plus American Express, Discover, and gift cards. However, the sponsor of each issued card might be reporting that activity individually. Without providing explicit requirements, compliance with this Proposal might simply be impossible in such a manner that the data doesn't raise more questions than it provides answers.

### **House and Senate Proposal Specific Concerns**

Included below are additional concerns that the ETA has with both versions of the Proposal before Congress. Although this statement represents ETA's major concerns, this statement does not provide an exhaustive list of our concerns and suggestions.

Additionally, it is important to point out that while the ETA opposes this Reporting Proposal, the industry is engaged in an ongoing dialogue with the House Ways and Means and Senate Finance Committees on this issue. ETA deeply appreciates their willingness to have continuing discussions with the association and its members regarding this Proposal.

1. There is significant uncertainty over the benefits to be achieved by the Proposal. This is starkly demonstrated by comparing Treasury's estimates of what it hopes the Proposal will generate in tax revenues (the following economic analysis is based on the Proposal as contained in the Administration's FY Budget).
  - **FY2007 report:** Treasury estimated that the Proposal would generate the following.
    - \$9 million in 2007;
    - \$92 million during the years 2007-2011;
    - \$225 million during the years 2007-2016.

- **FY2008 report:** Treasury estimated that the Proposal would generate the following.
  - \$113 million in 2008;
  - \$3.3 billion during the years 2008-2012;
  - \$10.8 billion during the years 2008-2017.

The 2009 budget estimates an even greater total 10-year amount, roughly \$18 billion.

These estimates are purportedly based on data gathered from prior tax years. There is no explanation for how Treasury or the president estimated these increases from year to year. While it is true that there have been some minor revisions from the FY2007 to FY2009 versions of the Proposal, they certainly do not account for this revenue jump. The more likely explanation is that Treasury based the increase on the desired result, not on new or more accurate data. Whatever the explanation may be, the end result is that the Proposal places a heavy burden on small businesses and merchant acquiring banks without properly explaining how the proposed fiscal estimates have been calculated.

2. The terms and definitions in the various versions of the Proposal (offered by the Administration, the Senate Finance Committee and the House Ways and Means Committee) are unclear. They bear no relationship to accepted payments industry terminology. This use of unique definitions leads to confusion and ambiguity; it will create a higher probability of problems during implementation. Common terms and definitions currently exist within the payments industry. To be comprehensible, the Proposal should use these generally accepted definitions. Further commentary may well be required once the ambiguities in the definitional section are clarified. The Proposal should be redrafted to use a common set of terminology that would be understood by the industry that is intended to comply.
3. The Senate version of the Proposal uses the term “Qualified Payment Facilitator” which applies to everyone in the payment chain and, based on how our industry operates, could hold multiple parties responsible for submitting the same information for the same merchant. The Senate version should be redrafted to amend the reporting obligations to ensure as far as reasonably possible that two different entities are not obliged to report on the same processed transaction.
4. It is unclear if the definition of “Participating Merchant,” also in the Senate version, was written to *exclude* “occasional” payments like ACH (Automated Clearing House) transactions.
5. From the Senate version of the Proposal it cannot be determined what business entity qualifies as an “Electronic Payment Mechanism.” Arguably, Visa and MasterCard would *not* be covered since they do not sponsor or issue any account or card.

