DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 35a

[T.D. 7929]

Temporary Employment Tax Regulations Under the Interest and Dividend Tax Compliance Act of 1983; Backup Withholding

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to backup withholding. Changes to the applicable tax law were made by the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 369). These regulations affect payors and payees of, and brokers with respect to, reportable payments and provide them with the guidance necessary to comply with the law. This document also clarifies A-21 of § 35a. 9999-2 of the Temporary Employment Tax Regulation.

DATES: The temporary regulations are effective for payments made after December 31, 1983.

FOR FURTHER INFORMATION CONTACT: Yerachmiel Weinstein (at 202-566-3289 with respect to the foreign provisions), Bruce Jurist (at 202-566-3238 with respect to broker transactions), and Diane Kroupa (at 202-566-3590 with respect to all other provisions) of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224.

SUPPLEMENTARY INFORMATION:

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 of the Internal Revenue Code of 1954 (48 FR 45362). Those amendments were published to conform the regulations to the statutory changes enacted by the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369). Section 3406 was added to the Internal Revenue Code of 1954 by section 104 of the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98-67, 97 Stat. 371), and section 6676 of the Code was amended by section 105 of the Act (Pub. L. 98-67, 97 Stat. 380).

Additional temporary regulations relating to the requirement to impose backup withholding on reportable payments and the exercise of due diligence by payors of reportable interest, dividends, and patronage dividends and brokers were published in the **Federal Register** (48 FR 53104) on November 25, 1983.

This document, containing additional temporary regulations relating to the requirement to impose backup withholding, adds new § 35a.9999-3 to Part 35a, Temporary Employment Tax Regulations under the Interest and Dividend Tax Compliance Act of 1983, to Title 26 of the Code of Federal Regulations. Because these provisions are generally effective for payments made after December 31, 1983, there is a need for immediate guidance so that payors and payees can prepare to comply with these provisions.

The Internal Revenue Service intends to publish a notice of proposed rulemaking in the **Federal Register** in the near future that will provide comprehensive rules regarding backup withholding. All pertinent provisions of the temporary regulations with respect to backup withholding will be incorporated in the notice of proposed rulemaking. The notice of proposed rulemaking will provide the public an opportunity to comment on the regulations. A public hearing will be held. Notice of the time and place of the public hearing will be published in the **Federal Register**. The temporary regulations contained in this document and §§ 35a.9999-1 and 35a.9999-2 will remain in effect until superseded by final regulations on this subject.

These temporary regulations, presented in question and answer format, are intended to provide guidelines upon which payors and payees of reportable payments (including reportable interest, dividend, and patronage dividend payments) may rely in order to resolve questions specifically set forth herein. However, no inference should be drawn regarding issues not raised herein or reasons certain questions, and not others, are included in these regulations.

Explanation of Provisions

The regulations provide additional guidance concerning the application of backup withholding to payments subject to reporting under section 6041 (relating to rents, royalties, commissions, etc.), section 6041A(a) (relating to nonemployee compensation), section 6042 (relating to dividends), section 6044 (relating to patronage dividends), section 6045 (relating to brokers and barter exchanges), section 6049 (relating to interest and original issue discount), and section 6050A (relating to certain fishing boat operators). A payment must be subject to information reporting under one of those provisions before backup withholding can apply. Thus, if a payment is not subject to information reporting, backup withholding cannot apply to the payment. With respect to payments subject to reporting under section 6041A(a), these regulations provide that the exceptions currently applicable under section 6041 shall apply until regulations are issued under section 6041A (LR-214-82). For example, payments made to certain corporations engaged in providing medical and health care services are not excepted from information reporting under sections 6041 or 6041A and also are not excepted from backup withholding if a condition for imposing withholding exists with respect to the payee.

