INVESTMENT COMPANY INSTITUTE

MEMO# 31446

October 18, 2018

Proposed Regulations on De Minimis Error Safe Harbor for Information Reporting; Comments Requested

[31446]

October 18, 2018 TO: Bank, Trust and Retirement Advisory Committee
Broker/Dealer Advisory Committee
Operations Committee
Small Funds Committee
Tax Committee
Transfer Agent Advisory Committee RE: Proposed Regulations on De Minimis Error Safe Harbor for Information Reporting; Comments Requested

The Internal Revenue Service (IRS) has released proposed regulations on the *de minimis* error safe harbor exceptions to the information reporting penalties under sections 6721 and 6722. The proposed regulations provide safe harbor rules that generally treat as correct, for penalty purposes, information returns and payee statements that contain *de minimis* dollar amount errors. The proposed regulations also provide rules on the payee election not to have the safe harbor rules apply, related rules on cost basis reporting by brokers, and updated penalty amounts and references to information reporting obligations to reflect changes in the law.

Background

The Protecting Americans from Tax Hikes Act of 2015 (P.L. 114-113) (the Path Act) amended sections 6721 and 6722 to provide a safe harbor from penalties for failure to file correct information returns and failure to furnish correct payee statements, respectively, for certain *de minimis* errors.[1] Under the safe harbor, an error is not required to be corrected and no penalty is imposed if the error relates to an incorrect dollar amount, and the error differs from the correct amount by no more than $100 ($25 in the case of an error with respect to an amount of tax withheld).

The safe harbor does not apply to any payee statement if the payee elects not to have the safe harbor apply.[2] It also does not apply with respect to any incorrect dollar mount to the extent that such an error on an information return relates to an amount with respect to which such an election is made.[3] If the payee makes such an election, a filer may be subject to penalties for an incorrect dollar amount appearing on an information return or payee statement even if the incorrect amount is a *de minimis*

The Path Act amendments are effective for returns required to be filed and payee statements required to be furnished after December 31, 2016.

The IRS and the Treasury Department have authority under the amendments to sections 6721 and 6722 to determine how and when the payee election is made and to issue regulations to prevent the abuse of the safe harbor. In accordance with this regulatory authority, the IRS released Notice 2017-09, which provides interim guidance on how a payee may elect out of the safe harbor, when the safe harbor does not apply, and filers' recordkeeping obligations.[4]

Proposed Regulations

Safe Harbor Exceptions for *De Minimis* Errors

The proposed regulations provide *de minimis* safe harbor exceptions to the penalties in sections 6721 and 6722, as provided in sections 6721(c)(3)(A) and 6722 (c)(3)(A). These exceptions generally apply when an information return or payee statement is otherwise correct and is timely filed or furnished but includes a *de minimis* error in a dollar amount reported. In these circumstances, no correction is required, and the information return or payee statement is treated as having been filed or furnished with all the correct information for purposes of sections 6721 or 6722.

An error is *de minimis* if the difference between the reported and correct amount is $100 or less, or, if the difference is with respect to an amount of tax withheld, the difference is $25 or less.

Errors Due to Intentional Disregard

As provided in sections 6721(e) and 6722(e), the proposed regulations provide that the *de minimis* safe harbor exception does not apply in cases of intentional disregard of the requirements to file correct information returns or to furnish correct payee statements. In such cases, higher penalties will apply. Thus, for example, a person may not choose to forego filing information returns or furnishing payee statements that are required under the law even though the information returns and payee statements report less than $100 and tax withheld of less than $25. Doing so would constitute intentional disregard and would result in the higher penalties.

Payee Election

Sections 6721(c)(3)(B) and 6722(c)(3)(B) allow a payee to elect to have the *de minimis* safe harbor exceptions not apply to the information reporting penalties. Under the proposed regulations, a payee may elect that the safe harbor exception not apply to a payee statement; that election also will apply to the safe harbor exception with respect to any corresponding information returns.

To receive a correct payee statement without having the *de minimis* safe harbor exceptions apply, the payee must make any such election no later than the later of: (i) 30 days after the date on which the payee statement is required to be furnished to the payee, or (ii) October 15 (the fully extended due date for individuals to file an income tax return).

The proposed regulations provide a default manner for making such an election. Pursuant to these rules, the payee may make the election in writing on paper and mailed to the address for the filer appearing on the payee statement the payee received with respect to which the election is being made, or as provided to them by the filer. The written election must (1) clearly state that the payee is making the election; (2) provide the payee's name, address, and taxpayer identification number (TIN); (3) indicate whether the payee wants the election to apply only to specific types of statements and identifying such; and (4) provide any other information required by the IRS.

The proposed regulations permit a payee to make the election in a reasonable alternative manner if the filer provides a valid notification to the payee describing the alternative manner. This may include electronic or telephonic elections. The notification of such alternative methods for making the election must be provided in writing (paper or electronic) and must explain to the payee the payee's ability to make the election. It also must provide an address to which the payee may send a written election and describe the information required for making the election. Such notification must be provided to the payee with, or at the same time as, the furnishing of the payee statement, or have been previously provided to the payee with a payee statement associated with the relevant account.

The election will remain in effect for all subsequent years until revoked, under the procedures set forth in the proposed regulations. If an election is revoked, the *de minimis* safe harbor exceptions will apply (thus permitting the person furnishing the payee statement to avoid sending corrected statements for *de minimis* errors). A revocation is effective for all payee statements furnished or due to be furnished after the revocation is received. It remains in effect until the payee makes a valid and timely election not to have the *de minimis* safe harbor exceptions apply.

Reasonable Cause

If a payee properly elects not to have the *de minimis* safe harbor exceptions apply, the rules in sections 6721 and 6722 will otherwise apply (excluding the *de minimis* safe harbor exceptions). The proposed regulations thus provide special rules to determine whether the exception for reasonable cause applies in such cases. Under the proposed regulations, a filer may establish that a failure caused by *de minimis* errors and a payee election is due to reasonable cause and not willful neglect by filing a corrected information return or furnishing a corrected payee statement within 30 days after the date of the payee election.

Cost Basis Reporting

The proposed regulations provide that for purposes of cost basis reporting under section 6045, a customer's adjusted basis generally may be determined by treating any incorrect dollar amount that falls within the *de minimis* safe harbor exception under sections 6721(c)(3) and 6722(c)(3) as the correct amount. If, however, the broker voluntarily files a corrected information return and issues a corrected payee statement showing the correct dollar amount, then regardless of any requirement under sections 6721 and 6722, the adjusted basis shall be that corrected dollar amount so reported.

Record Retention

The proposed regulations require information return filers to retain records of any election, revocation, or notification for as long as the contents may be material in the administration of any internal revenue law.

Effective Date

The proposed regulations generally will apply with respect to information returns required to be filed and payee statements required to be furnished on or after January 1 of the calendar year immediately following the date of publication of final regulations. Notice 2017-09 will continue to apply until such date.

Comments Requested

The IRS has requested comments on the proposed regulations by December 17, 2018. Therefore, please provide any comments on the proposed regulations to me (kgibian@ici.org or 202/371-5432) no later than **Monday, November 19, 2018**.

Karen Lau Gibian
Associate General Counsel

endnotes

[1] *See* Institute Memorandum No. 29576, dated December 18, 2015, available at: https://www.ici.org/my_ici/memorandum/memo29576.

[2] Section 6722(c)(3)(B).

[3] Section 6721(c)(3)(B).

[4] *See* Institute Memorandum No. 30503, dated January 5, 2017, available at: https://www.ici.org/my_ici/memorandum/memo30503.
