

Section 3406.—Backup Withholding

26 CFR 31.3406-0: Outline of the backup withholding regulations.

T.D. 8637

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 31, 35a, 301, and 602

Backup Withholding, Statement Mailing Requirements, and Due Diligence

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document provides final rules on backup withholding under sections 3406(a)(1)(A), (C), and (D) of the Internal Revenue Code of 1986 (Code) when a payee fails to provide a taxpayer identification number in the required manner to a person required to make an information return, when a payee is subject to notified payee underreporting, or when a payee fails to certify, under penalties of perjury, that the payee is not subject to backup withholding due to notified payee underreporting.

This document also provides final rules on the manner for providing a statement to a payee under sections 6042(c), 6044(e), 6049(c), and 6050N(b) of the Code.

This document also contains temporary regulations on the effective date of §§35a.9999-1 through 35a.9999-5, Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in *** [IA-33-95, page 00, this Bulletin].

DATES: These regulations are effective December 21, 1995. These regulations are applicable to transactions occurring after December 31, 1996.

FOR FURTHER INFORMATION CONTACT: Renay France of the Of-

office of Assistant Chief Counsel (Income Tax and Accounting) with respect to domestic transactions, 202-622-4910 (not a toll-free number); and Teresa Burridge Hughes of the Office of Assistant Chief Counsel (International) with respect to international transactions, 202-622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this final regulation has been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-0112. Responses to this collection of information are mandatory.

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

The estimated annual burden per respondent/recordkeeper is approximately 1 hour, depending on individual circumstances.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be directed to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, PC:FP, Washington, D.C. 20224, and to the Office of Management and Budget, Attention: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503.

Books or records relating to this 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

On October 4, 1983, the Federal Register published Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983 (26 CFR part 35a) under sections 3406 and 6676(b) of the Internal Revenue Code of 1954 (26 CFR part 35a.9999-1; TD 7916 (48 FR

45362), as amended on November 25, 1983, by TD 7922 (48 FR 53111), on November 23, 1987, by TD 8163 (52 FR 44861), and on April 11, 1989, by TD 8248 (54 FR 14341). Additional temporary regulations were published in the Federal Register on November 25, 1983 (26 CFR part 35a.9999-2; TD 7922 (48 FR 53106), as amended on December 20, 1983, by TD 7929 (48 FR 56342), on March 13, 1984, by TD 7922 (49 FR 9417), on November 23, 1987, by TD 8163, and on April 11, 1989, by TD 8248 (54 FR 14341)), on December 20, 1983 (26 CFR part 35a.9999-3; TD 7929 (48 FR 56332), as amended on January 3, 1984, by TD 7933 (49 FR 63), on August 22, 1984, by TD 7966 (49 FR 33236), on November 23, 1987, by TD 8163 (52 FR 44861), and on April 11, 1989, by TD 8248 (54 FR 14341)), on February 28, 1984 (26 CFR part 35a.9999-3A; TD 7946 (49 FR 7227)), on August 22, 1984 (26 CFR part 35a.9999-4T, TD 7966 (49 FR 33237), as amended on August 29, 1984, by TD 7972 (49 FR 34340); and 26 CFR part 35a.9999-5, TD 7967 (49 FR 33240), as amended on September 19, 1984, by TD 7973 (49 FR 36645), on August 20, 1985, by TD 8046 (50 FR 33526), on April 3, 1986, by TD 8046 (51 FR 11447), on December 19, 1986, by TD 8110 (51 FR 45453), and on May 19, 1988, by TD 8202 (53 FR 17927)), on April 23, 1987 (26 CFR part 35a.3406-2; TD 8137 (52 FR 13430)), and on November 23, 1987 (26 CFR part 35a.3406-1; TD 8163 (52 FR 44861), as amended on April 11, 1989, by TD 8248 (54 FR 14341)). Those regulations were published primarily to provide guidance under the Interest and Dividend Tax Compliance Act of 1983.

Proposed regulations on backup withholding, the statement mailing requirements, and due diligence were published in the Federal Register on September 27, 1990, 55 FR 39427. Those regulations were proposed under regulations file number IA-224-82 and RIN 1545-AE20, which numbers were closed in error. These final regulations are issued under regulations file number IA-31-95 and RIN 1545-AT76.

A public hearing on the proposed regulations was held on March 4, 1991. The public submitted written comments on the proposed regulations. After consideration of those comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

I. Overview.

The proposed regulations contain rules on the requirement to backup withhold, which section 3406 imposes in four situations. First, backup withholding under section 3406(a)(1)(A) applies if a payee fails to provide a taxpayer identification number (TIN) in the required manner (the A trigger or certification). Second, backup withholding under section 3406(a)(1)(B) applies if the Service or a broker notifies a payor that a payee provided an incorrect TIN (the B trigger). Third, backup withholding under section 3406(a)(1)(C) applies if the Service or a broker notifies a payor that a payee is subject to notified payee underreporting, *i.e.*, the payee has failed to report and pay tax on reportable interest and dividends (the C trigger). Fourth, backup withholding under section 3406(a)(1)(D) applies if a payee fails to certify, when required, that the payee is not subject to backup withholding under section 3406(a)(1)(C) (the D trigger).

Because the IRS published final regulations on the B trigger as a separate project (TD 8409) in 1992, the final regulations in this document address only the other three triggers, sections 3406(a)(1)(A), (C), and (D). The final regulations on these triggers considerably shorten as well as simplify the proposed regulations. In addition, the final regulations contain several modifications to the proposed regulations relating to grantor trusts, S corporations, reportable payments, and certain foreign provisions.

II. Changes regarding grantor trusts, S corporations, reportable payments, and certain foreign provisions.

A. Grantor trusts—proposed §31.3406(a)-2. The proposed regulations provide that a grantor trust with ten or fewer grantors is not a payor under section 3406 and, as a result, has no obligation to withhold under section 3406 on reportable payments flowing through the trust and includible in the gross income of its grantors. However, a grantor trust with eleven or more grantors is a payor and must withhold under section 3406 on reportable payments to its grantors who are subject to such withholding.

Recently, the IRS issued proposed regulations under section 671 on the methods of reporting by grantor trusts. These proposed regulations provide two regimes for reporting, one for a grantor trust that is owned (or treated as owned) by one grantor and another for a grantor trust that is owned by two or more grantors. To avoid confusion and thereby promote simplification, the final backup withholding regulations are conformed to these regimes. Accordingly, under these final regulations a grantor trust with two or more grantors is considered a payor and must withhold on payments to its grantors who are subject to backup withholding. For purposes of determining the number of grantors, a husband and wife filing a joint return are considered one grantor. See §31.3406(a)-2(b)(4).

B. S corporations—proposed §31.3406(a)-2(c)(3). Under an exception in the proposed regulations defining payors, a partnership making a payment of a distributive share to a partner is not considered a payor. The exception does not include S corporations. Because the tax treatment of both entities is similar, the final regulations provide that an S corporation making a similar distribution is not a payor under section 3406. See §31.3406(a)-2(c)(3).

C. Transferred short-term obligations—proposed §31.3406(b)(2)-2. The proposed regulations provide that a subsequent holder of a short-term obligation with original issue discount may establish the purchase price at which the subsequent holder purchased the obligation. That purchase price is then treated as the original issue price for purposes of computing the amount of original issue discount subject to backup withholding. To reduce the paperwork of issuers and payors of these obligations, the final regulations provide that a payor may disregard the subsequent holder's purchase price if the payor's computer or recordkeeping system is not able to accept that price without substantial manual intervention. See §31.3406(b)(2)-2(c)(1)(ii).

D. Foreign provisions. The proposed regulations contained several provisions on international transactions that are not included in the final regulations. For those international provisions relating to section 3406, the temporary regulations under §35a.9999 remain in effect.

III. *The C trigger (payee underreporting).*

A. Identifying the account subject to the C trigger—proposed §31.3406(c)-1(b)(3)(i) and (iv). The proposed regulations provide that a payor must withhold under section 3406(a)(1)(C) on reportable interest or dividend payments to all existing accounts of a payee that the payor can identify exercising reasonable care. Commentators suggested several modifications to or clarifications of the reasonable care standard. For example, some commentators suggested that the procedures for locating and identifying an account of a payee subject to the C trigger should more closely resemble the procedures for identifying an account subject to the B trigger. In response to this comment, the final regulations modify the procedures for identifying accounts subject to the C trigger, and thus require a payor to identify those accounts by identifying accounts with the same TIN as the one provided in the notice from the IRS to the payor that advises the payor to commence withholding on accounts of a payee.

Commentators also informed the IRS that some computer systems use a universal account number that retrieves all accounts of a payee with that payor. In light of this information, the final regulations require payors with such systems to identify all accounts that can be so retrieved.

Some commentators also addressed the requirement under the proposed regulations that a payor search for accounts of a payee on the computer or other recordkeeping system for the region, division, or branch that serves the geographic area in which the payee's mailing address is located. These commentators questioned whether payors must search every such computer or record system. The final regulations clarify that a payor need not search a computer or other recordkeeping system if it is highly unlikely that the system contains an account of the payee that should be identified as one subject to the C trigger. See §31.3406(c)-1(c)(3)(ii).

B. Newly opened accounts—proposed §31.3406(c)-1(b)(3)(ii). Under the proposed regulations, if a payee subject to the C trigger has one account with a payor and subsequently opens another account, the payor may not rely on the subsequent Form W-9 on which

the payee certifies that the payee is not subject to the C trigger, but only if the payor discovers while processing the Form W-9 or administering the account that the Form W-9 is false because the IRS previously notified the payor to withhold on the payee under the C trigger. Commentators argued that this discovery standard was unclear and potentially burdensome. As a result, the final regulations clarify when a payor may not rely on a Form W-9 provided by the payee.

Under the final regulations, a payor has knowledge that a payee opening a new account with the payor is subject to withholding under section 3406(a)(1)(C), and thus must commence backup withholding on reportable interest and dividend payments to the new account, only if (1) the employee or individual agent of the payor receiving the Form W-9 knows at the time the payee opens the account that the payee's statement under section 3406(a)(1)(D) is not true; (2) at the time the payor processes the Form W-9 or in administering the account to which it relates, the payor discovers that the payee is currently subject to withholding under section 3406(a)(1)(C) on a pre-existing account with the payor; (3) the payor uses a single Form W-9 for multiple accounts of the payee; or (4) the payor uses a universal identifier to associate all of the payee's accounts with the payor and other accounts under that universal identifier have been identified as subject to withholding under section 3406(a)(1)(C). See §31.3406(c)-1(c)(3)(iii).

C. Including certain dates in the notice that the payor must send to a payee—proposed §31.3406(c)-1(c)(2)-(ii) and (iii). A commentator objected to the proposed rule requiring a payor to include the following dates in the notice informing a payee that backup withholding for the C trigger has begun or will begin: (1) the last date before the payor must commence backup withholding, and (2) the date the payor received the notice from the IRS. The significant date for the payee is the date backup withholding begins on the payee's account. Therefore, to ease payors' administrative costs, the final regulations require the payor to include only the date the payor started (or plans to start) backup withholding in the notice to the payee. See §31.3406(c)-1(d)(2)(iii).

D. Monitoring accounts subject to withholding—proposed §31.3406(c)-1-

(e). Commentators asked the IRS to address how long a payor must monitor an account identified as one subject to the C trigger, if that account later becomes dormant. The final regulations provide that a payor is not required to backup withhold on dormant accounts. In this connection, backup withholding terminates no later than the close of the third calendar year ending after the later of (1) the date that the payor pays the last reportable payment to that account, or (2) the date that the payor received a notice from the IRS to impose the C trigger on that account. See §31.3406(c)-1(e)(3).

IV. *Special rules for acquiring accounts (including a readily tradable instrument) or selling a readily tradable instrument.*

A. *By electronic transmission—proposed §31.3406(d)-3.* A payee can acquire by electronic transmission an account or an instrument that earns reportable interest or dividends. Under the proposed regulations the payor, at its option, may permit a payee to furnish the certifications relating to the A and D triggers within 30 days after the establishment or acquisition of the account or the instrument (30-day period) by electronic transmission, provided that the payee furnishes the payee's TIN at the time of the establishment or the acquisition. However, if the payee makes any withdrawal within the 30-day period and before the payor receives the payee's certifications, the payor must withhold to the extent of any reportable interest or dividends paid to the payee during the 30-day period and at the time of withdrawal.

The proposed regulations provide comparable rules for the sale of a readily tradable instrument by electronic transmission. In this context, the payee is permitted to withdraw (or reinvest) up to 69 percent of the gross proceeds from the sale during the relevant 30-day period.

Commentators requested that backup withholding be applied in the same manner whether the electronic transmission involves the establishment or acquisition of an account or a readily tradable instrument or the sale of a readily tradable instrument. In response to this comment, the final regulations provide that backup withholding applies if the payee withdraws more than

69 percent of the reportable interest or dividends paid to the payee during the relevant 30-day period and at the time of withdrawal, but only if the payor has not received the payee's certifications relating to the A and D triggers at the time of the withdrawal. See §31.3406(d)-3(a).

B. *By mail—proposed §31.3406(d)-3(a)(1).* The proposed regulations provide that a payee may provide the certifications relating to the A and D triggers within 30 days after a payee establishes or acquires a readily tradable instrument by mail before January 1, 1985, provided the payee furnishes the payee's TIN upon the establishment or acquisition. The proposed regulations do not provide a similar rule for the sale of a readily tradable instrument by mail.

To simplify the procedures for entering into investments which do not occur in person, the final regulations provide a 30-day rule for the establishment or acquisition of an account or readily tradable instrument by mail and extend the 30-day rule to the sale of a readily tradable instrument by mail. Under the final regulations, if the payee furnishes the payee's TIN before the transaction, backup withholding applies during the 30-day period only if the payee withdraws more than 69 percent of the reportable payment and if the payor has not received the payee's certifications relating to the A or D triggers, whichever applies, at the time of the withdrawal. See §31.3406(d)-3(a).

V. *Section 3406 confidentiality issues—proposed §31.3406(f)-1(a).* Section 3406(f) provides that a payor may not use information obtained under section 3406 except for meeting a requirement of that section. Commentators requested clarification on what actions a payor or broker may take, consistent with section 3406(f), in response to a payee's failure to provide the payee's TIN under section 3406(a)-(1)(A). The final regulations provide that a payor who closes an account at or before the end of a calendar year in which the payee opens the account without providing the payee's TIN or documentation of foreign status, as required, during that year will not, in the absence of evidence to the contrary, be deemed in violation of section 3406(f).

Another commentator inquired whether prohibiting a payee from with-

drawing funds from the payee's account is a violation of section 3406(f). The final regulations clarify that refusing to allow a payee to withdraw funds from the payee's account solely because the payee has not furnished a TIN violates section 3406(f). See §31.3406(f)-1(b)(1).

VI. *Exemptions from backup withholding.*

A. *Interaction of information reporting and backup withholding exemptions—proposed §31.3406(g)-1(a).* Several commentators questioned the interaction between the rules exempting payees from information reporting and those exempting payees from backup withholding. The class of recipients exempt from information reporting is larger than the class exempt from backup withholding. The final regulations clarify that the list of the payees that are specifically exempt from backup withholding is not exclusive and that other payees that are exempt from information reporting also are exempt from backup withholding. See §31.3406(g)-1(a)(2).

B. *Interest on certain life-insurance contracts—proposed §31.3406(g)-1(a)-(4).* Commentators requested that the temporary exemption from backup withholding for interest payments made before January 1, 1992, on "advance premiums", "prepaid premiums", or "premium deposit funds", on certain insurance policies be made permanent. The final regulations provide an extension through December 31, 1996.

C. *Payments reportable under section 6047—proposed §31.3406(g)-2(c)-(1) and (2).* Commentators noted that, contrary to the position set forth in the proposed regulations, backup withholding does not apply to designated distributions paid after December 31, 1984. The final regulations clarify that backup withholding does not apply to those payments. See §31.3406(g)-2(d).

D. *Awaiting-TIN certificate—proposed §31.3406(g)-3.* Commentators requested simplification of the backup withholding rules applicable to accounts for which a payor has received an awaiting-TIN certification. One suggestion was that backup withholding should not apply during the period (up to 60 days) that the payee is waiting for the payee's TIN if no more than 69 percent of the reportable payment is withdrawn during the 60-day period.

The final regulations adopt this suggestion. Therefore, backup withholding is deferred during the 60-day period unless the payee makes a withdrawal (of more than \$500 in one transaction) during that time or has failed to provide the certification relating to the D trigger. If the payee makes a withdrawal of more than \$500 in one transaction during the 60-day period, backup withholding applies to the extent of any reportable interest or dividends made to the account during the 60-day period and at the time of withdrawal unless the payee reserves 31 percent of all reportable payments made to the account during that period. Payors may elect, however, to impose withholding during the 60-day period. See §31.3406(g)-3(a)(2) and (3).

Commentators requested clarification of the interaction of the awaiting-TIN rules for post-1983 accounts or instruments and the obligation of the payee to provide the certification relating to the D trigger that the payee is not subject to backup withholding due to the C trigger. The final regulations clarify that in spite of the awaiting-TIN certification, backup withholding applies under section 3406(a)(1)(D) during the 60-day period if the payee has not provided this certification to the payor. See §31.3406(g)-3(a)(1).

A commentator asked whether the 60-day period refers to calendar or business days. Accordingly, the final regulations clarify that the term “day” means a calendar day. See §§31.3406(g)-3 and 31.3406(h)-1(e).

VII. Other changes.

A. *Identifying the person listed on a joint account as the one subject to withholding—proposed §31.3406(h)-2(a).* Under the proposed regulations, a payor of a reportable payment to a joint account may treat the first person listed on the account (or on the instrument) as the payee subject to information reporting and backup withholding. The final regulations provide that the relevant payee is the one whose name and TIN combination the payor uses for information reporting purposes, whether or not that account or instrument registration lists that payee first. See §31.3406(h)-2(a)(1).

B. *Backup withholding on payments made in property—proposed §31.3406(h)-2(b).* Under the proposed regulations, a payor making a reportable

payment in property subject to backup withholding must withhold on an amount equal to the fair market value of the property. The obligation to withhold occurs at the time the property is paid to the payee. Consequently, the payor must find an alternative source, such as another account of the payee, from which the payor can satisfy its backup withholding liability. Otherwise, the payor must continue to look for accounts of the payee to satisfy the payor’s backup withholding liability. A commentator suggested that the final regulations add an ending date after which a payor no longer has to search for alternative sources from which to satisfy a backup withholding obligation arising from a payment in property. According to this commentator, the obligation should extinguish after a reasonable period of time. In response to this comment, the final regulations provide that a payor’s obligation to backup withhold on property terminates on the earlier of the date sufficient cash is deposited to the account to fully satisfy the obligation or the close of the fourth calendar year after the obligation arose. See §31.3406(h)-2(b)(2)(ii).

C. *Gross-up of payments by middlemen—proposed §31.3406(h)-2(d).* Under the proposed regulations, a middleman is required to remit the full amount due a payee unless one of the requirements for imposing backup withholding exists at the time of payment. Thus, the middleman is required to remit the full amount even though an upstream payor erroneously withheld on that payment to the middleman. In that event, the middleman may recover the difference between the amount received and the amount paid to the payee, *i.e.*, 31 percent, by seeking a refund from the upstream payor or by taking an equivalent credit against the next required deposit of employment taxes. One commentator noted that the middleman payor incurs a loss in the time value of money measured from the time it pays the full amount due to the payee to the time the payor receives a refund or credit. Because of this, the commentator suggested that the regulations allow the middleman to remit only the net amount due its payee. This suggestion presents several problems. First, it requires a new reconciliation process to correlate the backup withholding reflected on the upstream payor’s Form 945 with the backup withholding

shown as withheld tax on the payee’s income tax return. Second, the suggestion produces an anomalous result, namely, withholding occurs even though none of the statutory conditions requiring withholding exist. For these reasons the final regulations do not adopt this suggestion.

D. *Refund of amount erroneously subject to backup withholding—proposed §31.6413(a)-3.* Under the proposed regulations, a payor must refund an amount previously withheld under the C trigger if the IRS instructs the payor to do so. This provision is also set forth in §35a.9999-3 Q/A-38 of the Temporary Employment Tax Regulations issued under the Interest and Dividend Tax Compliance Act of 1983, as amended by TD 8248 (54 FR 18713) on May 2, 1989. One commentator suggested eliminating this refund provision. This rule was needed initially to allow refunds in certain cases where payees had interest or dividend income subject to backup withholding under the C trigger but had no income tax liability on this income. The IRS has subsequently enhanced its C withholding program to eliminate C notices to payors in such cases. Thus, the final regulations adopt the suggestion and delete the proposed rule. See §31.6413(a)-3.

