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FULL COMMITTEE HEARING ON ELECTRONIC PAYMENTS TAX REPORTING: ANOTHER TAX BURDEN FOR SMALL BUSINESSES

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UNITED STATES HOUSE OF REPRESENTATIVES

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FULL COMMITTEE HEARING ON ELECTRONIC PAYMENTS TAX REPORTING: ANOTHER TAX BURDEN FOR SMALL BUSINESSES

Thursday, June 12, 2008

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 10:02 a.m., inRoom 1539, Longworth House Office Building, Hon. Nydia M. Velázquez [Chair of the Committee] Presiding.

Present: Representatives Velázquez, Hirono, and Chabot.

OPENING STATEMENT OF CHAIRWOMAN VELÁZQUEZ

Chairwoman VELÁZQUEZ. Good morning. I call this hearing to order.

Among its duties, this Committee is charged with evaluating the impact of legislative proposals on this Nation's small businesses. That includes policy consequences ranging from health care and energy to transportation and taxation.

The bulk of these proposals are crafted with the best of intentions, and this panel has supported many of them. On occasions, we also face policies that appear innocuous and may have laudable goals but have detrimental impact on small firms. Today we will examine one such proposal requiring small-business tax reporting on credit card receipts.

A little more than a year ago this Congress, under Democratic leadership, wisely reinstated the budget rule known as PAYGO. It requires all new spending, including tax cuts, to be made revenue-neutral. The restoring of PAYGO signals a firm commitment to fiscal responsibility and makes clear that any new spending must be paid for. These rules fundamentally change the way in which we discuss new proposals. Evaluating underlying policies remain key, but PAYGO implications must also be considered.

Today's hearing to examine requiring small-business tax reporting on electronic payments is just such a case. The proposal has been broached in various forms, and over the past year it was even suggested as a means of helping pay for the farm bill. Promises of valuable offsets are always tempting, but this proposal raises significant technical and financial challenges for banks and entrepreneurs alike.

In today's fast-paced marketplace, electronic payment systems are integral to the daily working of the U.S. economy. They link

merchants, consumers and banks through secure means that are both efficient and convenient.

As we will hear today, the administrative and financial burdens associated with the reporting requirements of this proposal are indeed significant. They might even be justified if the trade-off for small businesses was greater certainty, but the opposite is true. The proposal is built on an incorrect premise that electronic payments foreshadow profits. The reality is quite different for most small businesses. Electronic transactions bear little relation to actual income, especially when charge-backs, merchant discounts and other fees are accounted for. The result is that even careful compliance by entrepreneurs could lead to costly IRS audits.

At a time when data security is being challenged constantly, the new reporting requirements also pose serious privacy risks for millions of citizens. For many small firms, the owner's Social Security number is used by the IRS to track the revenue and tax compliance of their business. Under this proposal, banks will have to include that same information in their reports, which could leave important personal data exposed to identity thieves and other criminals.

Equally troubling is the provision to withhold 28 percent of credit card payment reimbursements to enforce compliance. Banks will be required to withhold the amount from each entrepreneur whose personal information is not collected in time. That means if a bank sends out a mass mailing asking small-business owners for their Social Security numbers, those that do not receive the letter will see 28 percent of their credit card revenue withheld. For every $100,000 in credit card sales, their business will receive just $72,000. For many businesses whose profit margins are between 3 and 5 percent, that can mean the difference between making payroll and having to permanently close their doors.

In short, what at first sounds like a promising budget offset has very real costs for the Nation's small-business economy. These unintended consequences are exactly what we must keep in mind during the consideration of such proposals. After all, even in a PAYGO environment, we cannot afford to focus blindly on revenue figures while creating unreasonable costs for the small firms that drive economic growth.

I want to thank all the witnesses in advance for their testimony today. The Committee is looking forward to their insights on this issue, and we are very pleased that they could join us this morning.

With that, I recognize the ranking member for his opening statement.

OPENING STATEMENT OF MR. CHABOT

Mr. CHABOT. Good morning. And thank you, Madam Chair, for holding this hearing on an important topic for small businesses, proposals to use electronic payments reporting as a way to increase tax compliance.

I would like to extend a special thanks to each of our witnesses who have taken the time to provide this Committee with their testimony. I would especially like to welcome fellow Cincinnatian, Donald Boeding, who I will be introducing a little later.

The IRS estimates that the United States collects 83.7 percent of the total taxes due. After adjusting for delinquent taxes collected

by existing compliance efforts, the IRS estimates that 86.3 percent of tax revenues are collected. The net uncollected taxes are currently estimated by the IRS National Research Program at nearly $290 billion for the tax year 2001, the last year for which data is available.

We all recognize that $290 billion is a significant amount. Because of noncompliance, the burden of funding our Nation's commitments falls more heavily on responsible taxpayers who willingly and accurately pay their taxes. That is most unfair.

However, many small-business groups and merchant banks have serious concerns regarding the proposal to address noncompliance through electronic payments reporting. With small firms already struggling under the weight of massive paperwork burdens, this initiative would add to that burden. Further, there is uncertainty over the benefit of this reporting requirement.

I firmly believe that the first and best thing that we could do to address noncompliance is to simplify the tax code. The code has become a morass of complicated regulations and laws that grow increasingly complex.

For small businesses that are just starting out especially, it can be exceptionally difficult to know exactly what to do and when to do it. Most small businesses pay their taxes in full and on time. However, doing so isn't easy, as the cost of compliance and the time spent to understand and interpret the tax code can be overwhelming.

According to a 2001 Small Business Administration Office of Advocacy report, small businesses with fewer than 20 employees spend over $1,200 per employee to comply with tax paperwork, record-keeping and reporting requirements. This is more than twice the compliance costs faced by larger firms.

The IRS should also focus greater attention on education and compliance assistance. The IRS implied that roughly $148 billion of uncollected taxes comes from underreported business and self-employment taxes. Expanding efforts to help small businesses and the self-employed to prepare their returns accurately and on time could improve compliance.

Unfortunately, there will always be bad actors trying to skirt the system. Finding them isn't easy, but we must continue to look for and penalize those who deliberately evade paying their taxes.

We have an excellent panel of witnesses here today, as I mentioned before, and I look forward to hearing their thoughts. And I again want to thank you, Madam Chair, for holding this important hearing. And I yield back the balance of my time.

Chairwoman VELÁZQUEZ. Thank you.

I welcome all the witnesses.

You will have 5 minutes, and you have the timer in front of you, with the green, and the red meaning that your time is up.

Our first witness is Ms. Kim Stubna. Ms. Stubna is the director of Public policy for the First Data Corporation, a payment-processing company based in Greenwood Village, Colorado. First Data is the Nation's leading provider of merchant transaction processing services including credit, debit, private label, gift, payroll and other

payment solutions that power millions of small-business transactions each day.

Welcome.

STATEMENT OF MS. KIM STUBNA, DIRECTOR OF PUBLIC POLICY, FIRST DATA CORPORATION, GREENWOOD VILLAGE, COLORADO

Ms. STUBNA. Thank you, Madam Chair, members of the Committee. Again, I am Kim Stubna, with First Data Corporation.

I would actually like to focus, really, on three areas today: the impact, again, to our Nation's small business, as you alluded in your opening statement; the administrative burden that others in the payment industry along with First Data would be facing; and, really, a solution that we think would be a lot more simple.

But first let me just tell you a little bit more about First Data. So, as mentioned, we are a Denver-based payments processor. We are a Fortune 500 company. We employ about 29,000 employees globally. And by ″payments processor,″ what I mean is that we facilitate the ability of merchants to accept electronic payments of all sorts: credit cards, debit cards, stored value, loyalty cards. So when you swipe your credit or debit card, say, at a Safeway grocery store, we are the ones actually powering that transaction from the point of sale through Visa, Master Card, Amex, Discover to the bank and back. And we do that for over 4 million merchant locations in this country.

So, again, as you mentioned in your opening statement, we are extremely concerned about the backup withholding requirement of this proposal. You know, when we actually sign up a merchant to do business, we actually ask for the name that they are going to be doing business as, their DBA, which a lot of times is different than the name that they may have filed with the IRS. So, for instance, Dr. Bob Jones, Incorporated may be on file with the IRS, but we have on file Jones Foot Clinic. So that is going to obviously result in a discrepancy that we would have to then institute backup withholding.

If you figure, conservatively, there may be 10 percent of our merchant base that has this discrepancy, that is 400,000 merchant locations in the United States that we would withhold 28 percent of their income. And, as you mentioned, in this time of economic uncertainty, 28 percent could very well mean them having to go out of business.

From an administrative standpoint, one of the difficulties is linking the TIN to transaction information. So, again, when First Data signs up a merchant for business, we may accept their SSN, we may accept their TIN, do some due diligence. But once we actually start transacting for them, they are put into a different system. And we actually assign them a unique First Data ID. And we do that because of locations. So take something like Hallmark Cards. They may have one TIN on file with the IRS, but they may have 3,000 locations across the country that we are transacting for. So we assign a different ID based on each one of those locations so that we can track the transactions, look for fraud and things like that.

On the other end of the spectrum, maybe you have a doctor's office where we have one unique ID for that doctor's office because of the transactions, but there may be five doctors within that office who each have TINs with the IRS.

So even if we were able to link the two systems from the due diligence and the application process to the transaction, you still have the issue of reconciling all of those different locations, the different IDs, the TINs. So that is obviously an administrative burden that would be quite difficult if you look at 4 million merchant locations across the country.

Also, there is an issue about inaccurate data reporting. So if you take an example, I go to Safeway, I buy $60 worth of groceries, but I decide to get $40 cash back at the point of the sale, from a transaction perspective, First Data would report to IRS $100. We don't distinguish between the cash back. So that information then that we would report to the IRS would be biased against Safeway. So now we are put in an adversarial relationship with our customer, because we are reporting information that is inaccurate, and you expose risk of litigation, all those kinds of issues. So, again, from an administrative perspective, that is really problematic.

What we think is actually that there is a much easier solution. Why not add a line on the Form 1099 and have merchants self-report their number of electronic transactions?

That, kind of, follows the same rationale that the IRS has done in the past. In meetings that we had with them, one of the IRS personnel used the example that when they started requiring SSNs to be listed for each dependent that was listed, the number of people claiming dependents, or at least the number of dependents people were claiming, went down.

So why not at least try self-reporting and see it if it meets—you know, we think it would increase some of the compliance and at least be much less costly than the current proposal.

So, really, the bottom line is, again, administrative nightmare, 4 million merchant locations for First Data, others within the payments industry. And, ultimately, I think that it would increase the cost of accepting electronic payments. We can't bear all of the costs of this proposal on our own. So we would pass a portion off to merchants, who would likely pass a portion of their costs to consumers. So you are looking at increased costs of electronic transactions. And, again, we can't ignore the backup withholding issue and the fact that it would drive any number of merchants in this country to go out of business.

Thank you.

[The prepared statement of Ms. Stubna may be found in the Appendix on page 25.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Stubna.

Our next witness, Mr. David Sohn, the staff counsel for the Center for Democracy and Technology, a Washington, D.C.-based organization with expertise in law, technology and policy that seeks practical solutions to enhance free expression on privacy and global communications technologies.

Welcome.

STATEMENT OF MR. DAVID SOHN, STAFF COUNSEL, CENTER FOR DEMOCRACY AND TECHNOLOGY

Mr. SOHN. Thank you, Chairwoman Velázquez, Ranking Member Chabot. First let me say thanks for inviting me to participate here, on behalf of the Center for Democracy and Technology.

CDT is a nonprofit public interest group dedicated to preserving privacy, civil liberties and other democratic values in the digital age. And we have been a leader on privacy and closely related data security and data retention issues. So we are very happy to be able to offer our views on the privacy and security questions raised by the proposal that is the subject of today's hearing.

CDT believes that the proposal could have serious consequences for data privacy and data security, particularly in the case of small businesses. First, there is the issue concerning Social Security numbers of sole proprietors and other individuals engaged in small-scale business activity.

The proposal would require banks and other payment processors to keep track of merchants' taxpayer identification numbers, or TINs. And for sole proprietors and other individual business people, the TIN will often be the individual's Social Security number, as Chairwoman Velázquez noted in her opening statement. So for these individuals, the proposal will mean that their Social Security numbers will be stored and linked to further personal information about them in corporate databases that today don't keep that information.

The reason that is significant is that, in the words of the President's Identity Theft Task Force, which issued a report last year, the Social Security number is ″the most valuable commodity for an identity thief.″ And the more parties and the more databases where that commodity is held, the greater the risk that it could fall into the wrong hands.

In recent years, we have seen virtually a constant stream of high-profile data breaches at institutions of all kinds—corporations, educational institutions and government agencies. And that is why the Federal Government has established a clear policy of trying to move away from and reduce the use and storage of Social Security numbers.

Now, to their credit, the merchant banks seem to recognize this risk. The standard practice today for banks issuing merchant accounts is to discard the merchant's TIN as soon as the account is approved. And this is consistent with the widely accepted privacy principle called ″data minimization.″ The principle is really pretty simple. It just means: Only collect the data you really need, and only keep it for as long as you need it. Banks are following that principle today regarding TINs and Social Security numbers of sole proprietors. And CDT does not believe that Congress should force them to abandon that kind of sound privacy practice, as this proposal would force them to do.

