

# DOES THE IRS KNOW ABOUT VENMO? CHANGES IN REPORTING REQUIREMENTS OF DIGITAL PAYMENTS



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A major convenience in smartphone technology is the availability of third-party payment networks like Venmo and PayPal, which replace payments by cash, check, or debit card. The IRS calls these transactions third-party network transactions (TPNTs) and the entities making the payments third-party settlement organizations (TPSOs).<sup>1</sup>

TPSOs have a duty to report certain TPNTs to the IRS. At its inception, the minimum reporting threshold was \$20,000 but in 2021, that threshold decreased to \$600.<sup>2</sup> As a result, many more taxpayers were to receive a Form 1099-K for tax year 2022. In Notice 2023-10, published on January 3, 2023, the IRS delayed the duty of TPSOs to issue notice of TPNTs at this new lower threshold.<sup>3</sup> Even with the IRS

delay, taxpayers started to see some of these Form 1099-Ks in January. Attorneys and tax professionals should understand the status of the requirements and be prepared to address the taxability of TPNTs.

## TPNTS EXPLAINED

A TPNT is a convenient method of moving money. In the not-so-distant past, paying a bill or reimbursing a friend could involve mailing a paper check, with the payee cashing the check days later. By using a TPSO, such as Apple Pay, Venmo, or PayPal, that same payment can be made within minutes.<sup>4</sup> A parent, for instance, who wishes to send their far-flung college student some spending money, can do so instantly with just a few taps on their iPhone. A festivalgoer

may pay a vendor with a smartphone and have the convenience of not carrying cash. These transactions solve issues of time, distance, and security.

Roughly 79 percent of Americans surveyed in 2020 said they use a TPSO on their mobile phone to send and receive money.<sup>5</sup> Additionally, 43 percent of respondents said they use these services to repay friends and family members, with another 40 percent using these services to pay bills.<sup>6</sup> But must these TPNTs be accounted for at tax time? As often happens, government struggles to maintain pace with technological developments. The challenge for the IRS, and, in turn, for taxpayers, is accounting for those TPNTs that are taxable.

### THRESHOLD FOR REPORTING TPNT

Since 2011, the IRS mandated that a TPSO send to taxpayers and the IRS a reporting form called a 1099-K for any gross payment which “exceeds \$20,000,” and the aggregate “number of such transactions...exceeds 200.”<sup>7</sup> Given this rather high threshold, most taxpayers paid little attention to the TPNTs they made or received throughout the tax year. A provision in the American Rescue Plan Act of 2021 changed the reporting significantly and some states have adopted the same lower threshold.<sup>8</sup> Instead of the \$20,000 reporting threshold that had existed since 2011,<sup>9</sup> the threshold became a mere \$600 regardless of the number of transactions.<sup>10</sup> Because of the confusion and controversy over the reporting changes, the IRS issued guidance, delaying the threshold change for tax year 2022. The IRS views calendar year 2022 “as a transition period for purposes of IRS enforcement and administration of the modified de minimis exception for ... third party network transactions.”<sup>11</sup>

Although the IRS guidance states that TPSOs will not be penalized for 2022 reporting, taxpayers have started seeing 1099-Ks under the new thresholds. Regardless of receipt of a 1099-K, if the amounts received by a taxpayer as a TPNT were for goods or services, those amounts are income. Below are some reminders and helpful tips in assessing tax liability for money received through a TPNT.

### Documentation regarding goods or services

Many business taxpayers should be familiar with a 1099-K from a TPSO. If the business received over 200 TPNTs and \$20,000 in any year since 2011, the business already has been receiving 1099-Ks. Small businesses, however, may be receiving a 1099-K for the first time. The taxpayer most likely to be unfamiliar with a 1099-K is an individual taxpayer who received money through a TPSO in exchange for “goods and services.”

To be clear, if the TPNT is money from friends and family (e.g., for repayment of an expense or to split the check at dinner), the taxpayer need not include the amount as income. Gifts do not need to be included either. Nevertheless, if the payor categorized an amount as “goods or services,” the payee taxpayer must be able to document that the payment was for some other purpose in order to exclude that amount as income.