E. *Effective date.* The final regulations are effective for reportable payments made and transactions occurring after December 31, 1996, and, optionally, for reportable payments made and transactions occurring on or after December 21, 1995. See §31.3406(i)-1.

F. *Coordination with the temporary regulations—§35a.9999-1 through 35a.9999-5.* The temporary regulations issued under 26 CFR Part 35a are not effective for noninternational transactions occurring on and after the effective date of the final regulations. The temporary regulations, however, remain effective for the due diligence safe harbor and for international transactions, including transactions involving a foreign payee, a foreign payor, or a payment from sources without the United States.

G. *Statement mailing requirement—proposed §§1.6042-5, 1.6044-6, 1.6049-6, and 1.6050N-1.* These final regulations set forth rules on the manner in which a payor who is required to file an information return for dividends and corporate earnings and profits, patronage dividends, interest,

and royalties under sections 6042(c), 6044(e), 6049(c), and 6050N(b), respectively, must provide a copy of that information return to the payee, *i.e.*, payee statement mailing.

The proposed regulations limit the permissible nontax enclosures includable in a statement mailing. Several commentators requested that the inclusion of additional nontax enclosures be permitted. This suggestion was not adopted because the relevant legislative history indicates that Congress wanted to substantially restrict the nontax enclosures in a statement mailing.

H. *Correct identifying number for estates—proposed §301.6109-1.* The final regulations clarify that the taxpayer identification number to be used to identify estates of decedents is the employer identification number (rather than a social security number).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in E.O. 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) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Renay France of the Office of Assistant Chief Counsel (Income Tax and Accounting), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

The amendments to 26 CFR parts 1, 31, 35a, 301, and 602 read as follows:

PART 1—INCOME TAXES

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

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

Section 1.6049-6 also issued under 6049(a), (b), and (d). * * *

Par. 2. Section 1.6042-4 is revised as follows:

§1.6042-4 Statements to recipients of dividend payments.

(a) *Requirement.* A person required to make an information return under section 6042(a)(1) and §1.6042-2 must furnish a statement to each recipient whose identifying number is required to be shown on the related information return for dividend payments.

(b) *Form of the statement.* The statement required by paragraph (a) of this section must be either the official Form 1099 prescribed by the Internal Revenue Service for the respective calendar year or an acceptable substitute statement that contains provisions that are substantially similar to those of the official Form 1099 for the respective calendar year. For further guidance on how to prepare an acceptable substitute statement, see Rev. Proc. 95-30 (1995-27 I.R.B. 9) (or its successor), republished as “Rules and Specifications for Private Printing of Substitute Forms 1096, 1098, 1099 Series, 5498, and W-2G.” See §601.601(d)(2) of this chapter.

(c) *Aggregation of payments.* A payor may aggregate on one Form 1099 all payments made to a recipient with respect to each separate account during a calendar year.

(d) *Manner of providing statements to recipients—(1) In general.* The Form 1099, or acceptable substitute statement, must be provided to the recipient either in person or by first-class mail to the recipient’s last known address in a statement mailing.

(2) *Statement mailing requirement.* The mailing required under section 6042(c) of a Form 1099 to a payee-recipient must qualify as a statement mailing. A statement mailing must contain the required Form 1099 or acceptable substitute statement (written statement) and must comply with enclosure and envelope restrictions.

(i) *Enclosure restrictions.* To qualify as a statement mailing, the mailing cannot contain any enclosures except those

listed in this paragraph (d)(2)(i). Moreover, no promotional or advertising material is permitted in the mailing of the written statement. Even a *de minimis* amount of promotional or advertising material violates the statement mailing requirement. However, a logo on the envelope containing the written statement and on nontax enclosures described in paragraph (d)(2)(i)(A) through (D) of this section does not violate the written statement requirement. The written statement required under section 6042(c) and paragraph (a) of this section may be perforated to a check or to a statement of the recipient-payee’s specific account with the payor described in paragraph (d)(2)(i)(A) or (C) of this section. The enclosure to which the written statement is perforated must contain, in a bold and conspicuous type, the legend: “Important Tax Return Document Attached.” The enclosures permitted in a mailing are limited to—

(A) A check with respect to the account reported on the written statement;

(B) A letter explaining why a check with respect to such account is not enclosed with the written statement (for example, because a dividend has not been declared payable);

(C) A statement of the taxpayer-recipient’s specific account with the payor if payments on such account are reflected on the written statement;

(D) A letter limited to an explanation of the tax consequences of the information set forth on the enclosed written statement;

(E) Payee statements related to other Forms 1099, Form 1098, and Form 5498 (or the account balance on a Form 5498), Forms W-2 and W-2G; and

(F) Any document concerning the solicitation of the Form W-9 or Form W-8.

(ii) *Envelope and delivery restrictions—(A) Envelope restrictions.* The outside of the envelope in which the written statement is mailed and each nontax enclosure enclosed in the envelope must contain, in a bold and conspicuous type, the legend: “Important Tax Return Document Enclosed.” For purposes of this paragraph (d)(2)-(ii), a nontax enclosure is any item listed in paragraphs (d)(2)(i)(A) through (C) of this section. However, a payor is not required to include the legend on the outside of an envelope

containing only the enclosures in paragraph (d)(2)(i)(D) through (F) of this section.

(B) *Delivery restrictions.* The requirement to provide the written statement in person or by first-class mail may be satisfied by sending the written statement and any enclosures described in paragraph (d)(2)(i) of this section by intra-office mail, provided that intra-office mail is used by the payor in sending account activity, balance information, and other correspondence to the payee. If a payor does not personally deliver the written statement (*i.e.*, the Form 1099 or its acceptable substitute) to the recipient or mail it to the recipient in a statement mailing as described in this paragraph (d), the payor is considered to have failed to mail the statement required under section 6042(c) and will be subject to the penalty under section 6722.

(e) *Time for furnishing statements—*
(1) *In general.* Each statement required by section 6042(c) and this section to be furnished to any person for a calendar year must be furnished to such person after November 30 of the year and on or before January 31 (February 10 in the case of a nominee filing under §1.6042-2(a)(1)(iii)) of the following year, but no statement may be furnished before the final dividend for the calendar year has been paid. However, the statement may be furnished at any time after April 30 if it is furnished with the final dividend for the calendar year.

(2) *Extensions of time.* For good cause upon written application of the person required to furnish statements under this section, the Director, Martinsburg Computing Center, may grant an extension of time not exceeding 30 days in which to furnish such statements. The application must be addressed to the Director, Martinsburg Computing Center, and must contain a full recital of the reasons for requesting the extension to aid the Director in determining the period of the extension, if any, that will be granted. Such a request in the form of a letter to the Director, Martinsburg Computing Center, signed by the applicant will suffice as an application. The application must be filed on or before the date prescribed in paragraph (e)(1) of this section.

(3) *Last day for furnishing statement.* For provisions relating to the time for performance of an act when

the last day prescribed for performance falls on Saturday, Sunday, or a legal holiday, see section 7503 and §301.7503-1 of this chapter (Regulations on Procedure and Administration).

(f) *Penalty.* For provisions relating to the penalty for the failure to furnish a statement under this section, see section 6722.

(g) *Effective date.* This section is effective for payee statements due after December 31, 1995, without regard to extensions. For the substantially similar statement mailing requirements that apply with respect to forms required to be filed after October 22, 1986, and before January 1, 1996, see Rev. Proc. 84-70 (1984-2 C.B. 716) (or successor revenue procedures). See §601.601(d)-(2) of this chapter.

Par. 3. Section 1.6044-5 is revised as follows:

§1.6044-5 Statements to recipients of patronage dividends.

(a) *Requirement.* A person required to make an information return under section 6044(a)(1) and §1.6044-2 must furnish a statement to each recipient whose identifying number is required to be shown on the related information return for patronage dividends paid.

(b) *Form, manner, and time for providing statements to recipients.* The statement required by paragraph (a) of this section must be either the official Form 1099 prescribed by the Internal Revenue Service for the respective calendar year or an acceptable substitute statement. The rules under §1.6042-4 (relating to statements with respect to dividends) apply comparably in determining the form of an acceptable substitute statement permitted by this section. Those rules also apply for purposes of determining the manner of and time for providing the Form 1099 or its acceptable substitute to a recipient under this section. However, each Form 1099 or acceptable substitute statement required by this section must be furnished on or before January 31 of the following year, but no statement may be furnished before the final payment has been made for the calendar year.

(c) *Penalty.* For provisions relating to the penalty for the failure to furnish a statement under this section, see section 6722.

(d) *Effective date.* This section is effective for payee statements due after

December 31, 1995, without regard to extensions. For the substantially similar statement mailing requirements that apply with respect to forms required to be filed after October 22, 1986, and before January 1, 1996, see Rev. Proc. 84-70 (1984-2 C.B. 716) (or successor revenue procedures). See §601.601(d)(2) of this chapter.

Par. 4. Section 1.6049-6 is amended by:

1. Revising the section heading.
2. Removing the language “section 3451” and adding “section 3406” in each of the following locations:
 - a. Paragraph (a), second sentence.
 - b. Paragraph (a), third sentence.
 - c. Paragraph (a), fourth sentence.
3. Removing the language “section 3451” and adding “section 3406” in each of the following locations:
 - a. Paragraph (b)(1)(ii).
 - b. Paragraph (b)(2)(ii).
4. Adding paragraph (e).
5. Removing the authority citation at the end of the section.

The revision and additions read as follows:

§1.6049-6 Statements to recipients of interest payments and holders of obligations for attributed original issue discount.

* * * * *

(e) *Statements to recipients—*(1) *Requirement.* A person required to make an information return under section 6049(a) and §1.6049-4 must furnish a statement to each recipient whose identifying number is required to be shown on the related information return for interest or original issue discount paid or accrued.

(2) *Form, manner, and time for providing statements to recipients.* The statement required by paragraph (e)(1) of this section must be either the official Form 1099 prescribed by the Internal Revenue Service for the respective calendar year or an acceptable substitute statement. The rules under §1.6042-4 (relating to statements with respect to dividends) apply comparably in determining the form of an acceptable substitute statement permitted by this paragraph (e). Those rules also apply for purposes of determining the manner of and time for providing the Form 1099 or its acceptable substitute to a recipient under paragraph (e)(1) of

this section. However, with respect to original issue discount, the Form 1099 or acceptable substitute statement required by paragraph (e)(1) of this section must show the aggregate amount of original issue discount includible in the gross income by the recipient for the calendar year with respect to the obligation (determined by applying the rules of §1.6049-4(b)(2)), and the amount, serial number, or other identifying number of each obligation with respect to which a return is being made. With respect to interest or original issue discount, the Form 1099 or acceptable substitute statement required by paragraph (e)(1) of this section must be furnished to the recipient on or before January 31 of the year following the calendar year for which the return under section 6049(a)(1) was required to be made.

(3) *Penalty.* For provisions relating to the penalty for the failure to furnish a statement under this section, see section 6722.

(4) *Effective date.* This paragraph (e) is effective for payee statements due after December 31, 1995, without regard to extensions. For the substantially similar statement mailing requirements that apply with respect to forms required to be filed after October 22, 1986, and before January 1, 1996, see Rev. Proc. 84-70 (1984-2 C.B. 716) (or successor revenue procedures). See §601.601(d)(2) of this chapter.

Par. 5. Section 1.6050N-1 is added to read as follows:

§1.6050N-1 Statements to recipients of royalties.

(a) *Requirement.* A person required to make an information return under section 6050N(a) must furnish a statement to each recipient whose name is required to be shown on the related information return for royalties paid.

(b) *Form, manner, and time for providing statements to recipients.* The statement required by paragraph (a) of this section must be either the official Form 1099 prescribed by the Internal Revenue Service for the respective calendar year or an acceptable substitute statement. The rules under §1.6042-4 (relating to statements with respect to dividends) apply comparably in determining the form of the acceptable substitute statement permitted by this section. Those rules also apply for purposes of determining the manner of

and time for providing the Form 1099 or its acceptable substitute statement to a recipient under this section.

(c) *Penalty.* For provisions relating to the penalty for failure to furnish a statement under this section, see section 6722.

(d) *Effective date.* This section is effective for payee statements due after December 31, 1995, without regard to extensions. For the substantially similar statement mailing requirements that apply with respect to forms required to be filed after October 22, 1986, and before January 1, 1996, see Rev. Proc. 84-70 (1984-2 C.B. 716) (or successor revenue procedures). See §601.601(d)-(2) of this chapter.

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 6. The authority for Part 31 is amended by removing the entry for §31.3406(d)-5 and by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * * Sections 31.3406(a)-1 through 31.3406(i)-1 also issued under 26 U.S.C. 3406(i).

Par. 7. Section 31.3406-0 is revised to read as follows:

§31.3406-0 Outline of the backup withholding regulations.

This section lists paragraphs contained in §§31.3406(a)-1 through 31.3406(i)-1.

§31.3406(a)-1 Backup withholding requirement on reportable payments.

- (a) Overview.
- (b) Conditions that invoke the backup withholding requirement.
 - (1) Conditions applicable to all reportable payments.
 - (2) Conditions applicable only to reportable interest or dividend payments.
- (c) Exceptions.
- (d) Cross references.

§31.3406(a)-2 Definition of payors obligated to backup withhold.

- (a) In general.
- (b) Middlemen treated as payors.
- (c) Persons not treated as payors.

§31.3406(a)-3 Scope and extent of accounts subject to backup withholding.

§31.3406(a)-4 Time when payments are considered to be paid and subject to backup withholding.

- (a) Timing.
 - (1) In general.
 - (2) Special rules for dividends.
- (b) Amounts reportable under section 6045.
 - (1) In general.
 - (2) Special rule for interest accrued on bonds.
- (c) Middlemen.
 - (1) In general.
 - (2) Special rule for common trust funds.
 - (3) Special rule for certain grantor trusts.

§31.3406(b)(2)-1 Reportable interest payment.

- (a) Interest subject to backup withholding.
 - (1) In general.
 - (2) Special rule for tax-exempt interest.
- (b) Amount subject to backup withholding.
 - (1) In general.
 - (2) Special rule to adjust for premature withdrawal penalty.

§31.3406(b)(2)-2 Original issue discount.

- (a) Original issue discount subject to backup withholding.
- (b) Amount subject to backup withholding and time when backup withholding is imposed with respect to short-term obligations.
- (c) Transferred short-term obligations.
 - (1) Subsequent holder may establish purchase price.
 - (2) Subsequent holder unable (or not permitted) to establish purchase price.
 - (3) Transferred obligation.
- (d) Amount subject to backup withholding and time when backup withholding is imposed with respect to long-term obligations.
 - (1) No cash payments prior to maturity.
 - (2) Registered long-term obligations with cash payments prior to maturity.

- (3) Transferred registered long-term obligations with payments prior to maturity.
- (e) Bearer long-term obligations.
 - (1) Payments prior to maturity.
 - (2) Payments at maturity.

§31.3406(b)(2)–3 Window transactions.

- (a) Requirement to backup withhold.
- (b) Window transaction defined.
- (c) Manner of furnishing taxpayer identification number in the case of a window transaction.

§31.3406(b)(2)–4 Reportable dividend payment.

- (a) Dividends subject to backup withholding.
- (b) Dividends not subject to backup withholding.
- (c) Amount subject to backup withholding.
 - (1) In general.
 - (2) Reasonable estimate of amount of dividend subject to backup withholding.
 - (3) Reinvested dividends.

§31.3406(b)(2)–5 Reportable patronage dividend payment.

- (a) Patronage dividends subject to backup withholding.
- (b) Amount subject to backup withholding.
 - (1) Failure to provide taxpayer identification number or notification of incorrect taxpayer identification number.
 - (2) Notified payee underreporting or payee certification failure.

§31.3406(b)(3)–1 Reportable payments of rents, commissions, nonemployee compensation, etc.

- (a) Section 6041 and 6041A(a) payments subject to backup withholding.
- (b) Amount subject to backup withholding.
 - (1) In general.
 - (2) Net commissions.
 - (3) Payments aggregating \$600 or more for the calendar year.

§31.3406(b)(3)–2 Reportable barter exchanges and gross proceeds of sales of securities or commodities by brokers.

- (a) Transactions subject to backup withholding.
- (b) Amount subject to backup withholding.
 - (1) In general.
 - (2) Forward contracts, including foreign currency contracts, and regulated futures contracts.
 - (3) Security sales made through a margin account.
 - (4) Security short sales.
 - (5) Fractional shares.

§31.3406(b)(3)–3 Reportable payments by certain fishing boat operators.

- (a) Payments subject to backup withholding.
- (b) Amount subject to backup withholding.

§31.3406(b)(3)–4 Reportable payments of royalties.

- (a) Royalty payments subject to backup withholding.
- (b) Amount subject to backup withholding.

§31.3406(b)(4)–1 Exemption for certain minimal payments.

- (a) In general.
- (b) Manner of making the election.
- (c) How to annualize.
 - (1) In general.
 - (2) Special aggregation rule for reportable interest and dividends.
- (d) Exception for window transactions and original issue discount.

§31.3406(c)–1 Notified payee underreporting of reportable interest or dividend payments.

- (a) Overview.
- (b) Definitions.
 - (1) Notified payee underreporting.
 - (2) Payee underreporting.
- (c) Notice to payors regarding backup withholding due to notified payee underreporting.
 - (1) In general.
 - (2) Additional requirements for payors that are also brokers.

- (3) Payor identification of accounts of the payee subject to backup withholding due to notified payee underreporting.

- (d) Notice from payors of backup withholding due to notified payee underreporting.
 - (1) In general.
 - (2) Procedures.
- (e) Period during which backup withholding is required.
 - (1) In general.
 - (2) Stop withholding.
 - (3) Dormant accounts.
- (f) Notice to payees from the Internal Revenue Service.
 - (1) Notice period.
 - (2) Payee subject to backup withholding.
 - (3) Disclosure of names of payors and brokers.
 - (4) Backup withholding certification.
- (g) Determination by the Internal Revenue Service that backup withholding should not start or should be stopped.
 - (1) In general.
 - (2) Date notice to stop backup withholding will be provided.
 - (3) Grounds for determination.
 - (4) No underreporting.
 - (5) Correcting any payee underreporting.
 - (6) Undue hardship.
 - (7) Bona fide dispute.
- (h) Payees filing a joint return.
 - (1) In general.
 - (2) Exceptions.
- (i) [Reserved.]
- (j) Penalties.

§31.3406(d)–1 Manner required for furnishing a taxpayer identification number.

- (a) Requirement to backup withhold.
- (b) Reportable interest or dividend account.
 - (1) Manner required for furnishing a taxpayer identification number with respect to a pre-1984 account or instrument.
 - (2) Determination of pre-1984 account or instrument.
 - (3) Manner required for furnishing a taxpayer identification number with respect to an account or instrument that is not a pre-1984 account.

- (4) Special rule with respect to the acquisition of a readily tradable instrument in a transaction between certain parties acting without the assistance of a broker.
- (c) Brokerage account.
 - (1) Manner required for furnishing a taxpayer identification number with respect to a brokerage relationship that is not a post-1983 brokerage account.
 - (2) Manner required for furnishing a taxpayer identification number with respect to a post-1983 brokerage account.
- (d) Rents, commissions, non-employee compensation, and certain fishing boat operators, etc.—Manner required for furnishing a taxpayer identification number.

§31.3406(d)–2 Payee certification failure.

- (a) Requirement to backup withhold.
- (b) Exceptions.

§31.3406(d)–3 Special 30-day rules for certain reportable payments.

- (a) Accounts or readily tradable instruments acquired directly from the payor (including a broker who holds an instrument in street name) by electronic transmission or by mail.
- (b) Sale of an instrument for a customer by electronic transmission or by mail.
- (c) Application to foreign payees.

§31.3406(d)–4 Special rules for readily tradable instruments acquired through a broker.

- (a) Readily tradable instruments acquired through post-1983 brokerage accounts with a broker who is not a payor.
 - (1) In general.
 - (2) Additional requirements.
 - (3) Transactions entered into through a brokerage account that is not a post-1983 brokerage account.
- (b) Notices.
 - (1) Form of notice by broker to payor.

- (2) Form of notice by payor to payee.
- (c) Payor’s reliance on information from broker.
 - (1) In general.
 - (2) Amount subject to backup withholding.

§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.

