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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 31 and 301

[REG-116644-01]

RIN 1545-BA18

Receipt of Multiple Notices With Respect to Incorrect Taxpayer Identification Numbers

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations relating to backup withholding. The regulations clarify the method of determining whether the payor has received two notices that a payee's taxpayer identification number (TIN) is incorrect. If a payor receives two or more such notices with respect to the same account during a three-year period, the payor must begin backup withholding unless the payee provides verification of its correct TIN pursuant to the regulations. This document also contains proposed regulations which clarify when an information return filer must solicit a payee's TIN following the receipt of a penalty notice. In addition, this document provides notice of a public hearing on these proposed regulations.

DATES: Written and electronic comments must be received by October 1, 2002. Requests to speak (with outlines of topics to be discussed) at the public hearing scheduled for October 22, 2002, at 10:00 a.m., must be received by October 1, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-116644-01), 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 5 p.m. to: CC:ITA:RU (REG-116644-01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at www.irs.gov/regs. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Nancy Rose (202) 622-4910; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Employment Tax Regulations (26 CFR Part 31) under section 3406 of the Internal Revenue Code (Code), and to the Procedure and Administration Regulations (26 CFR Part 301) under section 6724 of the Code. These proposed amendments to the regulations would revise existing §§31.3406(d)-5(d)(2)(ii) and (g)(4), and 301.6724-1(f)(2), (f)(3), (f)(5) and (k).

These proposed regulations address certain issues identified by the Commissioner's Information Reporting Program Advisory Committee (IRPAC) and take into account comments and information provided by IRPAC members.

Section 3406

Section 3406 imposes a requirement to backup withhold on any reportable payment where the Secretary notifies the payor that the TIN furnished by the payee is incorrect. After receiving a notice of incorrect TIN, the payor must backup withhold on reportable payments until the payee furnishes another TIN. However, if the payor receives two notices with respect to the same account within a three year period, the payor must backup withhold on reportable payments until the payor receives a verification of the payee's TIN from the Social Security Administration or the IRS.

The regulations under section 3406 set forth detailed procedures for payors to follow after receipt of a notice of incorrect TIN from the IRS. When the first such notice is received by the payor, the payor must send a notice (commonly referred to as a "B" notice) to the payee stating that the payee will be subject to backup withholding if the payee does not furnish a certified TIN. If a second notice of incorrect TIN is received by a payor with respect to the payee's account within a three-year period, the payor must send a second "B" notice to the payee stating that the payee will be subject to backup withholding unless the payor receives verification of the payee's TIN from the Social Security Administration or IRS.

If the payor receives two or more notices of incorrect TIN with respect to a payee's account within the same calendar year, the regulations provide that the multiple notices may be treated as one notice for purposes of sending out a first "B" notice, and must be treated as one notice for purposes of sending out a second B notice. However, in some cases, a payor may receive multiple notices of incorrect TIN in different calendar years which relate to the same payee's account for the same year. This may occur where a payor files different types of information returns with respect to the

same payee, such as a Form 1099-B (gross proceeds reported by brokers) and a Form 1099-DIV (payment of dividends).

Typically these information returns all contain the same TIN, following information contained in the payor's records.

Variations in the processing of such returns by the IRS may result in the issuance of incorrect TIN notices at different times.

The regulations currently do not provide that two or more notices of incorrect TIN relating to the same payee and the same year, but which are received in different calendar years, count as one notice. Accordingly, a payor must send a first "B" notice to the payee after receipt of the first notice of incorrect TIN, and a second "B" notice after receipt of the second notice of incorrect TIN, even if the second notice relates to an information return filed for the same year as the first notice. The payee must respond to the second notice by obtaining verification of its TIN from the IRS or Social Security Administration.

To avoid this burden on both payor and payee, the proposed amendments to the regulations provide that when a payor receives two or more notices of incorrect TIN with respect to the same payee's account for the same year, the

payor is treated as receiving one notice, regardless of the calendar year in which the notices are received.

Section 6724

Section 6724 provides for a waiver of information reporting penalties under sections 6721 through 6723 where the failure giving rise to such penalties was due to reasonable cause and not willful neglect. Under §301.6724-1(a) of the regulations, in order to prove reasonable cause for a failure, the filer must establish either that there are significant mitigating factors with respect to the failure or that the failure arose from events beyond the filer's control. In addition, the filer must have acted in a responsible manner both before and after the failure.

The regulation provides that certain actions of the payee or another person providing necessary information with respect to the return may be an event beyond the filer's control. Thus, a payee's furnishing of an incorrect TIN to a payor may be an event beyond the payor's control. However, the payor must also act in a responsible manner with respect to the failure. Section 301.6724-1(f) sets forth special rules for acting in a responsible manner with respect to incorrect TINs. The filer is required to make an initial solicitation for the payee's correct TIN at the time the account is opened, and up

to two annual solicitations following receipt of penalty notices.

Under the current regulation, if a filer receives a penalty notice with respect to an incorrect payee TIN and a notice of incorrect TIN under section 3406(a)(1)(B) during the same calendar year for the same payee, the filer will satisfy the section 6724 annual solicitation requirements by sending the required "B" notice. The filer does not have to make another solicitation pursuant to section 6724. However, if the filer receives a section 3406(a)(1)(B) notice with respect to a payee in one year, and the following year receives a penalty notice with respect to the same payee and the same year as the section 3406(a)(1)(B) notice, the filer must make an annual solicitation pursuant to section 6724.