Second, the proposal may well entail other types of expanded data collection from small-business owners. Sometimes reporting the aggregate amount of credit card receipts from a particular merchant account can paint an incomplete or misleading picture. And when that happens, it is easy to predict what is going to happen next. There will be pressure to provide more detailed information.

For example, you could have small businesses that share a merchant account. Think about flea market sellers who are neighbors at the flea market. In these kinds of cases, the aggregate amount reported will say little about what the actual revenues or profits of those businesses are. So it is likely to lead to pressure for the IRS to ask for a more detailed breakdown of that information, which would mean significantly more tracking by the banks of their merchants' activities than occurs today.

Anyway, the point on this is simply that, before Congress adopts any new proposal here on this topic, it really should carefully explore the additional types of data collection that would likely be demanded as part of any new reporting system.

The final concern I want to mention is that the proposal would set a dangerous precedent. CDT is actually very concerned that if this proposal is enacted it could encourage additional government efforts to enlist private-sector intermediaries in tracking the behavior of their customers.

For example, if the Federal Government goes this direction, it is easy to imagine that State governments might try to follow suit and impose tax-reporting obligations of their own. Other types of data-retention requirements that have been proposed in the past and that could get an unwarranted boost here would be proposals to have Internet service providers, for example, track the browsing behavior of their entire customer base simply because something might someday prove of interest to law enforcement.

CDT objects to those proposals and would hate to see them get encouragement from congressional action on this subject.

So, for all these reasons, CDT believes that this Committee and Congress should pay careful attention to the data privacy and security concerns that this proposal raises and, in light of those concerns, really should put a heavy burden of proof on the proponents of the proposal to show that it is effective, that it is necessary and that it is better than possible alternatives.

Thanks again for the opportunity to testify.

[The prepared statement of Mr. Sohn may be found in the Appendix on page 27.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Sohn.

Our next witness is Mr. Todd McCracken. Mr. McCracken is the president of the National Small Business Association, a national, nonprofit organization representing more than 150,000 of America's small-business companies and entrepreneurs. The NSBA is the first and oldest national small-business advocacy organization in the United States.

It is always a pleasure to welcome you.

STATEMENT OF MR. TODD McCRACKEN, PRESIDENT, NATIONAL SMALL BUSINESS ASSOCIATION

Mr. MCCRACKEN. Thank you, Madam Chairwoman. It is good to be here. And I appreciate the Committee inviting us to testify today. This is quite a crucial issue.

I would like to ask that my written statement be submitted to the record, because I am going to try to narrow my oral remarks a little bit. You have a lot of expertise up here—

Chairwoman VELÁZQUEZ. Without objection.

Mr. MCCRACKEN. —on some of the more technical questions of how the information gets processed and how the money gets transferred. So I would like to focus my remarks on some of the more practical objections that small businesses have, but also the question of whether this, even in a perfect world, would really be a solution to the tax gap, you know, as the IRS perceives it.

The bulk of the tax gap, as the IRS has reported, it comes from the underreporting of income. And so this clearly is an attempt by them to figure out a way to get more of that income reported. There are a few problems, I think, with that analysis. And one of them is that there is not a lot of evidence to suggest that most of the underreporting of income comes from credit card transactions. Some evidence suggests that there is underreporting of cash transactions and some other things like that; not so much on the credit card side of things.

So you begin to at least have to question, well, why is this seen to be so important? And we think that one of the reasons it is important is for a couple of—actually, there are a couple reasons we think it is important for them.

One is because they think it will enable the agency to do some modeling. And that is to say, if your credit card transactions are outside the norm for your industry, it will send up a flag that maybe there is something funny going on in your business and we should come look at what you are doing.

That is enormously concerning to us because of, again, for a couple of reasons. One is because there is a great diversity in the small-business community. And just because, you know, an average of 60 percent of transactions in a given industry are on credit cards and another business seems to have, you know, 80 or 90 percent of their transactions on credit cards doesn't necessarily mean anything is going on that is unusual. It has a lot to do with the demographics of the customer base of that business, perhaps, a lot to do with the way that person has chosen to run their business. It doesn't necessarily mean anything funny is going on. But those kinds of businesses, we think, are going to become subject to greatly increased audits and administrative burdens that come with those audits for no real good reason.

Secondly, the IRS tells us that they want to find non-audit-based ways of collecting revenue. That doesn't seem to fall in that category.

And then there is a whole raft of concerns that we have about what small businesses would have to do to, sort of, reconcile their books with the reporting that they get. And we have already heard a few of them, but the list goes on. There is lots of sharing of credit card processing services amongst small businesses. It could be the flea market. It could be the doctor's office you have already heard about. But there is a lot more that goes on in the economy as well, and that is going to have to get sorted out. And it may ultimately mean a lot less use of credit cards in the small-business community, which provides whole other layers of burden for those small companies.

But there is also the question of reconciling, you know, cash versus accrual systems. A business may send out an invoice in De-

cember for a printing job, for instance, to a customer, and it goes on their books as, you know, a receivable that year. Well, they may not get paid, and get paid on a credit card the next year, and it will get reported as income the next year. They have to figure out a way to reconcile those kinds of things.

Lots of businesses take deposits. Well, that is not income until you actually take delivery. That deposit could be refundable. You don't count that as taxable income until you actually purchase it. Yet, a lot of deposits, whether it is for a new kitchen or a boat or whatever, are paid on credit cards.

And so there is just a huge stream of money that flows to businesses on credit card transactions that simply isn't taxable income. And that is going to have to be sorted out, not just by the IRS, but by the business owners themselves.

So, again, even if all of these technical questions can be addressed—and we don't think they can be—but even if they could be and the credit card processors could find an easy, seamless, lawsuit-free way of providing good data, there are still huge obstacles for how this data would actually get used by the IRS in any meaningful way to actually increase the revenue in a way that makes sense for small companies.

So we appreciate your having this hearing. And we would strongly urge you to do everything you can to convince your friends at the Ways and Means Committee and over in the Senate in the Finance Committee that this is a particularly bad idea.

[The prepared statement of Mr. McCracken may be found in the Appendix on page 43.]

Chairwoman VELÁZQUEZ. Thank you, Mr. McCracken.

Our next witness is Ms. Kristie Darien. Ms. Darien is the executive director for the National Association for the Self-Employed, the Nation's leading resource for the self-employed micro businesses, providing a broad range of benefits and support to help the smallest businesses succeed.

Welcome.

STATEMENT OF MS. KRISTIE DARIEN, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION FOR THE SELF-EMPLOYED

Ms. DARIEN. Thank you. I am really happy to be here on behalf of our 250,000 member businesses.

NASE's members are micro-businesses, 10 or less employees, and the self-employed that are the segment of the business population that repeatedly struggles with complying with our complex and ever-changing tax code. And they do so without the benefit of professional assistance.

We feel that any recommendation relating to tax compliance must be reasonable and effective. And, unfortunately, we believe this recommendation is neither.

This proposal is likely to have significant unintended consequences. The lack of clear details regarding its implementation must be addressed to accurately gauge its effect on both the micro-business community and our economy.

Todd mentioned quite a bit about the use of data, which is one of our top concerns, so I will second all of his comments in regards

to that, particularly our concern of the use of industry profiles to make estimations on other types of items on the tax return, like cash payments. We think that will be riddled with inaccuracies and cause a lot of significant difficulties for small business.

Another area that is ripe for mishandling in regards to this proposal is the taxpayer identification number verification and the backup withholding process that would be required of credit and debit card issuers under this plan. These companies would be required to verify the TIN of a business, and if that is inaccurate, they would have to backup withhold 28 percent of the gross transactions for that business.

Obviously, no specifics have been released to date as to how to IRS plans to effectively implement these components. There are likely to be inadvertent reporting errors through this process, yet there is confusion regarding where a small-business owner would go to rectify any problems.

Many sole proprietors, the majority of NASE's membership use their Social Security number as their identifier. Therefore, we are concerned about privacy and protection of personal data under this plan.

In addition, withholding on gross transactions will create a substantial cash-flow problem for the self-employed. In 2007, the median gross revenue of an NASE member's business was only $62,500, and overwhelmingly their business was the main source of household income. Thus, backup withholding could also place a severe financial strain on their families.

Cost is another factor that we must consider. Overall implementation of this proposal will require financial and human capital resources by both the IRS and the credit and debit card companies. We think it is prudent that Congress require IRS to prepare a cost-benefit analysis of this plan to determine potential costs of administration as it compares to projected revenue.

Moreover, our bigger concern is the credit and debit card companies who are more than likely to pass the cost of compliance onto their microbusiness merchants in the form of higher user fees. NASE member Keith Kaufman own a business in Arizona. He receives about 60 percent of his transactions through credit and debit cards, and he is significantly worried about the additional financial burden on his business in the form of higher credit card fees. Because he cannot charge more for credit card transactions, he would essentially have to eat those fees, and it would affect his bottom line.

So we strongly encourage Congress to reach out to these pertinent companies to determine the ultimate impact on consumers before they even think of moving forward on this proposal.

In conclusion, I think there are two key questions that we need to ask: Will this proposal increase tax compliance? And will Government recoup funds with the implementation of this plan?

The majority of NASE members feel that this recommendation will not increase tax compliance. They are quick to point out that this proposal will be collecting information that is well-documented, already likely reported, and would be revealed easily upon review. Therefore, the taxpayer who willingly underreports would not

knowingly choose to exclude credit card receipts, since those items show up on bank statements and have a paper trail.

In regards to recovering revenue, the NASE believes that it is highly unlikely that this plan will identify any additional taxable income. In fact, we think that the majority of the revenue collected would be from inaccuracies or mistakes that would trigger backup withholding.

The NASE does not support this recommendation, and we urge Congress to look to alternative solutions. In our opinion, legislators' true interest in this proposal lies with its possible use as an offset for various congressional spending priorities. We understand the fiscal climate our government is facing. However, you are asking the segment of the economy that is affected most by the current high health-care costs, by high energy costs, facing difficulties due to our current credit crunch to foot the bill for other proposals, many of which they would receive no benefit from.

Congress should focus on ensuring passage of effective policy at a reasonable cost for all citizens before they rush to put the financial squeeze on the self-employed and micro-business.

Thank you.

[The prepared statement of Ms. Darien may be found in the Appendix on page 51.]

Chairwoman VELÁZQUEZ. Thank you, Ms. Darien.

And now I recognize Mr. Chabot for the purpose of introducing our next witness.

Mr. CHABOT. Thank you, Madam Chair.

I would like to welcome a fellow Cincinnatian, Donald Boeding. He is the senior vice president and general manager of merchant services for the Fifth Third Bank Processing Solutions. Fifth Third is one of the more significant employers in the city of Cincinnati, and we are very pleased that they are there.

He has direct responsibility for the day-to-day operations of the merchant processing business alliance. Mr. Boeding has been with the Fifth Third Bank since September 2004 and has been involved with merchant services for most of his career.

He holds a BS in finance from the University of Iowa.

And Fifth Third Bank Processing Solutions is one of the five principal activities of Fifth Third Bank Corp, a diversified financial services company headquartered, as I mentioned, in Cincinnati, Ohio.

In addition to the Fifth Third Processing Solutions, Fifth Third is involved in commercial banking, retail banking, consumer lending and investment advising. Fifth Third Processing Solutions provides electronic funds transfer; debit, credit and merchant transaction processing; operates an ATM network; and provides data-processing services to affiliated and unaffiliated customers.

Fifth Third processes $175 billion in card sales annually. According to the March 2008 Nielsen report, Fifth Third is the fourth-largest Visa, Master Card acquirer in the country.

Mr. Boeding, we look forward to your testimony. Thank you.

STATEMENT OF MR. DONALD BOEDING, GENERAL MANAGER OF MERCHANT SERVICES, FIFTH THIRD PROCESSING SOLUTIONS, CINCINNATI, OHIO

Mr. BOEDING. Good morning, Chairwoman Velázquez, Ranking Member Chabot and distinguished members of the Committee.

As Mr. Chabot said, my name is Donald Boeding, and I am the general manager for the Merchant Services Division of Fifth Third. I appreciate the opportunity to appear today and offer you some industry perspective on the proposal to require institutions that make payments to merchants for payment card transactions to file those annual information reports with the IRS.

First, I would like to give you some general thoughts on the increased information reporting and then dive a little deeper on some of the aspects that maybe some of the other panel members haven't touched on.

To begin, in short, I think we can draw a few initial conclusions about this potentially sweeping proposal, notwithstanding the limited availability of detail as to its specific requirements and implementation parameters.

First, the enactment of such an increased information reporting measure would come at a very difficult time in the economy, particularly for financial institutions and small-business sectors. New and increased reporting requirements will translate into significant IT investment expense and allocation of employee talent by processors like myself to ensure compliance during both the ramp-up period and on a go-forward basis.

Second, the potential application of backup withholding presents tremendous risks for both processors and merchants. At 28 percent, backup withholding will have deep impacts on merchants and, in some cases, represent the difference between success and failure.

Third, the merchant processing industry as developed does not operate in a way to comply with the known parameters of this proposal.

Fourth, the proposal will strain the relationship between payment processors and merchant customers, in some cases driving merchants to avoid the convenience and security of electronic payment systems.

Finally, given the vague nature of the proposals offered to date, the full impact on all parties will not be known until implementation and compliance have been audited. It is likely that interested parties are not fully aware of the operational impacts that this will have.