- (a) Overview.
- (b) Definitions and special rules.
 - (1) Definition of an incorrect name/TIN combination.
 - (2) Definition of account.
 - (3) Definition of business day.
 - (4) Certain exceptions.
- (c) Notice regarding an incorrect name/TIN combination.
 - (1) In general.
 - (2) Additional requirements for payors that are also brokers.
 - (3) Payor identification of the account or accounts of the payee that have the incorrect taxpayer identification number.
 - (4) Special rule for joint accounts.
 - (5) Date of receipt.
- (d) Notice from payors of backup withholding due to an incorrect name/TIN combination.
 - (1) In general.
 - (2) Procedures.
- (e) Period during which backup withholding is required due to notification of an incorrect name/TIN combination.
 - (1) In general.
 - (2) Grace periods.
 - (3) Dormant accounts.
- (f) Manner required for payee to furnish certified taxpayer identification number.
- (g) Receipt of two notices within a 3-year period.
 - (1) In general.
 - (2) Notice to payee who has provided two incorrect name/TIN combinations within 3 calendar years.
 - (3) Period during which backup withholding is required due to a second notice of an incorrect name/TIN combination within 3 calendar years.
 - (4) Receipt of two notices in one calendar year.

- (5) Notification from the Social Security Administration (or the Internal Revenue Service) validating a name/TIN combination.
- (h) Payors must use newly provided certified number.
- (i) Effective date.
- (j) Examples.

§31.3406(e)–1 Period during which backup withholding is required.

- (a) In general.
- (b) Failure to furnish a taxpayer identification number in the manner required.
 - (1) Start withholding.
 - (2) Stop withholding.
- (c) Notification of an incorrect taxpayer identification number.
- (d) Notified payee underreporting.
- (e) Payee certification failure.
 - (1) Start withholding.
 - (2) Stop withholding.
- (f) Rule for determining when the payor receives a taxpayer identification number or certificate from a payee.

§31.3406(f)–1 Confidentiality of information.

- (a) Confidentiality and liability for violation.
- (b) Permissible use of information.
 - (1) In general.
 - (2) Window transactions.
- (c) Specific restrictions on the use of information.

§31.3406(g)–1 Exception for payments to certain payees and certain other payments.

- (a) Exempt recipients.
 - (1) In general.
 - (2) Nonexclusive list.
- (b) Determination of whether a person is described in paragraph (a)(1) of this section.
- (c) Prepaid or advance premium life-insurance contracts.

§31.3406(g)–2 Exception for reportable payments for which backup withholding is otherwise required.

- (a) In general.
- (b) Payment of wages.
- (c) Distribution from a pension, annuity, or other plan of deferred compensation.
- (d) Gambling winnings.

- (1) In general.
- (2) Definition of a reportable gambling winning and determination of amount subject to backup withholding.
- (3) Special rules.
- (e) Certain real estate transactions.
- (f) Certain payments after an acquisition of accounts or instruments.
- (g) Certain gross proceeds.

§31.3406(g)-3 Exemption while payee is waiting for a taxpayer identification number.

- (a) In general.
 - (1) Backup withholding not required for 60 days.
 - (2) Reserve method.
 - (3) Alternative rule; 7-day grace period.
- (b) Special rule for readily tradable instruments.
- (c) Exceptions.
 - (1) In general.
 - (2) Special rule for amounts subject to reporting under section 6045 other than proceeds of redemptions of bearer obligations.
- (d) Awaiting-TIN certificate.
- (e) Form for awaiting-TIN certificate.

§31.3406(h)-1 Definitions.

- (a) In general.
- (b) Taxpayer identification number.
 - (1) In general.
 - (2) Obviously incorrect number.
- (c) Broker.
- (d) Readily tradable instrument.
- (e) Day.
- (f) Business day.

§31.3406(h)-2 Special rules.

- (a) Joint accounts.
 - (1) Relevant name and taxpayer identification number combination.
 - (2) Optional rule for accounts subject to backup withholding under section 3406(a)(1)(B) or (C) where the names are switched.
 - (3) Joint foreign payees.
- (b) Backup withholding from an alternative source.
 - (1) In general.
 - (2) Exceptions for payments made in property.
- (c) Trusts.

- (d) Adjustment of prior withholding by middleman.
- (e) Conversion of amounts paid in foreign currency into United States dollars.
 - (1) Convertible foreign currency.
 - (2) Nonconvertible foreign currency. [Reserved]
- (f) Coordination with other sections.
- (g) Tax liabilities and penalties.
- (h) To whom payor is liable for amount withheld.

§31.3406(h)-3 Certificates.

- (a) Prescribed form to furnish information under penalties of perjury.
 - (1) In general.
 - (2) Use of a single or multiple Forms W-9 for accounts of the same payee.
- (b) Prescribed form to furnish a noncertified taxpayer identification number.
- (c) Forms prepared by payors or brokers.
 - (1) Substitute forms; in general.
 - (2) Form for exempt recipient.
- (d) Special rule for brokers.
- (e) Reasonable reliance on certificate.
 - (1) In general.
 - (2) Circumstances establishing reasonable reliance.
- (f) Who may sign certificate.
 - (1) In general.
 - (2) Notified payee underreporting.
- (g) Retention of certificates.
 - (1) Accounts or instruments that are not pre-1984 accounts and brokerage relationships that are post-1983 brokerage accounts.
 - (2) Accounts or instruments that are pre-1984 accounts and brokerage relationships that are not post-1983 brokerage accounts.
- (h) Cross references.

§31.3406(i)-1 Effective date.

Par. 8. Sections 31.3406(a)-1 through 31.3406(a)-4, 31.3406(b)(2)-1 through 31.3406(b)(2)-5, 31.3406(b)(3)-1 through 31.3406(b)(3)-4, 31.3406(b)(4)-1, 31.3406(c)-1, 31.3406(d)-1 through 31.3406(d)-4, 31.3406(e)-1, 31.3406(f)-1, 31.3406(g)-1 through

31.3406(g)-3, 31.3406(h)-1 through 31.3406(h)-3, and 31.3406(i)-1 are added to read as follows:

§31.3406(a)-1 Backup withholding requirement on reportable payments.

(a) *Overview.* Under section 3406, a payor must deduct and withhold 31 percent of a reportable payment if a condition for withholding exists. *Reportable payments* mean interest and dividend payments (as defined in section 3406(b)(2)) and other reportable payments (as defined in section 3406(b)(3)). The conditions described in paragraph (b)(1) of this section apply to all reportable payments, including reportable interest and dividend payments. The conditions described in paragraph (b)(2) of this section apply only to reportable interest and dividend payments.

(b) *Conditions that invoke the backup withholding requirement—(1) Conditions applicable to all reportable payments.* A payor of a reportable payment must deduct and withhold under section 3406 if—

(i) The payee of the reportable payment does not furnish the payee's taxpayer identification number to the payor, as required in section 3406(a)(1)(A) and §31.3406(d)-1; or

(ii) The Internal Revenue Service or a broker notifies the payor that the taxpayer identification number furnished by its payee for a reportable payment is incorrect, as described in section 3406(a)(1)(B) and §31.3406(d)-5.

(2) *Conditions applicable only to reportable interest or dividend payments.* A payor of a reportable interest or dividend payment must deduct and withhold under section 3406 if—

(i) The Internal Revenue Service or a broker notifies the payor that its payee has underreported interest or dividend income, as described in section 3406(a)(1)(C) and §31.3406(c)-1; or

(ii) The payee fails to certify to the payor or broker that the payee is not subject to withholding due to notified payee underreporting, as described in section 3406(a)(1)(D) and §31.3406(d)-2.

(c) *Exceptions.* The requirement to withhold does not apply to certain minimal payments as described in §31.3406(b)(4)-1 or to payments exempt from withholding under §31.3406(g)-1 through 31.3406(g)-3.

(d) *Cross references.* For the definition of *payor*, see §31.3406(a)-2. For the definition of *taxpayer identification number*, see §31.3406(h)-1(b).

§31.3406(a)-2 Definition of payors obligated to backup withhold.

(a) *In general.* *Payor* means any person who is required to make an information return with respect to any reportable payment (as described in section 3406(b)) under section 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, or 6050N, including any middleman as described in paragraph (b) of this section.

(b) *Middlemen treated as payors.* A person who receives or collects a reportable payment on behalf of or for the account of a payee is a middleman and is treated as the payor of the payment. These persons include, but are not limited to—

(1) A custodian of a payee's account, such as a bank, financial institution, or brokerage firm acting as custodian of an account;

(2) A nominee, including the joint owner of an account or instrument, except if the joint owners are husband and wife or if the payment is actually owned by another person whose name is also shown on the information return filed with respect to the payment;

(3) A broker holding a security (including stock) for a customer in street name;

(4) A grantor trust established after December 31, 1995, all of which is owned by two or more grantors, and for this purpose spouses filing a joint return are considered to be one grantor;

(5) A common trust fund; and

(6) A partnership or an S corporation that makes a reportable payment.

(c) *Persons not treated as payors.* The following persons are not treated as payors for purposes of section 3406 if the person does not have a reporting obligation under the section on information reporting to which the payment relates:

(1) An agent of the payor who is acting on behalf of the payor in making the payment and who has not entered into an agreement with the payor (for further guidance see Rev. Proc. 84-33 (1984-1 C.B. 502), and §601.601(d)(2) of this chapter), such as a bank that acts as a paying agent in making a payment of dividends on behalf of a

corporation (although payments made by the agent are considered to be payments made by the payor, and thus are subject to withholding, reporting, and the depositing requirements pertaining to section 3406 as if they were made by the payor itself, and failure by the agent so to withhold, report, or deposit is considered to be failure by the payor);

(2) A trust (other than a grantor trust as described in paragraph (b)(4) of this section) that files a Form 1041 and furnishes each beneficiary a Form K-1 containing information required to be shown on an information return, including amounts withheld under section 3406; or

(3) A partnership making a payment of a distributive share or an S corporation making a similar distribution.

§31.3406(a)-3 Scope and extent of accounts subject to backup withholding. A payor who is required to withhold under §31.3406(a)-1 must withhold—

(a) On the accounts subject to withholding under §31.3406(a)-1(b)(1)(i) or (b)(2)(ii); and

(b) On the accounts subject to withholding under §31.3406(a)-1(b)(1)(ii) or (b)(2)(i), as described under §31.3406(d)-5 (relating to notification of incorrect TIN) or §31.3406(c)-1 (relating to notified payee underreporting), respectively.

§31.3406(a)-4 Time when payments are considered to be paid and subject to backup withholding.

(a) *Timing*—(1) *In general.* If backup withholding is required under section 3406 on a reportable payment (as defined in section 3406(b)), the payor must withhold at the time it makes the payment to the payee or to the payee's account that is subject to withholding. Amounts are considered paid when they are credited to the account of, or made available to, the payee. Amounts are not considered paid solely because they are posted (e.g., an informational notation on the payee's passbook) if they are not actually credited to the payee's account or made available to the payee. See paragraph (c) of this section for the timing of withholding by a middleman.

(2) *Special rules for dividends.* For purposes of section 3406 and this section—

(i) *Record date earlier than payment date.* In the case of stock for which the record date is earlier than the payment date, the dividends are considered paid on the payment date.

(ii) *Dividends paid in corporate reorganizations.* In the case of a corporate reorganization, if a payee is required to exchange stock held in the former corporation for stock in the new corporation before the dividends that have been paid with respect to the stock in the new corporation will be provided to the payee, the dividend is considered paid on the date the payee actually exchanges the stock and receives the dividend.

(b) *Amounts reportable under section 6045*—(1) *In general.* Notwithstanding paragraph (a) of this section, in the case of a transaction reportable under section 6045 (except in the case of forward contracts (including foreign currency contracts), regulated futures contracts, and security short sales), the obligation to withhold under section 3406 arises on the date the sale is entered on the books of the broker or the date the exchange occurs as provided in §1.6045-1(f)(3) of this chapter. A broker (in its capacity as payor) is not required, however, to satisfy its withholding liability until payment is made. See §31.3406(b)(3)-2(b)(2) for special rules applicable to forward contracts (including foreign currency contracts), regulated futures contracts, and security short sales.

(2) *Special rule for interest accrued on bonds.* For purposes of determining the time that interest is considered paid and subject to withholding under section 3406 when bonds are sold between interest payment dates, the portion of the sales price representing interest accrued to the date of sale is considered a portion of a reportable payment of gross proceeds under section 6045 (provided that the accrued interest is not tax-exempt as described in section 103(a), relating to certain governmental obligations), and is not considered to be a payment of interest for purposes of section 6049.

(c) *Middlemen*—(1) *In general.* Any middleman (as defined in §31.3406(a)-2(b)) must withhold under section 3406 at the time the reportable payment is received by or credited to the middleman. If the middleman makes or credits the reportable payment to the payee prior to the middleman's receipt of the corresponding payment, the middleman may withhold at the time the reportable

payment is made or credited to the payee.

(2) *Special rule for common trust funds.* A common trust fund (as defined in section 584) must withhold either—

(i) At the time the reportable payment is received by or credited to the common trust fund as provided in paragraph (c)(1) of this section;

(ii) On the date on which the assets of the common trust fund are valued; or

(iii) At the time the common trust fund pays or credits the reportable payment to a participant of the common trust fund.

(3) *Special rule for certain grantor trusts.* For grantor trusts described in §31.3406(a)–2(b)(4), reportable payments made to the trust are treated as paid by the trust to each grantor, in an amount equal to the distribution made by the trust to each grantor, on the date that the reportable payment is paid to the trust (except for gross proceeds reportable under section 6045). Paragraph (b)(2) of this section applies to a grantor trust making a payment of gross proceeds under section 6045 subject to withholding under section 3406. For purposes of this paragraph (c)(3) a husband and wife filing a joint return are considered to be one grantor.

§31.3406(b)(2)–1 Reportable interest payment.

(a) *Interest subject to backup withholding—(1) In general.* A payment of a kind, and to a payee, that is required to be reported under section 6049 (relating to returns regarding interest and original issue discount) is a reportable payment for purposes of section 3406, subject to the special rules of §31.3406(b)(2)–2 (relating to original issue discount) and §31.3406(b)(2)–3 (relating to window transactions). See §31.6051–4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(2) *Special rule for tax-exempt interest.* When an issuer is required to make an information return under §1.6049–4(d)(8) of this chapter because a payee provided a signed written statement on the envelope or shell incorrectly claiming that the interest was exempt from taxation under section 103(a) (as described in §1.6049–5(b)(1)(ii) of this chapter), the issuer is not required to impose withholding under section 3406.

(b) *Amount subject to backup withholding—(1) In general.* The amount of interest subject to withholding under section 3406 is the amount subject to reporting under section 6049.

(2) *Special rule to adjust for premature withdrawal penalty.* Solely for purposes of computing the amount subject to withholding under section 3406, the payor may elect not to withhold from the portion of any interest payment that is not received by the payee because a penalty is in fact imposed for premature withdrawal of funds deposited in a time savings account, certificate of deposit, or similar class of deposit.

§31.3406(b)(2)–2 Original issue discount.

(a) *Original issue discount subject to backup withholding.* The amount of original issue discount, treated as interest, subject to withholding under section 3406 is the amount subject to reporting under section 6049, but is limited to the amount of cash paid. In addition, if an original issue discount obligation, subject to reporting under section 6045, is sold prior to maturity and with respect to the seller a condition exists for imposing withholding under section 3406 on the gross proceeds, then withholding under §31.3406(b)(3)–2 applies to the gross proceeds of the sale reportable under section 6045, and not to the amount of any original issue discount includible in the gross income of the seller for the calendar year of the sale. See §31.6051–4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding and time when backup withholding is imposed with respect to short-term obligations.* In the case of an obligation with a fixed maturity date not exceeding one year from the date of issue (a short-term obligation), withholding under section 3406 applies to any payment of original issue discount on the obligation includible in the gross income of the holder to the extent of the cash amount of the payment. See §1.1273–1 of this chapter to determine the amount of original issue discount on a short-term obligation. See §1.446–2(e)(1) of this chapter to determine the amount of a payment treated as original issue discount.

(c) *Transferred short-term obligations—(1) Subsequent holder may*

establish purchase price—(i) In general. At maturity of a short-term obligation, a subsequent holder (*i.e.*, any person who purchased or otherwise obtained the obligation after the obligation was issued to the original holder) may establish the price of the obligation. The price established by the subsequent holder must then be treated as the original issue price for purposes of computing the amount of the original issue discount subject to withholding under section 3406. The price of a short-term obligation may be established by confirmation receipt or other record of a similar type or, if the obligation is redeemed by or through the person from whom the obligation was purchased or otherwise obtained, by the records of the person from whom or through whom the obligation was purchased or otherwise obtained. The subsequent holder is not required to certify under penalties of perjury that the price determined under this paragraph (c)(1)(i) is correct.

(ii) *Exception.* A payor may elect to disregard the price at which the subsequent holder purchased or otherwise obtained the obligation if the payor's computer or recordkeeping system on which the details of the obligation are stored is not able to accept that price without significant manual intervention.

(2) *Subsequent holder unable (or not permitted) to establish purchase price.* If a subsequent holder fails (or is unable, pursuant to paragraph (c)(1)(ii) of this section) to establish the purchase price of the obligation, then the person redeeming the obligation must determine the amount subject to withholding under section 3406 as though the obligation had been purchased by the holder on the date of issue. If the person redeeming the obligation is the issuer of the obligation, then the issuer must determine the amount subject to withholding from its records. If a person other than the issuer of the obligation redeems the obligation and the obligation is listed in Internal Revenue Service Publication 1212, List of Original Issue Discount Obligations, that person must determine the amount subject to withholding by using the issue price indicated in Publication 1212.

(3) *Transferred obligation.* If a short-term obligation is transferred, no part of the purchase price is considered a reportable interest payment under section 6049. Withholding under section 3406 applies, however, to the

gross proceeds of the sale of the obligation if the transfer is subject to reporting under section 6045 and a condition exists for imposing withholding. For the rules regarding withholding for amounts subject to reporting under section 6045, see §31.3406(b)(3)–2.

(d) *Amount subject to backup withholding and time when backup withholding is imposed with respect to long-term obligations*—(1) *No cash payments prior to maturity*. In the case of an obligation with a fixed maturity date that is more than one year from the date of issue (a long-term obligation) and with no cash payments prior to maturity, withholding under section 3406 applies at the maturity of the obligation to the amount of original issue discount includible in the gross income of the holder for the calendar year in which the obligation matures. The amount required to be withheld must not exceed the amount of the cash payment.

(2) *Registered long-term obligations with cash payments prior to maturity*. In the case of a long-term obligation in registered form that provides for cash payments prior to maturity, withholding under section 3406 applies at the time cash payments are made to the sum of the amounts of qualified stated interest and original issue discount includible in the gross income of the holder for the calendar year in which the cash payments are made. The amount required to be withheld at the time of any cash payment, however, must not exceed the amount of the cash payment. If more than one cash payment is made during a calendar year, the tax that is required to be withheld with respect to original issue discount must be allocated among all the expected cash payments in the ratio that each cash payment bears to the total of the expected cash payments.

(3) *Transferred registered long-term obligations with payments prior to maturity*. In the case of a long-term obligation that is transferred after its issuance from the original holder, the amount subject to withholding under section 3406 with respect to a subsequent holder is the amount of original issue discount includible in the gross income of all holders during the calendar year (without regard to any amount paid by a subsequent holder at the time of transfer). If the person redeeming the obligation at maturity is the issuer of the obligation, the issuer

must determine the amount subject to withholding through its records by treating the holder as if he were the original holder. If a person redeeming the obligation at maturity is a person other than the issuer of the obligation, and the obligation is listed in Internal Revenue Service Publication 1212, List of Original Issue Discount Obligations, the person must determine the amount subject to withholding by using the issue price indicated in Publication 1212.

(e) *Bearer long-term obligations*. In the case of a bearer long-term obligation with cash payments prior to maturity—

(1) *Payments prior to maturity*. Withholding under section 3406 applies prior to maturity only to the payment of qualified stated interest (and not to any amount of original issue discount) includible in the gross income of the holder for the calendar year.

(2) *Payments at maturity*. At maturity of the obligation, withholding applies to the sum of any qualified stated interest payment made at maturity and the total amount of original issue discount includible in the gross income of the holder during the calendar year of maturity. The amount required to be withheld at the time of the cash payment, however, must not exceed the amount of the cash payment.

§31.3406(b)(2)–3 *Window transactions*.

