

**MEMO# 2253**

October 12, 1990

# **INFORMATION REPORTING AND BACKUP WITHHOLDING REGULATIONS AMENDED AND REISSUED IN PROPOSED FORM**

- 1 - October 12, 1990 TO: TAX MEMBERS NO. 44-90 OPERATIONS MEMBERS NO. 31-90  
CLOSED-END FUND MEMBERS NO. 41-90 UNIT INVESTMENT TRUST MEMBERS NO. 67-90  
TRANSFER AGENT ADVISORY COMMITTEE NO. 38-90 RE: INFORMATION REPORTING AND  
BACKUP WITHHOLDING REGULATIONS AMENDED AND REISSUED IN PROPOSED FORM

As you know, over the past several years the IRS has issued and periodically revised regulations regarding information reporting, backup withholding and due diligence. (See, e.g., Institute Memorandum to Tax Members No. 14-89, Unit Investment Trust Members No. 22-89, Closed-End Fund Members No. 18-89, Operations Members No. 15-89, and Transfer Agent Shareholder Advisory Committee No. 9-89, dated April 18, 1989.) The attached recent amendments to these regulations, which relate principally to backup withholding, are proposed to be generally effective with respect to reportable payments made and transactions occurring after December 31, 1983. Unlike the existing temporary regulations, which are in question and answer ("Q&A") format, the proposed regulations are in traditional (narrative) regulation format. The period for comments and requests for a public hearing with respect to these proposed regulations expires on January 25, 1991. The proposed regulations generally reorganize and restate, in traditional regulation format, the existing temporary regulations. Thus, the proposed regulations cover all of the topics previously covered by the temporary regulations. In addition, the proposed regulations would change various aspects of the withholding system in response to comments received. As you know, the Institute has filed numerous comment letters on these regulations. (See, e.g., Institute Memorandum to Tax Committee No. 18-90, Operations Committee No. 14-90 and Transfer Agent Advisory Committee No. 24-90, dated July 25, 1990.) The preamble to these proposed regulations describes some of the changes made.

- 2 - Backup Withholding Regulations One significant clarification in the proposed regulations is a definition of readily tradable instrument that specifically includes mutual fund shares. Previously, only the preamble to regulations issued in 1983 suggested that fund shares were included in this term. The proposed regulations further clarify that a payor may assume that a TIN received from a broker is correct. One issue regulated investment companies ("RICs") have with the existing regulations is whether an entire fund complex may rely on a shareholder's broker-provided TIN when shares are later acquired in other funds in the complex without the broker's assistance. The proposed regulations restate the existing rule that a payee of a mutual fund that has a common investment adviser or common principal underwriter with other mutual funds may be permitted to provide one W-9 with respect to shares acquired or owned in any of the funds. The proposed regulations then provide a special rule stating that a broker

may act as a payee's agent for purposes of furnishing a certification to a payor. Unfortunately, these proposed regulations do not explicitly answer the question of whether other funds in the complex may rely upon the broker-introduced TIN, which the funds may assume is correct, if the broker does not furnish the fund complex with the actual W-9. In another change, the proposed regulations define an obviously incorrect taxpayer identification number ("TIN") as one that does not contain nine numerals. Thus, for example, a TIN of 123-45-6789 would not be treated as obviously incorrect. The definition of payor is also clarified to include a broker who holds an investment as nominee for a payee (i.e., in street name). Clarifications have also been made to the amount of a payment subject to withholding. For example, the proposed regulations provide that backup withholding only applies to reportable payments that are not withheld upon under another section of the Code. In addition, the proposed regulations provide that, with respect to reinvested dividends, payors need not backup withhold on amounts in excess of the actual cash value of the dividend declared, such as where dividends are reinvested at less than the market price. In this situation, withholding would be imposed on the amount that the payee would have received had the payee not participated in the dividend reinvestment plan. With respect to the time at which backup withholding must be imposed, the proposed regulations provide that the proceeds of a broker transaction need not be withheld upon until payment is made, even though the obligation to withhold arises on the sale date. - 3 -