First, focusing on the costs of compliance. System modification and contract renegotiations and the time associated with both will place significant expense on payment processors. Further, processors will need to store and secure the data provided to the IRS. The expected hard costs associated with ramping up and maintaining a program to facilitate compliant reporting are only part of the cost that should be expected to arise out of this proposal.

It should be expected that the number of hours a processor will ultimately have to devote to trouble-shooting alleged errors in the reporting would be significant. For instance, if the IRS reporting from a processor does not reconcile with other reporting received by a particular merchant, it will likely result in significant hours

spent by myself and my team trying to help that merchant reconcile through that process. This will add a level of complexity to all new product initiatives, additional analysis, and possible extra development will be required each time a new payment product is developed and/or rolled out.

Specific to backup withholding, as noted, the merchant reporting proposal includes a proposal to withhold 28 percent of payments made to merchants on whom we do not have a valid TIN. Processors would be required to immediately withhold on any payment on which a TIN is missing or is obviously an incorrect number.

The impact of this new withholding on merchants, particularly smaller merchants, would be substantial, presenting great complication and burden on their cash-management procedures, as has been already noted by the panel. The reduction of cash-flow based upon transactions that may have no income tax consequence would be a tremendous burden to our merchant clients.

At a minimum, should back-up withholding remain a part of any increased merchant reporting proposal, a period of significant phase-in, perhaps 2 to 3 years, should be provided before withhold is required. This will allow payers time to obtain the necessary information. And, additionally, any new compliance regime in this area should include appropriate safe harbors from penalties where 100 percent compliance is not achieved.

Focusing on the impact of the merchant reporting entity relationship, it is certainly possible that the reporting could create tensions between acquirers and processors and their merchant customers, who don't understand how the information is going to be used and/or disagree with the methodology by which the processors have created the reporting. This will result in a tremendous amount of concern and confusion among our merchant customers. Additionally, fear of audit can make merchants less likely to accept electronic payments.

On a final note, it should be expected that the noncompliant taxpayers this proposal targets will ultimately find and develop schemes to avoid recognition through this type of reporting. Some may simply stop accepting cards all together, thereby making it less likely that the IRS will be able to track taxable income. Others may simply work to find loopholes in the reporting mechanisms that are ultimately established.

The benefits expected to arise from this initiative may ultimately result in increased cost to the compliant payment card participants—consumers, acquirers, processors, issuers and merchants—with no real benefit to these same participants.

Thank you for your time, and I look forward to answering any questions that you may have.

[The prepared statement of Mr. Boeding may be found in the Appendix on page 56.]

Chairwoman VELÁZQUEZ. Thank you, Mr. Boeding.

I would like to address my first question to Ms. Stubna.

Ms. STUBNA. Yes.

Chairwoman VELÁZQUEZ. It has been suggested that only banks providing services to businesses would be affected by these new re-

porting requirements. Is that an accurate assessment of who would be required to file information reports?

Ms. STUBNA. Madam Chairwoman, we don't actually believe it would just fall on banks. In fact—and First Data's role to accept—when a merchant wants to accept a credit or debit card, a bank must actually sponsor the merchant into the system. That is what Visa and Master Card, at least, require for their particular cards. And First Data is then usually a party to that contract. So, in our role as a service provider to a bank, we would assume that the bank would ask First Data, because we are actually part of the processing arrangement, to actually report the information. So, no, we feel like it would fall on banks, processors, merchant acquirers.

Chairwoman VELÁZQUEZ. Thank you.

Mr. McCracken or Ms. Darien, Ms. Stubna suggested self-reporting electronic payments as an alternative to bank reporting. Could you comment on that proposal?

Ms. DARIEN. Yeah, one of the less burdensome recommendations that we have made is that we think that there are very easy things that can be done with the current tax forms to help facilitate reporting.

One of the things we recommended was modifying the Form 1040 Schedule C, which is the form that sole proprietors use, which is who the IRS seems to think is the segment of the population that are underreporting. Where, in part one of the form, we could simply separate the line item for gross receipts and sales into two and ask them to distinguish between cash payments and also credit and debit card transactions. It is an easy way to self-report, and it is also an easy way to remind the businesses that they have to track their cash payments equally as well as their electronic transactions.

So, yes, we agree that would be a great way to begin the process of increasing compliance.

Mr. MCCRACKEN. It is not something we have specifically dealt with yet, but I would agree that it would be a better alternative than what we have on the table now. I am not in a position to endorse it yet, but it is something that I think bears some looking at.

Chairwoman VELÁZQUEZ. Okay. Mr. McCracken, many businesses, particularly small businesses, make agreements to sell their card payment income to other entities, often with franchise or separate station agreements.

Do the proposed reporting requirements account for this type of arrangement, where the merchant never receives the full value of their card payment income? Can you comment on that?

Mr. MCCRACKEN. I am probably not the best person up here to comment on that, but it does strike me that that would be a significant problem. I mean, I think that gets at the heart of, I think, the whole issue, is you can't begin to catalog all of the situations where the money that moves through the credit card processing system is not reflective of real income.

Chairwoman VELÁZQUEZ. Any other member of the panel would like to comment on that? Yes, Mr. Boeding?

Mr. BOEDING. I think I can specifically address that where the merchant effectively sells their receivables and they instruct me to credit their daily receipts to the entity that has fronted them the

money. And that would present tremendous difficulties of determining who is responsible for the tax burden.

Chairwoman VELÁZQUEZ. Thank you.

Ms. Stubna, when this new reporting requirement was first proposed for 2007, it was estimated that it could generate approximately $225 million over 10 years. Only 1 year later, that figure jumped to $10.8 billion over 10 years.

What accounts for this large discrepancy in those estimates?

Ms. STUBNA. You know, actually, we asked the same question. We posed that question to Treasury in the meetings that we had with them. And nobody ever really actually gave us an answer as to what accounted for the jump. And, I mean, it has been, obviously, significant.

One of the things that Treasury said was that the large number accounted for all of the different tax gap proposals together, and it wasn't just the credit card reporting ones. So, I am sorry I don't have a better answer, but—

Chairwoman VELÁZQUEZ. Does anyone on the panel have any comment?

Mr. MCCRACKEN. Well, we don't know either where the number came from. And there are so many different ways that you hear that this could raise revenue, that increased reporting increases revenue, that being able to track this and get more—audits raises revenue. But we are not really sure which of these they think are the primary ways that the revenue will come in.

Chairwoman VELÁZQUEZ. Sure.

Ms. Darien?

Ms. DARIEN. Again, we agree, we don't know where their numbers are coming from. And a big concern is that I don't think there has been any account for how many businesses would go under because of this and how many entrepreneurs would be deterred, because if they want to go into a business which happens to be an electronic-payment-card-heavy business, like retail, for example, high fees are a great way to push people out of entering entrepreneurship. And I am certain that that has not been accounted for in their numbers.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Sohn, in your opinion, how should consumers and merchants be made aware of the privacy risks if a card payment reporting requirement were enacted?

Mr. SOHN. Right, well, I think the initial thing is to make sure we have a full public debate on it now, before the proposal is put into effect, and that it is fully considered, that Congress looks into all the different ways that this might end up expanding information reporting requirements and that that be fully part of the public debate.

You know, I think to some extent if a proposal like this is actually enacted, it is to a large extent too late. If people are aware of the privacy consequences and concerned about it, their real option will be to not use credit cards as a means of payment. And that strikes us as an unfortunate consequence.

Chairwoman VELÁZQUEZ. Are there ways that entrepreneurs could protect themselves from the privacy risks associated with the

reporting regime if they currently use their Social Security number as their taxpayer ID number?

Mr. SOHN. Yes. I mean, they certainly could. Individuals could register as a business and get a taxpayer identification number that is different from their Social Security number. I think, again, when you are talking about individuals doing relatively small-scale sales, that, too, puts a significant burden on them to take that extra step. But it might well be, if this proposal were to go into effect, that that is something they would want to do to try to protect their Social Security numbers.

Chairwoman VELÁZQUEZ. Ms. Darien, if backup withholding, which will require 28 percent of a business card reimbursement directly be sent to the IRS, were made part of the reporting requirements, what would be the effect on small businesses?

Ms. DARIEN. It would be a massively detrimental effect, particularly on our members. Again, the majority of our businesses are 10 or less. Our average member is a two-person business. It is typically a family business. And as mentioned, when you are looking at a median gross revenue of a little over $62,000 and you are going to withhold 28 percent of gross transactions and that money directly flows through to their household income, you are going to put a severe strain on millions of American families that are counting on the self-employed bread-winner in their family. So it will have widespread damaging effects on the self-employed community.

Chairwoman VELÁZQUEZ. Todd, I suspect you are having discussion with the IRS in terms of the implications, economic implications, that this will represent for small businesses. And have you posed a question to them if they have done any economic analysis as to the effect of 28-percent withholding on credit card reimbursements?

Mr. MCCRACKEN. I don't know that we specifically asked the IRS if they looked at that. We certainly have asked them for more information on how they arrived at revenue estimates of it. But, clearly, the economic implications are potentially enormous.

I mean, they clearly have not looked at all of the ways that, even aside from clerical errors, that the TIN just isn't going to correspond with the businesses being reported about. And so there is going to be not an inconsequential amount of backup withholding if this proposal goes forward, which is going to be just—and just think about a business—I mentioned deposits before.

I mean, you may be running an inn. You may require a night or two stay deposit, and someone pays on a credit card. They cancel. You may issue them a refund via check; doesn't necessarily go back on their credit card. Well, you are getting backup withholding on revenue you are not going to have for another year until you file your taxes. And for those folks, every dollar counts.

Chairwoman VELÁZQUEZ. Thank you.

Mr. Chabot?

Mr. CHABOT. Thank you, Madam Chair.

Mr. Boeding, I will begin with you. Why is the withholding aspect of the proposal such a significant issue to both small businesses and merchant banks? And can you ID a better approach to improve the compliance than we currently have?

Mr. BOEDING. Well, let me start with the small business, as I have spoken with some of my customers about this particular initiative and the impact that it may have upon them.

You know, concepts of the way that we paid in the 1970s and 1980s are coming back. The desire to offer discounts for cash to be able to avoid—you know, wanting to accept checks as a preferred form of payment are the words that we are hearing from our clients. And, as you might imagine, in the business that I run, that is not a particularly good thing. And I also don't think it is a good thing for, you know, for our economy in general.

Impacts to me and our business from a backup withholding perspective, we don't know. You know, the merchant processing business, you know, has been around for, you know, well over 30 years, and this is not anything that we have ever contemplated in executing our business model. So there are so many intricacies that we have to work through to try to determine how we will do it and how we will communicate, how we will report and, most definitely, how we will work with our clients to try to help explain to them the numbers that we have submitted, especially if we are reporting on gross. Some of the other panel members have mentioned that.

You know, charge-backs, refunds, you know, the prepayment-type aspects all go into some very serious things that have to be considered. You know, many merchants, especially in, like, in the card-not-present space, they have, you know, 15 to 20 percent return rates on some of the goods that they sell. So, you know, 28 percent for those types of clients, it would be a much higher effective rate against their net proceeds.

We would prefer that no backup withholding be a part of this, that this simply be an information reporting at most.

Mr. CHABOT. Okay. Thank you very much.

Ms. Darien, right at the end of your closing statement, you said something that I really agreed with strongly, and I thought I would just read it again. You said, ″It is in our opinion that legislators″—that means us or Congress or the Ways and Means Committee or whoever the bad guys are in this—″their true interest in this proposal and others relating to the tax gap lies with its possible use as an offset for various congressional spending programs. Congress should focus on ensuring passage of effective policy at a reasonable cost to all our citizens before they rush to put the financial squeeze on the self-employed and microbusinesses, which remain the foundation of both America's economy and communities.″

And, as we all know, small businesses are responsible for creating about 70 percent of the jobs, and they would be hit particularly hard in these various reporting requirements.

And the term ″tax gap,″ you didn't hear that years ago. It is a term that crept up recently, in recent years. And I think it is exactly what you said in your statement. It is a way for Congress to think there is this money that is sitting there, that all we have to do is get it and then we can continue to spend in the free spending style Congress has for years, both under Republican control and Democratic control; we have seen it under both. And, of course, my colleague here would indicate that it has been much more responsible recently—

Chairwoman VELÁZQUEZ. Bigger, bigger under a Republican administration, by the way.

Mr. CHABOT. We could debate that, too.

But, in any event, I think you are right, that it is this new thing, that that is going to solve the fact that Congress doesn't balance its budget every year, even though families have to do that, but we don't. And that is just wrong. But I completely agree with you on that statement.

Any comment?

Ms. DARIEN. Yes, I mean, we understand—of course we want to increase tax compliance, help people to meet their responsibilities better. But, as a Nation, we have consistently had a tax gap since we have had a tax code. I don't think you find any industrial nation that has 100 percent tax compliance; I don't think you ever will.

And I think the focus should really be on our government tightening their purse strings, learning how to be responsible with our money, just like a small business does. And I agree that, all of a sudden, it seemed like this pot of money was an exciting pot of money to go after as we are looking to pay for different proposals.

And, again, many of these proposals that they are looking to attach these recommendations to will actually have no benefit to a small-business owner. So you are asking these people, this foundation of our economy, who have $62,000 a year, to squeeze out a little more to help our government, and they are already struggling. So I think we need to be mindful of who we want to help and who we are going to hurt in that process.

