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DEPARTMENT OF THE TREASURY

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Internal Revenue Service

26 CFR Parts 31 and 301

[REG-116641-01]

RIN 1545-BA17

Information Reporting and Backup Withholding for Payment Card Transactions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking; notice of proposed rulemaking by cross-reference to temporary regulations; and notice of public hearing.

SUMMARY: In the Rules and Regulation section of this issue of the **Federal Register**, the IRS is issuing temporary regulations relating to the IRS Taxpayer Identification Number (TIN) Matching Program. The text of the temporary regulations published in the Rules and Regulations section of this issue of the **Federal Register** serves as the text of this portion of the proposed regulations. This document also contains proposed regulations relating to the information reporting requirements, information reporting penalties, and backup withholding requirements for payment card transactions. These regulations affect payors (and their authorized agents) and payees of certain reportable payments and provide guidance necessary to comply

with the law. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by May 1, 2003. Outlines of topics to be discussed at the public hearing scheduled for May 21, 2003, must be received by April 30, 2003.

ADDRESSES: Send submissions to: CC:PA:RU (REG-116641-01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG-116641-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue., NW., Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS internet site at www.irs.gov/regs. The public hearing will be held in room 6718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Donna Welch, (202) 622-4910; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Sonya Cruse, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management

and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by April 1, 2003. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collections of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §31.3406(g)-1(f)(3). This information is required in order for a Qualified Payment Card Agent (QPCA) to notify a cardholder/payor that a merchant/payee is not a qualified payee for purposes of the proposed regulations. This information will alert a cardholder/payor that backup withholding under 3406 may apply. The collection of information is voluntary to obtain a benefit. The likely respondents are business or other for-profit institutions.

Estimated total annual reporting burden: 11,750,000 hours.

Estimated average annual burden hours per respondent: 5,875 hours.

Estimated number of respondents: 2,000.

Estimated annual frequency of responses: monthly.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

1. Summary

This document contains proposed amendments to 26 CFR part 31 relating to backup withholding under section 3406 of the Internal Revenue Code and proposed amendments to 26 Part 301 relating to waivers under section 6724 of information reporting penalties under sections 6721 and 6722.

Temporary regulations in the Rules and Regulations portion of this issue of the **Federal Register** provide that, for purposes of the IRS TIN Matching Program, the term payor includes an agent designated by the payor to participate in TIN matching on behalf of the payor. The text of those temporary regulations also serves as the text of proposed amendments to §31.3406(j)-1(a) of the regulations. The preamble to the temporary regulations explains the proposed amendments to §31.3406(j)-1(a).

2. Information Reporting and Backup Withholding Provisions

Section 6041(a) requires persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any one taxable year to file information returns with the IRS and to furnish information statements to payees. Among other items, the payor must include the

payee's name and taxpayer identification number (TIN) on the information return and the information statement.

Section 1.6041-3 of the Income Tax Regulations provides that information returns are not required for certain payments. Section 1.6041-3(p)(1) provides that an information return is not required for payments made to a corporation. Section 1.6041-3(c) provides that an information return is not required for payments of bills for merchandise, telegrams, telephone, freight, storage, and similar charges.

Section 6109(a)(1) provides that a person required to make a return must include that person's identifying number in the return. Section 6109(a)(2) provides that a person (the payee) with respect to whom a return is required to be made by another person (the payor) or whose identifying number is required to be shown on a return of another person must furnish to the other person the identifying number prescribed for securing the proper identification of the payee. Section 6109(a)(3) provides that a person (the payor) required to make a return with respect to another person (the payee) must ask the other person for the identifying number prescribed for securing the proper identification of the payee and include that number in the return.

In general, section 6721(a)(1) imposes a \$50 penalty for each failure to file an information return on or before the required

filing date, for any failure to include all of the information required to be shown on the return, or for the inclusion of incorrect information.

Section 6724(a) provides that no penalty will be imposed under section 6721 if it is shown that the failure is due to reasonable cause and not to willful neglect.

Section 3406(a)(1) requires a payor to withhold on any reportable payment (as defined in section 3406(b)(1)) in certain situations, including if (1) the payee fails to furnish his TIN to the payor as required or (2) the Secretary notifies the payor that the TIN furnished by the payee is incorrect.

Section 3406(i) provides that the Secretary shall prescribe the regulations necessary or appropriate to carry out the purposes of section 3406.