In addition, these regulations provide that certain amounts that are subject to information reporting are not subject to backup withholding. For example, a premature withdrawal penalty with respect to a time savings account, a certificate of deposit, or similar deposit, does not reduce the amount of interest that is subject to information reporting, but, in the payor's discretion, only the net payment is subject to backup withholding. In addition, the regulations describe certain categories of dividends that are not subject to backup withholding.

Payments of interest to a mortgage escrow account at a financial institution and interest earned on certain premiums paid with respect to an insurance policy are reportable payments and thus may be subject to backup withholding. While such payments were exempt from 10 percent withholding on interest and dividends, the underlying purpose of backup withholding is to ensure that payees' taxpayer identification numbers are provided on information returns in order to match the information with the payee's income tax return. Thus, such payments will be subject to backup withholding.

These regulations define "an obviously incorrect number", delineate how often withholding applies, and describe the penalties associated with backup withholding.

Special rules are provided with respect to readily tradable instruments. When a readily tradable instrument is acquired in a transaction between parties unrelated to the payor and without the assistance of a broker, no certification is required.

These regulations also provide special rules when an account is established directly with, or an instrument is acquired directly from, the payor. If acquisition is effected by means of electronic transfer, the payee, at the payor's option, is given 30 days after

such acquisition to provide the required certifications before the payor is obligated to impose backup withholding on any reportable interest and dividends, provided that the payee furnishes a taxpayer identification number to the payor at the time of the acquisition. The payor must, however, withhold 20 percent of the reportable amount if the payee withdraws any funds before the certifications are received. If the acquisition is by means of mail communication, the special rule applies with respect to acquistions before January 1, 1985.

The amount subject to backup withholding is generally the amount subject to information reporting. The amount subject to backup withholding with respect to patronage dividends and payments of certain fishing boat operators is limited generally to the amount paid in cash (or paid by qualified check in the case of patronage dividends). Special rules are provided to show the amount subject to backup withholding with respect to short sales, futures contracts, margin accounts, and foreign currency contracts.

In addition, the regulations explain that while withholding from an alternative source generally is not available to payors as under the now repealed provisions of 10 percent withholding on interest and dividends, payors of payments in property may withhold from an alternative source if the payee is subject to backup withholding.

The regulations prescribe rules governing the confidentiality of the information the payor receives in connection with backup withholding. In addition, the penalty associated with wrongful disclosure is described.

The regulations explain when withholding under section 3406(a)(1) (A) and (D) is requried to stop. In general, if a payor is withholding because he has not received a taxpayer identification number or a required certification, the payor must stop withholding on the date that the payor receives a taxpayer identification number from the payee in the manner required or the date that the payor receives the required certification, as applicable. Under A–17 of § 35a.9999–2 a payor has 30 days in which to treat a taxpayer identification number or required certification as having been received.

The regulations also explain the circumstances in which erroneously withheld amounts may be refunded to the payee. In general, a payor may refund taxes to the payee if, due to the payor's error, the payor improperly withholds. A payor may not refund taxes withheld due to a payee's error or failure to provide a taxpayer identification number or a required certification. For example, if a payor withholds because no taxpayer identification number has been received by the payment date, the payor may not refund the tax to the payee even though the payee subsequently furnishes the taxpayer identification number in the manner required to the payor before an information return is required to be made. In this situation, the payor properly withheld. A payor may only refund the tax if the payor has made an error in withholding.

The regulations provide that if a payor is required to withhold, the payor is required to make an information return and is required to furnish a statement to the recipient showing the amount paid and the amount of tax withheld. Thus, the payor is required to make an information return whenever the payor imposes backup withholding even though the amount of the payment is less than the minimum amount that generally must be paid before an information return is required to be made.

The regulations also provide rules for determining whether a payor has exercised due diligence with respect to an account opened or an instrument acquired after December 31, 1983.