Mr. CHABOT. Thank you.

Mr. McCracken, you mentioned that one of your principal concerns or worries was the additional audits that small businesses could be subjected to. And, obviously, other than the psychological trauma that the small-business owner and their employees, because their jobs could literally be at risk depending on how the audit comes out, could you tell us why that is particularly burdensome to a small business, that they have to go through an audit?

Mr. MCCRACKEN. Oh, sure. I mean, an audit can be an extraordinarily time-consuming activity. A lot of small companies don't have a full-time CPA on staff or even on retainer for their company. So it is an issue they are often in the position of dealing with personally. And it can go on for quite some time and really sap a lot of time and energy out of a company, even if, at the end of the day, there is no additional tax revenue that is required to be paid.

So, I mean, an audit is no small thing. And to the extent the IRS—I mean, we think it is a good idea for the IRS to figure out ways to target audits appropriately. And they have said they want to do that. And we think, to the extent they are going to audit people, they ought to figure out who are the best targets. Our concern is that the credit card information is going to provide a great deal of misleading information about who those targets really ought to be and that they are going to be auditing folks that aren't appropriate targets.

Mr. CHABOT. Okay. Thank you.

Mr. Sohn, you had mentioned that—and, of course, you have privacy concerns as one of your big concerns. And I have been very active in that area over the years and very interested in it as well.

And you mentioned that one of the concerns was the Social Security numbers being more susceptible to thieves getting a hold of these things. And could you explain the significance of that, what it is that the thieves do with these things and why that is such a risk to both the small business and anybody that may be listed on there?

Mr. SOHN. Sure. It has been a finding of everyone who has looked into identity theft that, really, the most important piece of information an identity thief would like to get is a Social Security number. For purposes of trying to open fake bank accounts in someone else's name and so forth, that is an extraordinarily valuable piece of information and is really the gateway to identity theft and a variety of scams.

So the general principle—and this is the precise policy the Government has adopted—is, we need to stop relying on Social Security numbers so much, we need to stop collecting and using them as much as we do, because when they are out there and when they are stored in lots of different databases all over the place, it just creates more opportunities that, through data breaches, they could fall into the wrong hands.

So really trying to minimize Social Security number use is a core piece of the strategy of combating identity theft, and this proposal goes the opposite direction.

Mr. CHABOT. Thank you very much.

And, finally, Ms. Stubna, you mentioned that—well, I think the panel here and I think both the chairwoman and myself agree that this electronic payments reporting is greatly suspect and that there ought to be other ways found.

Could you again point out what alternatives are out there, what should be done instead of this if—and, again, I don't use the term ″tax gap,″ but the noncompliance or underreporting or the fact that some people historically have gotten away with not paying their fair share to the detriment of everybody else. But what would you do as an alternative that might work, compared to this, which we all agree would be too burdensome?

Ms. STUBNA. Well, we are actually still trying to come up with—we have been having quite a few meetings internally with operations to find maybe some other alternatives, whether it is, you know, looking at the monthly transaction statements that we supply to merchants. You know, we are trying to figure out if we could do that on an annual basis.

But I really do think that, first and foremost, the self-reporting would at least be a good start. You know, if it doesn't meet the compliance that the IRS is hoping to achieve, then maybe look at other alternatives. But, you know, we weren't set up to be an extension of the IRS. We were set up to move money efficiently, quickly, securely, not to report information to the IRS. And so we would love to be not placed in that spotlight.

And I will just point out too, you know, the whole thing seems to be predicated on this 90 percent compliance rate for reporting. But, you know, in the meetings that we have had, the issues about

inaccurate data, the problems with our systems, it doesn't seem like they care. They are just looking at this magic 90 percent compliance number.

And I think it would be more appropriate to look into some of the concerns that we have raised before moving forward with it.

Mr. CHABOT. Okay.

Thank you, Madam Chair.

And I just would conclude by commenting that your statement just then about not being an extension of the IRS, I think unfortunately the Government looks at all of us as an extension of the IRS.

I yield back.

Chairwoman VELÁZQUEZ. Ms. Hirono?

Ms. HIRONO. Thank you, Madam Chair.

I conclude from the testimony from all of you that this is, while well-intentioned as a way to make sure that everybody pays the taxes they owe, it is very broad and burdensome. So I am glad, Ms. Darien, that you offered an alternative way for people to comply with the IRS's needs.

I am not sure whether anybody talked about how much it would cost the businesses to comply with this. Is there a ballpark figure? You all, I think, testified that this is going to be very costly to comply, but is there a figure that you can come up with?

Mr. BOEDING. I think we are having a difficult time, being a processor, coming up with what that will be. Certainly, the number for us, in just our business, ranges well into the millions to establish the ability.

What is most concerning to us and really an unknown is the ongoing costs associated with compliance and servicing and dealing with our customers and the ongoing explanation. We think that is going to be, over the long term, the most significant portion of the expense.

Ms. HIRONO. When you are having your discussions with the various committees, including the IRS, do you kind of go as a group, or are you individually doing that? Because I notice we have testimony from the ABA. That is a large interest group out there. Are you coordinating or collaborating in any way?

Ms. DARIEN. Of the small-business groups, there is a Coalition for Fairness in Tax Compliance, which is a large coalition of small-business organizations that are addressing some of the tax gap recommendations, including this. So we have begun to work together on these particular issues.

But in terms of your cost, I think that one of the big issues is this proposal has been misrepresented as being not burdensome to small business, because actually the onus on compliance is on the credit and debit card companies. But what they doesn't take into consideration, again, are the consequences of the proposal, the time costs for small business in having to address any inaccuracies, the time costs in dealing with backup withholding and, more specifically, the cost they are going to face with higher user fees on their credit cards, which is almost a guarantee should this go through. And that would be a substantial cost on small business.

Ms. HIRONO. I just think that that cost that is ultimately going to be borne by the merchants, that should be a pretty basic kind

of an understanding. And including the 28 percent backup withholding, I think that is very burdensome.

My question is, since this seems to be an idea that—has the train left the station already? Do you think that we can do some things that will cause us to pause on this?

Because let's face it, we are looking for all kinds of ways to comply with our PAYGO requirements. And I think, as business people, you would agree that Government should make sure that we have money for the programs that we are supporting.

So what is your sense of where we are?

Ms. DARIEN. I think we are all here asking, maybe, you for help. Obviously, Senate Finance had a public comment period on this particular proposal. And they, the Chair and ranking member of that Committee, are extremely interested in using the tax gap proposals to finance various priorities. So that is a big concern for us.

So, you know, we seek your assistance, being the voice for small business in Congress, to get our message across about this particular proposal and others, and get people understanding what they are about to do to this important sector of our economy.

Ms. STUBNA. And I think the problem is, too, you have this enormous number that has been tagged to this proposal, you know, $12 billion, $18 billion, whatever it is now—it keeps changing, but—

Ms. HIRONO. It doesn't seem real, right?

Ms. STUBNA. It doesn't. And as long as that is associated with it, unfortunately I think it is just an easy target.

Ms. HIRONO. An easy target, yes. Well, that is the purpose of this hearing, so I thank the chairwoman for convening all of us. Thank you.

Chairwoman VELÁZQUEZ. I have two or three more questions.

Mr. Boeding, how much time would be required for the payment processing industry to change its system to effectively implement new reporting requirements?

Mr. BOEDING. We have held several meetings with that, and our ranges are very extreme. The amount of time for us to do this will be significant. To put a specific number to it, Madam Chairwoman, it is difficult for us to do.

The thing that is absolutely certain to us is that it will come at the cost of other product innovation and offering better, more efficient services for consumers and merchants to get consumers to pay. And that is, you know, a reality for us, is that we will have to stop much of the innovation in the industry in order to seek compliance.

Chairwoman VELÁZQUEZ. Ms. Stubna, do you have any comments on that?

Ms. STUBNA. Yes. We were looking—when this originally came out in 2006, we talked to some of our IT folks. And we have about 10 platforms throughout the country that we process from. And they were estimating that just to link the 10 to the First Data ID, like I mentioned earlier, that it would take about 3,000 man-hours for each system. That is, again, not even taking into account the errors and all of that once it is implemented.

Chairwoman VELÁZQUEZ. Thank you.

Mr. McCracken, what should be done to ensure that businesses with a high volume of small-dollar transactions do not face exces-

sive administrative burdens to reconcile their information reports with their books and records?

Mr. MCCRACKEN. I am not sure there is an easy solution aside from not doing this. I think that is the very real danger that you have in moving this forward, are, if you have—especially people who do a lot of small transactions who are bent on being tax cheats and they don't want to report their income, and you decide to do this, I mean, all you are doing is creating incentives for them to move to cash.

And either set an amount, like a lot of merchants already do, of a minimum of $15, $20, $25 to accept credit cards or not to accept credit cards at all, and you have moved those businesses from at least having some credit card data collection, which if there is an audit the IRS can go get that data and prove that those transactions occurred—instead you have moved those businesses to an entirely cash basis, in many cases.

So if there is—and there is a very small minority of companies that don't want to report all their income, but they do exist—by doing this, you have created yet less of an ability to track what they are really doing and what income actually going to their business.

Chairwoman VELÁZQUEZ. Thank you.

Ms. Darien, like always happens, do you think it is reasonable to assume that the additional costs associated with these new reporting requirements will be passed along from banks and processors to merchants?

Ms. DARIEN. Oh, yes, definitely. I mean, I have no doubt that that will be the case. I mean, they are a business as well, and you are going to see that a lot of these fees or costs of compliance will be passed on to small businesses. And what will likely happen is either they will, as Todd had mentioned, no longer take credit cards and move specifically to a cash economy, or either raise their prices for their customers, which will just hurt them in the end.

Again, I think you will see a huge deterrence from people going into businesses, like, such as retail, where you almost have to take credit cards in order in order to stay in business. So, yes, I definitely think the cost will be passed on to small business.

Chairwoman VELÁZQUEZ. Okay. Thank you.

And again to Ms. Darien, officials from the IRS concede that extraneous economic data will be necessary to make information reported on business card reimbursement useful. Does the IRS already have this type of information, or will it be necessary to acquire this data from another source?

Ms. DARIEN. I am not quite sure what data they are seeking. You know, we take the position that information can be a good thing; it is the way you go about doing it. As mentioned, there are simple ways that we can use the system we have in place, the forms we have in place, to acquire additional data that might help them take a look or just get a better accurate figure on the quote/unquote ″tax gap.″

I don't know if they will seek again—and this is the perfect proposal—going to other companies that have a whole host of data on merchants in hopes of getting additional data. I am not quite sure if they will go in that direction.

Chairwoman VELÁZQUEZ. Mr. Chabot, do you have any additional questions?

Mr. CHABOT. Thank you, Madam Chair. Just kind of a final comment, at least wrap it up from our point of view, not necessarily a question.

But this electronic payment tax reporting that we are dealing with here, which I think we all sort of agree is not a good idea, is part of the whole tax gap. It is a way for the Government to find more money to, kind of, mask what we are not doing right, which is being restrained in our spending up here. So we are trying to pick that number out of the air and say, ″We have this money, it is a tax gap, so we can continue to spend because it is there.″ And then we put the burden on you, that is how we are going to collect the money. We all agree it is not going to work and it will just be more burdensome on small-business folks.

But the tax gap reminds me of a couple of these things. We used to do this, Congress did, by—we were going to sell the spectrum. And we had all this money out there. Every year, that would be part of the budget, the selling of the spectrum, that there would be billions of dollars that we would get.

There was the infamous peace dividend. And the Cold War ended, so we had all this extra money we were going to spend for universal health care or you name it. It was there. But we all know that there are always things which are faced and additional costs. And so, arguably, that wasn't there either.

And the chairwoman kidded me before about when was I going to bring up ANWR again, well, I just figured out a way to get it in.

Chairwoman VELÁZQUEZ. Oh my.

Mr. CHABOT. Ethanol was going to be the solution to all our problems. We didn't need to drill in ANWR. We didn't need to drill in the Outer Continental Shelf. Ethanol was going to take care of things. And, as we found out, it has driven up the costs, because we are diverting our food stock into now ethanol, and we are still seeing the prices go up. And now we are seeing food prices go up also.

So I got ethanol in there.

Chairwoman VELÁZQUEZ. I see that. Okay.

Mr. CHABOT. All right. But anyway, thank you very much. I thought the panel was excellent.

Chairwoman VELÁZQUEZ. Let me thank all of you for being here today.

And, clearly, this proposal really represents a problem for the members of this Committee. We are going to continue to monitor what is happening and what will take place in Ways and Means. But I intend to send a letter to the Ways and Means chairman and ranking member with a copy of the transcript and comments of this hearing.

I probably will be asking the Government Accountability Office to do an evaluation on those numbers that came out from the Treasury Department, to take a look at those numbers. And I will invite the ranking member to join me on those letters and requests.

So, with that, I ask unanimous consent that members will have 5 days to submit a statement and supporting materials for the record.

Without objection, so ordered.

This hearing is now adjourned. Thank you.

[Whereupon, at 11:15 a.m., the Committee was adjourned.]