3. TIN Matching

Regulations issued under section 3406(i)(§31.3406(j)-1 of the Employment Tax Regulations) provide that the Commissioner has the authority to establish TIN matching programs through revenue procedures or other appropriate guidance. Under the regulations, a payor participating in a TIN matching program may contact the IRS with respect to the TIN furnished by a payee before filing information returns for reportable payments. The regulations further provide that the IRS will inform the payor whether or not the

name/TIN combination furnished by the payee matches a name/TIN combination maintained for the TIN matching program.

Pursuant to the authority in §31.3406(j)-1, the IRS issued Rev. Proc. 97-31 (1997-1 C.B. 703) and implemented TIN matching for reportable payments by Federal agency payors. The IRS is issuing a second TIN matching revenue procedure to expand the scope of the TIN Matching Program by allowing all payors (and not merely Federal agency payors) to participate in TIN matching for reportable payments. Under the authority of the temporary regulations discussed above, payors' authorized agents will also be permitted to participate in TIN matching.

4. Payment Card Transactions

A payment card transaction is a transaction in which a cardholder/payor uses a payment card to purchase goods or services and a merchant agrees to accept a payment card as a means of obtaining payment. A payment card is a card (or an account) issued by a payment card organization, or one of its members or affiliates, to a cardholder/payor which, upon presentation to a merchant/payee, represents an agreement of the cardholder to pay the merchant through the payment card organization. A payment card organization is an entity that sets the standards and provides the mechanism, either directly or indirectly through members and affiliates, for effectuating payment between a purchaser and a merchant in a payment

card transaction. A payment card organization generally provides this mechanism by issuing payment cards, enrolling merchants as authorized acceptors of payment cards for payment for goods or services, and ensuring the system conducts the transactions in accordance with prescribed standards of payment card transactions.

The parties involved in payment card transactions may include the cardholder/payor, the merchant/payee, a bank that issues a payment card (issuing bank), a merchant/payee's bank (merchant bank, acquiring bank, or acquirer), and the payment card organization.

Cash does not pass directly from the cardholder/payor to the merchant/payee for purchases made with a payment card. Rather, in some situations, payment is made by a credit from the issuing bank, through the payment card organization, to the merchant's bank account. In turn, the cardholder pays the issuing bank upon receipt of the payment card monthly billing statement. In other situations, payment is made directly from the payment card organization to the merchant. In turn, the cardholder pays the payment card organization upon receipt of the payment card monthly billing statement.

5. Information Reporting and Backup Withholding Difficulties for Payment Card Transactions

Information reporting compliance is difficult in payment card transactions because an invoice may not be issued, and the employee of the cardholder/payor may not request and obtain the name/TIN combination of the merchant/payee at the time of the transaction. In

addition, backup withholding may be difficult because a merchant receives payment from the payment card organization within a few days after the transaction, but the cardholder does not pay the payment card organization until after it receives a payment card monthly billing statement from the payment card organization.

Because of these difficulties, representatives of the payment card industry and the Information Reporting Program Advisory Committee (IRPAC) have proposed that the IRS allow a payment card organization to act on behalf of a cardholder/payor for purposes of soliciting, collecting, and validating the names/TINs of the merchant/payees through TIN matching. In addition, they suggest that the payment card organization be allowed to inform the cardholder about a merchant's corporate status.

The IRS is issuing a proposed revenue procedure that would allow a payment card organization to obtain an IRS determination that it is a Qualified Payment Card Agent (QPCA). The proposed procedure would permit a QPCA to act on behalf of a payor for purposes of soliciting, collecting, and validating merchants' names/TINs, and providing merchants' corporate status. To obtain a QPCA determination, the payment card organization would be required, among other things, to demonstrate the reliability of its data by participating in the IRS TIN Matching Program and matching its merchant name/TIN data with IRS name/TIN data.

Certain payment card industry representatives have suggested that, for payments made through a QPCA, the information provided to the cardholder/payor should be sufficiently reliable that backup withholding should not apply. In addition, they have suggested that a cardholder/payor who files incorrect information returns should be considered to meet the reasonable cause requirements for a waiver under section 6724 if the cardholder/payor relied on payee information provided by a QPCA.

The IRS and the Treasury Department agree that QPCAs, by obtaining TINs and participating in the IRS TIN Matching Program, can enhance the accuracy of information reporting by the cardholder/payors. Accordingly, the IRS and the Treasury Department agree that a limited exception to the backup withholding requirements is appropriate if cardholder/payors rely on a QPCA to solicit, collect, and validate merchant/payees' TINs. In addition, the IRS and the Treasury Department agree that cardholder/payors may establish reasonable cause based on reliance on merchant/payees' TINs supplied through a QPCA.

