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New Massachusetts DOR Enforcement Effort

By Christopher R. Agostino on August 2, 2017

Enhanced Scrutiny for Underreporting of Cash Receipts

The Massachusetts Department of Revenue (DOR) has recently begun cross-checking 1099-K credit card receipt information against total reported revenue in order to investigate and uncover potential underreporting of cash receipts and thus potential underpayment of sales and/or income tax. After estimating potential cash income based on credit card receipt information reported to the IRS by payment processors (i.e. American Express, Pay Pal, etc.), the DOR is sending notice of any discrepancy to restaurants and retailers warning of potential under-reporting.

Massachusetts restaurateurs should check their record-keeping procedures to ensure compliance in light of the DOR's interest in this particular subject. Pursuant to DOR Directive 16-1, a restaurant's POS system must provide enough detail to confirm the amount of tax potentially due and collected on each individual transaction via cash, credit card or otherwise. With the proliferation of alternative payment systems, new systems should be vetted to ensure compliance with specific state requirements.

To ensure compliance in Massachusetts, generally, each sale record must identify:

- individual item(s) sold,
- selling price,
- tax due,
- invoice number,
- date of sale,
- method of payment, and
- POS terminal number and POS transaction number.

Because 1099-K's report gross receipts, including tips and taxes, transaction records must be detailed enough to reconcile non-income related items. Large discrepancies may exist between gross receipts and reported income because of tips or other non-income related items; therefore, compliant POS records are important to document the source of any discrepancy. Pursuant to the Directive 16-1, records may be deemed inadequate if:

- they do not verify sales receipts,
- they do not verify whether those receipts are subject to sales tax,
- they do not provide details of each individual transaction (summary reports and daily summary or "Z" tapes are not sufficient),
- they do not verify the taxable status of purchases,
- they do not show that a business's purchases correlate to its sales,

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- it is not possible to conduct a complete audit using those records,
- they are not made available to the auditor,
- they are not in a form that can be audited by DOR, or
- an evaluation of the accounting system utilized discloses that the system does not provide adequate internal control procedures which assure the accuracy and completeness of the transactions recorded in the books and records (e.g., the lack of sequentially numbered invoices or guest checks, or the lack of dates on receipts).

At a minimum, adequate POS records must be maintained for three years and longer if a taxpayer is under audit or otherwise subject to a request for information from the DOR or another agency. If you receive a notice from the DOR that identifies any reporting discrepancy contact your professional advisor(s). In the meantime, check with your POS vendor to ensure that your POS system is generating data in compliance with the Directive 16-1 that can be used to explain away any perceived reporting deficiencies.

Our thanks to Philip R. Dardeno, CPA, MST and Lucien Gauthier, Esq., CPA of the Boston Tax Institute for alerting us to this issue.

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