(a) *Requirement to backup withhold*. Withholding under section 3406 applies to a window transaction (as defined in paragraph (b) of this section) only if the payee does not furnish a taxpayer identification number to the payor in the manner required in paragraph (c) of this section or furnishes an obviously incorrect number as described in §31.3406(h)–1(b)(2). Withholding does not apply to a window transaction even though the Internal Revenue Service notifies the payor of the payee's incorrect taxpayer identification number under section 3406(a)(1)(B) or of notified payee underreporting under section 3406(a)(1)(C). The payee in a window transaction is not required to certify under penalties of perjury that the payee is not subject to withholding due to notified payee underreporting (as described in §31.3406(d)–2(b)(2)).

(b) *Window transaction defined*. *Window transaction* means a payment

of interest with respect to any of the following obligations:

(1) An interest coupon in bearer form that is subject to taxation (*i.e.*, other than exempt interest described in §1.6049–5(b)(1)(ii) of this chapter);

(2) A United States savings bond; or

(3) A discount obligation having a maturity at issue of one year or less, including commercial paper and bankers' acceptances that are in definitive form (*i.e.*, evidenced by a paper document other than a confirmation receipt) but not including short-term government obligations (as defined in section 1271(a)(3)(B)).

(c) *Manner of furnishing taxpayer identification number in the case of a window transaction*. A payee must furnish the payee's taxpayer identification number to the payor with respect to a window transaction either orally or in writing at the time that the window transaction occurs. See §31.3406(g)–3(c)(1)(i), which provides that a payee may not claim the payee is awaiting receipt of a taxpayer identification number with respect to a window transaction. The payee is not required to certify, under penalties of perjury, that the taxpayer identification number provided is correct.

§31.3406(b)(2)–4 *Reportable dividend payment*.

(a) *Dividends subject to backup withholding*. A payment of a kind, and to a payee, that is required to be reported under section 6042 (relating to returns regarding payments of dividends and corporate earnings and profits) is a reportable payment for purposes of section 3406. See paragraph (b) of this section for certain dividends not subject to withholding under section 3406. See §31.6051–4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Dividends not subject to backup withholding*. Except as provided in §31.3406(b)(3)–2 (relating to transactions reportable under section 6045), withholding under section 3406 does not apply to—

(1) Any amount treated as a taxable dividend by reason of section 302 (relating to redemptions of stock), section 304 (relating to redemptions through the use of related corporations), section 306 (relating to disposition of certain stock), section 356

(relating to receipt of additional consideration in connection with certain reorganizations), or section 1081(e)(2) (relating to certain distributions pursuant to an order of the Securities and Exchange Commission);

(2) Any exempt-interest dividend, as defined in section 852(b)(5)(A), paid by a regulated investment company; or

(3) Any amount paid or treated as paid during a year by a regulated investment company, provided that the payor reasonably estimates, as provided in paragraph (c)(2) of this section, that 95 percent or more of all dividends paid or treated as paid during the year are exempt-interest dividends.

(c) *Amount subject to backup withholding*—(1) *In general*. The amount of a dividend subject to withholding under section 3406 is the amount subject to reporting under section 6042, including any dividend that is reinvested pursuant to a plan under which a shareholder may elect to receive stock as a dividend instead of property. Except as otherwise provided in this paragraph (c), withholding applies to the entire amount of the distribution.

(2) *Reasonable estimate of amount of dividend subject to backup withholding*. Pursuant to section 6042(b)(3) and §1.6042-3(c) of this chapter, if the payor is unable to determine the portion of a distribution that is a dividend, the entire amount of the distribution must be treated as a dividend for information reporting under section 6042. Hence, withholding applies to the entire amount of the distribution. If a payor is able reasonably to estimate under section 6042 and §1.6042-3(c) of this chapter the portion of a distribution that is not a dividend, however, the payor must not withhold on that portion (which is not considered a dividend). A payor making a payment, all or a portion of which may not be a dividend, may use previous experience to estimate the portion of a distribution that is not a dividend. The payor's estimate is considered reasonable if—

(i) The estimate does not exceed the proportion of the distributions made by the payor during the most recent calendar year for which a Form 1099 was required to be filed that was not reported by the payor as a dividend; and

(ii) The payor has no reasonable basis to expect that the proportion of the distribution that is not a dividend

will be substantially different for the current year.

(3) *Reinvested dividends*. In the case of a dividend paid pursuant to a dividend reinvestment plan, withholding under section 3406 applies, pursuant to §31.3406(a)-4(a), at the time and to the amount made available to the shareholder or credited to the shareholder's account. At the discretion of the payor, withholding under section 3406 need not be applied to any excess of the fair market value of the shares of stock received by the shareholder or credited to the shareholder's account over the purchase price of the shares (including shares acquired by the shareholder at a discount in connection with the dividend distribution) or to any fee that is paid by the payor in the nature of a broker's fee for purchase of the stock or service charge for maintenance of the shareholder's account. The payor must, however, treat any excess amounts and fees on a consistent basis for each calendar year.

§31.3406(b)(2)-5 *Reportable patronage dividend payment*.

(a) *Patronage dividends subject to backup withholding*. A payment of a kind, and to a payee, that is required to be reported under section 6044 (relating to returns regarding patronage dividends) is a reportable payment for purposes of section 3406. See §31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding*—(1) *Failure to provide taxpayer identification number or notification of incorrect taxpayer identification number*. For purposes of sections 3406(a)(1)(A) and (B), the amount of a payment described in paragraph (a) of this section that is subject to withholding under section 3406 is the amount subject to reporting under section 6044, but only to the extent the payment is made in money. For purposes of this paragraph (b), *money* includes cash or a qualified check (as defined in section 1388(c)(4)).

(2) *Notified payee underreporting or payee certification failure*. For purposes of sections 3406(a)(1)(C) and (D), the amount of a payment described in paragraph (a) of this section that is subject to withholding under section 3406 is the amount subject to withhold-

ing under paragraph (b)(1) of this section, but only if 50 percent or more of that reportable amount is paid in money. Thus, a payor is required to withhold according to this paragraph (b)(2) on a payment if—

(i) There has been a notified payee underreporting described in section 3406(a)(1)(C) and §31.3406(c)-1 or there has been a payee certification failure described in section 3406(a)(1)(D) and §31.3406(d)-2;

(ii) The payor makes a reportable payment subject to reporting under section 6044 to the payee; and

(iii) Fifty percent or more of the payment is in cash or by qualified check.

§31.3406(b)(3)-1 *Reportable payments of rents, commissions, nonemployee compensation, etc.*

(a) *Section 6041 and 6041A(a) payments subject to backup withholding*. A payment of a kind, and to a payee, that is required to be reported under section 6041 (relating to information reporting of rents, commissions, nonemployee compensation, etc.) or a payment that is required to be reported under section 6041A(a) (relating to information reporting of payments to nonemployees for services) is a reportable payment for purposes of section 3406. See paragraph (b) of this section for an exception concerning payments aggregating less than \$600. See §31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding*—(1) *In general*. The amount of a payment described in paragraph (a) of this section subject to withholding under section 3406 is the amount subject to reporting under section 6041 or section 6041A(a).

(2) *Net commissions*. Withholding under section 3406 does not apply to net commissions paid to unincorporated special agents with respect to insurance policies that are subject to reporting under section 6041, provided that no cash is actually paid by the payor to the special agent.

(3) *Payments aggregating \$600 or more for the calendar year*—(i) *In general*. A payment is a reportable payment under paragraph (a) of this section only if the aggregate amount of the current payment and all previous payments to the payee during the

calendar year aggregate \$600 or more. The amount subject to withholding is the entire amount of the payment that causes the total amount paid to the payee to equal \$600 or more and the amount of any subsequent payments made to the payee during the calendar year. This paragraph (b)(3)(i) does not apply to gambling winnings (as provided in §1.3406(g)-2(e)(1)).

(ii) *Exceptions—(A) The \$600 aggregation rule.* The \$600 aggregation rule of paragraph (b)(3)(i) of this section does not apply if the payor was required to make an information return under section 6041 or 6041A(a) for the preceding calendar year with respect to payments to the payee, or the payor was required to withhold under section 3406 during the preceding calendar year with respect to payments to the payee that were reportable under section 6041 or 6041A(a).

(B) *Determination of whether payments aggregate \$600 or more.* In determining whether payments to a payee aggregate \$600 or more during a calendar year for purposes of withholding under section 3406, the payor must aggregate only payments of the same kind made to the same payee. For this purpose, payments are of the same kind if they are of the same type, regardless of whether they are reportable under the same section. However, a payor with different paying departments making reportable payments of the same kind is not required to aggregate payments made by all those departments unless it is the payor's customary method to aggregate those payments. A payor may, in its discretion, aggregate—

(1) Payments not of the same kind to the same payee, reportable under either section 6041 or 6041A(a); and

(2) Payments reportable under section 6041 with payments reportable under section 6041A(a).

§1.3406(b)(3)-2 Reportable barter exchanges and gross proceeds of sales of securities or commodities by brokers.

(a) *Transactions subject to backup withholding.* A payment of a kind, and to a payee, that any broker (as defined in section 6045(c) and §1.6045-1(a)(1) of this chapter) or any barter exchange (as defined in section 6045(c) and §1.6045-1(a)(4) of this chapter) is required to report under section 6045 is

a reportable payment for purposes of section 3406. See §31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding—(1) In general.* The amount subject to withholding under section 3406 is the amount subject to reporting under section 6045. The amount subject to withholding with respect to broker reporting is the amount of gross proceeds (as determined under §1.6045-1(d)(5) of this chapter). The amount subject to withholding with respect to barter exchanges is the amount received by any member or client (as determined under §1.6045-1(f)(4) of this chapter).

(2) *Forward contracts, including foreign currency contracts, and regulated futures contracts—(i) In general.* If a customer is subject to withholding under section 3406 with respect to a forward contract (subject to information reporting under §1.6045-1(c)(5) of this chapter), including a foreign currency contract (as defined in section 1256(g)(2)), or a regulated futures contract (as defined in section 1256(g)(1)), or with respect to an account through which those contracts are disposed of or acquired, the broker must withhold on both of the following amounts:

(A) All cash or property withdrawn from the account by the customer during the relevant year; and

(B) The amount of cash in the account available for withdrawal by the customer at the relevant year-end (including both gross proceeds and variation margin).

(ii) *Rules concerning withdrawals.* A withdrawal includes the use of money (including both gross proceeds and variation margin) or property in the account to purchase any property other than property acquired in connection with the closing of a contract. For this purpose, the acceptance of a warehouse receipt or other taking of delivery to close a contract is in connection with the closing of a contract only if the property acquired is disposed of by the close of the seventh trading day following the trading day that the customer takes delivery under the contract. In addition, making delivery to close a contract is in connection with the closing of a contract only if the broker is able to determine that the property used to close the contract was acquired

no earlier than the seventh trading day prior to the trading day on which delivery is made. Withdrawals do not include repayments of debt incurred in connection with making or taking delivery that meets the requirements of this paragraph (b)(2). Withdrawals also do not include payments of commissions, fees, transfers of cash from the account to another futures account that is subject to this paragraph (b)(2) or cash withdrawals traceable to dispositions of property other than futures (not including profit on the contract separately reportable under §1.6045-1(c)(5)(i)(b) of this chapter).

(iii) *Special rule for forward contracts, including foreign currency contracts, and regulated futures contracts.* The determination of whether the customer is subject to withholding under section 3406 with respect to an account containing forward contracts, including foreign currency contracts, or regulated futures contracts must be made at the time of the cash or property withdrawals or the relevant year-end, whichever is applicable.

(3) *Security sales made through a margin account.* The amount described in paragraph (a) of this section that is subject to withholding under section 3406 in the case of a security sale made through a margin account (as defined in 12 CFR part 220 (Regulation T)) is the gross proceeds (as defined in §1.6045-1(d)(5) of this chapter) of the sale. The amount required to be withheld with respect to the sale, however, is limited to the amount of cash available for withdrawal by the customer immediately after the settlement of the sale. For this purpose, the amount available for withdrawal by the customer does not include amounts required to satisfy margin maintenance under Regulation T, rules and regulations of the National Association of Securities Dealers and national securities exchanges, and generally applicable self-imposed rules of the margin account carrier.

(4) *Security short sales—(i) Amount subject to backup withholding.* The amount subject to withholding under section 3406 with respect to a short sale of securities is the gross proceeds (as defined in §1.6045-1(d)(5) of this chapter) of the short sale. At the option of the broker, however, the amount subject to withholding may be the gain upon the closing of the short sale (if any); consequently, the obligation to withhold under section 3406 would be

deferred until the closing transaction. A broker may use this alternative method of determining the amount subject to withholding under section 3406 with respect to a short sale only if at the time the short sale is initiated, the broker expects that the amount of gain realized upon the closing of the short sale will be determinable from the broker's records. If, due to events unforeseen at the time the short sale was initiated, the broker is unable to determine the basis of the property used to close the short sale, the property must be assumed for this purpose to have a basis of zero.

(ii) *Time of backup withholding.* The determination of whether a short seller is subject to withholding under section 3406 must be made on the date of the initiation or closing, as the case may be, or on the date that the initiation or closing, as the case may be, is entered on the broker's books and records.

(5) *Fractional shares.* A broker is not required to withhold under section 3406 with respect to a sale of a fractional share of stock resulting in less than \$20 of gross proceeds (as described in §5f.6045-1(c)(3)(ix) of this chapter).

§31.3406(b)(3)-3 Reportable payments by certain fishing boat operators.

(a) *Payments subject to backup withholding.* A payment of a kind, and to a payee, that is required to be reported under section 6050A (relating to information reporting by certain fishing boat operators) is a reportable payment for purposes of section 3406. See §31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding.* The amount described in paragraph (a) of this section subject to withholding under section 3406 is the amount subject to reporting under section 6050A, but only to the extent the amount is paid in money and represents a share of the proceeds of the catch.

§31.3406(b)(3)-4 Reportable payments of royalties.

(a) *Royalty payments subject to backup withholding.* A payment of a kind, and to a payee, that is required to be reported under section 6050N (relating to information reporting of pay-

ments of royalties) is a reportable payment for purposes of section 3406. See §31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Amount subject to backup withholding.* In general, the amount described in paragraph (a) of this section that is subject to withholding under section 3406 is the amount subject to reporting under section 6050N. However, if the reportable payment is for an oil or gas interest, the amount subject to withholding is the net amount the payee receives (*i.e.*, the gross proceeds less production-related taxes such as state severance taxes).

§31.3406(b)(4)-1 Exemption for certain minimal payments.

(a) *In general.* A payor of reportable interest or dividends (as described in section 3406(b)(2)) or of royalties (as described in section 3406(b)(3)(E)) may elect not to withhold from a payment that does not exceed \$10 and that on an annualized basis does not exceed \$10 (see paragraph (c) of this section). A broker or barter exchange may elect not to withhold on gross proceeds of \$10 or less without regard to the annualization requirement. See §31.6051-4 for the requirement to furnish a statement to the payee if tax is withheld under section 3406.

(b) *Manner of making the election.* The election not to withhold from payments that do not exceed \$10 can be made only for payments described in paragraph (a) of this section. The election may be made on a payment-by-payment basis.

(c) *How to annualize—(1) In general.* To annualize a reportable interest payment, dividend payment, or royalty payment, a payor must calculate what the amount of the payment would be if it were paid for a 1-year period (instead of the period for which it actually is paid). The annualized amount is determined by dividing the amount of the payment by the number of days in the period for which it is being paid and then multiplying that result by the number of days in the year. If the annualized amount is \$10 or less, the payor may elect not to withhold on that payment regardless of whether more than \$10 may be or has been paid to the payee in other reportable payments during the calendar year. Conversely, if the annualized

amount is more than \$10, withholding applies even if \$10 or less is actually paid to the payee during the calendar year. For purposes of computing the annualized amount, the payor may assume that February always consists of 28 days and that the year always consists of 360 days. For amounts that are deposited with a payor in a new account or certificate between the dates on which the payor customarily pays or credits interest, the payor may assume that the period for which the interest is paid is the payor's customary period for paying or crediting interest.

(2) *Special aggregation rule for reportable interest and dividends.* If a payor maintains records that reflect multiple holdings of one payee and the payor makes an aggregate payment of reportable interest or dividends (as defined in section 3406(b)(2)) with respect to those multiple holdings (such as a dividend check that reflects payment on all stock owned by the payee), the payor must annualize the aggregate payment.

(d) *Exception for window transactions and original issue discount.* A payor is not required to annualize payments made in window transactions (as defined in §31.3406(b)(2)-3(b)) or payments of original issue discount. With respect to a window transaction, however, the payor is required to aggregate all payments made in the same transaction (*e.g.*, payments made with respect to coupons or obligations presented for payment at the same time as described in §1.6049-4(e)(4) of this chapter).

§31.3406(c)-1 Notified payee underreporting of reportable interest or dividend payments.

(a) *Overview.* Withholding under section 3406(a)(1)(C) applies to any reportable interest or dividend payment (as defined in section 3406(b)(2)) made with respect to an account of a payee if the Internal Revenue Service or a broker notifies a payor under paragraph (c)(1) or (2) of this section that the payee is subject to withholding due to notified payee underreporting (as defined in paragraph (b)(1) of this section), and the payor is required under paragraph (c)(3) of this section to identify that account. After receiving the notice and identifying accounts, the payor must notify the payee, in accordance with paragraph (d) of this section,

that withholding due to notified payee underreporting has started. Paragraph (e) of this section describes the period for which withholding due to notified payee underreporting is required. Paragraph (f) of this section provides rules concerning notices that the Internal Revenue Service will send to a payee before notifying a payor that the payee is subject to withholding due to notified payee underreporting. Paragraph (g) of this section provides rules that a payee can use to prevent withholding due to notified payee underreporting from starting or to stop it once it has started. Paragraph (h) of this section provides special rules for joint accounts of payees who have filed a joint return. See section 6682 for the penalties that may apply to a payee subject to withholding under section 3406(a)(1)(C).

(b) *Definitions*—(1) *Notified payee underreporting*. *Notified payee underreporting* means that the Internal Revenue Service has—

(i) Determined that there was a payee underreporting (as defined in paragraph (b)(2) of this section);

(ii) Mailed at least four notices under paragraph (f)(1) of this section to the payee (over a period of at least 120 days) with respect to the underreporting; and

(iii) Assessed any deficiency attributable to the underreporting in the case of any payee who has filed a return.

(2) *Payee underreporting*—(i) *In general*. *Payee underreporting* means that the Internal Revenue Service has determined, for a taxable year, that—

(A) A payee failed to include in the payee's return of tax under chapter 1 of the Internal Revenue Code for that year any portion of a reportable interest or dividend payment required to be shown on that tax return; or

(B) A payee may be required to file a return for that year and to include a reportable interest or dividend payment in the return, but failed to file the return.

(ii) *Payments included in making payee underreporting determination*. The determination of whether there is payee underreporting is made by treating as reportable interest or dividend payments, all payments of dividends reported under section 6042, all patronage dividends reported under section 6044, and all interest and original issue discount reported under section 6049, regardless of whether withholding due to notified payee underreporting applies to those payments.

(c) *Notice to payors regarding backup withholding due to notified payee underreporting*—(1) *In general*. If the Internal Revenue Service or a broker notifies a payor that a payee is subject to withholding due to notified payee underreporting, the payor must—

(i) Identify any accounts of the payee under the rules of paragraph (c)(3) of this section; and

(ii) Notify the payee and withhold under section 3406 on reportable interest or dividend payments made with respect to any identified account under the rules of paragraphs (d) and (e) of this section.

(2) *Additional requirements for payors that are also brokers*—(i) *In general*. A broker must notify the payor of a readily tradable instrument that the payee of the instrument is subject to withholding due to notified payee underreporting if—

(A) The broker (in its capacity as a payor) receives a notice from the Internal Revenue Service under paragraph (c)(1) of this section that a payee is subject to withholding due to notified payee underreporting and the broker is required to identify an account of the payee under paragraph (c)(3) of this section;

(B) The payee subsequently acquires the instrument from the broker through the same account; and

(C) The acquisition of the instrument occurs after the close of the 30th business day after the date that the broker receives the notice (or on any earlier date that the broker may begin applying this paragraph (c)(2) after receipt of the notice described in paragraph (c)(1) of this section).

(ii) *Transfer out of street name*. For purposes of this paragraph (c)(2), an acquisition includes a transfer of an instrument out of street name into the name of the registered owner (*i.e.*, the payee).

(iii) *Method of providing notice*. A broker must provide the notice required under this paragraph (c)(2) to the payor of the instrument with the transfer instructions for the acquisition. See §31.3406(d)-4(a)(2).

(iv) *Termination of obligation to provide information*. The obligation of a broker to provide notice to payors under this paragraph (c)(2) terminates simultaneously with the termination of the broker's obligation to withhold (in its capacity as payor) due to notified

payee underreporting on reportable interest or dividends made with respect to the account.