Explanation of Provisions

1. Backup Withholding

The proposed regulations provide that backup withholding does not apply to payment card transactions if the reportable payments are made through a QPCA and the payee is a qualified payee. The proposed

regulations provide that a payee is qualified if, at the time of the payment, the QPCA has validated the payee's TIN through the IRS TIN Matching Program or if the payment is made during the 6-month period following the date on which the QPCA first obtained the payee's TIN.

The proposed regulations provide that reportable payments made through a QPCA are also exempt from backup withholding if the payment is made within 60 days after the date of the first payment with respect to which the QPCA is required to provide notification to the payor that the payee is not a qualified payee. Under the proposed regulations, a QPCA must notify a cardholder/payor of any merchant/payees that are not qualified payees. The notice must appear on the billing information for the payment. The regulations clarify that this notification does not constitute notice by the IRS that the payee's TIN is incorrect for purposes of backup withholding.

2. Waiver Under Section 6724 for Reasonable Cause

The proposed regulations provide that a cardholder/payor may establish reasonable cause based on its reliance on a QPCA. Under the proposed regulations, special solicitation rules will apply if the cardholder/payor relies on a QPCA. Under those rules, a cardholder/payor is not required to make the initial solicitation of a payee's TIN at the time of the transaction and generally is not required to undertake the first and second annual solicitations. Under the proposed regulations, a cardholder/payor that relies on a

QPCA is required to solicit a payee's TIN only if the QPCA fails to provide, within a specified period, a TIN that the cardholder/payor believes in good faith to be the payee's correct TIN.

3. Effective Dates

Section 31.3406(j)-1(a) and (f) are applicable January 31, 2003. The amendments of §31.3406(g)-1 are proposed to be applicable for payments on or after January 1, 2004. The amendments of §301.6724-1 are proposed to be applicable for information returns required to be filed, and information statements required to be furnished, after December 31, 2004. The amendments to §§31.3406(g)-1 and 301.6724-1 will not be applicable until they are finalized.

Special Analyses

It has been determined that these proposed regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6) that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. The reporting burden affects financial institution members of the payment card network that are affiliates of QPCAs. Most of these financial institution members

are large businesses. To the extent that small financial institutions have a reporting burden, the burden is expected to be insignificant. Accordingly, a Regulatory Flexibility Analysis is not required.

Pursuant to section 7805(f), this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written or electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for May 21, 2003, beginning at 10 a.m. in room 6718 of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be permitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name

placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight copies by April 30, 2003. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of the regulations is Donna Welch, Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. However, other personnel from the IRS and the Treasury Department participated in the development of the regulations.

List of Subjects

26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social security, Unemployment compensation.

26 CFR Part 301

Employment taxes, Estate taxes, Excise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 31 and 301 are proposed to be amended as follows:

PART 31--EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 2. Section 31.3406(g)-1 is amended by adding paragraph (f) to read as follows:

§31.3406(g)-1 Exceptions for payments to certain payees and certain other payments.

* * * * *

(f) Special rule for certain payment card transactions--(1) In general. No withholding under section 3406 is required for a reportable payment made through a payment card organization if the payment is made on or after January 1, 2004, the organization is a Qualified Payment Card Agent (QPCA), and--

(i) The payee is a qualified payee (as defined in paragraph (f)(2)(v) of this section) with respect to the payment; or

(ii) The payment is made during the 60-day period following the date on which the payor made the first payment with respect to which

the QPCA is required under paragraph (f)(3) of this section to provide notification that the payee is not a qualified payee.

(2) Definitions--(i) Payment card defined. For purposes of this section, a payment card is a card (or an account) issued by a payment card organization, or one of its members or affiliates, to a cardholder/payor which, upon presentation to a merchant/payee, represents an agreement of the cardholder to pay the merchant through the payment card organization.

(ii) Payment card organization defined. For purposes of this section, a payment card organization is an entity that sets the standards and provides the mechanism, either directly or indirectly through members and affiliates, for effectuating payment between a purchaser and a merchant in a payment card transaction. A payment card organization generally provides such a payment mechanism by issuing payment cards, enrolling merchants as authorized acceptors of payment cards for payment for goods or services, and ensuring the system conducts the transactions in accordance with prescribed standards for payment card transactions.