Almost immediately following the threshold change, TPSOs began to educate their users of the change on their respective websites. Venmo, for example, states the following on its customer website, included in part, with emphasis added:

### 3. What makes a payment goods and services?

When sending money on Venmo, users can choose to tag a payment as being for “goods and services”.

Whether it’s for a product you sell, a service you provide, or even an old couch you don’t want anymore, *the person paying for the item or service can decide whether to tag the payment.*

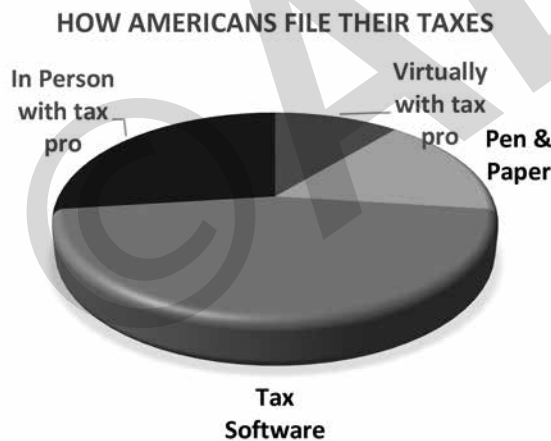
All payments sent to business profiles on Venmo are tagged as purchases automatically and are therefore considered to be for goods and services.<sup>12</sup>

Venmo’s summary above addresses the key parts of this law most likely to cause confusion: Venmo will rely on the payor’s “tag” on the payment to determine what to report on the 1099-K.<sup>13</sup>

Savvy taxpayers should keep files with backup documentation. If the money was received for goods and services, it should be marked as such in the taxpayer's records, in much the same way as the Venmo recommendation above. If the taxpayer intends to dispute that a payment was for goods or services, the taxpayer should have receipts or some form of documentation to show what the payment was actually intended for.

### Always include taxable amounts

In a 2021 survey, 46 percent of Americans said they file their taxes themselves using online tax software.<sup>14</sup> To keep up with the new 1099-K reporting threshold, tax software companies will have updated programs to account for the reports taxpayers will receive. The software should prompt the taxpayer by asking for what purpose the TPNT was received. For instance, the software would ask: (i) "Did you receive over \$600 from a TPSO during the tax year?"; and (ii) "Was that money received in exchange for any goods you sold or services you performed?" Taxpayers who prepare a paper return need to ask the same two questions.



Taxpayers who failed to make adequate withholdings or to make quarterly estimated tax payments to the IRS on taxable TPNTs will be especially impacted. It may be tempting for taxpayers who receive TPNTs to "forget" to include these amounts as income, just as some taxpayers fail to report the receipt of cash. The obligation on the taxpayer, however, has always

been to report income accurately, whether or not it appears on a 1099.

Tax professionals should counsel their clients to evaluate honestly whether goods or services were involved in any TPNT and to report amounts accordingly. To advise otherwise could amount to tax fraud. If a taxpayer receives a 1099-K that they believe is incorrect, the taxpayer should request a correction from the issuer and give an explanation on the return if a corrected 1099-K is not timely received. Tax professionals also should counsel the taxpayer to keep separate business and individual bank accounts and records. A business that is a separate entity (a partnership, corporation, or LLC) should be accustomed to keeping records of transactions. By contrast, an individual whose sale of goods or services is only occasional may have failed to keep original records during the tax year to substantiate TPNTs. A tax professional should counsel the taxpayer to try to obtain copies of past receipts and, in the future, to keep separate business and individual bank accounts or records for payments involving a third-party network.

### Deductions may offset TPNT income

Taxpayers should bear in mind that the change in reporting does not change the way that income and expenses are treated. Again, the process starts with separating a taxpayer's business and individual transactions. TPNTs may be reportable on Schedule "C" of the taxpayer's 1040, and ordinary and necessary business expenses may be listed as deductions.