Several persons questioned whether various types of interest payments which are not subject to information reporting under section 6049 are, nevertheless, subject to backup withholding. If a payment is not subject to information reporting, it is not subject to backup withholding. These regulations generally do not change any information reporting responsibilities under section 6049. For example, interest which is exempt from taxation under section 103 (relating to certain governmental obligations) is not a reportable payment. If the holder of a tax exempt obligation provides written certification to the payor that the interest payment is exempt from taxation, the payor is not required to make an information return under § 1.6049–5(b)(1)(ii). Because such a payment is not subject to information reporting, the payor is not required to impose backup withholding. Similarly, interest paid by an individual on its own obligation (*i.e.*, a mortgage) is not a reportable payment under § 1.6049–5(b)(1)(i) and, accordingly, the individual has no backup withholding responsibilities. The result is the same irrespective of whether such interest is collected on behalf of the holder of the obligation by a middleman. Amounts paid with respect to repurchase agreements, however, are reportable under section 6049 and accordingly backup withholding applies to such reportable interest amounts. Thus, as with any account that is not a pre-1984 account, the payee is required to make the certifications described in A–32 of § 35a.9999–1 with respect to repurchase agreements.

Clarification has also been requested with respect to the application of backup withholding to original issue discount. Answer 15 of § 35a.9999–2 restates that the amount of original issue discount includible in the holder's gross income is treated as a payment of interest under section 6049(d)(6) and § 1.6049–5(c). Original issue discount is, therefore, subject to backup withholding. Answer 15 of § 35a.9999–2 also provides that the rules of 10 percent withholding on interest and dividends shall apply for purposes of determining the amount of original issue discount subject to backup withholding. Thus, backup withholding only applies to original issue discount when a cash payment is made to the payee, such as a payment of stated interest, or at redemption of the obligation at maturity. When interest payments are made on a long-term registered obligation with original issue discount, backup withholding applies to the stated interest plus the amount of original issue discount includible in the gross income of the holder during the calendar year (although the amount to be withheld cannot exceed the cash paid). In the case of a short-term obligation or a long-term obligation in bearer form, backup withholding with respect to original issue discount applies only at maturity of the obligation. At maturity of a long-term original issue discount obligation in bearer form, backup withholding applies only with respect to the amount of original issue discount includible in gross income of the holder for the calendar year in which the obligation matures.

If a person purchases an original issue discount obligation from another holder, the purchaser generally does not have to impose backup withholding. If, however, a broker was involved with respect to the sale of the obligation and was required to make an information return under section 6045, the broker would be required to impose backup withholding on the gross proceeds of the sale of the obligation. Similarly, if a person purchases a bond between interest payment dates, backup withholding generally only applies when the interest is paid. If however, a broker was involved with respect to the sale of the obligation and was required to make an information return under section 6045,

the broker would be required to impose backup withholding on the gross proceeds of the sale of the obligation.

Clarification has also been requested with respect to readily tradable instruments. A payor may assume that the taxpayer identification number received from a broker with respect to a readily tradable instrument is furnished in the manner required unless and until the broker notifies the payor otherwise as required in A–41 of § 35a.9999–1. If the broker notifies the payor that the payee is subject to backup withholding, the payor generally is required to impose backup withholding and is required to notify the payee as provided in A–39 of § 35a.9999–1 and A–18 of § 35a.9999–2 that backup withholding has commenced, or will commence. For purposes of backup withholding, the term readily tradable instrument includes shares in a mutual fund. For purposes of A–41 of § 35a.9999–1, the term "transfer instructions" includes account registration instructions transmitted by a broker with respect to acquisitions of shares in a mutual fund.

With respect to the manner of delivery of Forms 1099 of reportable interest or dividend payments made in 1984 and in subsequent years, a payor of such payments is required either to deliver personally an official Form 1099 or to mail the form in a separate first-class mailing to the payee. If a payor of reportable interest or dividends made in 1984 does not personally deliver or mail the Form 1099 in a separate first-class mailing to the payee, the payor shall be considered to have failed to furnish the required statement to the payee, and the payor will be subject to a $50 penalty for each failure under section 6678. The only material that may be included in the separate mailing of Form 1099 is information relating to solicitation of the payee's correct taxpayer identification number. Payors may not include Form 1099 in the same envelope used to mail a payment, such as where a United States savings bond is redeemed by mail. Payors are not required to send a separate Form 1099 for each interest or dividend payment but may aggregate payments made to a payee during a calendar year on one Form 1099. Payors will be allowed to use a substitute Form 1099 provided the specifications of the applicable Revenue Procedure are followed.