(3) *Payor identification of accounts of the payee subject to backup withholding due to notified payee underreporting*—(i) *In general*—(A) *Notice from the Internal Revenue Service*. If a payor receives a notice from the Internal Revenue Service under paragraph (c)(1) of this section, the payor must identify, exercising reasonable care, all accounts using the same taxpayer identification number for information reporting purposes as the one provided in the notice. The notice may provide, however, that the payor need only identify the account or accounts corresponding to any account number or designation and related taxpayer identification number used for information reporting purposes as that listed on the notice.

(B) *Notice from a broker*. If a payor receives a notice from a broker under paragraphs (c)(1) and (2) of this section, the payor is not required to identify any account other than the account identified in the notice.

(ii) *Exercise of reasonable care*. If an account identified pursuant to paragraph (c)(3)(i)(A) of this section contains a customer identifier that can be used to retrieve systemically any other accounts that use the same taxpayer identification number for information reporting purposes, the payor must identify all accounts that can be so retrieved. Otherwise, a payor is considered to exercise reasonable care in identifying accounts subject to withholding under section 3406(a)(1)(C) if the payor searches any computer or other recordkeeping system for the region, division, or branch that serves the geographic area in which the payee's mailing address is located and that was established (or is maintained) to reflect reportable interest or dividend payments.

(iii) *Newly opened accounts*. (A) In general, a new account is not subject to withholding under section 3406(a)(1)-(C) if the payee provides to the payor a Form W-9 (or other acceptable substitute) on which the payor may reasonably rely (within the meaning of §31.3406(h)-3(e)(2) without regard to §31.3406(h)-3(e)(2)(v)), unless the payor has actual knowledge (within the meaning of paragraph (c)(3)(iii)(B) of this section) that the statements made on the form are not true.

(B) For purposes of paragraph (c)(3)(iii)(A) of this section, a payor is considered to have actual knowledge that a payee's statement that the payee is not subject to withholding under section 3406(a)(1)(C) is not true if—

(1) The employee or individual agent of the payor who receives the payee's certification knows that the statement is not true;

(2) In conducting the investigation, if any, required by paragraph (c)(3)-(iii)(C) of this section, the payor identifies any other accounts of the payee that are already subject to withholding under section 3406(a)(1)(C); or

(3) In the course of processing the certification or in administering an account to which a certification relates, the payor discovers that the payor was previously notified by the Internal Revenue Service that the payee is subject to withholding under section 3406(a)(1)(C) and no notice was received to stop withholding pursuant to section 3406(c)(3) prior to the time of the discovery.

(C) Except as provided in this paragraph (c)(3)(iii)(C), a payor is not required to investigate whether the statements made on the Form W-9 described in paragraph (c)(3)(iii)(A) of this section are true. If, however, in opening a new account, the payor relies on the same Form W-9 (or appropriate substitute) that it relied on previously in opening another account, the payor must investigate whether any such existing account is subject to withholding under section 3406(a)(1)(C). Similarly, if the payor utilizes a universal account system described in the first sentence of paragraph (c)(3)(ii) of this section, and in opening a new account the payor searches its records to determine whether the new account should be identified under an existing identifier (because the payee has existing accounts with the payor), the payor must investigate whether any existing accounts identified with the same identifier are subject to withholding under section 3406(a)(1)(C).

(d) *Notice from payors of backup withholding due to notified payee underreporting*—(1) *In general.* If a payor receives notice from the Internal Revenue Service or a broker under paragraph (c)(1) of this section and is required to identify an account under paragraph (c)(3) of this section as an account of the payee, the payor must

notify the payee in accordance with paragraph (d)(2) of this section that withholding due to notified payee underreporting has started.

(2) *Procedures.* The payor must send the notice required by paragraph (d)(1) of this section to the payee no later than 15 days after the date that the payor makes the first payment subject to withholding due to notified payee underreporting. The payor must send the notice by first-class mail to the payee at the payee's last known address. The notice to the payee required by paragraph (d)(1) of this section must state—

(i) That the Internal Revenue Service has given notice that the payee has underreported reportable interest or dividends;

(ii) That, as a result of the underreporting, the payor is required under section 3406(a)(1)(C) of the Internal Revenue Code to withhold 31 percent of reportable interest or dividend payments made to the payee;

(iii) The date that the payor started (or plans to start) withholding due to notified payee underreporting under section 3406(a)(1)(C);

(iv) The account number or numbers that are subject to withholding due to notified payee underreporting;

(v) That the payee must obtain a determination from the Internal Revenue Service in order to stop the withholding due to notified payee underreporting; and

(vi) That while the payee is subject to withholding due to notified payee underreporting, the payee may not certify to a payor making reportable interest or dividend payments (or to a broker acquiring a readily tradable instrument for the payee) that the payee is not subject to withholding due to notified underreporting.

(e) *Period during which backup withholding is required*—(1) *In general.* If a payor receives notice from the Internal Revenue Service or a broker under paragraph (c)(1) of this section, the payor must impose withholding under section 3406(a)(1)(C) on all reportable interest or dividend payments with respect to any account of the payee required to be identified under paragraph (c)(3) of this section made after the close of the 30th business day after the day on which the payor receives that notice and before the stop date (as described in paragraph (e)(2) of this section). A payor may

choose to start withholding under this paragraph (e)(1) at any time during the 30-business-day period described in the preceding sentence.

(2) *Stop withholding*—(i) *When no underreporting exists or undue hardship exists*—(A) *Stop date.* In the case of a determination under paragraph (g)(3)(i) or (iii) of this section that no underreporting exists or that an undue hardship exists, the stop date is the day that is 30 days after the earlier of—

(1) The date on which the payor receives written notification from the Internal Revenue Service under paragraph (g) of this section that withholding is to stop; or

(2) The date on which the payor receives a copy of the written certification provided to the payee by the Internal Revenue Service under paragraph (g) of this section that withholding is to stop.

(B) *Acceleration of stop date.* A payor may choose to stop withholding at any time during the 30-day period described in paragraph (e)(2)(i)(A) of this section.

(ii) *When underreporting is corrected or bona fide dispute exists.* In the case of a determination under paragraph (g)(3)(ii) or (iv) of this section that the underreporting has been corrected or that a bona fide dispute exists, the stop date occurs on the first day of January (immediately following a period of at least twelve months ending on October 15 of any calendar year in which the determination has been made) or if later, the stop date determined under paragraph (e)(2)(i) of this section.

(3) *Dormant accounts.* The requirement that a payor withhold under this paragraph (e) on reportable interest or dividend payments made with respect to an account terminates no later than the close of the third calendar year ending after the later of—

(i) The date that the most recent reportable interest or dividend payment was made with respect to that account; or

(ii) The date that the payor received notice under paragraph (c)(1) of this section.

(f) *Notice to payees from the Internal Revenue Service*—(1) *Notice period.* After the Internal Revenue Service determines under paragraph (b)(2) of this section that payee underreporting exists, the Internal Revenue

Service will mail to the payee at least four notices over a period of at least 120 days (the notice period) before payors will be notified under paragraph (c)(1) of this section that the payee is subject to withholding due to notified payee underreporting. The notices may be accompanied by, or incorporated in, other notices provided to the payee by the Internal Revenue Service.

(2) *Payee subject to backup withholding.* After the Internal Revenue Service provides the notices described in paragraph (f)(1) of this section, the Internal Revenue Service will send notices to payors under paragraph (c)(1) of this section unless—

(i) A payee obtains a determination under paragraph (g) of this section; or

(ii) In the case of a payee who has filed a tax return, the Internal Revenue Service has not assessed the deficiency attributable to the underreporting.

(3) *Disclosure of names of payors and brokers.* Pursuant to section 3406(c)(5) the Internal Revenue Service may require a payee subject to withholding due to notified payee underreporting to disclose the names of all the payee's payors of reportable interest or dividend payments and the names of all of the brokers with whom the payee has accounts which may involve reportable interest or dividend payments. To the extent required in the request from the Internal Revenue Service, the payee must also provide the payee's account numbers and other information necessary to identify the payee's accounts.

(4) *Backup withholding certification.* After a payee receives a final notice from the Internal Revenue Service under paragraph (f)(1) of this section, the payee is not permitted to certify to any payor or broker, under penalties of perjury, that the payee is not subject to withholding under section 3406(a)(1)(C), until the payee receives the certification from the Internal Revenue Service under paragraph (g) of this section advising the payee that the payee is no longer subject to withholding under section 3406(a)(1)(C). A final notice will contain the information described in this paragraph (f)(4). See sections 6682 and 7205(b) for civil and criminal penalties for making a false certification.

(g) *Determination by the Internal Revenue Service that backup withholding should not start or should be stopped—(1) In general.* A payee may

prevent withholding due to notified payee underreporting from starting, or stop the withholding once it has started, by requesting and receiving a determination from the Internal Revenue Service under one or more of the provisions of paragraph (g)(3) of this section. Following its review of a request for a determination under paragraph (g)(3) of this section, the Internal Revenue Service will either make the determination or provide the payee with a written report informing the payee that the request for determination is being denied and the reasons for the denial. If a determination is made during the notice period (as defined in paragraph (f)(1) of this section), the payee is not subject to withholding due to notified payee underreporting with respect to any taxable year for which a determination was made. If a determination is made after the notice period, the Internal Revenue Service will, at the time prescribed in paragraph (g)(2) of this section, provide written certification to a payee that withholding is to stop, and will notify payors who were contacted pursuant to paragraph (c)(1) of this section to stop withholding. A broker who (in its capacity as payor) under this paragraph (g)(1) receives a notice from the Internal Revenue Service or a copy of the certification provided to a payee by the Internal Revenue Service is not required to provide a corresponding notice to any payors whom the broker has previously notified under paragraph (c)(2) of this section.

(2) *Date notice to stop backup withholding will be provided—(i) Underreporting corrected or bona fide dispute.* If the Internal Revenue Service makes a determination under paragraph (g)(3)(ii) or (iv) of this section during the 12-month period ending on October 15 of any calendar year (as described in paragraph (e)(2)(ii) of this section), the Internal Revenue Service will provide the certification and the notices described in paragraph (g)(1) of this section no later than December 1 of that calendar year.

(ii) *No underreporting or undue hardship.* If the Internal Revenue Service makes a determination under paragraph (g)(3)(i) or (iii) of this section, the Internal Revenue Service will provide the notices described in paragraph (g)(1) of this section no later than the 45th day after the day on which the Internal Revenue Service makes its determination.

(3) *Grounds for determination.* The Internal Revenue Service will make a determination that withholding due to notified payee underreporting should not start or should stop once it has started if the payee—

(i) Shows that there was no payee underreporting (as provided in paragraph (g)(4) of this section) for each taxable year with respect to which the Internal Revenue Service determined under paragraph (b)(2) of this section that there was payee underreporting;

(ii) Corrects any payee underreporting (as provided in paragraph (g)(5) of this section) for each taxable year with respect to which the Internal Revenue Service determined under paragraph (b)(2) of this section that there was payee underreporting;

(iii) Shows that withholding will cause or is causing an undue hardship (as defined in paragraph (g)(6) of this section) and that it is unlikely that the payee will underreport interest or dividend payments again; or

(iv) Shows that a bona fide dispute exists regarding whether any underreporting has occurred (as provided in paragraph (g)(7) of this section) for each taxable year with respect to which the Internal Revenue Service determined under paragraph (b)(2) of this section that there was payee underreporting.

(4) *No underreporting.* A payee may show that no underreporting of reportable interest or dividends payments exists by presenting—

(i) Receipts or other satisfactory documentation to the Internal Revenue Service showing that all taxes relating to the payments were reported; or

(ii) Evidence showing that the payee did not have to file a return for the taxable year in question (e.g., because the payee did not make enough income) or that the underreporting determination was based upon a factual, clerical, or other error.

(5) *Correcting any payee underreporting—(i) Before issuance of a statutory notice of deficiency.* Before a statutory notice of deficiency is issued to a payee pursuant to section 6212, the payee may correct underreporting—

(A) By filing a return if one was not previously filed and including the unreported interest and dividends thereon;

(B) By filing an amended return in the event a return was filed and

including the unreported interest and dividends thereon; or

(C) By consenting to the additional assessment according to applicable notices and forms sent to the payee by the Internal Revenue Service with respect to the underreporting, and paying taxes, penalties, and interest due with respect to any underreported interest or dividend payments.

(ii) *After issuance of a statutory notice of deficiency.* After a statutory notice of deficiency is issued to a payee—

(A) The payee may correct underreporting at any time, by filing a return if one was not previously filed and paying the entire deficiency and any other taxes including penalties and interest attributable to any payee underreporting of interest or dividend payments; or

(B) The payee may correct underreporting after the mailing of the statutory notice of deficiency but before the expiration of the 90-day or 150-day period described in section 6213(a) or, if a petition is filed with the United States Tax Court, before the decision of the Tax Court is final, by making a remittance to the Internal Revenue Service of the amounts described in paragraph (g)(5)(ii)(A) of this section. The payee must specifically designate in writing that the remittance is a deposit in the nature of a cash bond.

(iii) *Special rules.* For purposes of paragraph (g)(5)(ii) of this section, the payee will not be deemed to have corrected the payee underreporting under paragraph (g)(5)(ii)(B) of this section after the remittance is returned to the payee in the manner described in any applicable administrative procedure. For further guidance on a deposit in the nature of a cash bond, see subparagraph 2 of section 4.01 of Rev. Proc. 84-58 (1984-2 C.B. 501). (See §601.601(d)(2) of this chapter.) Once the remittance is returned to the payee, the rules of this section will apply. If the Internal Revenue Service previously contacted payors of the payee to start withholding with respect to the notified payee underreporting, however, the Internal Revenue Service will recontact those payors to start withholding under paragraph (c)(1) of this section with respect to the payee underreporting without regard to paragraph (f) of this section.

(6) *Undue hardship*—(i) *In general.* A determination of undue hardship will

be based on the overall impact to the payee of having reportable interest or dividend payments withheld at a 31 percent rate under section 3406. In addition, a determination of undue hardship will be made only if the Internal Revenue Service concludes that it is unlikely that any payee underreporting will occur again.

(ii) *Factors.* Factors that will be considered in determining whether withholding causes undue hardship include, but are not limited to, the following—

(A) Whether estimated tax payments, and other credits for current tax liabilities, or amounts withheld on employee wages or pensions, in addition to withholding under section 3406, would cause significant overwithholding;

(B) The payee's health, including the payee's ability to pay foreseeable medical expenses;

(C) The extent of the payee's reliance on interest and dividend payments to meet necessary living expenses and the existence, if any, of other sources of income;

(D) Whether other income of the payee is limited or fixed (e.g., social security, pension, and unearned income);

(E) The payee's ability to sell or liquidate stocks, bonds, bank accounts, trust accounts, or other assets, and the consequences of doing so;

(F) Whether the payee reported and timely paid the most recent year's tax liability, including interest and dividend income; and

(G) Whether the payee has filed a bankruptcy petition with the United States Bankruptcy Court.

(7) *Bona fide dispute.* The Internal Revenue Service may make a determination under this paragraph (g)(7) if there is a dispute between the payee and the Internal Revenue Service on a question of fact or law that is material to a determination under paragraph (g)(3)(i) of this section and, based upon all the facts and circumstances, the Internal Revenue Service finds that the dispute is asserted in good faith by the payee and there is a reasonable basis for the payee's position.

(h) *Payees filing a joint return*—(1) *In general.* For purposes of this section, if payee underreporting is found to exist with respect to a joint return, then the provisions of this section

apply to both payees (i.e., the husband and wife). As a result, both payees are subject to withholding on accounts in their individual names as well as accounts in their joint names. Either or both payees may satisfy the criteria for a determination that no payee underreporting exists, that the underreporting has been corrected, or that a bona fide dispute exists (as provided in paragraph (g)(3)(i), (ii), or (iv) of this section). Both payees, however, must satisfy the criteria for a determination that withholding will cause or is causing undue hardship (as provided in paragraph (g)(3)(iii) of this section).

(2) *Exceptions*—(i) *Innocent spouse.* A spouse who files a joint return may obtain a determination that withholding should stop or not start with respect to payments made to his or her individual accounts, if the spouse shows that—

(A) He or she did not underreport income because he or she is a spouse described in section 6013(e), i.e., innocent spouse; or

(B) There is a bona fide dispute regarding whether he or she is an innocent spouse and hence did not underreport income.

(ii) *Divorced or legally separated payee.* A payee who, at the time of the request for a determination under paragraph (g) of this section, is divorced or separated under state law may obtain a determination that undue hardship exists (or would exist) under paragraph (g)(3)(iii) of this section with respect to reportable interest or dividend payments made to his or her individual accounts if the divorced or legally separated payee satisfies the criteria for a determination under paragraph (g)(6) of this section.

(i) *Reserved.*

(j) *Penalties.* For the application of penalties related to this section, see sections 6682 and 7205(b).

§31.3406(d)-1 Manner required for furnishing a taxpayer identification number.

(a) *Requirement to backup withhold.* Withholding under section 3406(a)(1)-(A) applies to a reportable payment (as defined in section 3406(b)) if the payee does not furnish the payee's taxpayer identification number to the payor in the manner required by this section. The period for which withholding is required is described in §31.3406(e)-

1(b). See §31.3406(d)-3(a) and (b) for special rules when an account is established directly with, or an instrument is acquired directly from, the payor by electronic transmission or by mail, or an instrument is sold through a broker by electronic transmission or by mail. See §31.3406(d)-4 for special rules applicable to readily tradable instruments acquired through a broker. See §31.3406(h)-3(e) for the rules on when a payor may rely on a Form W-9. See also §31.3406(g)-3 for rules regarding a payee awaiting receipt of a taxpayer identification number. See the applicable information reporting sections and section 6109 and the regulations thereunder to determine whose taxpayer identification number should be provided.

(b) *Reportable interest or dividend account*—(1) *Manner required for furnishing a taxpayer identification number with respect to a pre-1984 account or instrument.* A payee must furnish the payee's taxpayer identification number to the payor with respect to any obligation, deposit, certificate, share, membership, contract, investment, account, or other relationship or instrument established or acquired on or before December 31, 1983 (a pre-1984 account) and with respect to which the payor makes a reportable interest or dividend payment (as defined in section 3406(b)(2)). The manner of determining whether an account or an instrument is a pre-1984 account is described in paragraph (b)(2) of this section. The payee of a pre-1984 account may furnish the payee's taxpayer identification number to the payor orally or in writing. The payee is not required to certify under penalties of perjury that the taxpayer identification number is correct.

(2) *Determination of pre-1984 account or instrument*—(i) *In general.* An account that is in existence before January 1, 1984, will be considered a pre-1984 account, regardless of whether additional deposits are made to the account on or after January 1, 1984. An account established as an expansion of a credit union prime account in existence prior to January 1, 1984, constitutes a pre-1984 account. If funds taken from one account in existence prior to January 1, 1984, are used to create a new account on or after that date, however, the new account does not constitute a pre-1984 account except as provided in the preceding sentence. An instrument ac-

quired prior to January 1, 1984, is a pre-1984 account. Regardless of when an instrument was acquired, if it is negotiated in a window transaction as defined in §31.3406(b)(2)-3(b), it is treated as an instrument acquired after December 31, 1983. An obligation in bearer form and subject to reporting under section 6045, whenever acquired, is not a pre-1984 account. Any instrument, whenever acquired, that is held in a brokerage account is considered a pre-1984 account if the brokerage account is not a post-1983 brokerage account (as described in paragraph (c)(1)(ii) of this section). If shares of a corporation are held before January 1, 1984 (or considered held before that date by operation of this paragraph (b)(2)), and additional shares are acquired by the holder, irrespective of whether the shares are received by reason of a stock dividend, investing new cash, or otherwise, the new shares, in the discretion of the payor, may be considered a pre-1984 account. In the case of a qualified employee trust that distributes instruments in kind, any instrument distributed from the trust is considered a pre-1984 account with respect to employees who were participants in the trust before 1984. Similarly, when a payor offers participants in a plan the opportunity to purchase stock of the payor after a specified time, using the money that the payee invested during that period of time, the stock so purchased after December 31, 1983, is considered a pre-1984 account with respect to participants in the plan who either owned shares or invested money in the plan before January 1, 1984.

(ii) *Account or instrument automatically acquired on the maturity or termination of an account.* When an account is opened, or an instrument is acquired, automatically on the maturity or termination of an account that was in existence or an instrument that was held before January 1, 1984 (or considered to have been in existence or held before that date by operation of this paragraph (b)(2)(ii)), without the participation of the payee, the new account or instrument, in the discretion of the payor, may be considered a pre-1984 account. For purposes of the preceding sentence, a payee is not considered to have participated in the acquisition of the new account or instrument solely because the payee failed to exercise a right to withdraw funds at the maturity or termination of the old account or instrument.