NYDIA M. VELAZQUEZ, NEW YORK
CHAIRWOMAN

STEVE CHABOT, OHIO
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business
2361 Rayburn House Office Building
Washington, DC 20515-6315

STATEMENT
Of the Honorable Nydia M. Velazquez, Chairwoman
United States House of Representatives, Committee on Small Business
Full Committee Hearing: "Electronic Payments Tax Reporting: Another Tax Burden for Small Businesses"
June 12, 2008

Among its duties, this Committee is charged with evaluating the impact of legislative proposals on the nation's small businesses. That includes policy consequences ranging from health care and energy to transportation and taxation.

The bulk of these proposals are crafted with the best of intentions, and this panel has supported many of them. On occasions, we also face policies that appear innocuous—and may have laudable goals—but have detrimental impacts on small firms. Today we will examine one such proposal, requiring small business tax reporting on credit card receipts.

A little more than a year ago, this Congress—under Democratic leadership—wisely reinstated the budget rule known as PAYGO. It requires all new spending—including tax cuts—to be made revenue neutral. The restoring of PAYGO signals a firm commitment to fiscal responsibility, and makes clear that any new spending must be paid for.

These rules fundamentally change the way in which we discuss new proposals. Evaluating underlying policies remains key, but PAYGO implications must also be considered. Today's hearing to examine requiring small business tax reporting on electronic payments is just such a case.

The proposal has been broached in various forums and, over the past year, it was even suggested as a means of helping pay for the Farm Bill. Promises of viable offsets are always tempting. But this proposal raises significant technical and financial challenges for banks and entrepreneurs alike.

In today's fast-paced marketplace, electronic payment systems are integral to the daily workings of the U.S. economy. They link merchants, consumers and banks through secure means that are both efficient and convenient.

As we will hear today, the administrative and financial burdens associated with the reporting requirements of this proposal are indeed significant. They might even be justified if the tradeoff for small businesses was greater certainty. But the opposite is true.

The proposal is built on an incorrect premise—that electronic payments foreshadow profits. The reality is quite different for most small businesses. Electronic transactions bear little relation to actual income—especially when charge-backs, merchant discounts, and other fees are accounted for. The result is that even careful compliance by entrepreneurs could lead to costly IRS audits.

At a time when data security is being challenged constantly, the new reporting requirements also pose serious privacy risks for millions of citizens. For many small firms, the owner's Social Security number is used by the IRS to track the revenue and tax compliance of their business. Under this proposal, banks would have to include that same information in their reports, which could leave important personal data exposed to identity thieves and other criminals.

Equally troubling is the provision to withhold 28% of credit card payment reimbursements to enforce compliance. Banks would be required to withhold the amount from each entrepreneur whose personal information is not collected in time.

That means if a bank sends out a mass mailing asking small business owners for their social security numbers, those that don't receive the letter would see 28% of their credit card revenue withheld. For every $100,000 in credit card sales, their business would receive just $72,000. For many businesses whose profit margins are between 3% and 5% that can mean the difference between making payroll and having to permanently close their doors.

In short, what at first sounds like a promising budget offset, has very real costs for the nation's small business economy. These unintended consequences are exactly what we must keep in mind during the consideration of such proposals. After all, even in a PAYGO environment, we cannot afford to focus blindly on revenue figures while creating unreasonable costs for the small firms that drive economic growth.

U.S. House of Representatives
SMALL BUSINESS COMMITTEE
Representative Steve Chabot, Republican Leader

Thursday,
June 12, 2008

Opening Statement of Ranking Member Steve Chabot

Electronic Payments Tax Reporting: Another Tax Burden for Small Businesses

Good morning. Thank you, Madam Chair, for holding this hearing on an important topic for small businesses – proposals to use electronic payments reporting as a way to increase tax compliance.

I'd like to extend a special thanks to each of our witnesses who have taken the time to provide this Committee with their testimony. I'd like to extend a special welcome fellow Cincinnatian Donald Boeding, who I will introduce later.

The IRS estimates that the United States collects 83.7 percent of the total taxes due. After adjusting for delinquent taxes collected by existing compliance efforts, the IRS estimates that 86.3 percent of tax revenues are collected. The net uncollected taxes are currently estimated by the IRS' National Research Program at nearly $290 billion for the tax year 2001 — the last year for which data is available.

We all recognize that $290 billion is a significant number. Because of non-compliance, the burden of funding our nation's commitments falls more heavily on responsible taxpayers who willingly and accurately pay their taxes. That is most unfair.

Many small business groups and merchant banks have serious concerns regarding the proposal to address non-compliance through electronic payments reporting. With small firms already struggling under the weight of massive paperwork burdens, this initiative would add to that burden. Further, there is uncertainty over the benefit of this reporting requirement.

I firmly believe that the first and best thing we can do to address non-compliance is to simplify the tax code. The code has become a morass of niche laws and regulations that is growing increasingly complex. For small businesses that are just starting out, it can be exceptionally difficult to know exactly what to do and when to do it.

Most small businesses pay their taxes in full and on time. However, doing so is not easy, as the cost of compliance and the time spent to understand and interpret the tax code can be overwhelming. According to a 2001 Small Business Administration Office of Advocacy report, small businesses with fewer than 20 employees spend over $1200 per employee to comply with tax paperwork, recordkeeping, and reporting requirements. This is more than twice the compliance cost faced by larger firms.

The IRS should also focus greater attention on education and compliance assistance. The IRS implied that roughly $148 billion of uncollected taxes comes from underreported business and self-employment taxes. Expanding efforts to help small businesses and the self-employed to prepare their returns accurately and on time could improve compliance.

Unfortunately, there will always be bad actors trying to skirt the system. Finding them is not easy, but we must continue to look for and penalize those who deliberately evade paying their taxes.

We have excellent witnesses here today, and I look forward to hearing their thoughts. Thank you Madam Chair, and I yield back the balance of my time.

Testimony of Kim Stubna, Director of Public Policy, First Data Corporation
Before the House Small Business Committee
June 12, 2008

Good morning, Madam Chairwoman and members of the Committee. My name is Kim Stubna, and I am Director of Public Policy at First Data Corporation. I am pleased to be here today on behalf of First Data, and I appreciate the opportunity to share with you our concerns with the Administration's and Senate Finance Committee's proposals to require annual reporting to the IRS of merchants' electronic transactions. After providing a brief overview of First Data's role in the payments sector, I will focus my comments on three primary areas of concern with the proposals: (1) the negative economic impact to our nation's small businesses; (2) the difficulty of linking the required data; and (3) the inevitable reporting of inaccurate merchant payment transaction data to the IRS. While the proposals would unequivocally subject First Data and others within the payments sector to considerable new operational challenges and costs along with significant administrative and compliance costs, we believe that America's small businesses – the backbone of our nation's economy – will suffer considerably if this proposal is enacted into law.

First Data is a Denver-based technology services company that is the leading processor of electronic payment transactions. We rank in the top 320 on the Fortune 500 list and employ over 27,000 employees globally. Our services help consumers, businesses and governmental entities make payments for goods and services using virtually any form of payment – credit card, debit and stored value card, electronic checks and paper checks – at the point of sale and over the Internet. Additionally, we own and operate the STAR debit network, one of the leading nationwide electronic funds transfer (EFT) networks, as well as the Instant Cash ATM network.

Under the Visa/MasterCard Association rules, in order for a merchant (e.g. online retailer, convenience store, restaurant, or grocery store) to be able to accept Visa or MasterCard credit cards as a form of payment, a member bank must "sponsor" that merchant into the system – and thus becomes the acquiring bank. Any one of the 2,000 banks in the United States that is a member of the card associations must be a party to the merchant processing contract. For the

actual processing services, however, many bank members outsource to third parties such as First Data.

Under these processing arrangements, First Data authorizes, captures and settles merchants' credit, debit, stored value and loyalty card transactions, and we do this for over 4 million merchant locations in the U.S. Stated more simply, the services we provide with our bank partners enable you to approach a check-out counter (whether it be bricks and mortar or through the Internet) and pay for your goods or services with a credit, debit or stored value card such as a gift card.

In short, the proposals on which we're commenting today would require merchant acquirers to annually report to the IRS through a form 1099 the aggregate value of electronic transactions received by every merchant. (First Data has provided comments to both the Administration and the Senate Finance Committee staff on their versions of the proposal.) First Data partners with merchant acquiring banks to process the largest number of transactions in the United States, so it is clear that we, along with our nation's small businesses, would shoulder the impact of this ill-conceived proposed regulatory burden.

There are several components of the proposals to which we're opposed, but one of the most harmful provisions to small businesses would require us to subject merchants to backup withholding. This provision would require us to withhold 28 percent of a small business' cash flow until the accuracy of their Taxpayer Identification Number (TIN) was verified. Withholding 28 percent of a small business' cash flow could very well mean the difference between making payroll and laying off employees or worse. Such government mandated actions, particularly during an economic slowdown, could serve to exacerbate our current economic struggle. We feel strongly that the potential for inaccurately withholding payments to merchants also places merchant acquirers in a liability position that would be extremely difficult to correct. The damage to a merchant of not being able to make payroll or keep the lights on has long lasting irrevocable effects. In turn, payment processors would be exposed to significantly new litigation risk directly attributable to the IRS proposal. In addition, it is clear to us that the potential for withholding payments to merchants that fail to submit or inaccurately complete a

Form W-9 would place acquirers and processors in an adversarial position with their merchant customers.

The issue of correctly matching the merchant TIN information leads to our second point, which is the difficulty of linking merchant payment transaction data to the TIN. Our merchant processing business may collect a merchant's SSN (Social Security Number) or TIN during an initial application process, but then each merchant is assigned a unique identification number. At this point, merchants are identified solely by their unique ID numbers which, in various scenarios, do not correspond with the TIN that would have to be utilized for reporting the processed sales to the IRS. Even if our payment systems were developed with a structure that assigned merchant IDs in a fashion consistent with TIN assignment, compiling composite data is much more complex and challenging than simply matching transactions associated with one merchant ID to one applicable SSN or TIN. In some circumstances, more than one merchant ID (same merchant/multiple locations) would need to be linked to the same TIN. In short, our systems do not currently track merchant payment transaction data to TINs and it will be extremely expensive and time consuming to reprogram our systems to comply with the new mandates.

Another complex scenario occurs with a merchant that has multiple franchise members that are separate legal entities with individual TINs or SSNs. In this case, First Data will establish a merchant ID family for that franchise that may begin with a corporate owner with a specific TIN, but each franchise member has its own TIN or SSN, and First Data assigns individual merchant IDs within that family.

As a result, First Data's numerous and intricate payment processing systems would likely have to be entirely reprogrammed with complex logic designed to find the correct information links to accommodate the various scenarios that could arise. Conservative estimates place this programming at over 3,000 man hours for *each* of our processing systems, and First Data has between 4 and 10 processing platforms depending on the defined payment types included. Additional expenses would be incurred from maintenance, management and servicing needs. First Data cannot absorb this enormous expense on its own, so these costs would likely be passed

on to merchants. Consequently, it would not be implausible for this proposal to discourage some merchants from accepting electronic payments and steering customers toward cash and checks – making it that much more difficult for the IRS to achieve its main objective to identify entities that under-report their taxable income.

Finally, the proposals would result in the reporting of inaccurate merchant payment transaction data to the IRS for a portion of merchants. This fact is a critical issue that cannot be minimized or overlooked. From a processing standpoint, determining the revenue of a merchant transaction is not as simple as looking at the final sale on a receipt. For example, a typical merchant transaction in our system may include a sale minus returns, plus/minus charge backs, plus/minus reversals, plus/minus arbitration charge backs, plus/minus compliance filings, to name a few. Additionally, discount fees, interchange and other processing fees must be accounted for when assessing the sales revenue of an individual merchant. To further complicate matters, PIN (Personal Identification Number) debit cash back transactions are not separated in our systems. For example, in a PIN debit cash back scenario a consumer uses their debit card and their PIN to purchase $60 worth of goods and decides to get $40 in cash at the same time. With these types of transactions, First Data's payment systems see that the merchant needs to be paid $100 by the consumer's bank. As a result, we would be required to report to the IRS that the merchant received $100 in sales revenue, when in fact they only received $60 in sales revenue. This would be unfair to the merchant since it is clearly erroneous information biased against that particular merchant.

Another likely example of reporting inaccurate data would occur when the transaction lifecycle (from original sale to last chargeback cycle) exceeds one year and/or carries over from one year to the next. For instance, a cardholder orders a custom computer and pays at the time of the order. The order is expected to be delivered in three months, but after four months, the cardholder hasn't received the computer and initiates a chargeback for goods not received. At this point, the merchant would be at $0 net payment. However, the merchant provides shipping proof and authentication at the time of the sale, the cardholder receives the computer and a chargeback reversal occurs. The merchant is now net for the transaction amount. Once the cardholder starts using the computer, it doesn't operate as requested, so the cardholder initiates

another chargeback as "item not as described," and the cycle begins again. Processing and interchange fees must also be factored into the equation, as they affect the transaction amounts as well. It is not uncommon for these processes to occur over two tax years.

While First Data stands firmly opposed to the merchant card reporting proposals, we do believe that a legitimate alternative exists: to create a new section on the current merchant tax filing form that requires the merchant to self report its total annual amount of credit and debit card and open loop card stored value card transactions (e.g. stored value cards issued by a financial institution). Based on past discussions we have had with the IRS, it appears this has some precedence, as they remarked that the number of taxpayers claiming dependents decreased when taxpayers were required to report a dependent's SSN on the form. Extending this same rationale to our alternative, the number of merchants accurately reporting their electronic transactions should increase at some level, and it would impose significantly fewer operational costs and administrative burdens on the payments industry. Furthermore, a study could be mandated in conjunction with the self reporting requirement to assess its effectiveness in increasing compliance.