6. In the House Ways and Means version, the following issues would need to be addressed:
  - There is no safe harbor for back-up withholding (TIN matching);
  - It is unclear what businesses the House version is addressing when it refers to "third-party network transactions";
  - The House version's reference to "Intermediaries" is undefined;
  - There should be statutory removal of duplication and this should not be left to the regulatory process;
  - There should be no exemption for tax exempt entities or governments; and
  - There should not be a *de minimis* rule (since this likely adds complexity).
7. A question arises on how reporting would be handled for the purchase of gift cards. The use of gift card programs by small businesses is on the rise, particularly as small merchants look for more effective ways to compete with the large national chains that can dominate an area and threaten their businesses. Consumers frequently purchase gift cards using credit and debit cards. Merchants classify gift cards sold but not yet redeemed as a balance sheet liability and not an income statement item. Only when a gift card is redeemed for goods or services does it become an income item to the business. The reporting of credit and debit card sales would be inclusive of any gift card purchases; card processors would have no mechanism to distinguish those from any other transaction since they are not privy to the items sold, only the total dollar amounts of a transaction. This reporting could lead to duplicate counting of gift card transactions as income to a small business, once when a gift card is sold, a second time when it is redeemed. The reconciliation of these transactions would be burdensome to a small business, especially those currently performing their own accounting, and might very well require that they have to employ the services of a professional accountant. This would increase a small business's costs, which it could not absorb, and would increase costs to consumers.
8. In the Senate version, a "Qualified Payment Facilitator" would be responsible for rendering a "true and accurate" return for "the aggregate amount of such payments made during a calendar year." There is no definition of what constitutes the "aggregate amount of payments" to a merchant. There are various ways in which industry members pay merchants today based on how they handle the processing of items such as Interchange, credits, chargebacks, and fees. Consider: (a) some industry providers pay card sales gross daily and debit Interchange, credits, chargebacks, and fees through some other mechanism at another time; (b) some industry providers pay card sales net of qualified Interchange daily, and debit non-qualified Interchange, credits,

chargebacks, and fees through another mechanism at another time; (c) some industry providers pay card sales net of Interchange and chargebacks daily and debit credits and fees through another mechanism at another time; (d) some industry providers pay card sales net of Interchange, chargebacks and credits daily and only debit fees through another mechanism at another time. This list of four potential ways to determine merchant payments each day does not even consider all of the potential scenarios but just provides a glimpse of how different processors could calculate and report a different “aggregate amount of payments” for the same business if they were providing the reporting. The current draft language in the Senate version is so ambiguous that it could allow each of these calculation methods, although inconsistent, as legitimate calculations for “aggregate amount of payments.” This could result in completely different data for merchants that have the identical annual revenues but use different processors. By contrast, the House version mandates the “net amount of such payments made to each such participating payee.” Netting in the case of the House version of the Proposal will be virtually impossible (for many of the reasons explained herein).

9. Merchants are increasingly selling internationally. Unknown and not addressed by the any version of the Proposal is how international transactional fees and currency exchange should be handled in any reporting. This is an additional item that would need to be covered.
10. The Senate version does not clarify who is the primary “reporter” per payment type or classification. This will result in duplicate reporting to the detriment of all parties: (a) the IRS will be swamped with irreconcilable and duplicative data; (b) the IRS will somehow have to reconcile the data; (c) the payments industry will bear the cost of massive duplicative reporting and subsequent remediation; and (d) the merchants will be exposed to the risk and cost of unsubstantiated tax audits. The American taxpayer will ultimately bear the expense burden of any well-intentioned but incompletely thought-out and administered plan.
11. The timeframes proposed for reporting (within 30 days of year-end for the prior year’s data in the Senate version, and by January 31 for the prior year’s data in the House version) are totally unrealistic given the level of work required. The proposed timeframe provides neither a mechanism nor time for resolving potential errors, clarifying miscommunication, or reconciling data.
12. No version of the Proposal recognizes the simple fact that the TIN number<sup>2</sup> is not an effective unique indicator of a business’s activity within the card payments industry. Common industry database reporting mechanisms are not designed to report by TIN, but instead by industry-assigned merchant account numbers.

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<sup>2</sup> The Proposal establishes an EXEMPTION under section 6050W that a report does NOT have to be made if the processor had validated the payee’s TIN. This is NOT the same as saying that the TIN must be used to identify the payee. Would this then just require the name and address of the payee? There does not appear to be anything in the Proposal about the TIN of the payee being required. (a) What is the effect of this exemption? (b) Presumably, the statute could later be amended to require payee TINs.

Within a multi-location business, individual locations roll up to a hierarchical merchant account for reporting purposes. In this situation there could be multiple-location merchant accounts tied to one hierarchy account and TIN, or multiple TINs tied to a merchant hierarchy account. The payments industry will have to re-tool how it sets up accounts for reporting roll up to match a TIN reporting structure. This is not something the industry processing systems are designed to do today since the mechanism for a merchant aggregating its gross receipts and revenues for tax reporting is its internal accounting software, not its credit and debit processing statements and reports. In addition, the industry will have to re-tool the TIN process, including significant “clean-up” of the accuracy of the existing TINs on file and their corresponding matching locations before they could even potentially be useful.

