

## **Section 3406.—Backup Withholding**

*26 CFR 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.*

**T.D. 9055**

## **DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 31 and 301**

## **Receipt of Multiple Notices With Respect to Incorrect Taxpayer Identification Numbers**

**AGENCY:** Internal Revenue Service (IRS), Treasury.

**ACTION:** Final Regulations.

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

**DATES:** These regulations are effective January 1, 2004.

**FOR FURTHER INFORMATION CONTACT:** Nancy L. Rose at (202) 622–4910 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

### **Background**

This document contains amendments to the Employment Tax Regulations (26 CFR

part 31) under section 3406 of the Internal Revenue Code (Code), and to the Procedure and Administration Regulations (26 CFR part 301) under section 6724 of the Code. These regulations finalize proposed amendments to existing §§31.3406(d)-5(d)(2)(ii) and (g)(4), and 301.6724-1(f)(2), (f)(3), (f)(5), and (k). These regulations also revise existing §301.6724(f)(1) and (g)(1) to remove obsolete cross-references. A notice of proposed rulemaking (REG-116644-01, 2002-31 I.R.B. 268 [67 FR 44579]) was published in the **Federal Register** on July 3, 2002. The IRS received written comments responding to the notice of proposed rulemaking, but no commentators requested the opportunity to present oral comments at a public hearing. A notice cancelling the public hearing scheduled for October 22, 2002, was published on October 17, 2002 (67 FR 64067).

## **Explanation of Provisions and Summary of Comments**

### *Section 3406*

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

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

If the payor receives two or more notices of incorrect TIN with respect to a pay-

ee's account within the same calendar year, the regulations provide that the multiple notices may be treated as one notice for purposes of sending out a first "B" notice, and must be treated as one notice for purposes of sending out a second "B" notice. However, in some cases, a payor may receive multiple notices of incorrect TIN in different calendar years which relate to the same payee's account for the same year. This may occur where a payor files different types of information returns with respect to the same payee, such as a Form 1099-B (gross proceeds reported by brokers) and a Form 1099-DIV (payment of dividends). Typically these information returns all contain the same TIN, following information contained in the payor's records. Variations in the processing of such returns by the IRS may result in the issuance of incorrect TIN notices at different times.

The amendments to the regulations provide that two or more notices of incorrect TIN relating to the same payee and the same year, but which are received in different calendar years, count as one notice. Accordingly, a payor who sends a first "B" notice to the payee after receipt of the first notice of incorrect TIN would not be required to send a second "B" notice after receipt of the second notice of incorrect TIN if the second notice relates to an information return filed for the same year as the first notice.

### *Section 6724*

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

Section 301.6724-1(c)(1)(v) of the regulations provides that certain actions of the payee or another person providing necessary information with respect to the return may be an event beyond the filer's control. Thus, a payee's furnishing of an incorrect TIN to a payor may be an event beyond the payor's control.

As provided in §301.6724-1(a), the payor must also act in a responsible manner with respect to the failure. That section sets forth special rules for acting in a responsible manner with respect to incorrect TINs. The filer is required to make an initial solicitation for the payee's correct TIN at the time the account is opened, and up to two annual solicitations following receipt of penalty notices.

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

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

The written comments received expressed the view that the proposed regulations clarified the backup withholding rules and reduced the regulatory burden associated with backup withholding. No revisions to the proposed amendments were suggested by commentators.

## **Special Analyses**

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

## **Drafting Information**

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

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**Adoption of Amendments to the Regulations**

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

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

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

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

Par. 2. Section 31.3406(d)–5 is amended by revising paragraphs (d)(2)(ii) and (g)(4) to read as follows:

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

\* \* \* \* \*

(d) \* \* \*

(2) \* \* \*

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

\* \* \* \* \*

(g) \* \* \*

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

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**PART 301—PROCEDURE AND ADMINISTRATION**

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

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

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

1. Amending paragraph (f)(1)(ii), fourth sentence, by removing “(n)” after “section 6721”.

2. Revising paragraphs (f)(2) and (f)(3).

3. Amending paragraph (f)(5)(vi), last sentence, by removing the language “paragraph (f)(2)” and adding “paragraph (f)(3)” in its place.

4. Amending paragraph (g)(1) by removing the language “as provided under section 6724(c)(1)”.

5. Amending paragraph (k), *Example 3(ii)*, second sentence, by removing the language “§35a.3406–1(c)(1) of this paragraph” and adding “§31.3406(d)–5(d)(2)(i) of this chapter” in its place; and by removing the language “(f)(2)” and adding “(f)(3)” in its place.

6. Amending paragraph (k), *Example 3(ii)*, fifth sentence, by removing the language “§301.6721–1T” and adding “§301.6721–1” in its place.

7. Amending paragraph (k), *Example 3(iii)*, fifth sentence, by removing the language “§35a.3406–1(c)(1)” and adding “§31.3406(d)–5(d)(2)(i)” in its place.

8. Amending paragraph (k), *Example 3(iii)*, last sentence, by removing the language “§301.6721–1T” and adding “§301.6721–1” in its place.

9. Amending paragraph (k), *Example 5*, final sentence, by removing the language “§301.6721–1T” and adding “§301.6721–1” in its place.

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

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

12. Amending paragraph (k), *Example 7(ii)*, fifth sentence, by removing the language “§35a.3406–1(c)(1)” and adding “§31.3406(d)–5(g)(1)(ii)” in its place.

The revisions read as follows:

*§301.6724–1 Reasonable cause.*

\* \* \* \* \*

(f) \* \* \*

(2) *Manner of making annual solicitation if notified pursuant to section 6721.* A filer that has been notified of an incorrect TIN by a penalty notice or other notification pursuant to section 6721 may satisfy the solicitation requirement of this para-

graph (f) either by mail, in the manner set forth in paragraph (e)(2)(i) of this section; by telephone, in the manner set forth in paragraph (e)(2)(ii) of this section; or by requesting the TIN in person.

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

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

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

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

(iii) A filer that has been notified of an incorrect TIN by a notice pursuant to section 6721 with respect to a fiduciary or nominee account to which §31.3406(d)–5(b)(4)(i)(A) of this chapter applies is required to make the annual solicitation of this paragraph (f).

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

Approved April 13, 2003.

Pamela F. Olson,  
*Assistant Secretary of the Treasury (Tax Policy).*