If, on the other hand, the proposals move forward in their current constructs, there is little concrete evidence that the benefits that the IRS expects to realize outweigh the enormous costs that would be imposed on the payments industry and our nation's small businesses. Instead, the proposals are predicated on the IRS' belief that many merchants, particularly smaller ones, are under-reporting their income, and that third party reporting could result in a material increase in compliance in reported taxable income by businesses.

The reality is that due to the complexity of the payments system that was designed to safely and quickly move money rather than become an extension of the IRS, the proposal would lead to: (1) the distinct possibility that some merchants, subject to a withholding penalty, may go out of business; (2) the expenditure of significant financial and operational resources; (3) the reporting of inaccurate merchant payment transaction data; (4) an increase in the cost of accepting electronic payments, harming both consumers and merchants; and (5) a shift by payment

processors to re-direct data processing and compliance specialists away from innovative, revenue generating products, reducing our competitiveness.

We urge the Committee to convey its concerns with and opposition to these proposals to both the Administration and to congressional leaders in both parties and in both chambers. The issues that we have outlined should not be underestimated because the ramifications would be detrimental to the payments industry, to small businesses that drive the nation's growth, and to consumers who would likely see an increase in the cost of goods and services – directly attributable to the costs of implementing these proposals.

Testimony of
David Sohn
Senior Policy Counsel
Center for Democracy and Technology

Before

The House Committee on Small Business

June 12, 2008

Hearing on
"Electronic Payments Tax Reporting: Another Tax Burden for Small Businesses"

Chairwoman Velázquez, Ranking Member Chabot, members of the committee, thank you for holding this hearing on newly proposed reporting requirements concerning electronic payments. CDT appreciates the opportunity to participate.

CDT is a non-profit, public interest organization dedicated to preserving and promoting privacy, civil liberties, and other democratic values in the digital age. CDT has been a leader in addressing emerging threats to consumer privacy and the related issues of data security and data retention. CDT advocates a reasonable balance between privacy concerns regarding sensitive personal information and the legitimate needs of law enforcement and business. We believe that the proposal under discussion raises serious privacy and data security concerns that are especially significant in the small business context.

The proposed legislation would force banks that enable merchants to receive credit card payments to abandon the sound privacy and security practice whereby they currently do not track those merchants using Taxpayer Identification Numbers (TINs). For many of the smallest businesses, the TIN is the proprietor's Social Security Number (SSN). Thus, the proposal carries particularly acute privacy implications for many small business owners and runs contrary to the federal government's established goal of reducing the collection and use of SSNs in order to combat identity theft. In addition, the proposal would likely lead to the collection and retention of further personal and financial information relating to small business accounts; could create serious problems for small businesses in the event that credit card companies or other payment facilitators make

errors in recording or reporting data; and would establish a dangerous precedent in enlisting private sector intermediaries to track the behavior of customers for purely governmental purposes.

1. Background – Data Minimization Is an Important and Long-Recognized Privacy Principle

A set of commonly accepted "Fair Information Practices" (FIPS) has been the cornerstone of privacy protection for many years. The FIPs were initially articulated in the 1970s and embodied to various degrees in the Privacy Act of 1974, the Fair Credit Reporting Act, and other federal privacy laws. While the FIPs have been enumerated in various ways, they generally include the concept of data minimization.

The principle of "data minimization" means that companies and government agencies should limit their collection of information about individuals to what is directly relevant and necessary to accomplish a specified purpose, and should retain the data only for as long as is necessary to fulfill that purpose.[1] In other words, entities should collect only the personal data they really need, and should keep it only for as long as they really need it.

Data minimization provides an important safeguard against privacy and security risks. First, it reduces the likelihood of unauthorized or accidental disclosure of personal data.

[1] *See, e.g.*, "Privacy Technology Implementation Guide," United States Department of Homeland Security, August 16, 2007 (http://www.dhs.gov/xlibrary/assets/privacy/privacy_guide_ptig.pdf).

The more data is collected and the longer it is electronically stored, the greater the risk that it will be leaked, stolen, sold, or otherwise disclosed. The ongoing parade of high-profile data security breaches in recent years makes it clear that once data is stored electronically, it is extremely difficult to guarantee its protection. Bad actors will work to gain access, and simple oversights such as an unattended laptop can result in unauthorized access to data. At least nine major data breach incidents were reported in just the last two weeks, each affecting thousands of Americans.[2] The Office of Management and Budget has rightly noted that an important step in preventing costly data breaches is "reducing the volume of collected and retained information to the minimum necessary."[3]

Data minimization also helps protect against "mission creep." This is the risk that personal data collected for one purpose will prove an attractive target for other parties with other purposes, resulting in disclosures and uses of the data that are significantly broader than the original parties to the collection of data (both the entity doing the collecting and the person from whom the information is collected) could have anticipated or expected. Collecting and retaining data that is not strictly necessary for a particular purpose opens the door to unanticipated uses and abuses.

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[2] For an unofficial list of data breaches announced pursuant to breach disclosure laws, see The Breach Blog: http://breachblog.com/.
[3] *See* Memorandum from the Deputy Director for Management, May 22, 2007 (http://www.whitehouse.gov/omb/memoranda/fy2007/m07-16.pdf).

2. Forcing Payment Facilitators To Keep TINs for Extended Periods Would Undermine Privacy and Security Protections Regarding the SSN of Many Small Business Owners

Consistent with the data minimization principle discussed above, the standard practice of banks providing merchant accounts for credit card payments is to collect a merchant's TIN when establishing an account, but then to delete the TIN once the account is approved. Instead of using a TIN (which may be a Social Security Number) to identify and distinguish different merchants, the bank assigns an internal merchant identifier. Thus, the bank's databases do not link merchants with TINs and a security breach would not expose merchants' TINs. The Treasury Department's proposal to require reporting on each merchant's credit card receipts would force banks to abandon this sound security practice. Payment facilitators such as banks effectively would be required to retain and keep track of each merchant's TIN for an extended period.

This would raise particular privacy and security concerns for sole proprietorships. For owners of such small businesses or individuals engaged in small-scale business activity, the TIN may be the individual's Social Security Number. Banks therefore would need to include many SSNs in their databases, and to tie those SSNs to individual merchant data for reporting purposes.

Requiring banks to maintain databases containing and tied to SSNs would set back the effort to prevent identity theft and other forms of fraud. It runs contrary to the recommendations of experts in privacy and identity theft, who continue to urge companies to wean themselves from excessive use of SSNs. It also runs contrary to the

federal government's own strategy for reducing identity theft. When the President's Identity Theft Task Force issued its findings last year, its foremost recommendation was to reduce the use of SSNs.[4] The Task Force observed that a Social Security number is "the most valuable commodity for an identity thief."[5] In light of this, banks' current practice of not retaining TINs is a sensible and important data security practice, and forcing them to abandon it would increase the risk of identity theft in the event of a data breach.[6] CDT believes Congress should not push banks to abandon a common data security safeguard and potentially create a new target for identity thieves at a time when Americans are deeply and justifiably concerned about the prospect of identity theft.[7]

3. Implementing the Proposal May Entail Additional Expansion in Data Collection from Small Business Owners

CDT urges Congress to be skeptical of Administration claims that the reporting envisioned by the proposal would translate neatly into major revenue increases. CDT is particularly concerned that this proposal, if enacted, would lead to further requirements

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[4] *See, generally,* the Identity Theft Task Force's report, "Combating Identity Theft: A Strategic Plan," April 23, 2007 (http://www.idtheft.gov/reports/StrategicPlan.pdf).
[5] *See* "The President's Identity Theft Task Force Releases Comprehensive Strategic Plan to Combat Identity Theft," Press Release, April 23, 2007 (http://www.ftc.gov/opa/2007/04/idtheft.shtm).
[6] According to one analysis, 30 percent of known identity thefts in 2006 were caused by corporate data breaches. *See* Sasha Romanosky, et al., "Do Data Breach Disclosure Laws Reduce Identity Theft?" Seventh Workshop on the Economics of Information Security, June 25, 2008 (http://weis2008.econinfosec.org/papers/Romanosky.pdf).
[7] An April 2008 survey found that 81% of Americans are concerned about having their identity stolen. *See* Sheyna Steiner, "Consumers take steps to thwart ID thieves," *Bankrate*, April 21, 2008 (http://www.bankrate.com/brm/news/Financial_Literacy/identity_theft/ID_theft_poll_national_a1.asp?caret=95a). There were roughly 8 million victims of identity theft in the U.S. in 2007, with damages totaling $45 billion. *See* "2008 Identity Fraud Survey Report," Javelin Research, February 2008.

for data collection because it is quite likely that the government will need even more information in order to make use of the information that banks would be required to report initially. For example, sometimes more than one small business may share a single merchant account, as in the case of multiple vendors at a flea market. Aggregate receipts for such an account would not provide a meaningful picture of the income received by any individual vendor. To make the information useful to the I.R.S., the bank providing the merchant account would need to collect and track substantially more data about account holder activity than it does today. Similarly, many small businesses may rely on payment systems such as PayPal. These systems could be pressed to collect further data from users in order to ensure that information reported to the IRS more accurately reflects individual activity.

Wherever data about aggregate credit card receipts might paint an incomplete or misleading picture, there likely will be pressure to provide more detailed breakdowns and hence to collect and store more data. Before moving to adopt any legislative proposal in this area, Congress should carefully inquire into the types of additional data collection that would be demanded, either as an express requirement of the regime or as a logical follow-on or supplement to it.

4. The Proposal Is Particularly Inappropriate at a Time When the Privacy Framework Governing Personal Data Is Lacking

More broadly, before Congress imposes new obligations that would expand the scope of personal data that companies collect and maintain, it should conduct a full-scale

reexamination of existing data privacy laws. The United States' current privacy framework relating to private-sector data is uneven, and in recent years government has moved to weaken the legal standards under which government can access such information. Congress should not enact new laws that would exacerbate the already serious weaknesses in the nation's privacy framework.

5. Forcing Banks To Collect, Store, and Report Additional Customer Data for Purely Governmental Purposes Sets a Bad Precedent

A major concern for CDT is that the proposal to require reporting on credit card payments could establish a dangerous precedent and could encourage additional government efforts to enlist private-sector intermediaries in tracking the behavior of their customers. For example, if Congress were to enact this proposal, state governments might well consider enacting obligations for payment facilitators to keep and report data for state tax collection purposes.

Outside the context of credit card payments and tax collection, the Justice Department has advocated federal legislation to require Internet service providers to retain information about their customers' online activities for months or even years at a time for the assistance of law enforcement. CDT believes such data collection and retention mandates are highly objectionable. They threaten personal privacy, through the creation of massive new databases with personal information that could be subject to security breaches or misuse. They are susceptible to "mission creep." They undermine public trust, especially given the inadequate current legal framework governing use of private-

sector data and the government's ability to access it. And they are burdensome and costly. Congress should not embrace a mandatory private-sector data collection and retention scheme that could pave the way for additional mandates that would greatly undermine consumer privacy.

6. Conclusion

As this Committee and Congress evaluate proposals to require payment processors to report merchant transaction data to the I.R.S., CDT urges careful consideration of the impact for data privacy and security. CDT believes that the potential impact is serious, particularly for the small businesses that are the focus of this Committee. At a minimum, this suggests that proponents of the proposal should bear a heavy burden proof concerning whether the proposal is necessary, effective, and better than possible alternatives. CDT appreciates the opportunity to participate in this hearing and to share our views on this important topic.

Testimony of Todd McCracken

President

On Behalf of
The National Small Business Association

House Small Business Committee

Hearing:

"Electronic Payments Tax Reporting: Another Tax Burden for Small Businesses"

June 12, 2008

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Chairwoman Velazquez, Ranking Member Chabot and Members of the Committee, on behalf of the 150,000 small-business owners represented by the National Small Business Association, I would like to thank you for the opportunity to appear today to discuss the administration's budget proposal to require information tax reporting on all credit card receipts of small businesses.

As the nation's oldest nonpartisan small business group, our top priority for the 110th Congress is working to find a solution to the tax gap—the difference between taxes owed and taxes actually paid—without placing excessive and intrusive burdens on honest small business owners.

Small business tends to be an easy target since many small-business owners cannot afford to employ teams of accountants and lawyers to fight their cases—a luxury enjoyed by big business. Approximately 36 percent of NSBA members have less than 5 employees—few, in any, of whom is a tax attorney—leaving business owners with no other choice but to hire outside help to keep track of all their paperwork.

Not only is the burden a heavy one, but it is disproportionate as well. According to the U.S. Small Business Administration (SBA) Office of Advocacy, the cost of tax compliance for small firms is 67 percent higher than for their larger counterparts. For firms with less than twenty employees, the per-employee cost of complying with the tax code is $1,304. Now the administration is trying to further complicate and scrutinize our tax system by considering expanding information reporting requirements on business owner's annual electronic payment transactions.

Information Reporting Requirements on Merchant Payment Card Transactions

The basic premise of the proposal is that a "payment facilitator" would provide the Internal Revenue Service (IRS) and the merchant with an annual, aggregate total of the gross receipts an individual merchant processed with that payment facilitator. After thorough review, NSBA has found that this recommendation would not effectively

increase compliance and minimize the tax gap. Instead, it will add additional and unnecessary regulatory, reporting and withholding burdens on already over-burdened small-business owners—all in an effort to try to catch other businesses that might not be reporting all of their income.