(iii) Payment card transaction defined. For purposes of this section, a payment card transaction is a transaction in which a cardholder/payor uses a payment card to purchase goods or services and a merchant agrees to accept a payment card as a means of obtaining payment.

(iv) Qualified Payment Card Agent (QPCA) defined. For purposes of this section, a Qualified Payment Card Agent (QPCA) is a payment card organization that has a current QPCA determination from the Internal Revenue Service (IRS) under applicable procedures (see §601.601(d)(2) of this chapter).

(v) Qualified payee defined. For purposes of this section, a payee is a qualified payee with respect to a reportable payment if--

(A) At the time of the payment, the QPCA has obtained the payee's TIN and the payee's TIN has been validated through the IRS TIN Matching Program; or

(B) The payment is made during the 6-month period following the date on which the QPCA first obtained the payee's TIN.

(3) Notification of payee status. In the case of a reportable payment to a payee other than a qualified payee (as defined in paragraph (f)(2)(v) of this section) with respect to the payment, the QPCA must notify the payor on the billing information for the payment that the payee is not a qualified payee. The notification must appear on the face of the bill in print size no smaller than the print size used for the charge amount relating to the purchase from the payee. Notification may consist of an asterisk, footnote, or other mark next to the payee's name or the charge, with the text of the notification at the bottom of the page or at the end of the list of charges. Notification by the QPCA that a payee is not a qualified

payee does not constitute notice by the IRS that the payee's TIN is incorrect for purposes of section 3406(a)(1)(B) and §31.3406(d)-5.

Par. 3. In §31.3406(j)-1, paragraphs (a) and (f) are revised to read as follows:

§31.3406(j)-1 Taxpayer Identification Number (TIN) matching program.

(a) [Section 31.3406(j)-1(a) is the same as §31.3406(j)-1T(a) published elsewhere in this issue of the **Federal Register**.]

* * * * *

(f) [Section 31.3406(j)-1(f) is the same as §31.3406(j)-1T(f) published elsewhere in this issue of the **Federal Register**.]

PART 301--PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation for part 301 continues to read in part as follows:

Authority: 26 U.S.C. 7805. * * *

Par. 5. Section 301.6724-1 is amended by:

1. Revising the introductory language of paragraph (c)(6).
2. Adding paragraphs (e)(1)(vi)(H) and (f)(5)(vii).

The revision and additions read as follows:

§301.6724-1 Reasonable cause.

* * * * *

(c)* * *

(6) Actions of the payee or any other person. In order to establish reasonable cause under paragraph (c)(1) of this section due

to the actions of the payee or any other person, such as a broker as defined in section 6045(c) or a Qualified Payment Card Agent (QPCA) as defined in §31.3406(g)-1(f)(2)(iv) of this chapter, providing information with respect to the return or payee statement, the filer must show either--

* * * * *

(e) * * * (1) * * *

(vi) * * *

(H) In the case of information returns required to be filed, and information statements required to be furnished, after December 31, 2004, the filer--

(1) Satisfies the solicitation requirements of paragraphs (e)(1)(i) and (ii) of this section with respect to a payment made through a QPCA if the filer relies in good faith on the QPCA to solicit, record, validate, and furnish the payee's TIN; and

(2) Satisfies the solicitation requirement of paragraph (e)(1)(iii) of this section with respect to such a payment if, on or before December 31 of the year immediately succeeding the calendar year in which the payment is made, the filer undertakes a solicitation of the payee's TIN or receives from the QPCA a TIN that the filer believes in good faith to be the payee's correct TIN.

* * * * *

(f) * * *

(5) * * *

(vii) In the case of information returns required to be filed, and information statements required to be furnished, after December 31, 2004, the filer--

(A) Satisfies the solicitation requirement of paragraph (f)(1)(i) of this section with respect to a payment made through a QPCA if the filer relies in good faith on the QPCA to solicit, record, validate, and furnish the payee's TIN; and

(B) Satisfies the solicitation requirement of paragraph (f)(1)(ii) or (iii) of this section, whichever is applicable, with respect to such a payment if, after the date the filer is notified that the account of the payee contains an incorrect TIN and on or before the date by which the applicable requirement must be satisfied, the filer solicits the payee's correct TIN in a manner that satisfies the applicable requirement or receives from the QPCA a TIN that the filer believes in good faith to be the payee's correct TIN.

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David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.