13. On a related note, the Senate version of the Proposal refers to a “validated” TIN. There is no definition of a “validated” TIN.
14. The Senate version appears to deal only with credit card transactions. However, inherent in the processing of credit cards is also the processing of card-based access to checking accounts, i.e., signature-based debit cards. Would that mean that other forms of electronic payments from similar consumer accounts should be included? For example, consumers also electronically pay from their checking accounts from other card-based vehicles such as ACH access cards and from check to ACH conversion. Reporting on a business’s credit and debit cards would only be a portion of its electronic payments received and still would not help the IRS ascertain cash since other payment mechanisms would still need to be figured in from other unreported sources. Additionally, consumers may pay a business from their credit card, debit card, checking accounts, or even deposits on file, if they are paying a business through a company such as PayPal, or an electronic wallet system. If a small merchant uses one of these mechanisms to process its payments, would only part of its payments from that provider be reported?
15. There are a number of merchants that have multiple processing accounts with multiple banks, both national and international. Merchants that process through international banks as well as through U.S. banks, with multiple accounts, possibly have multiple accounts so that the second account takes over when a maximum volume is reached in the first. How would the reporting compliance be managed in the cases of multiple processing entities, some over which this Proposal may have no jurisdictional authority?
16. The Senate version of the Proposal proposes to become effective to payments made after December 31, 2009. This is unrealistic and unworkable. Industry companies do not currently have the systems structures in place to report under this type of mechanism. The Reporting Proposal leaves many unanswered questions that would have to be resolved before the development of workable systems could even be started. Once scoped out, software would still need to be developed to accommodate this and database structures created for the capture

of the information that would ultimately be run in a report. (The House version of the Proposal does not have an effective date identified, so it is hard to determine whether that might be sooner or later.)

17. Industry representatives have had discussions with Committee staff regarding additional complexities. **None** of these issues are addressed or clarified by the House version. These issues include:

- How would multiple merchants at different addresses with a centralized headquarters be treated? Which would be considered the payee? For example, how would Wal-Mart, which allows other businesses to operate within its stores, be handled? In franchise models such as Shell Oil and its independent service stations, is Shell the covered payment mechanism? In hotel kiosk payments or chain stores, which is the “participating merchant,” the headquarters or each store? For chain stores with sub-contracting merchants within them on which the chain receives a percentage of the sub-contractor’s sales, which address is the proper address, the headquarters, the street address of each store, the P.O. Box, or another address? The questions go on.
- How should factoring or securitization arrangements be handled?
- How should gift card sales be handled, when the \$20 added to the Starbucks card is not a sale but, more properly, a balance sheet liability and the sale does not take place until the latte is sold? Is that transaction \$40 in sales (i.e., 100% overstated)?
- Is the true purpose of this enormous and complex system still merely to extrapolate from this data the **cash** transactions? If so, what proof or the statistical extrapolation model exists? Can it be verified?

18. There are privacy concerns. The Reporting Proposal likely creates increased data storage, and greater opportunity for such data to be lost and/or stolen. Specifically, current versions of the Proposal will involve another private sector database tied to Social Security numbers at a time when ID theft experts, including the Government’s own experts, are urging companies (and the Government) to wean themselves from the use and collection of such information. According to an analysis by the Center for Democracy & Technology, the administration’s version of the Proposal would require credit card companies to report the aggregate transactions of all businesses that have merchant accounts with the card issuers. The reports to the IRS would be tied to each merchant’s taxpayer identification number. The problem is that, in many cases, small businesses use their owners’ Social Security numbers as their taxpayer ID.

## **Conclusion**

ETA requests that this Committee and Congress consider the likely inaccuracies that would be created by every offered version of the Merchant Card Information Reporting Proposal; the burden the Proposal makes on every business involved in the electronic transaction; and the resulting risk of trickle-down cost increases to be borne by the American consumer.

The Merchant Card Information Reporting Proposal should not be enacted and Congress should start fresh in examining how it can address the tax gap or any perceived underreporting.

The ETA welcomes the opportunity to assist Congress in this effort.