It must be said—NSBA does not condone the non-payment of tax obligations. The overwhelming majority of small businesses are honest, hard-working organizations that are critical to the economic success of the American economy. Given the extraordinary burden that compliance with the unbelievably complex tax code already imposes on small businesses, it is unfair to ask truthful small businesses to do even more in order to catch a few potential cheats.

Currently, taxpayers are subject to some level of information reporting and withholding requirements. Employers must report wages and withhold applicable payroll taxes and federal income taxes for their employees. Businesses are required to report payments made for services in connection with their trade and business of more than $600 per year. However, the administration's proposal on increasing information reporting by requiring credit and debit card issuers to report to the IRS annually on aggregate reimbursement payments made to businesses, would be extremely burdensome and raises questions of intrusiveness on the business owner.

Use of Data

NSBA has significant concerns about the use of the data collected by the IRS. In theory, the IRS can conduct some sort of matching exercise with a merchant's reported gross receipts on tax returns. Additionally, the data could be used by the IRS for the purpose of developing trends and reporting profiles, by taking the total credit card receipts reported for a particular business and then extrapolating total income based on industry averages. According to a recent NSBA survey, 93 percent of our members do not support the IRS using the collected information for determining whether businesses are accurately reporting their gross receipts.

Not only would it be difficult to determine an applicable average for a particular small business, creating a huge new audit burden on companies that may legitimately fall outside their industries' "averages" but it also raises privacy concerns. The new industry profiles would then be used by the IRS to judge other items on a tax return.

For example, the IRS might see that dry cleaners make an average of 60 percent of their transactions through credit cards, so if the agency reviewed the tax return of a dry cleaner that significantly deviated from that average, it may question that return. In turn, that business may be more likely to be audited, especially since the IRS has, in the last two years alone, increased audits of small corporations by 150 percent and there is every reason to believe that number will continue to increase.

The sheer volume of the information returns generated by this proposal will ensure most of it will never be evaluated or used by the IRS. NSBA questions how the IRS will be able to match and use the information reported by the processor to identify merchants that are truly underreporting electronic payments, or that reliable composites of gross receipts reporting including projected cash transactions can be developed. The diversity of merchant activity based on industry, geographic location and even an owner's efforts to manage cash flow or acceptance of only certain credit cards are all factors that make the latter objective more difficult.

Backup Withholding

Additionally, the proposal requires that the credit and debit card processors verify the business's Taxpayer Identification Number (TIN). If the merchant fails to verify the TIN or the information is inaccurate, the processors must backup withhold 28 percent of businesses transactions. Eighty percent of those surveyed by the NSBA do not believe it is fair or reasonable for credit and debit card companies to withhold 28 percent of their gross receipts.

Meanwhile no specifics have been outlined on how the IRS plans to work with these credit and debit card companies to implement this proposal. Although the burden is intended to be placed on the processor to verify the TIN, it is likely if there are any mistakes the burden will fall back on the business, requiring them to deal with the IRS and certify that their TIN is correct.

Small business owners should be given a reasonable amount of time to correct any errors with their TINs before processors backup withholding begins. NSBA supports an accurate and real-time verification system that is easily accessible via online or phone to businesses so they can properly verify these TINs. Otherwise, there will be significant reporting errors and delays in services while trying to verify TINs. A system with substantial requests for paperwork and long wait times to receive needed approvals would harm daily operations of the business and disrupt the companies' cash flow.

Cost Concerns

It is not clear whether merchant processors have a system in place that could accurately and efficiently report the merchant's payment card receipts to the IRS. If such a system is required and it imposes an additional cost to the merchant processor, that cost could be passed on to the small business. A disparity will exist when the merchant processor is reporting payment card transactions and small businesses are reporting both payment card transactions and cash transactions without distinguishing between the two. Further, there is no data available to differentiate between payment card transactions and cash transactions as a contributor of the tax gap.

NSBA understands the recommendation is appealing because the direct impact on a merchant is perceived to be limited. Nevertheless, this new level of regulatory burden on credit card issuers likely will lead to increased fees being passed on to businesses which conduct credit card transactions. These increased fees will have a negative impact on business revenue and sales, and in turn tax revenue.

Some members of the small business community have expressed concern that if the proposal becomes law, some small firms may stop taking credit cards or will have to charge higher prices because of the cost to comply. According to the NSBA member survey, if this regulation became law 60 percent of the respondents would change the way they conduct business accounting which would ultimately have a negative financial impact on consumers and severe consequences on our already weak economy.

Administration Recommendation Conclusions

This proposal, which calls for increased reporting requirements, will add to the existing regulatory burdens small businesses face in complying with IRS regulations. Eighty-five percent of those surveyed by NSBA do not believe that this proposal would increase tax compliance if it became law. Instead of using resources to invest and grow their businesses, owners will now be forced to spend valuable time and financial resources on record-keeping and outside help to ensure their compliance.

The overall goal of the administration and Congress is to increase tax compliance and minimize the tax gap. However, it is not possible to completely close the tax gap. There will always be those who employ tax shelters, willfully non-comply, or inaccurately report their income. There will even be those circumstances where it is the unqualified tax preparers who are making the mistakes and should be held responsible for the filer's errors.

Beyond the invasiveness and red tape, NSBA is concerned about whether the current infrastructure and staffing levels of the IRS is adequate to handle the surge of paperwork that this proposal will create. While the concept of significantly increasing taxpayer compliance may appear justifiable, the practical impact of implementing it could be devastating to the individual taxpayer.

NSBA Position

NSBA believe efforts to close the tax gap must focus on overall simplification, eliminating inequities within the tax code, and enhancing taxpayer education and outreach. Addressing the tax gap must entail balancing the desire to collect taxes that are duly owed with the importance of minimizing intrusive and complicated reporting requirements and additional audits of small businesses. Accurate tax reporting and compliance is extremely important to small business. Those who make a good faith effort, yet are inaccurately complying should be assisted through education and tax simplification efforts. Those willfully disregarding their tax liability should be held accountable. The more assistance offered to taxpayers and the simpler it is to understand and comply with tax laws, the more taxpayers will accurately meet their tax obligations. However, increased enforcement at the expense of taxpayer education will not in the long term accomplish sustained, improved compliance.

The complexity of the IRS tax code is particularly troublesome for small-business owners and is a snare for unintentional noncompliance. Vague rules and poorly defined regulations understandably result in mistakes. In order for taxpayers to comply more easily with the tax laws, taxpayer services should include providing timely guidance on issues, promoting electronic filing of tax returns, explaining IRS notices and correspondence, and helping taxpayers with problems. With the complexity facing many taxpayers, NSBA believes a key priority should be the development and implementation of initiatives to improve IRS guidance.

NSBA concludes that the Committee should work with the IRS to conduct more research to better identify noncompliant taxpayers, enhance taxpayer services to inform taxpayers of correct tax obligations and adjust its enforcement tools to target those who intentionally evade paying taxes.

As you move forward in your efforts to close the tax gap, NSBA is hopeful that you will take our recommendations into consideration. Now is the time for Congress to support

proposals that are fair and reasonable, and that do not hinder the survival, growth and innovation of our nation's entrepreneurs.

I would like to thank Chairwoman Velazquez for holding this hearing, bringing this proposal to the forefront and for the opportunity to testify.

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Testimony of
Kristie L. Darien

Executive Director of the
National Association of the Self-Employed (NASE)

"Electronic Payments Tax Reporting: Another Tax Burden for Small Businesses."

U.S. House of Representatives, Committee on Small Business

June 12, 2008

On behalf of our 250,000 member businesses, I would like to thank the Chairwoman Velazquez and Members of the Committee for allowing the National Association for the Self-Employed (NASE) the opportunity to speak with you today regarding the proposal to expand information reporting by requiring credit and debit card issuers to report business owners' annual electronic payment transactions to the IRS. This is just one of the many alarming tax gap recommendations which would increase tax regulation on small business.

The micro-business and self-employed members of the NASE are the segment of the business population that repeatedly struggles to comply with our complex and ever-changing tax code without the benefit of professional assistance. According to a 2005 study by the Tax Foundation, individuals, businesses and nonprofits spent an estimated 6 billion hours complying with the federal income tax code, with an estimated compliance cost of over $265.1 billion. Businesses bear the majority of tax compliance costs, totaling nearly $148 billion or 56 percent of total compliance costs. Despite their difficulties, our members understand the importance of tax compliance and support efforts to improve our system. In addition, they believe that those who willfully do not fulfill their tax responsibilities should be penalized.

However, the NASE and our members have become concerned that the zeal of Congress to find funding in our strict budget climate has shifted the delicate balance between what is reasonable and what is detrimental to the latter. The electronic payments tax reporting recommendation is a prime example of this shift. We feel that the current proposal is likely to have significant unintended consequences. As they say "the devil is in the details" and this proposal lacks clear details regarding its implementation which must be brought to light to accurately gauge its affect on both the micro-business community and our economy.

Use of Data

One of our chief concerns with increased information reporting on electronic payment card transactions is the use of the data to be collected by the IRS. There has been no clear indication of how this information would facilitate tax compliance. The IRS has suggested that the data could be utilized to create industry profiles, taking the total credit card receipts reported for a particular business sector and then extrapolating this information to create industry averages. These new industry profiles stemming from credit card receipts could then be used by the IRS to make judgments regarding other items on the tax return such as estimations on cash payments. If this is the intended use of the data, problems will arise. Our association does not support the use of any collected data for this purpose.

NASE member **Mark Harrison** is the owner of The Framing Alternative in York, Maine. About 80 percent of his business is credit and debit card transactions. He says that the proposal "seems very costly and irrelevant." In his opinion, the differing demographics of individual

businesses will make accurate industry profiles impossible and only unnecessarily hurt the self-employed.

We fully agree with Mark. Use of these averages will only provide discrimination against those businesses that have higher than average credit card receipts. This higher average could be a function of the affluence of their community, regional disparities, an owner's efforts in managing cash flow and even the decision of the business on whether to accept a particular credit card. It will be very difficult to determine a relevant, applicable average for a particular small business sector. Therefore, any action taken by the IRS based on these profiles such as examinations, requests for additional information or even tax assessments would be both burdensome to micro-business and most importantly, could be negligent.

Verification and Withholding

The Taxpayer Identification Number (TIN) verification process and backup withholding required of credit and debit card issuers under this proposal is also ripe for mishandling. The proposal requires credit and debit card issuers to verify the TIN of a business. If this information is inaccurate the issuer must backup withhold 28% of the gross transactions of that business. Unfortunately, no specifics have been released as to how the IRS plans to work with credit and debit card companies to effectively implement these components of the proposal. There are likely to be reporting errors through this process of verifying TINs yet there is confusion regarding whether a small business owner must contact their credit card company or the IRS to address the problem.

In particular, small businesses should have a reasonable amount of time to correct any errors before backup withholding kicks in. The self-employed business owner typically handles all aspects of their business including tax compliance. They do not have the benefit of a team of accountants or administrative staff to assist them with compliance efforts.

Furthermore, in 2007 an NASE member's business had median gross revenue of $62,500 and overwhelming their business was the main source of household income for their family. Withholding on gross transactions will create a substantial cash flow problem for the self-employed and could not only considerably harm their business, but could also place severe financial strain on their family. Thus, we must have a clear understanding of the verification process and back up withholding procedures outlined in this recommendation.

Cost Concerns

Overall implementation of this proposal will clearly require substantial financial and human capital resources by both the IRS and the credit/debit card companies. Questions abound regarding whether the IRS has the infrastructure to create a streamlined verification system and

can handle the volume of paperwork they will receive should this proposal be enacted. We think it is prudent for Congress to work with the IRS to prepare a cost/ benefit analysis of this proposal which would determine the potential costs of implementation and administration as it compares to projected revenue.

Moreover, credit and debit card companies are likely to pass on the cost of compliance to their micro-business merchants in the form of higher user fees. NASE member **Keith Kaufman** owns a small business in Camp Verde, Arizona that receives approximately 60 percent of its transactions through credit or debit cards. Keith is worried about the additional financial burden in the form of increased fees that this policy would place on his business. Because he cannot charge more for credit card transactions, he'd have to "eat" the additional charges which would hurt his bottom line. He feels he is "already taxed to death".

Increased fees will have a negative impact on revenues and sales of micro-business owners, forcing them to either minimize their acceptance of credit cards or increase prices of their goods/services. This could have significant consequences on our weakening economy. **Sondra Daggett**, an NASE member in Cedar Rapids, Iowa believes that the possibility of increased credit card fees that would stem from this recommendation will "wreak havoc with small retailers who are scraping to get by as it is."

We encourage the Committee to reach out to credit/debit card companies, banks and other pertinent parties to determine the ultimate financial impact on consumers before moving forward with this proposal.

Overall Effectiveness

In conclusion, there are two key questions related to overall effectiveness that need to be asked:

- Will this proposal increase tax compliance?
- Will the government recoup funds with the implementation of this proposal?