Numerous procedural changes and clarifications would also be made by the proposed regulations. For example, the proposed regulations describe exempt recipients and permit payors, if they so choose, to require payees to file a certificate claiming exempt status before exempting the payee from backup withholding. Similarly, a payor may refuse to accept forms or certifications that the payor has not prepared itself, so long as the payor promptly furnishes to the payee an acceptable form. In addition, if a payor or broker devises a substitute Form W-9, neither the Form W-9 instructions nor the substance of those instructions need be provided, so long as the payee is instructed to strike out the language of the certification relating to payee underreporting if the payee is subject to backup withholding due to notified payee underreporting. The proposed regulations also clarify the procedures for depositing amounts withheld and the procedures to remit amounts erroneously withheld. Further, the proposed regulations permit payors to retain only a microfilm or microfiche copy of the certification and to destroy the paper certificates.

**B Notice Requirements** The proposed regulations include the changes made to the temporary regulations with respect to backup withholding under the so-called B Notice procedure of Internal Revenue Code section 3406(a)(1)(B). (See Institute Memorandum to Tax Members No. 37- 90, Operations Members No. 27-90, Closed-End Fund Members No. 36- 90, Unit Investment Trust Members No. 61-90, Transfer Agent Advisory Committee No. 34-90, dated September 21, 1990.) Thus, comments on these changes to the temporary regulations may be included in comments on the proposed regulations.

**Confidentiality of Information** The proposed regulations also discuss the confidentiality of information obtained under section 3406. Under the proposed regulations, a payor may, without violating the Internal Revenue Code, refuse to issue shares to or redeem shares of a person who fails to furnish his TIN in the manner required. However, a payor may not use information obtained under section 3406, such as the fact that an account is subject to backup withholding, to surcharge or close an account. A payor is deemed to surcharge an account if the payor charges an account more than the fee charged a similar account that is not subject to backup withholding. The proposed regulations do not directly address the issue of whether a surcharge may be imposed on every account for which a TIN is not furnished in the manner required.

**Due Diligence and Reasonable Cause** The proposed regulations do not revise the definition of due diligence. As you know, due diligence is the standard for defending the penalties that may be imposed under section 6676(b) - 4 - on

returns or statements the due date for which was before - 5 - January 1, 1990, and for which a TIN was either incorrect or not provided as required. A new proposed regulation merely cross references numerous questions and answers in the existing temporary regulations pertaining to the due diligence defense. Neither do the proposed regulations provide any definition of reasonable cause. As you know, reasonable cause is the new standard, applicable to returns or statements the due date for which is after December 31, 1989, for defending penalties for failure to comply with the TIN reporting requirements. (See Institute Memorandum to Closed-End Fund Members No. 68-89, Tax Members No. 48-89, Unit Investment Trust Members No. 70-89, Operations Committee No. 27-89, Accounting/Treasurers Committee No. 55-89, and Transfer Agent Advisory Committee No. 31-89, dated December 19, 1989.) Other Changes The regulations also reflect changes announced earlier by the IRS to the separate mailing requirement for dividend statements. As previously announced, a payor may attach a payee statement of dividends to a check or statement of a payee's account so long as the dividend statement is perforated. (See Institute Memorandum to Tax Members No. 42-87, Operations Members No. 27-87, Transfer Agent Advisory Committee No. 22-87, Closed- End Fund Committee No. 2-87, and Unit Investment Trust Committee No. 27-87, dated October 22, 1987.) \* \* \* \* This memorandum describes only some of the changes that would be made by the proposed regulations. Although these regulations are quite long, they should be carefully reviewed for other relevant items. To this end, the Institute will create a task force to study the proposed regulations and prepare industry comments before the January 25, 1991 deadline. We will keep you informed of developments. Keith D. Lawson Associate General Counsel  
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