To avoid this burden, the proposed amendments to the regulations provide that if a filer receives a section 3406(a)(1)(B) notice with respect to a payee in one year and the following year receives a penalty notice with respect to the same payee and the same year as the 3406(a)(1)(B) notice, the filer is not required to make an annual solicitation for the payee's TIN pursuant to section 6724 provided the filer has sent the required B notice.

Effective Date of Proposed Regulations

The provisions of these regulations are proposed to be applicable the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information of small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely (in the manner described in the **ADDRESSES** portion of this preamble) to the IRS. The IRS and the Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public

inspection and copying. Written comments on the proposed regulations are due by October 1, 2002.

A public hearing has been scheduled for October 22, 2002, beginning at 10:00 a.m. in Room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted 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** portion of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by October 1, 2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for reviewing outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Nancy L. Rose, Office of Associate Chief Counsel (Procedure and

Administration). However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects

26 CFR Part 31

Employment taxes, Income taxes, Penalties, 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 SOURCE

Par. 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(d)-5 is amended by revising paragraphs (d)(2)(ii) and (g)(4) to read as follows:

§31.3406(d)-5 Backup withholding when the Service or a broker notifies the payor to withhold because the payee's taxpayer identification number is incorrect.

* * * * *

(d) * * *

(2) * * *

(ii) Two or more notices for an account for the same year or received in the same year. A payor who receives, under the same payor taxpayer identification number, two or more notices under paragraph (c)(1) or (2) of this section with respect to the same payee's account for the same year, or in the same calendar year, need only send one notice to the payee under this section.

* * * * *

(g) * * *

(4) Receipt of two notices for the same year or in the same calendar year. A payor who receives, under the same payor taxpayer identification number, two or more notices under paragraph (c)(1) or (2) of this section with respect to the same payee's account for the same year, or in the same calendar year, must treat such notices as one notice for purposes of this paragraph (g).

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PART 301--PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

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

Par. 4. Section 301.6724-1 is amended as follows:

1. Revising paragraphs (f)(2) and (f)(3).
2. Amending paragraph (f)(5)(vi), last sentence, by removing the language "paragraph (f)(2)" and adding "paragraph (f)(3)" in its place.
3. Amending paragraph (k), Example 3(ii), second sentence, by removing the language "§35a.3406-1(c)(1) of this paragraph" and adding "§31.3406(d)-5(d)(2)(i)" in its place; and by removing the language "(f)(2)" and adding "(f)(3)" in its place.
4. Amending paragraph (k), Example 3(ii), fifth sentence, by removing the language "§301.6721-1T" and adding "§301.6721-1" in its place.
5. Amending paragraph (k), Example 3(iii), fifth sentence, by removing the language "§35a.3406-1(c)(1)" and adding "§31.3406(d)-5(d)(2)(i)" in its place.
6. Amending paragraph (k), Example 3(iii), last sentence, by removing the language "§301.6721-1T" and adding "§301.6721-1" in its place.
7. Amending paragraph (k), Example 5, final sentence, by removing the language "§301.6721-1T" and adding "§301.6721-1" in its place.

8. Amending paragraph (k), Example 6(ii), sixth sentence, by removing the language "(f)(3)" and adding the language "(f)(2) in its place.

9. Amending paragraph (k), Example 7(ii), fourth sentence, by removing the language "(f)(2)" and adding "(f)(3)" in its place; and by removing the language "§35a.3406-1(c)(1)" and adding "§31.3406(d)-5(g)(1)(ii)" in its place.

10. Amending paragraph (k), Example 7(ii), fifth sentence, by removing the language "§35a.3406-1(c)(1)" and adding "§31.3406(d)-5(g)(1)(ii)" in its place.

The revisions read as follows:

§301.6724-1 Reasonable cause.

* * * * *

(f) * * *

(2) Manner of making annual solicitation if notified pursuant to section 6721. A filer that has been notified of an incorrect TIN by a penalty notice or other notification pursuant to section 6721 may satisfy the solicitation requirement of this paragraph (f) either by mail, in the manner set forth in paragraph (e)(2)(i) of this section; by telephone, in the manner set forth in paragraph (e)(2)(ii) of this section; or by requesting the TIN in person.

(3) Coordination with solicitations under section 3406(a)(1)(b). (i) A filer that has been notified of an incorrect TIN pursuant to section 3406(a)(1)(B) (except filers to which §31.3406(d)-5(b)(4)(i)(A) of this chapter applies) will satisfy the solicitation requirement of this paragraph (f) only if it makes a solicitation in the manner and within the time period required under §31.3406(d)-5(d)(2)(i) or (g)(1)(ii) of this chapter, whichever applies.

(ii) A filer that has been notified of an incorrect TIN by a notice pursuant to section 6721 (except filers to which §31.3406(d)-5(b)(4)(i)(A) of this chapter applies) is not required to make the annual solicitation of this paragraph (f) if--

(A) The filer has received an effective notice pursuant to section 3406(a)(1)(B) with respect to the same payee, either during the same calendar year or for information returns filed for the same year; and

(B) The filer makes a solicitation in the manner and within the time period required under §31.3406(d)-5(d)(2)(i) or (g)(1)(ii) of this chapter, whichever applies, before the filer is required to make the annual solicitation of this paragraph (f).

(iii) A filer that has been notified of an incorrect TIN by a notice pursuant to section 6721 with respect to a fiduciary or nominee account to which §31.3406(d)-5(b)(4)(i)(A) of this chapter

applies is required to make the annual solicitation of this paragraph
(f).

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Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.