Many in the general public, and even some members of Congress, have pushed back on the 2021 law, deriding it as an invasion of privacy. Wyoming Republican Senator Cynthia Lummis asked Treasury Secretary Janet Yellen during a Senate hearing if she was aware of "how unnecessary this regulatory burden is?" Senator Lummis continued by asking the Secretary: "Do you distrust the American people so much that you need to know when they bought a couch? Or a cow?"<sup>15</sup> There are numerous bills to again change the thresholds, but the likelihood of success of these proposals is uncertain.<sup>16</sup>

TPNTs are undoubtedly the wave of the future. The IRS needs to keep up with income sources if it is to continue bringing in needed revenue. Taxpayers should understand that it is not the taxable nature of the TPNT that has changed, but only the reporting requirement. The change to a \$600 threshold will result in a more equitable and accurate taxing of what taxpayers receive for goods or services. The better job taxpayers do in processing 1099-Ks, the fewer returns the IRS will flag for review. With an already slow and overwhelmed processing system, taxpayers' understanding of the 1099-K benefits all of us. 🍂

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## Notes

- 1 Internal Revenue Service, Understanding Your 1099-K, <https://perma.cc/Y3KV-VNNS>.
- 2 American Rescue Plan Act of 2021, 117 P.L. 2, 2021 Enacted H.R. 1319, 135 Stat. 4 (2021), codified at 26 USC § 6050W.
- 3 IRS Notice 2023-10, Revised Timeline Regarding Implementation of Amended Section 6050W(e) (Jan. 3, 2023), available at <https://www.irs.gov/pub/irs-drop/n-2023-10.pdf>.
- 4 Andrew Bloomenthal, Venmo: Its Business Model and Competition (Feb. 10, 2022), <https://perma.cc/B86Q-GA7A>.
- 5 Erin El Issa, Most Americans Go Mobile With Payment Apps—Here's How They Roll, [nerdwallet.com](https://nerdwallet.com) (Feb. 26, 2020), available at <https://perma.cc/5LD5-34T8>.
- 6 Id.
- 7 Housing and Economic Recovery Act of 2008, 110 P.L. 289, 122 Stat. 2654, 2853 (2008).
- 8 American Rescue Plan Act of 2021, *supra* note 2; see, e.g., House Bill 730 (Chapter 248 of the 2020 Acts of Assembly), and Senate Bill 211 (Chapter 63 of the 2020 Acts of Assembly) (third-party settlement organizations must submit Form 1099-K information to the Virginia Department of Taxation and certain participating payees using the de minimis thresholds imposed for purposes of federal Form 1099-MISC); Virginia Department of Taxation Tax Bulletin 20-10 issued October 30, 2022.
- 9 KPMG, Evolving 1099-K Thresholds, (March 25, 2022), available at <https://perma.cc/W264-B9P3>.
- 10 American Rescue Plan Act of 2021, *supra* note 2.
- 11 IRS Notice 2023-10, *supra* note 3.
- 12 Venmo, 2023 Tax FAQ, available at <https://help.venmo.com/hc/en-us/articles/4407389460499-2023-Tax-FAQ>.
- 13 Id.
- 14 Robert Farrington, How Much Americans Pay to File Their Taxes, *The College Investigator* (Sept. 18, 2021), available at <https://perma.cc/X2X5-UV6W> (46 percent of Americans said they file their taxes themselves using online tax software; 27 percent went to a tax professional in person, 11 percent met virtually with a professional, and 16 percent prepared their own in pen-and-paper and mailed it to the IRS processing center).
- 15 Tamar Lupin, "Do You Need to Know When They Bought a Couch?" Senator rips Yellen over Biden IRS plan <https://perma.cc/J73B-FAPA>; Callie Patteson, Yellen Defends IRS Rule Requiring Banks to Report all Transactions Over \$600 (Oct. 5, 2021), <https://perma.cc/NSH9-RQ22>.
- 16 Legislators of both parties introduced bills, in both houses designed to change the \$600 threshold back to higher levels, reported on Congress.gov, as follows: the SNOOP Act of 2022 was introduced on Feb. 1, 2022, in the Senate. 117 Bill Tracking S. 3546 (2022). On Mar. 3, 2022, its House counterpart was introduced. 117 Bill Tracking H.R. 6913 (2022). On Mar. 15, 2022, The Cut Red Tape for Online Sales Act was introduced into the House, and that same day, an identical bill was introduced in the Senate. 117 Bill Tracking H.R. 7079 (2022); 117 Bill Tracking S. 3840 (2022). On Mar. 20, 2022, the Saving Gig Economy Taxpayers Act was introduced in the House. 117 Bill Tracking H.R. 3425 (2022). All of these measures have failed to proceed to the floor of their respective chamber for a full vote.