

MEMO# 3693

April 16, 1992

IRS FINALIZES "B NOTICE" REGULATIONS AND UPDATES CORRESPONDING REVENUE PROCEDURE

April 16, 1992 TO: TAX MEMBERS NO. 24-92 OPERATIONS MEMBERS NO. 16-92 CLOSED-END FUND MEMBERS NO. 20-92 UNIT INVESTMENT TRUST MEMBERS NO. 26-92 TRANSFER AGENT ADVISORY COMMITTEE NO. 21-92 RE: IRS FINALIZES "B NOTICE" REGULATIONS AND UPDATES CORRESPONDING REVENUE PROCEDURE

As we previously informed you, in 1990 the IRS issued revised temporary regulations under Code section 3406(a)(1)(B), the so-called "B Notice" regulations, relating to the imposition of backup withholding due to notification of an incorrect taxpayer identification number ("TIN"). (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 and Transfer Agent Advisory Committee No. 34-90, dated September 21, 1990.) The Institute supported these regulations because they adopted several suggestions that we had previously made. (See, e.g., Institute Memorandum to Tax Committee No. 7-88, Operations Committee No. 13-88, Closed-End Fund Committee No. 14-88 and Transfer Agent Advisory Committee No. 8-88, dated April 21, 1988.) In 1991, the IRS further revised the temporary regulations and also issued a revenue procedure (Rev. Proc. 91-58) providing guidance for when a payor receives notification from the IRS or a broker twice within three calendar years that a payee's TIN is incorrect (the "2/3 rule"). (See Institute Memorandum to Tax Members No. 40-91, Operations Members No. 23-91, Closed-End Fund Members No. 41-91, Unit Investment Trust Members No. 43-91 and Transfer Agent Advisory Committee No. 44-91, dated September 24, 1991.) Attached are B Notice regulations, issued yesterday in final form, which generally apply to notices received on or after September 1, 1990. Also attached is IRS Revenue Procedure 92-32, which provides the procedures to be followed under the B Notice program. The revenue procedure, which is also effective for notices received on or after September 1, 1990, supersedes the revenue procedure relating to the 2/3 rule (Rev. Proc. 91-58) that was issued last year. - 1 - The Final Regulations In general, the final B Notice regulations both include previous amendments to the regulations and, as described in the Explanation of Provisions section, make additional changes. We are pleased to inform you that the final regulations have resolved the Institute's principal remaining concern with the previously-issued B Notice regulations by making permanent the exception from B Notice withholding for fiduciary and nominee accounts. While this exception was previously provided in the temporary regulations, the IRS had intended to eliminate it upon issuance of final regulations. In making the exception permanent, the IRS acknowledged that its processing system, which reads only the first 80 characters of the account registration, can cause name/TIN "mismatches" for fiduciary and nominee accounts

when the proper name and TIN have, in fact, been provided. The Explanation of Provisions further indicates that the fiduciary/nominee exception will be reconsidered by the IRS in the future, when the IRS has improved its system. The final regulations also clarify that B Notices are not required to be sent to payees of fiduciary and nominee accounts and that receipt of such a Notice on a fiduciary or nominee account has no effect on whether the 2/3 rule is triggered. However, receipt of a B Notice with respect to these accounts (to which Form 1099 tax information must be sent) continues to trigger certain solicitation requirements for satisfying the Code section 6724 reasonable cause exception for waiver of certain information reporting penalties. (See Institute Memorandum to Tax Members No. 2-92, Operations Members No. 1-92, Closed-End Fund Members No. 1-92, Unit Investment Trust Members No. 1-92 and Transfer Agent Advisory Committee No. 1-92, dated January 10, 1992.) In addition, the final regulations clarify that a payor receiving a B Notice is not required to notify the payee of an account (or to backup withhold with respect to an account) if the B Notice relates to payments that were made to an exempt recipient or that were not, in fact, reportable payments. The final regulations also make a few changes to the rules for identifying accounts subject to withholding when the payor receives a B Notice from the IRS. As under the temporary regulations, if the B Notice includes an account number or designation, the payee need only determine whether the account has the incorrect name/TIN combination. Where the B Notice does not contain an account number or designation, the final regulations clarify that the payor satisfies its duty to exercise reasonable care in identifying accounts subject to withholding if it searches the computer or record system that it can "reasonably associate" with the information return that generated the B Notice. If a payor of a readily tradable instrument (such as fund shares) receives a B Notice from a broker, rather than the - 2 - IRS, the final regulations provide that the payor need not - 3 - determine if other accounts of that payee have the incorrect name/TIN combination. In addition, the final regulations provide a definition of "business day" for purposes of applying various time requirements under the B Notice rules. Under the regulations, the term "business day" means any day other than a Saturday, Sunday or legal holiday, as defined in Code Section 7503 (which generally means any legal holiday in the District of Columbia). Other changes and clarifications of interest to investment companies have also been made by the final regulations and are described in the Explanation of Provisions. Among the relevant changes are those made to rules for determining the proper name/ TIN "match" for joint accounts and for applying the B Notice rules to dormant accounts. While the final regulations do not address operational issues relating to implementation of the B Notice program, such as whether B Notices could be sent to a designated contact person, the IRS is continuing to consider them. The Revenue Procedure Rev. Proc. 92-32 prescribes (1) the form, content and manner of delivery of the notice of a name/TIN "mismatch" that payors must provide to payees and (2) the form and content of the IRS or Social Security Administration ("SSA") notification validating a name/TIN combination. Attached to the revenue procedure are two sample B Notices that may be sent to payees, one for a "first" B Notice and one for a "second" B Notice. The rules in Rev. Proc. 92-32 with respect to the first notification of a name/TIN mismatch (a "first" B Notice) are generally the same as those in the temporary and proposed regulations, with the following changes. First, payors may follow the substitute notice rules in the temporary regulations only with respect to B Notices received by payors prior to September 1, 1993. Thereafter, the rules in the final regulations must be followed. Second, a payor is required to state in a substitute notice only the date that the payor will begin backup withholding, rather than the dates that the payor (a) received the B Notice and (b) is required to begin backup withholding. Third, payors sending substitute notices need not give payees whose name has changed the option of providing both surnames to the payor; instead, payors may instruct the payees to send the payor a Form W-9 and contact SSA to correct the

problem. Fourth, payors may use envelopes marked either "Important Tax Document Enclosed" or "Important Tax Return Document Enclosed" and need not enclose reply envelopes. Fifth, payors may omit or revise material inapplicable (or add information to clarify material applicable) to the payee. - 4 - The rules in Rev. Proc 92-32 with respect to the second notification of a name/TIN mismatch (a "second" B Notice) are - 5 - generally the same as in Rev. Proc. 91-58, with the following exceptions. First, payors may follow the procedural rules in the temporary regulations only with respect to B Notices received by payors prior to September 1, 1993. Second, payors are required to instruct payees to provide a copy of the notice from the payor to SSA. This will allow SSA to provide the account number back to the payor on Form SSA-7028. Third, the changes to the first notice rules discussed above, relating to (i) the date backup withholding will commence, (ii) envelope markings and (iii) omissions, revisions or deletions of certain material, also apply to second notices. Finally, as discussed above, Rev. Proc. 92-32 contains a sample second notice. * * * We will keep you informed of developments. Keith D. Lawson Associate Counsel
- Tax Attachments

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