(iii) *Insurance policies.* In the case of insurance policies in effect on December 31, 1983, the election of a dividend accumulation option pursuant to which interest is paid (as defined in §1.6049-5(a)(4) of this chapter), or the creation of an account in which proceeds of a policy are held for the policy beneficiary, may, in the payor's discretion, be treated as a pre-1984 account.

(iv) *Acquisitions of accounts and instruments*—(A) *Pre-1984 or post-1983 status known.* If a payor acquires accounts or instruments of another payor (including through a tax-free reorganization under section 368), the acquiring payor must treat the persons specified in this paragraph (b)(2)(iv)(A) as having the same requirement to furnish a taxpayer identification number in the manner required under this paragraph (b) to the acquiring payor for information reporting, withholding, and related tax provisions as existed with respect to the payor whose accounts or instruments were acquired. Persons specified in this paragraph (b)(2)(iv)(A) are persons who held accounts or instruments in the other payor immediately before the acquisition and who receive an account or instrument in the acquiring payor immediately after the acquisition.

(B) *Pre-1984 or post-1983 status unknown.* If the acquiring payor, as described in paragraph (b)(2)(iv)(A) of this section, is unable to identify from the business records of the other payor whether any or all of the accounts or instruments of the persons specified in paragraph (b)(2)(iv)(A) of this section are pre-1984 (or post-1983) accounts or instruments, then the acquiring payor may treat these unidentified accounts or instruments as pre-1984 accounts or instruments.

(C) *Cross reference.* See §31.3406(g)-2(g) for the limited exception from withholding under section 3406(a)(1)(A) on accounts or instruments described in paragraphs (b)(2)(iv)(A) and (B) of this section for which the payor does not have a taxpayer identification number.

(3) *Manner required for furnishing a taxpayer identification number with respect to an account or instrument that is not a pre-1984 account.* A payee who receives reportable interest or dividend payments (as defined in section 3406(b)(2)) from a payor must certify under penalties of perjury that

the taxpayer identification number the payee furnishes to the payor is the payee's correct taxpayer identification number. The payee must make the certification only with respect to an account or instrument that is not a pre-1984 account (as described in paragraph (b)(2) of this section). See §31.3406(h)-3 for a description of the certificate on which the certification must be made. See §31.3406(d)-2 for the requirement that the payee must certify under penalties of perjury that the payee is not subject to withholding due to notified payee underreporting. See §31.3406(d)-3(a) with respect to an account established directly with, or an instrument acquired directly from, the payor by electronic transmission or by mail. See §31.3406(d)-4 for the rules applicable to readily tradable instruments acquired through a broker.

(4) *Special rule with respect to the acquisition of a readily tradable instrument in a transaction between certain parties acting without the assistance of a broker.* If a payee, at any time, acquires a readily tradable instrument without the assistance of a broker, and no party to the acquisition is a broker or an agent of the payor, the payee must furnish the payee's taxpayer identification number to the payor prior to the time reportable payments are made on the instrument. The payee is not required to certify under penalties of perjury that the number is correct. See §31.3406(d)-2 for the rule that a payee is not subject to withholding due to notified payee underreporting with respect to a readily tradable instrument acquired in the manner described in this paragraph (b)(4). A broker is considered to provide assistance in the acquisition of an instrument if the person effecting the acquisition would be required to make an information return under section 6045 if such person were to sell the instrument. See §31.3406(d)-4 for rules relating to an acquisition of a readily tradable instrument when a broker is involved.

(c) *Brokerage account—(1) Manner required for furnishing a taxpayer identification number with respect to a brokerage relationship that is not a post-1983 brokerage account—(i) In general.* With respect to any instrument, investment, or deposit made through a brokerage account that is not a post-1983 brokerage account, a payee must furnish the payee's taxpayer identification number to the broker either orally or in writing. The payee is

not required to certify under penalties of perjury that the taxpayer identification number is correct. See paragraph (b)(2)(i) of this section for the rule that any instrument, whenever acquired, that is held in a brokerage account that is not a post-1983 brokerage account, is considered held in an account that is not a post-1983 brokerage account. For example, in 1983 a payee established and acquired a readily tradable instrument from a brokerage account; no activity took place through that account until the payee purchased a readily tradable instrument in 1995. That readily tradable instrument is not held in a post-1983 brokerage account; therefore, the payee need not certify under penalties of perjury that the payee's taxpayer identification number is correct.

(ii) *Definition of a brokerage account that is not a post-1983 brokerage account.* A brokerage account that was established by a payee before January 1, 1984, through which during 1983 the broker either bought or sold securities for the payee or held securities on behalf of the payee as a nominee (*i.e.*, in street name), is an account that is not a post-1983 brokerage account.

(2) *Manner required for furnishing a taxpayer identification number with respect to a post-1983 brokerage account—(i) In general.* With respect to a post-1983 brokerage account, the payee must furnish the payee's taxpayer identification number to the broker and certify under penalties of perjury that the taxpayer identification number furnished is correct, except as provided in §31.3406(d)-3(b).

(ii) *Definition of a post-1983 brokerage account.* A brokerage account established after December 31, 1983 (or before January 1, 1984, through which during 1983 the broker neither bought nor sold securities nor held securities on behalf of the payee as a nominee (*i.e.*, in street name)), is a post-1983 brokerage account.

(d) *Rents, commissions, nonemployee compensation, and certain fishing boat operators, etc.—Manner required for furnishing a taxpayer identification number.* For accounts, contracts, or relationships subject to information reporting under section 6041 (relating to information reporting at source on rents, royalties, salaries, etc.), section 6041A(a) (relating to information reporting of payments for nonemployee

services), section 6050A (relating to information reporting by certain fishing boat operators), or section 6050N (relating to information reporting of payments of royalties), the payee must furnish the payee's taxpayer identification number to the payor either orally or in writing. Except as provided in §31.3406(d)-5, the payee is not required to certify under penalties of perjury that the taxpayer identification number is correct regardless of when the account, contract, or relationship is established.

§31.3406(d)-2 Payee certification failure.

(a) *Requirement to backup withhold.* Withholding under section 3406(a)-(1)(D) applies to a reportable interest or dividend payment (as defined in section 3406(b)(2)) if, and only if, the payee fails to certify to the payor, under penalties of perjury, that the payee is not subject to withholding due to notified payee underreporting under section 3406(a)(1)(C). The period for which withholding applies is described in §31.3406(e)-1(e). See §31.3406(d)-3(a) for special rules when an account is established directly with, or an instrument is acquired directly from, the payor by electronic transmission or by mail. See §31.3406(c)-1(c)(3)(iv) for rules with respect to a payor's reliance on a payee certification for a new account following notified payee underreporting. See §31.3406(d)-4 for special rules relating to the acquisition of a readily tradable instrument through a broker. The certificate on which the certification should be made is described in §31.3406(h)-3.

(b) *Exceptions.* Withholding under section 3406(a)(1)(D) and paragraph (a) of this section does not apply to reportable interest or dividend payments (as defined in section 3406(b)(2)) made—

(1) With respect to a pre-1984 account (as defined in §31.3406(d)-1(b)(1));

(2) In a window transaction (as defined in §31.3406(b)(2)-3(b));

(3) With respect to a readily tradable instrument described in §31.3406(d)-1(b)(2)(iv) or §31.3406(d)-4(a)(3); or

(4) During the period and with respect to an account or readily tradable instrument described in §31.3406(d)-3.

§31.3406(d)-3 Special 30-day rules for certain reportable payments.

(a) *Accounts or readily tradable instruments acquired directly from the payor (including a broker who holds an instrument in street name) by electronic transmission or by mail.* In the case of an account established directly with, or a readily tradable instrument acquired directly from, the payor by means of electronic transmission (*i.e.*, telephone or wire instruction) or by mail, the payor may permit the payee to furnish the certifications required in §31.3406(d)-1(b)(3) (relating to certification that the payee's taxpayer identification number is correct) and §31.3406(d)-2 (relating to certification of notified payee underreporting) within 30 days after the establishment or acquisition without subjecting the account to withholding during the 30 days. The preceding sentence applies only if the payee furnishes a taxpayer identification number to the payor at the time of the establishment or acquisition, and the payee does not withdraw more than 69 percent of a reportable interest or dividend payment before the certifications are received within the 30 days. If the payee does not provide the required certifications within 30 days of the establishment or acquisition, the payor must withhold 31 percent of any reportable interest or dividend payments made to the account after its acquisition. For purposes of this section, an account or instrument is considered acquired directly from the payor if the instrument was acquired by the payee without the assistance of a broker or the instrument was acquired directly from a broker who holds the instrument as nominee for the payee (*i.e.*, in street name) and who is considered a payor under §31.3406(a)-2.

(b) *Sale of an instrument for a customer by electronic transmission or by mail.* The special 30-day rules set forth in paragraph (a) of this section apply comparably with respect to certification of the taxpayer identification number for the sale of an instrument under section 6045 (as described in §31.3406(b)(3)-2) through a post-1983 brokerage account (as described in §31.3406(d)-1(c)(2)) for a customer by electronic transmission or by mail. However, these rules apply only if the payee furnishes the payee's taxpayer identification number before the sale occurs. For purposes of applying those 30-day rules under this paragraph (b), a

payee's reinvestment of the gross proceeds of the sale into other instruments constitutes a withdrawal.

(c) *Application to foreign payees.* The rules of paragraphs (a) and (b) of this section also apply to a payee from whom the payor is required to obtain a Form W-8 or a substitute of the form or is to obtain other evidence of foreign status (pursuant to the relevant regulations issued under sections 6049 and 6045), provided the payee represents orally or otherwise, before or at the time of the acquisition or sale of the instrument or the establishment of the account, that the payee is not a United States citizen or resident.

§31.3406(d)-4 Special rules for readily tradable instruments acquired through a broker.

(a) *Readily tradable instruments acquired through post-1983 brokerage accounts with a broker who is not a payor—*(1) *In general.* If a readily tradable instrument is acquired through a post-1983 brokerage account (as defined in §31.3406(d)-1(c)(2)) and the broker is not the payor of the instrument (as defined in §31.3406(a)-2(b)(3)), the broker must—

(i) Obtain once with respect to each account the certifications described in §31.3406(d)-2(a) and §31.3406(d)-1(b)(3) and (c)(2) from the payee (relating to certification regarding payee underreporting and taxpayer identification number, respectively);

(ii) Furnish the payee's taxpayer identification number to the payor; and

(iii) Notify the payor to impose withholding if the payee fails to make either of the required certifications to the broker or if the broker has been notified by the Internal Revenue Service before the acquisition of the instrument that the payee is subject to withholding due to notified payee underreporting under section 3406(a)-(1)(C) or that the payee is subject to withholding because the payee's taxpayer identification number is incorrect under section 3406(a)(1)(B) (as described in §31.3406(d)-5).

(2) *Additional requirements.* The broker must give the information required by paragraphs (a)(1)(ii) and (iii) of this section to the payor with the transfer instructions for the acquisition (including account registration instructions transmitted by a broker in the case of acquisitions of shares in a

mutual fund). A notice including the information described in paragraph (b)(1) of this section fulfills the broker's requirement to give notice to the payor. Once the broker transmits the transfer instructions containing the information required by this section, the broker has no further responsibility to obtain a missing taxpayer identification number or missing certification or to provide additional notices to the payee or payor with respect to the acquisition of the instrument. Upon receiving the notice from a broker, the payor must impose withholding on the account pursuant to §31.3406(a)-1.

(3) *Transactions entered into through a brokerage account that is not a post-1983 brokerage account.* If a broker acquires readily tradable instruments for a payee through an account (with the broker) that is not a post-1983 brokerage account (as defined in §31.3406(d)-1(c)(1)), and the broker is not the payor of the instruments, the broker must furnish the payee's taxpayer identification number to the payor. In addition, if the broker has been notified by the Internal Revenue Service that the payee is subject to withholding under section 3406 either because of an incorrect taxpayer identification number or due to notified payee underreporting as described in sections 3406(a)(1)(B) or (C), respectively, the broker must notify the payor of the instrument to impose withholding with respect to that payee and transmit the information in the manner described in this paragraph (a). After a payor receives a notice from a broker pursuant to section 3406(d)(2)(B) and this paragraph (a), the payor must impose withholding on any accounts of the payee paying reportable interest or dividends as defined in section 3406(b)(2) in accordance with §31.3406(a)-1.

(4) *Payor must notify payee—*(i) *Failure to provide certifications.* If a payor is notified by a broker, as required in paragraph (a)(1) of this section, that a payee is subject to withholding because the payee failed to provide the certifications, as described in §31.3406(d)-2(a) and §31.3406(d)-1(b)(3) and (c)(2), and the payor has not received the certifications from the payee, then the payor must notify the payee that withholding has started (or will start) no later than 15 days after the payor makes the first payment to the payee that is subject to withholding under section 3406. A notice that

contains the information described in paragraph (b)(2) of this section satisfies the payor's requirement to give notice to the payee. If the broker notifies the payor that the payee failed to make a required certification and the payor has received the certification from the payee, the payor may disregard the notice from the broker.

(ii) *Notified payee underreporting and incorrect taxpayer identification number.* The payor must notify the payee under this section if the Internal Revenue Service or a broker notifies the payor to withhold either because of an incorrect taxpayer identification number under section 3406(a)(1)(B) (as described in §31.3406(d)-5) or due to notified payee underreporting under section 3406(a)(1)(C) (as described in §31.3406(c)-1). If a payor is notified by the Internal Revenue Service or a broker with respect to a readily tradable instrument, the payor may not ignore the notice even if the payee previously provided the payee's taxpayer identification number under penalties of perjury to the payor and even if the payee certified to the payor that the payee is not subject to backup withholding due to a notified payee underreporting. See §31.3406(d)-5(c)(1) and (2) and (f)(2) for notice requirements under section 3406(a)(1)(B) due to an incorrect taxpayer identification number. See §31.3406(c)-1(c)(2) for notice requirements under section 3406(a)(1)(C) due to notified payee underreporting.

(b) *Notices*—(1) *Form of notice by broker to payor.* A broker who is required under paragraphs (a)(1)(iii) and (2) of this section to notify the payor with respect to a readily tradable instrument may notify the payor in connection with the transfer instructions by means of magnetic media, machine readable document, or any other medium, provided that the notice includes the following information—

(i) The payee's name, address, and taxpayer identification number (if provided to the broker); and

(ii) A statement that the payee is subject to withholding under section 3406(a)(1)(A), (B), (C), or (D) of the Internal Revenue Code, whichever section applies; and

(iii) When applicable, a statement that the broker was notified by the Internal Revenue Service that the payee is subject to withholding under sections 3406(a)(1)(B) or (C).

(2) *Form of notice by payor to payee.* A payor who is required to notify a payee that the payee is subject to withholding must provide notice that is substantially similar to the following—

(i) For a notification concerning a failure to provide a taxpayer identification number in the required manner under section 3406(a)(1)(A) or a failure to make the following certification described in section 3406(a)(1)(D):

Recently, you purchased (identify security acquired). Because of the existence of one or more of the following conditions, payments of interest, dividends, and other reportable amounts that are made to you will be subject to withholding of tax at a 31 percent rate: (specify the condition or conditions, described below, that are applicable)

(1) You failed to provide a taxpayer identification number, or failed to provide this number under penalties of perjury, in connection with the purchase of the acquired security. (An individual's taxpayer identification number is his or her social security number.)

(2) You failed to certify, under penalties of perjury, that you are not subject to withholding due to notified payee underreporting as required under section 3406(a)(1)(D) of the Internal Revenue Code.

If condition (1) applies, you may stop withholding by providing your taxpayer identification number on the enclosed Form W-9, signing the form, and returning it to us. If you do not have a taxpayer identification number, but have applied (or will soon apply) for one, you may so indicate on the Form W-9. Withholding may apply during the 60-day period you are waiting for your taxpayer identification number. You must provide us with your taxpayer identification number promptly after you receive it in order to avoid withholding after the end of the 60-day period or to stop withholding if it has already begun. Certain persons, described on the enclosed Form W-9, are exempt from withholding. Follow the instructions on that form if applicable to you.

If condition (2) applies, you may stop withholding by certifying on the enclosed Form W-9 that you are not subject to withholding due to notified payee underreporting, signing the form, and returning it to us.

If more than one condition applies, you must remove all applicable conditions to stop withholding.

Please address any questions concerning this notice to: [Insert payor identifying information].

(Do not address questions to the broker who purchased the securities for you.)

(ii) For the form of the notice concerning imposition of withholding due to an incorrect taxpayer identification number, see §31.3406(d)-5(d)(2) and (g)(2).

(iii) For the form of the notice concerning the imposition of withhold-

ing due to notified payee underreporting, see §31.3406(c)-1(d)(2).

(c) *Payor's reliance on information from broker*—(1) *In general.* A payor of an instrument acquired by a payee through a broker may rely on the information that the payor receives from the broker pursuant to paragraphs (a) and (b) of this section.

(2) *Amount subject to backup withholding.* The payor is required to withhold under section 3406 depending on the payor's customary method of making payment on an instrument or instruments owned by a payee. If it is the practice of a payor to combine in one account all readily tradable instruments of the same issue owned by a payee and if only certain of those instruments are subject to withholding, the payor must withhold on the aggregate payment made with respect to all the instruments in the account. Otherwise, the payor must withhold on the payment made on the instrument or instruments with respect to which the payee is subject to withholding.

§31.3406(e)-1 Period during which backup withholding is required.

(a) *In general.* A payor must withhold under section 3406 at a rate of 31 percent on any reportable payment (as defined in section 3406(b)) made to a payee during the period described in this section (irrespective of the number of conditions for imposing withholding under section 3406 that exist with respect to the payee). A payor must continue to withhold under section 3406 until no condition for imposing backup withholding exists with respect to the payee.

(b) *Failure to furnish a taxpayer identification number in the manner required*—(1) *Start withholding.* A payor is required to withhold under section 3406(a)(1)(A) at a rate of 31 percent on any reportable payment (as defined in section 3406(b)) at the time the payor pays the reportable payment (as described in §31.3406(a)-4) to a payee if—

(i) The payor has not received the payee's taxpayer identification number in the manner required in §31.3406(d)-1; or

(ii) The payor has received notice from a broker (as required in §31.3406(d)-4(a)(1)(iii)) with respect to a readily tradable instrument that the payee did not furnish a taxpayer identification

number to the broker in the manner required in §31.3406(d)-1 and the payor has not received the taxpayer identification number from the payee in this manner.

(2) *Stop withholding.* The payor must stop withholding under section 3406(a)(1)(A) within 30 days after the payor receives—

(i) The payee's taxpayer identification number in the manner required under §31.3406(d)-1; or

(ii) A statement, in such form and containing such information as is required under applicable regulations, that the payee is not a United States person.

(c) *Notification of an incorrect taxpayer identification number.* See §31.3406(d)-5(e) and (g)(3) for the period for which withholding is required in the case of notification of an incorrect taxpayer identification number.

(d) *Notified payee underreporting.* See §31.3406(c)-1(e) for the period for which withholding is required in the case of notified payee underreporting.

(e) *Payee certification failure—(1) Start withholding.* A payor is required to withhold under section 3406(a)-(1)(D) at a rate of 31 percent on any reportable interest or dividend payment (as defined in section 3406(b)(2)) at the time the payor pays such reportable interest or dividend payment (as described in §31.3406(a)-4) to a payee if—

(i) The payor has not received from the payee the certification required in §31.3406(d)-2; or

(ii) The payor has received notice from a broker (as required in §31.3406(d)-4(a)(1)(iii)) with respect to a readily tradable instrument that the payee did not make the required certification and the payor has not received the required certification from the payee.

(2) *Stop withholding.* The payor must stop withholding under section 3406(a)(1)(D) on any reportable interest or dividend payment within 30 days after the payor receives the certification from the payee in the manner required by §31.3406(d)-2.

(f) *Rule for determining when the payor receives a taxpayer identification number or certificate from a payee.* In determining whether a payee has failed to provide a taxpayer identification number or any certification to a payor (including a Form W-8 or substitute

form), a payor is required to process the taxpayer identification number or certification within 30 days after the payor receives the taxpayer identification number or certification from the payee or in certain cases, from a broker. Thus, the payor may take up to 30 days to treat the taxpayer identification number or a certificate as having been received.

§31.3406(f)-1 Confidentiality of information.