Addressing the first question, the majority of NASE's members feel that this recommendation will not increase tax compliance. They are quick to point out that this proposal will be collecting information that is likely already reported. The taxpayer who willingly underreports income would not knowingly choose to exclude credit card receipts since those items show up on their bank statements. Transactions via credit and debit cards are well documented and would be revealed upon review, so it is unlikely that those amounts would be a key source for intentional underreporting. Therefore, the NASE believes this approach will not be effective in increasing our current level of tax compliance.

As to the question of additional revenue recovered from actions taken as a result of implementing this recommendation, the NASE believes that it is highly unlikely this proposal

will identify any additional taxable income that would not have already been reported. We feel that any revenue collected would stem from inaccuracies or mistakes made during the Taxpayer Identification Number (TIN) verification process which would trigger the backup withholding mechanism suggested in this proposal.

The NASE proposes that increased information reporting on electronic payment transactions would have the opposite intended effect and actually increase costs for both the federal government, due to implementation and enforcement needs, and small business, due to enhanced fees associated with credit card usage. Furthermore, this recommendation may put the self-employed out of business and deter prospective entrepreneurs due to the likelihood that it will significantly add to the cost of starting up and running a business that requires credit and debit card transactions.

Final Thoughts

The National Association for the Self-Employed does not support the passage of this proposal and strongly urges Congress to consider alternate solutions to increase tax compliance. The focus of any balanced and effective policy to boost compliance should be on overall simplification, eliminating issues of inequity within the tax code, and enhancing taxpayer education and outreach.

Key elements of the tax gap are the underreporting of income and concern of the accuracy of cash payments reported on tax returns. The electronic payments tax reporting proposal does nothing to address these issues. The NASE has made recommendations to Congress and the IRS for simple changes to the tax code and tax forms that would assist in increasing documentation of revenue and lessening potential underreporting yet would have no significant negative impact on micro-business and the self-employed.

However, it is in our opinion that legislators' true interest in this proposal and others relating to the tax gap lies with its possible use as an offset for various congressional spending priorities. We understand that our government has bills to pay and services to maintain, however as one of our NASE members expressed to us, this proposal is simply "Robbing Peter to pay Paul." This is not the approach our government should be enlisting. You are asking the segment of our economy which is experiencing the most discomfort from high energy costs, high health care costs, and our credit crunch to foot the bill for various proposals. Many of which they will receive no benefit from.

Congress should focus ensuring passage of effective policy at a reasonable cost to **ALL** our citizens before they rush to put the financial squeeze on the self-employed and micro-businesses, which remain the foundation of both America's economy and communities.

Testimony of Donald Boeding

Senior Vice President and

General Manager of Merchant Services

Fifth Third Processing Solutions

Before the House Small Business Committee

June 12, 2008

"The Problems and Challenges of Electronic Payments Reporting for Small Business"

Introduction

Good morning Chairwoman Velazquez, Ranking Member Chabot, and distinguished Members of the Committee. My name is Donald Boeding and I am the General Manager of Merchant Services for Fifth Third Processing Solutions, one of five main business lines operated by Fifth Third Bank. Thank you for the opportunity to appear before you today to offer industry perspectives on a proposal to require institutions that make payments to merchants for payment card transactions to file annual information reports with the IRS.

Fifth Third is headquartered in Cincinnati, Ohio with origins dating back to the opening of the Bank of the Ohio Valley in 1858. Today, Fifth Third is a diversified financial services company with $111 billion in assets, nearly 23,000 employees, and retail banking centers in twelve states.

Fifth Third Processing Solutions (FTPS) processes electronic payments at over 157,000 merchant locations for thousands of merchant chains. Our annual volume in payment transactions is over $175 billion, making FTPS the 4th largest Visa/MasterCard acquirer in the U.S., and the largest processor of PIN debit transactions in the country. FTPS has been a premier source of merchant processing services for businesses nationwide for over 30 years. As a pioneer in payment technology, we've partnered with thousands of businesses to increase their sales and profitability by providing state of the art processing services, including:

- **Credit Card Acceptance:** In-house systems and capabilities allowing merchants to choose from a variety of authorization and settlement configurations
- **Debit Card Acceptance:** Featuring speed, security, and the dependability of redundant direct links to every major debit card network
- **Other Key Merchant Services, Including:** Electronic Benefits Transfer, Electronic Check Truncation, Point of Sale Terminal Hardware, and Gift Card Solutions

Brief Description of Payment Systems

The payment card industry is highly complex with many moving parts. The American Bankers Association, in their written statement to the Committee, provides detail on the mechanics of the system, so let me just touch briefly on the characteristics of these systems and transaction paths:

Four-Party Systems

- Often referred to as bankcard systems (such as MasterCard and Visa)
- Feature card issuing financial institutions and merchant acquiring institutions who sign up merchants to accept cards either directly or via third parties
- Often include third party processors who provide transaction processing services for some issuing or acquiring institutions

Three-Party Systems

- Feature a single company that issues payment cards, signs up merchants to accept cards, and performs functions to complete transactions (American Express and Discover are examples)
- Often feature third party processors as with the four-party system

- New growth in complexity through contracting with financial institutions to issue cards for use on third party networks

Two-Party Systems

- Merchants issue cards to customers for use at the merchant's locations only
- Growth in this area through financial institutions issuing cards bearing merchant brand – often referred to as "private label cards"
- The merchant that accepts the card may not be the entity ultimately reimbursed for conducting issuing and acquiring functions

General Thoughts on Increased Information Reporting

In short, we can draw a few initial conclusions about this potentially sweeping proposal, notwithstanding the limited availability of detail as to its specific requirements and implementation parameters.

First, enactment of such an increased information reporting measure would come at a very difficult time in the economy, particularly for the financial services and small business sectors. New and increased risks and reporting requirements will translate into significant IT investment expense and allocation of employee talent by processors to ensure compliance during both a ramp up period and on a go forward basis.

Second, the potential application of backup withholding presents tremendous risks both for processors and merchants. At 28%, backup withholding will have deep impacts on merchants, in some cases representing the difference between success and failure.

Third, the merchant processing industry as developed does not operate in a way to comply with the known parameters of the proposal.

Fourth, the proposal will likely strain the relationship between payment processors and merchant customers, in some cases driving merchants to avoid the convenience and security of electronic payment systems.

Finally, given the vague nature of proposals offered to date, the full impact on all parties will not be known until implementation and compliance has been audited. It is likely that interested parties are not fully aware of the operational impact this will have.

Specific Concerns to Consider

- **Costs of Compliance**

System modifications and contract re-negotiations and the time associated with both, will place significant expense on payment processors. Further, processors will need to store and secure data provided to the IRS.

The expected hard costs associated with ramping up and maintaining a program to facilitate compliant reporting are only a part of the costs that should be expected to arise out of this

proposal. It should be expected that the number of hours a processor will ultimately have to devote to troubleshooting alleged errors in the reporting would be significant. For instance if the IRS reporting from a processor does not reconcile with other reporting received by a particular merchant, it will likely result in significant hours spent by the processor's merchant relationship team to work through those issues with that merchant.

This will add a level of complexity to all new product initiatives. Additional analysis and possible extra development may be required each time a new payment product is developed and/or rolled out.

- **Backup Withholding**

As noted, the Merchant Reporting proposal includes the requirement to withhold 28% of payments made to merchants on whom we do not have a valid TIN. Processors would be required to withhold immediately on any payment on which the TIN is missing, or is obviously an incorrect number (for example, all the same digits, or sequential digits).

The impact of this new withholding on merchants, particularly smaller merchants would be substantial, presenting great complication and burden on their cash management procedures. The reduction of cash flow based on transactions that may have no income tax consequence would be a tremendous burden to our merchant clients.

In addition, the impact of withholding is potentially significant to processors. For any payments on which withholding is required, but a processor fails to withhold correctly, the processor is liable for the amount that should have been withheld, in addition to penalties and interest on the under-withheld amount. Because of the dollar volume involved in these electronic transactions for large processors, the liability for failure to withhold, penalties, and interest could be a very significant monetary risk.

There is nothing in any of the information published to date on this new initiative addressing if, or how, this proposal relates to payments made to non-resident aliens. The withholding and reporting regulations for payments made to non-residents are more complicated than the rules for domestic recipients. If payments to non-residents are included in the scope of this legislation, the processes required to document, withhold and report payments would be significantly more difficult than those for domestic merchants.

At a minimum, should backup withholding remain a part of any increased merchant-reporting proposal, a period of significant phase in, perhaps two to three years, should be provided before withholding is required. This will allow payers time to obtain the necessary customer information. Additionally, any new compliance regime in this area should include appropriate safe harbors from penalties where 100 percent compliance is not achieved.

- **Tax Identification Number Matching and Maintenance**

TIN validation and maintenance presents significant concern. Merchants are not currently identified by acquiring bank or processor systems by SSN or TIN, but rather they are generally assigned a merchant ID number. It could take years for banks to complete a matching process, at significant time and expense.

Payment processors would be required to obtain and store the Employer Identification Number (EIN) or Social Security Number (SSN) for each merchant on whom we are required to report.

In addition to obtaining a tax identification number (TIN) for each merchant, processors will need to verify the name under which the payment is reported is an exact match to the name under which IRS issued the tax identification number.

Since many businesses use a variation of their full business name or a DBA name, many processor records will need to be updated. This will require using the IRS TIN Matching Service or some other service to identify those accounts on which we do not have a name/TIN match. Merchants for whom we do not have a match will need to be contacted to obtain good information. This process can take multiple requests of the merchant to obtain an exact match to IRS records.

Unlike current 1099-MISC reporting done by payers, which limits reporting to services (goods are excluded), and to non-exempt recipients, (exempt entities such as corporations, government entities, etc. are excluded), this proposal will greatly expand the reach of the reportable universe. Because the type of record keeping and reporting required by IRS is not something that has been required of processors previously, the additional operational and IT support could be significant.

The IRS maintains a TIN Matching System through which a file of up to 100,000 records can be submitted to the IRS to verify the customer name and TIN is a match on IRS records. A suggestion has been made that as a part of the merchant reporting initiative, merchants who verify TIN's through this service may not be required to withhold. It is unclear at this time whether withholding would be required on accounts that are returned by the IRS as a mismatch, or if the processor would be relieved of withholding entirely if using the TIN Matching system.

The specifications for the file layout to submit files to the TIN Matching Service are very stringent, and the file is rejected if any record in the file does not meet the specifications exactly. There is likely very limited, if any, experience within most payment processor companies in working with this IRS system on the large scale basis likely required under this proposal.

- **Impact on Merchant Reporting Entity Relationship**

It's certainly possible that the reporting could create tensions between acquirers/processors and their merchant customers who don't understand how the information is going to be used and/or disagree with the methodology by which processors have created the reporting. This will result in a tremendous amount of concern and confusion among merchant customers. Additionally, fear of audit could make merchants less likely to accept electronic payments.

The potential for merchant concern over privacy issues should also not be overlooked. Recent media reports and analysis from the Center for Democracy & Technology raise questions regarding the wisdom of creating a new private sector database tied to Social Security numbers, which are used by many small businesses as their taxpayer ID number.

- **Reporting Questions**

Operationally, merchant payments would be reported on Form 1099-MISC. A file including all reportable information would need to be prepared from a processor reporting system and transmitted in the required format to the IRS reporting system.

At this point, it is unclear if the aggregate payments or another amount would be reported, and who would have reporting responsibility in cases where another party is a middleman in a transaction. Would the proposal include Debit and ACH? Including these products would pull almost every bank in the U.S. under the proposed reporting regime.

In addition, no definition has been provided for how reporting would be handled for companies with stores or divisions that operate independently or are franchisees of a business. Further, it is largely impossible for the payment industry to report on net receipts, given fees, interchange, gift card, chargeback, cash backs, etc. The only possible number to report on would be gross.

Given the variances in the systems utilized by the numerous processors in the industry, it is likely that the accuracy of reporting from acquirer to acquirer, or processor to processor has the potential to vary greatly.

Conclusion

On a final note, it should be expected that the non-compliant taxpayers this proposal targets will ultimately find and develop schemes to avoid recognition through this type of reporting. Some may simply stop accepting cards altogether thereby making it less likely that the IRS will be able to track taxable income, others may simply work to find loopholes in the reporting mechanisms that are ultimately established. The benefits expected to arise from this initiative may ultimately result in increased costs to the compliant payment card participants (consumers, acquirers, processors, issuers, merchants) with no real benefit to those same participants. I look forward to answering any questions you might have, and thank the Committee for taking valuable time to consider this important issue.

Statement of Rep. Jason Altmire
Committee on Small Business Hearing
"Electronic Payments Tax Reporting:
Another Tax Burden for Small Businesses"
June 12, 2008

Thank you, Chairwoman Velazquez, for holding today's hearing to discuss electronic payments tax reporting and the potential burden it imposes on small businesses. Electronic payment systems have become integral to every day life, providing convenience and efficiency. They quickly and easily link merchants, consumers and banks. However, the administrative and financial burdens that are associated with electronic payments tax reporting can be burdensome for small businesses.

A proposed measure we will discuss today would require small businesses to file tax reports on all credit card receipts. While the proposal is laudable, it could threaten entrepreneurs' bottom line. For small businesses, electronic transactions relate very little to actual income when the charge-backs, merchant discounts and other fees are factored in.

What seems like a sensible budget offset has very real costs for small businesses that operate on very small profit margins. We must take into account the unintended consequences of this change and the impact it could have on small businesses.

Chairwoman Velazquez, thank you again for holding this important hearing today. I yield back the balance of my time.

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