(a) *Confidentiality and liability for violation.* Pursuant to section 3406(f) no person may use any information obtained under section 3406 for any purpose except for the purpose of complying with the requirements of section 3406 or for purposes permitted under section 6103 (subject to the safeguards of section 6103). See section 7431 for civil damages for violating the confidential use of the information (subject to an exception for good faith).

(b) *Permissible use of information—*

(1) *In general.* A payor or broker may transmit information on a Form W-9, Form W-8, or other acceptable form relating to withholding to the department, institution, or firm (or to any employee therein) responsible for withholding or processing of taxpayer identification numbers, certifications described in §31.3406(h)-3, or other substitute forms. In addition, a broker may notify the payor with respect to a readily tradable instrument of the requirement to withhold and the condition or conditions for imposing withholding (as described in §31.3406(d)-4) that exist with respect to the payee. A payor or broker may, without violating the Internal Revenue Code, close an account of, refuse to open an account for, issue an instrument to, or redeem an instrument for, a person solely because the person fails to furnish the person's taxpayer identification number or documentation of foreign status in the manner required in §31.3406(d)-1 and §31.3406(g)-1, respectively. A payor who closes an account of a payee in the calendar year in which the account was opened and during which no taxpayer identification number or evidence of foreign status was provided for that account will be presumed in the absence of evidence to the contrary to have closed the account without violating section 3406(f) even though the payee is subject to backup

withholding under section 3406(a)-(1)(A). A payor, except as provided in §§31.3406(d)-3 and 31.3406(g)-3, may not prohibit a payee who fails to furnish the payee's taxpayer identification number in the manner required in §31.3406(d)-1 from withdrawing any funds in the account.

(2) *Window transactions.* In the case of a window transaction (as defined in §31.3406(b)(2)-3(b)), a payor may, without violating the Internal Revenue Code, refuse to redeem or may refuse to make payment if the payee fails to provide a taxpayer identification number regardless of when the obligation was issued or acquired.

(c) *Specific restrictions on the use of information.* Except as provided in paragraph (b) of this section, a payor or broker is not permitted to—

(1) Close an account (or instrument) of a payee solely because that payee (or the account of a payee) is subject to withholding under section 3406(a)(1)-(A), (B), (C), or (D);

(2) Refuse to open an account or to issue an instrument if the person fails to certify, under penalties of perjury, that the person is not subject to withholding under section 3406(a)-(1)(C) (relating to notified payee underreporting);

(3) Use information obtained under section 3406 (including a payee's failure or inability to certify that the payee is not subject to withholding due to notified payee underreporting or the fact that the account is subject to withholding), surcharge an account (*i.e.*, charge an account more than the fee charged a similar account that was not subject to withholding under section 3406), or use that information to determine whether to open or close an account, whether to issue or redeem an instrument, or whether to extend credit to the payee.

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

(a) *Exempt recipients—(1) In general.* A payor of any reportable payment (as defined in section 3406(b)) must not withhold under section 3406 if the payee is—

(i) An organization exempt from taxation under section 501(a) or an individual retirement account;

(ii) The United States or any wholly owned agency or instrumentality thereof;

(iii) A state, the District of Columbia, a possession of the United States, any political subdivision of any of the foregoing, or any wholly owned agency or instrumentality of any one or more of the foregoing;

(iv) A foreign government, a political subdivision of a foreign government, or any wholly owned agency or instrumentality of any one or more of the foregoing (as defined in regulations under section 892); or

(v) An international organization or any wholly owned agency or instrumentality thereof (as defined in section 7701(a)(18)).

(2) *Nonexclusive list.* Paragraph (a)(1) of this section does not prescribe an exclusive list of payees that are exempt from information reporting and also are exempt from withholding under section 3406.

(b) *Determination of whether a person is described in paragraph (a)(1) of this section.* The determination of whether a person is a payee described in paragraph (a)(1) of this section must be made as provided in the applicable provisions of section 6049 and the regulations issued thereunder. A payor, even if permitted to treat a person as an exempt recipient without requiring a certificate under the provisions of section 6049, may require a payee, otherwise not required to file a certificate regarding its exempt status, to file a certificate and may treat a payee who fails to file the certificate as a person who is not an exempt recipient. See §31.3406(h)-3 for a description of the Form W-9 or a substitute form prescribed under section 3406 for claiming exempt status.

(c) *Prepaid or advance premium life-insurance contracts.* A payor of a reportable payment (as defined in section 3406(b)(1)) may, but is not required to, withhold under section 3406 on reportable payments made from January 1, 1984, to December 31, 1996, on prepaid or advance premium life-insurance contracts to a payee who is the owner for tax purposes of the prepaid or advance premium life-insurance contract. For purposes of this exception from backup withholding, a prepaid or advance premium life-insurance contract is one entered into on or before June 30, 1984, by the payee and under which the increment in value of the prepaid or advance premium is used for the payment of premiums during the period in which

the exception from backup withholding applies.

§31.3406(g)-2 Exception for reportable payments for which withholding is otherwise required.

(a) *In general.* A payor of a reportable payment (as defined in section 3406(b)) must not withhold under section 3406 if the payment is subject to withholding under any other provision of the Internal Revenue Code.

(b) *Payment of wages.* A payor who is required to make an information return under section 6041 with respect to a payment of wages (as defined in section 3401) because, e.g., the employee makes a certification under section 3402(n) (relating to employees incurring no income tax liability), must not withhold under section 3406 on those wages.

(c) *Distribution from a pension, annuity, or other plan of deferred compensation.* An amount reportable under section 6047, such as a designated distribution under section 3405, is not a reportable payment subject to withholding under section 3406. See section 3406(b). Designated distributions not subject to withholding under section 3406 include—

(1) Distributions from a pension, annuity, profit-sharing, stock bonus plan, or other plan deferring the receipt of compensation;

(2) Distributions from an individual retirement account or annuity;

(3) Distributions from an owner-employee plan; and

(4) Certain surrenders of life insurance contracts.

(d) *Gambling winnings—(1) In general.* A payor of a reportable gambling winning must not withhold under section 3406 if tax is required to be withheld from the gambling winning under section 3402(q) (relating to the extension of withholding to certain gambling winnings). If the reportable gambling winning is not required to be withheld upon under section 3402(q), withholding under section 3406 applies to the gambling winning if, and only if, the payee does not furnish a taxpayer identification number to the payor. Section 31.3406(b)(3)-1(b)(3) does not apply to a reportable gambling winning. The payor of a reportable gambling winning is not required to aggregate all such winnings made to a payee

during a calendar year, nor is the payor required to determine whether an information return was required to be made with respect to the payee for the preceding year.

(2) *Definition of a reportable gambling winning and determination of amount subject to backup withholding.* For purposes of withholding under section 3406, a reportable gambling winning is any gambling winning subject to information reporting under section 6041. The amount of a reportable gambling winning is—

(i) The amount paid with respect to the amount of the wager reduced, at the option of the payor; by

(ii) The amount of the wager.

(3) *Special rules.* Amounts paid with respect to identical wagers are treated as paid with respect to a single wager. The determination of whether wagers are identical is made under §31.3402-(q)-1(c)(1)(ii). In addition, a gambling winning (other than a winning from bingo, keno, or slot machines) is a reportable gambling winning only if the amount paid with respect to the wager is \$600 or more and if the proceeds are at least 300 times as large as the amount wagered. See §7.6041-1 of this chapter to determine whether a winning from bingo, keno, or slot machines is a reportable gambling winning and thus subject to withholding under section 3406.

(e) *Certain real estate transactions.* A real estate reporting person (the so-called broker) as defined in section 6045(e)(2) must not withhold under section 3406 on a payment made with respect to a real estate transaction that is subject to reporting under sections 6045(a) and (e) and §1.6045-4 of this chapter.

(f) *Certain payments after an acquisition of accounts or instruments.* A payor who acquires pre-1984 accounts or instruments described in §31.3406-(d)-1(b)(2)(iv) for which the payor does not have a taxpayer identification number or has an obviously incorrect taxpayer identification number as defined in §31.3406(h)-1(b)(2) must start withholding under section 3406(a)(1)-(A) and §31.3406(d)-1 on those accounts or instruments no later than sixty days following the date of the payor's acquisition of those accounts or instruments.

(g) *Certain gross proceeds.* No withholding under section 3406 is required with respect to any portion of the

original issue discount on an instrument or security that is subject to withholding under section 3406 as reportable gross proceeds of such instrument or security under section 6045.

§31.3406(g)-3 Exemption while payee is waiting for a taxpayer identification number.

(a) *In general*—(1) *Backup withholding not required for 60 days.* If a payor has received an awaiting-TIN certificate from a payee with respect to an account or instrument receiving reportable interest or dividends as described in section 3406(b)(2), the payor must exempt the payee from withholding under section 3406(a)-(1)(A) during the 60-day exemption period to the extent and in the manner described in either paragraph (a)(2) or (3) of this section. The 60-day exemption period means the 60-consecutive-day period beginning with the day the payor receives the awaiting-TIN certificate. The payor must withhold under section 3406 beginning after the 60-day exemption period if the payor has not received a taxpayer identification number from the payee in the manner required in §31.3406(d)-1. Regardless of whether the payee provides an awaiting-TIN certificate to a payor, the payor is required to withhold under section 3406(a)(1)(D) and §31.3406(d)-2 on reportable interest or dividend payments as described in §31.3406(d)-2 if the payee fails to certify, under penalties of perjury, that the payee is not subject to withholding due to notified payee underreporting as required in section 3406(a)(1)(D) and §31.3406(d)-2.

(2) *Reserve method.* A payor must not withhold under section 3406 during the 60-day exemption period unless the payee (or a joint payee in the case of a joint account) desires to make a withdrawal of more than \$500 of either principal or interest from the account in any single transaction during the period. If a payee (or a joint payee) desires to make a withdrawal of more than \$500 during the 60-day exemption period, the payor is required under section 3406 to withhold 31 percent of all reportable payments made during the period and at the time of withdrawal unless the payee reserves 31 percent of all reportable payments made to the account during the period.

(3) *Alternative rule; 7-day grace period*—(i) *In general.* A payor who

receives an awaiting-TIN certificate may elect, on a payee-by-payee basis or in general, to exempt reportable interest or dividend payments to a payee from withholding under section 3406 applying the rules in paragraph (a)(3)(ii) or (iii) of this section.

(ii) *Withholding on withdrawals.* Under this paragraph (a)(3)(ii), a payor must obtain a certified taxpayer identification number from the payee within 60 days after the date that the payor receives the awaiting-TIN certification. In addition, the payor must withhold under section 3406 on any withdrawals made after the close of 7 business days after the date the awaiting-TIN certification is received and before the earlier of the date that the payor receives a certified taxpayer identification number from the payee, the date the account is closed (in which case the payor must withhold on any reportable payment made at the time the account or relationship is closed), or the date withholding under section 3406 starts on all reportable payments made to the account, instrument, or relationship. All cash withdrawals in an amount up to the reportable payments made from the day after the date of receipt of the awaiting-TIN certification to the date of withdrawal are treated as reportable payments.

(iii) *Withholding regardless of withdrawals.* Under this paragraph (a)(3)-(iii), a payor must start withholding under section 3406 on the account not later than 7 business days after the date the payor receives the awaiting-TIN certification on reportable payments thereafter made to the account (whether or not the payee makes a cash withdrawal). The payor must withhold under section 3406 until the earlier of the date the payor receives a certified taxpayer identification number from the payee, the date the account is closed, or the date withholding under section 3406 starts on all reportable payments made to the account, instrument, or relationship. The payor must obtain a certified taxpayer identification number from the payee within 60 days after the date that the payor receives the awaiting-TIN certificate or undertake a mailing each year soliciting the certified taxpayer identification number from the payee until the earlier of the calendar year that the certified taxpayer identification number is received, or the calendar year in which the account is closed. However, if the account is closed in December of a calendar year,

the mailing must be made after the account is closed and before January 31 of the subsequent calendar year.

(b) *Special rule for readily tradable instruments.* The 60-day awaiting-TIN exemption described in paragraph (a)(1) of this section applies to payments made with respect to readily tradable instruments only if the payee provides an awaiting-TIN certificate directly to the payor. If a broker acquires a readily tradable instrument through a post-1983 brokerage account (as described in §31.3406(d)-1(c)(2)) for a payee who has no taxpayer identification number, the broker must advise the payor as required in §31.3406(d)-4(a)(1) that the payee failed to provide a taxpayer identification number under penalties of perjury, regardless of whether the payee provides an awaiting-TIN certificate to the broker. Once a payor is notified by a broker that a payee failed to provide a taxpayer identification number in the required manner, or that the payee is subject to withholding under section 3406(a)(1)(B) or (C), the payor must impose withholding under section 3406 for the appropriate period described in §31.3406(e)-1.

(c) *Exceptions*—(1) *In general.* The 60-day awaiting-TIN exemption described in paragraph (a) of this section does not apply to—

(i) Window transactions (as defined in §31.3406(b)(2)-3(b));

(ii) Redemptions of bearer obligations that are subject to reporting under section 6045; or

(iii) Other amounts that are subject to reporting under section 6045 (except as described in paragraph (c)(2) of this section).

(2) *Special rule for amounts subject to reporting under section 6045 other than proceeds of redemptions of bearer obligations.* If a broker's customer does not provide a taxpayer identification number to the broker, and the broker effects a sale that is subject to reporting under section 6045 (other than a redemption of a bearer obligation), §31.3406(d)-3(b) applies, whether or not the sale is pursuant to an instruction by electronic transmission, provided the customer furnishes an awaiting-TIN certificate to the broker before the sale. For purposes of this paragraph (c)(2), the 30-day period provided in §31.3406(d)-3(b) is a 60-day period.

(d) *Awaiting-TIN certificate.* A payee qualifies for the 60-day awaiting-

TIN exemption provided in paragraph (a) of this section if the payee furnishes a written statement to the payor, signed under penalties of perjury, that the payee has not been issued a taxpayer identification number, that the payee has applied for a taxpayer identification number or intends to apply for a number in the near future, and that the payee understands that if the payee does not provide a number to the payor within 60 days, the payor is required under section 3406 to withhold 31 percent of any reportable payment thereafter made to the payee until the payor receives a number, and 31 percent of a withdrawal to the extent of reportable payments made to the payee during the 60-day period, as described in paragraph (a) of this section. Language that is substantially similar to the awaiting-TIN certification on Form W-9 will satisfy the requirements of this paragraph (d).

(e) *Form for awaiting-TIN certificate.* A payor may use Form W-9 for the awaiting-TIN certificate, or a payor may include language that is substantially similar to the awaiting-TIN certification on Form W-9 in any other document of the payor. See §31.3406(h)-3, which provides that Form W-9 is the prescribed form but permits use of substitute forms, and specifies the length of time the payor is required to retain the form. If Form W-9 is used, the payee should write “Applied For” in the space reserved for the taxpayer identification number.

§31.3406(h)-1 Definitions.

(a) *In general.* For purposes of section 3406 and the regulations thereunder, the definitions of this section apply.

(b) *Taxpayer identification number—(1) In general.* *Taxpayer identification number* means the identifying number assigned to a person under section 6109 (relating to identifying numbers, generally a nine-digit social security number for an individual and a nine-digit employer identification number for a nonindividual, e.g., a corporation, partnership, trust, or estate). An obviously incorrect number is not considered a taxpayer identification number. See §31.6011(b)-2 and §301.6109-1 of this chapter for provisions relating to obtaining a taxpayer identification number.

(2) *Obviously incorrect number.* *Obviously incorrect number* means a

number that does not contain nine digits or a number that includes an alpha character as one of the nine digits.

(c) *Broker.* *Broker* is defined in section 6045(c)(1) and §1.6045-1(a)(1) of this chapter. If there could be more than one broker with respect to any acquisition, only the broker having the closest contact (as determined under §5f.6045-1(c)(3)(ii) and (iii) of this chapter) with the payee is treated as a broker. In the case of any instrument, the term *broker* does not include any person who is the payor with respect to the instrument as described in §31.3406(a)-2.

(d) *Readily tradable instrument.* *Readily tradable instrument* means—

(1) Any instrument that is part of an issue any portion of which is traded on an established securities market (within the meaning of section 453(f)(5)); or

(2) Any instrument that is regularly quoted by brokers or dealers making a market.

(e) *Day.* *Day* means a calendar day unless specified otherwise under any section of the regulations under section 3406. For example, see §§31.3406(d)-5(a) and 31.3406(g)-3(a)(2).

(f) *Business day.* *Business day* means any day other than a Saturday, Sunday, or legal holiday (within the meaning of section 7503).

§31.3406(h)-2 Special rules.

(a) *Joint accounts—(1) Relevant name and taxpayer identification number combination.* For purposes of identifying the account subject to withholding under sections 3406(a)(1)(B) and (C), the relevant name and taxpayer identification number combination is that which is used for information reporting purposes.

(2) *Optional rule for accounts subject to backup withholding under section 3406(a)(1)(B) or (C) where the names are switched.* See §31.3406(d)-5(c)(4)(iii) under which a payor may withhold under section 3406(a)(1)(B) as required even though the names or taxpayer identification numbers on the account have been switched. The rules under §31.3406(d)-5(c)(4)(iii) may be applied comparably by a payor who is required to withhold under section 3406(a)(1)(C).

(3) *Joint foreign payees—(i) In general.* If the first payee listed on an

account or instrument provides the penalties of perjury statement regarding its foreign status, withholding under section 3406 applies unless—

(A) Every joint payee provides the statement regarding foreign status (pursuant to the relevant regulations issued under sections 6045 and 6049); or

(B) Any one of the joint payees who has not established foreign status provides a taxpayer identification number to the payor in the manner required in §31.3406(d)-1.

(ii) *Information reporting on an account including foreign payees.* If any one of the joint payees who has not established foreign status provides a taxpayer identification number under paragraph (a)(3)(i)(B) of this section, that number is the taxpayer identification number that is required to be furnished for purposes of information reporting and withholding under section 3406.

(b) *Backup withholding from an alternative source—(1) In general.* A payor may not withhold under section 3406 from a source maintained by the payor other than the source with respect to which there exists a liability to withhold under section 3406 with respect to the payee. See section 3403 and §31.3403-1, which provide that the payor is liable for the amount required to be withheld regardless of whether the payor withholds.

(2) *Exceptions for payments made in property—(i) Backup withholding from alternative source.* In the case of a payment that is made in property (other than money), the payor must withhold under section 3406 31 percent of the fair market value of the property determined immediately before or on the date of payment. The payor may withhold under section 3406 from the principal amount being deposited with the payor or from another source maintained by the payee with the payor. The source from which the tax is withheld under section 3406 must be payable to at least one of the persons listed on the account subject to withholding. If the account or source is not payable exclusively to the same person or persons listed on the account subject to withholding under section 3406, then the payor must obtain a written statement from all other persons to whom the account or source is payable authorizing the payor to withhold under section 3406 from the alternative account or source. A payor that elects to

withhold under section 3406 from an alternative source may determine the account or source from which the tax is to be withheld, or may allow the payee to designate the alternative source. A payee may not, however, require a payor to withhold under section 3406 from a specific alternative source. See §31.3402(q)-1(d), *Example 5*, for methods of withholding on prizes, awards, and gambling winnings paid in property other than cash.

(ii) *Deferral of withholding.* If the payor cannot locate, using reasonable care (following procedures substantially similar to those set forth in §31.3406(d)-5(c)(3)(ii)(A) and (B)), an alternative source of cash from which the payor may satisfy its withholding obligation pursuant to paragraph (b)(2)(i) of this section, the payor may defer its obligation to withhold under section 3406, except for reportable payments of property made in connection with prizes, awards, or gambling winnings, until the earlier of—

(A) The date the payor makes a cash payment to the account subject to withholding under section 3406 or cash is otherwise deposited in the account in a sufficient amount to satisfy the obligation in full; or

(B) The close of the fourth calendar year after the obligation arose.

(iii) *Barter exchanges.* In the case of a barter exchange that issues scrip to, or credits the account of, a member or client of the exchange in payment for property or services, the barter exchange may withhold under section 3406 from—

(A) The scrip or credit, if converted to cash in order to satisfy the deposit requirements of section 6302 and §31.6302-4; or

(B) Any other source maintained by the exchange for the member or client in the manner described in paragraph (b)(2) of this section.

(c) *Trusts.* Withholding under section 3406 applies to reportable payments made to a trust if any of the conditions for imposing withholding under section 3406 apply to the trust. Generally, a trust is not a payor and will not be required to withhold under section 3406 on reportable payments that it makes to its beneficiary who is subject to withholding under section 3406. The preceding sentence does not apply, however, to a grantor trust with two or more grantors described in §31.3406(a)-2(b)(4), which is treated

as a middleman payor. The trustee of a trust described in this paragraph (c) may certify that the trust's taxpayer identification number is correct and that the trust is not subject to withholding due to notified payee underreporting, without regard to the status of the beneficiaries of the trust.

(d) *Adjustment of prior withholding by middlemen.* A middleman payor (as defined in §31.3406(a)-2(b)) who receives a payment from which tax has been erroneously withheld under section 3406 may seek a refund of the tax withheld by the payor from whom the middleman payor received the payment (referred to as the "upstream payor"). Alternatively, the middleman payor may obtain a refund of the tax by claiming a credit for the amount of tax withheld by the upstream payor against the deposit of any tax imposed by this chapter which the middleman payor is required to withhold and deposit (as described in section 6413 and §31.6413(a)-2). In either case, the middleman payor must pay or credit the gross amount of the payment (including the tax withheld) to its payee as though it had received the gross amount of the payment from the upstream payor and must withhold under section 3406 only if one of the conditions for imposing backup withholding exists with respect to its payee. If its payee is not subject to withholding under section 3406, the middleman payor must pay or credit the full amount of the payment to the payee. See §31.6413(a)-3 regarding repayment by a payor of tax erroneously collected from a payee.

(e) *Conversion of amounts paid in foreign currency into United States dollars—*(1) *Convertible foreign currency.* If a payment is made in a currency other than the United States dollar, the amount subject to withholding under section 3406 is determined by applying the statutory rate of backup withholding to the foreign currency payment and converting the amount withheld into United States dollars on the date of payment at the spot rate (as defined in §1.988-1(d)(1) of this chapter) or pursuant to a reasonable spot rate convention. For example, a withholding agent may use a month-end spot rate or a monthly average spot rate. A spot rate convention must be used consistently with respect to all non-dollar amounts withheld and from year to year. Such convention cannot be changed without the consent of the Commissioner.

(2) *Nonconvertible foreign currency.*
[Reserved]

(f) *Coordination with other sections.* For purposes of section 31, chapter 24 (other than section 3402(n)) of subtitle C of the Internal Revenue Code (relating to employment taxes and collection of income tax at source) and so much of subtitle F (other than section 7205) of the Internal Revenue Code (relating to procedure and administration) as relates to this chapter, and the regulations thereunder—

(1) An amount required to be withheld under section 3406 must be treated as a tax required to be withheld under section 3402;

(2) An amount withheld under section 3406 must be treated as an amount withheld under section 3402;

(3) An amount withheld under section 3406 must be deposited as required under §31.6302-4;

(4) *Wages* includes the gross amount of any reportable payment (as defined in section 3406(b)) except for purposes of section 6014 (relating to an election by the taxpayer not to compute the tax on his annual return);

(5) *Employee* includes a payee of any reportable payment; and

(6) *Employer* includes a payor who is required to withhold the tax under section 3406 (as defined in §31.3406(a)-2(a)) with respect to any reportable payment (as defined in section 3406(b)).

(g) *Tax liabilities and penalties.* A payor is subject to the same civil and criminal penalties for failing to impose withholding under section 3406 as an employer who fails to withhold on a payment of wages. In addition, a broker may be subject to the penalty under section 6705 (failure of a broker to provide notice to a payor).

(h) *To whom payor is liable for amount withheld.* A payor is not liable to any person for any amount withheld under section 3406. A payor is liable only to the United States for an amount that is required to be withheld as provided in §31.3403-1.

§31.3406(h)-3 *Certificates.*

(a) *Prescribed form to furnish information under penalties of perjury—*(1) *In general.* Except as provided in paragraph (c) of this section, the Form W-9 is the form prescribed under section 3406 on which the payee

certifies, under penalties of perjury, that—

(i) The taxpayer identification number furnished to the payor is correct (as required in §31.3406(d)-1 and §31.3406(d)-5);

(ii) The payee is not subject to withholding due to notified payee underreporting (as required in §31.3406(d)-2);

(iii) The payee is an exempt recipient (as described in §31.3406(g)-1); or

(iv) The payee is awaiting receipt of a taxpayer identification number (as described in §31.3406(g)-3).

(2) *Use of a single or multiple Forms W-9 for accounts of the same payee.* A valid Form W-9 must include the name and taxpayer identification number of the payee. Except as provided in paragraph (b) of this section, the payee must sign under penalties of perjury and date the Form W-9 in order to satisfy the requirements of this section. A payor or broker may require a payee to furnish a separate Form W-9 for each obligation, deposit, certificate, share, membership, contract, or other instrument, or one Form W-9 for all the payee's obligations or relationships with the payor or broker. In addition, a payee of a mutual fund that has a common investment advisor or common principal underwriter with other mutual funds (within the same family of funds) may be permitted, in the discretion of the mutual fund, to provide one Form W-9 with respect to shares acquired or owned in any of the funds.

(b) *Prescribed form to furnish a noncertified taxpayer identification number.* With respect to accounts or other relationships where the payee is not required to certify, under penalties of perjury, that the taxpayer identification number being furnished is correct, the payor or broker may obtain the taxpayer identification number orally or may use Form W-9, a substitute form, or any other document, but the payee is not required to sign the form.

(c) *Forms prepared by payors or brokers—(1) Substitute forms; in general.* A payor or broker may prepare and use a form that contains provisions that are substantially similar to those of the official Form W-9. A payor or broker may use any document relating to the transaction, such as the signature card for an account, so long as the certifications are clearly set forth. A payor or broker who uses a substitute

form may furnish orally or in writing the instructions for the Form W-9 that relate to the account. A payor or broker may refuse to accept certifications (including the official Form W-9) that are not made on the form or forms provided by the payor or broker. A payor or broker may refuse to accept a certification provided by a payee only if the payor or broker furnishes the payee with an acceptable form immediately upon receipt of an unacceptable form or within 5 business days of receipt of an unacceptable form. An acceptable form for this purpose must contain a notice that the payor or broker has refused to accept the form submitted by the payee and that the payee must submit the acceptable form provided by the payor in order for the payee not to be subject to withholding under section 3406. If the payor or broker requires the payee to furnish a form for each account of the payee, the payor or broker is not required to furnish an acceptable form until the payee furnishes the payor or broker with the payee's account numbers. A payor or broker may use separate substitute forms to have a payee certify under penalties of perjury that—

(i) The payee's taxpayer identification number is correct; and

(ii) The payee is not subject to withholding under section 3406 due to notified payee underreporting.

(2) *Form for exempt recipient.* A payor or broker may use a substitute form for the payee to certify, under penalties of perjury, that the payee is an exempt recipient (described in §31.3406(g)-1 or described in the respective reporting section), provided the form contains provisions that are substantially similar to those of the official Form W-9 relating to exempt recipients. A certificate must be prepared in accordance with the instructions applicable to exempt recipients on Form W-9, and must set forth fully and clearly the data called for therein. If a payor will treat the payee as an exempt recipient only if the payee files a certificate as to its exempt status, the certificate is valid only if it contains the payee's taxpayer identification number. Thus, a payee must include the payee's taxpayer identification number on a certificate that a payor requires to be made in order to treat the payee as an exempt recipient.

(d) *Special rule for brokers.* A broker may act as the payee's agent for

purposes of furnishing a taxpayer identification number or certification to a payor with respect to any readily tradable instrument (as defined in §31.3406(h)-1(d)) provided the payee provides a taxpayer identification number on Form W-9 or other acceptable substitute form to the broker. The payor may rely on a taxpayer identification number provided by the broker unless certification is required (as described in §31.3406(d)-4) and the broker notifies the payor that the number was not certified.

(e) *Reasonable reliance on certificate—(1) In general.* A payor is not liable for the tax imposed under section 3406 if the payor's failure to deduct and withhold the tax is due to reasonable reliance, as defined in paragraph (e)(2) of this section, on a Form W-9 (or other acceptable substitute) required by this section.

(2) *Circumstances establishing reasonable reliance.* For purposes of paragraph (e)(1) of this section, a payor can reasonably rely on a Form W-9 (or other acceptable substitute) unless—

(i) The form does not contain the name and taxpayer identification number of the payee (or does not state, in lieu of a taxpayer identification number, that the payee is awaiting receipt of a taxpayer identification number (*i.e.*, an awaiting-TIN certificate));

(ii) The form is not signed and dated by the payee;

(iii) The form does not contain the statement, when required, that the payee is not subject to withholding due to notified payee underreporting;

(iv) The payee has deleted the jurat or other similar provisions by which the payee certifies or affirms the correctness of the statements contained on the form; or

(v) For purposes of section 3406(a)(1)(C), the payor is required to subject the account to which the form relates to withholding under section 3406(a)(1)(C) under the circumstances described in §31.3406(c)-1(c)(3)(iii).

(f) *Who may sign certificate—(1) In general.* A Form W-9 or other acceptable substitute form may be signed by any person who is authorized to sign a declaration under penalties of perjury on behalf of the payee as provided in section 6061 and the regulations thereunder (relating to who may sign generally for an individual, which includes certain agents who may sign returns and other documents), section

6062 and the regulations thereunder (relating to who may sign corporate returns), and section 6063 and the regulations thereunder (relating to who may sign partnership returns).

(2) *Notified payee underreporting.* A payee who has not been notified that he is subject to withholding under section 3406(a)(1)(C) as a result of notified payee underreporting may make the certification related to notified payee underreporting. In addition, a payee who was subject to withholding under section 3406(a)(1)(C) due to notified payee underreporting may certify that he is not subject to withholding under section 3406(a)(1)(C) due to notified payee underreporting if the Internal Revenue Service has provided the payee with written certification that withholding under section 3406(a)(1)(C) due to notified payee underreporting has terminated.

(g) *Retention of certificates—(1) Accounts or instruments that are not pre-1984 accounts and brokerage relationships that are post-1983 brokerage accounts.* With respect to an account or instrument that is not a pre-1984 account (as described in §31.3406(d)-1(b)(3)), or with respect to a brokerage relationship that is a post-1983 brokerage account (as described in §31.3406(d)-1(c)(2)), a payor or broker who receives a Form W-9 or other acceptable substitute form related to withholding under section 3406 must retain the form in its records for 3 years from the date the account is opened or the instrument is purchased. The form may be retained on microfilm or microfiche.

(2) *Accounts or instruments that are pre-1984 accounts and brokerage relationships that are not post-1983 brokerage accounts.* With respect to a pre-1984 account (as described in §31.3406(d)-1(b)(1)) or with respect to a brokerage relationship that is not a post-1983 brokerage account (as described in §31.3406(d)-1(c)(1)), a payor or broker is not required to retain any Form W-9 or other acceptable substitute form. If, however, the payor or broker requires the payee to file only one Form W-9 or substitute form for all accounts or instruments of the payee, the payor or broker must retain the single form in the manner and for the period of time described in paragraph (g)(1) of this section if that form relates to any account or instrument that is not a pre-1984 account or relates to a post-1983 brokerage ac-

count. If a payee has certified that the payee is an exempt recipient described in §31.3406(g)-1, the payor or broker must retain the form unless the payor or broker can establish the existence of procedures that are reasonably calculated to ensure that a payee who has so certified is accurately identified in the payor's or broker's records.

(h) *Cross references.* For the requirement to file an information return (and furnish the related statement) with respect to a reportable payment, particularly if that payment has been subject to withholding under section 3406, see subtitle F, chapter 61, subparts B and C of the Internal Revenue Code. See §31.6302-4 for the requirement to deposit amounts withheld under section 3406 on either a monthly or semi-weekly basis. See §31.6011(a)-4(b) for the requirement to file Form 945, Annual Return of Withheld Federal Income Tax, to reflect amounts withheld under section 3406. See §31.6071(a)-1 for the time for filing the Form 945.

§31.3406(i)-1 Effective date.

Sections 31.3406-0 through 31.3406(i)-1 (except §§31.3406(d)-5 and 31.3406(g)-1(c) and except for international transactions) are effective after December 31, 1996, and, optionally, for reportable payments made and transactions occurring on or after December 21, 1995. For the effective date of §31.3406(d)-5, see §31.3406(d)-5(i). Section 31.3406(g)-1(c) is effective before January 1, 1997. See §§35a.9999-0T through 35a.9999-5 of this chapter for rules that apply to international transactions after December 31, 1996.

Par. 9. Section 31.6011(a)-5(a) is amended by:

1. Removing the word "or" immediately after the language "941PR," in the first and third sentences of paragraph (a)(1).

2. Adding the language " , or Form 945" immediately after the language "Form 941VI" in the first and third sentences of paragraph (a)(1).

3. Adding the language "(or other person)" immediately after the word "employer" in the second, third, fourth, and sixth sentences of paragraph (a)(1).

4. Removing the authority citation at the end of the section.

Par. 10. Section 31.6011(a)-6 is amended by revising the heading and

the first and third sentences of paragraph (a)(1) to read as follows:

§31.6011(a)-6 Final returns.

(a) *In general—(1) Federal Insurance Contributions Act; income tax withheld from wages and nonpayroll payments.* An employer (or other person) who is required to make a return on a particular form pursuant to §31.6011(a)-1, §31.6011(a)-4, or §31.6011(a)-5, and who in any return period ceases to pay wages or nonpayroll payments in respect of which he is required to make a return on that form, must make the return for the period as a final return. * * * Every such person filing a final return (other than a final return on Form 942 or Form 943) must furnish information showing the date of the last payment of wages (as defined in section 3121(a) or section 3401(a)), and, if appropriate, the date of the last payment of nonpayroll payments defined in §31.6011(a)-4(b). * * *

* * * * *

Par. 11. Sections 31.6051-4 and 31.6413(a)-3 are added to read as follows:

§31.6051-4 Statement required in case of backup withholding.

(a) *Statements required from payor.* Every payor of any reportable payment (as defined in section 3406(b)(1)) who is required to deduct and withhold tax under section 3406 must furnish to the payee a written statement containing the information required by paragraph (c) of this section.

(b) *Prescribed form.* The prescribed form for the statement required by this section is Form 1099. In the case of any reportable interest or dividend payment as defined in section 3406(b)(2), the prescribed form is the Form 1099 required in §1.6042-4 of this chapter (relating to payments of dividends), §1.6044-5 of this chapter (relating to payments of patronage dividends), or §1.6049-6(e) of this chapter (relating to payments of interest or original issue discount). Statements required to be furnished by this section will be treated as statements required by the respective sections with respect to any reportable payment, except that the statement required under this section must include the amount of tax

withheld under section 3406. In no event will a statement be required under this section if a statement with the same information is required to be furnished to the recipient under another section.

(c) *Information required.* Each statement on Form 1099 must show the following:

(1) The name, address, and taxpayer identification number of the person receiving any reportable payment;

(2) The amount subject to reporting under section 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, or 6050N whether or not the amount of the reportable payment is less than the amount for which an information return is required. If tax is withheld under section 3406, the statement must show the amount of the payment withheld upon;

(3) The amount of tax deducted and withheld under section 3406;

(4) The name and address of the person filing the form;

(5) A legend stating that such amount is being reported to the Internal Revenue Service; and

(6) Such other information as is required by the form.

(d) *Time for furnishing statements.* The statement must be furnished to the payee no later than January 31 of the year following the calendar year in which the payment was made.

(e) *Aggregation.* The payor or broker may combine the information required to be shown under this section with information required to be shown under another section even if they do not relate to the same type of reportable payment.

§31.6413(a)-3 Repayment by payor of tax erroneously collected from payee.

(a) *In general—(1) Erroneous withholding under section 3406 of the Internal Revenue Code.* If a payor or broker withholds under section 3406 from a payee in error or withholds more than the proper amount of the tax under section 3406, the payor or broker may refund the amount erroneously withheld as provided in section 6413 and this section. A payor or broker will be considered to have withheld erroneously under section 3406 only if the amount is withheld because of an error by the payor or broker (e.g., an error in flagging or identifying an

account that is subject to withholding under section 3406). The payor or broker may, in its discretion, treat the amount withheld as an amount erroneously withheld and refund it to the payee if—

(i) The payor or broker requires a payee described in §31.3406(g)-1(a) or described in a provision of the Internal Revenue Code requiring the reporting of a payment subject to withholding under section 3406 to certify that it is an exempt recipient, the payee fails to make the required certification, and the payor or broker subsequently withholds under section 3406 from a payment to the payee;

(ii) The payor or broker does not require the payee to certify concerning its exempt status and the payor or broker withholds under section 3406; or

(iii) The payor or broker withholds under section 3406 from a payee after the payee provides a taxpayer identification number or required certification (including the certification relating to foreign status described in §1.6049-5(b)(2)(iv) of this chapter or §1.6045-1(g)(1) of this chapter) to the payor, but before the payor or broker treats the number or required certification as having been received under §31.3406(e)-1(b).

(2) *Limitation.* For purposes of paragraph (a)(1) of this section, if a payor or broker withholds because the payor or broker has not received a taxpayer identification number or required certification and the payee subsequently provides a taxpayer identification number or a required certification to the payor, the payor or broker may not refund the amount to the payee.

(b) *Refunding amounts erroneously withheld—(1) Time and manner.* If a payor or broker withholds under section 3406 from a payee in error (including withholding more than the correct amount, as described in paragraph (a) of this section), the payor or broker may refund the amount erroneously withheld to the payee if the refund is made prior to the end of the calendar year and prior to the time the payor or broker furnishes a Form 1099 to the payee with respect to the payment for which the erroneous withholding occurred. If the amount of the erroneous withholding is refunded to the payee, the payor or broker must—

(i) Keep as part of its records a receipt showing the date and amount of

refund and must provide a copy of the receipt to the payee (a canceled check or an entry in a statement is sufficient, provided that the check or statement contains a specific notation that it is a refund of tax erroneously withheld);

(ii) Not report on a Form 1099 any tax withheld any amount which the payor or broker has refunded to a payee; and

(iii) Not deposit the amount erroneously withheld if the payor or broker has not deposited the amount of the tax prior to the time that the refund is made to the payee.

(2) *Adjustment after the deposit of the tax.* For purposes of paragraph (b)(1) of this section, if the amount erroneously withheld has been deposited prior to the time that the refund is made to the payee, the payor or broker may adjust any subsequent deposit of the tax collected under chapter 24 of the Internal Revenue Code that the payor or broker is required to make in the amount of the tax that has been refunded to the payee.

PART 35a—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983

Par. 12. The authority citation for part 35a is amended by removing the entry for 35a.3406-2 to read, in part, as follows:

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

§35a.3406-2 [Removed]

Par. 13. Section 35a.3406-2 is removed.

Par. 14. Section 35a.9999-0T is added to read as follows:

§35a.9999-0T Effective date (temporary).

In general, the provisions of §§35a.9999-1, 35a.9999-2, 35a.9999-3, 35a.9999-3A, 35a.9999-4T, and 35a.9999-5 are effective before January 1, 1997. The provisions of those sections remain effective after December 31, 1996, however, for purposes of §301.6724-1(g) of this chapter, relating to due diligence safe harbor, and for international transactions, including transactions involving a foreign payee, a foreign payor, a foreign office of a

U.S. bank or broker, or a payment from sources without the United States. See §§31.3406-0 through 31.3406(i)-1 of this chapter for rules that apply to other transactions after December 31, 1996.

Cynthia G. Beerbower,
Deputy Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 20, 1995, 8:45 a.m., and published in the issue of the Federal Register for December 21, 1995, 60 F.R. 66105)

PART 301—PROCEDURE AND
ADMINISTRATION

Par. 15. The authority for part 301 continues to read in part as follows:

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

Par. 16. Section 301.6109-1 is amended by:

1. Revising the third sentence in paragraph (a)(1).

2. Revising the first sentence in paragraph (h).

The revised sentences read as follows:

§301.6109-1 *Identifying numbers.*

(a) *In general*—(1) *Social security numbers and employer identification numbers.* * * * Social security numbers identify individual persons, while employer identification numbers identify corporations, partnerships, non-profit associations, trusts, estates of decedents, and similar nonindividual persons. * * *

* * * * *

(h) *Effective date.* The provisions of this section are effective for information that must be furnished after April 15, 1974, except that the requirement that an estate obtain an Employer Identification Number applies on and after January 1, 1984. * * *

602—OMB CONTROL NUMBERS
UNDER THE PAPERWORK
REDUCTION ACT

Par 17. The authority for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 18. In §602.101, paragraph (c) is amended by adding an entry to the table in numerical order to read as follows:

“§31.3406(a)-1—§31.3406(i)-1 . . . 1545-0112”.

Dated November 28, 1995.

Margaret Milner Richardson,
Commissioner of
Internal Revenue.