Nonapplicability of Executive Order 12291

The Treasury Department has determined that these temporary regulations are not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

Regulatory Flexibility Act

No general notice of proposed rulemaking is required by 5 U.S.C. 553 (b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

Drafting Information

The principal authors of these regulations are Diane Kroupa, Bruce Jurist, Pam Olson, and Yerachmiel Weinstein of the Legislation and Regulations Division of the Office of the Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and the Treasury Department participated, however, in developing the regulations on matters of both substance and style.

List of Subjects in 26 CFR Part 35a

Employment taxes, Income taxes, Backup withholding, Interest and Dividend Tax Compliance Act of 1983.

Adoption of amendments to the regulations. Accordingly, Part 35a is amended as follows:

Paragraph 1. Section 35a.9999–3 is added immediately after § 35a.9999–2 to read as follows:

§ 35a.9999–3 Questions and answers concerning backup withholding.

The following questions and answers principally concern the backup withholding requirement with respect to reportable payments. These requirements are issued under the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98–67, 97 Stat. 369):

In General

Q–1. Who has the legal obligation to withhold on reportable payments made to a payee who is subject to backup withholding?

A–1. The person required to withhold (the payor) is the person who is required by the applicable provision to make an information return with respect to a payment under section 6041, 6041A(a), 6042, 6044, 6045, 6049, or 6050A. For example, in the case of a person who has a paying agent making a reportable payment to a payee, the paying agent is not the payor but is merely an agent for the principal (payor). In the case of a payment which is collected on behalf of, or for the account of, a payee, the payor ("middleman") is the person collecting or receiving the payment, irrespective of whether he is acting as the agent of the payee, or as agent for the issuer of the instrument. For example, a payee may establish a custodial account with a financial institution or brokerage firm where instruments are held for the benefit of the payee. The interest or dividends may be paid to a nominee of the financial institution or brokerage firm. The financial institution or brokerage firm will, in turn, credit the payee's custodial account. The financial institution or brokerage firm is the payor since it receives and credits payment to the payee's account and is required to make an information return showing such payment to the payee. See A–20 of § 35a.9999–2 for special rules related to grantor trusts.

Q–2. What consequences result if a payor fails to withhold on payments made to a payee who is subject to backup withholding?

A–2. A payor is subject to the same requirements and penalties for failing to impose backup withholding as an employer making a payment of wages. Consequently, under section 3403 and § 31.3403–1 of the Employment Taxes and Collection of Income Tax at Source Regulations, a payor is liable for the tax whether or not the payor withholds the tax from a payee who is subject to backup withholding. A payor may be relieved of liability for the tax which was required to be withheld if the payor can show that the tax has been paid by the payee, as provided in section 3402(d) and § 31.3402(d)–1 of the Employment Taxes and Collection of Income Tax at Source Regulations. In addition to liability for the tax, a payor who fails to withhold when required may be subject to civil penalties under section 6651 (addition to the tax for failure to pay any tax required to be shown on the payor's return), section 6656 (penalty for failure to make deposit of taxes) and section 6672 (penalty for failure to collect and pay over tax) and to criminal penalties under section 7201 (penalty for willfully attempting to evade or defeat any tax or the payment of any tax), section 7202 (penalty for willful failure to collect or pay over any tax), and section 7203 (penalty for willful failure to pay tax). The fact that a payor shows that the tax has been paid by the payee will not relieve the payor of liability for any civil or criminal penalty. The payor is not liable to any person for any withheld amount. The payor will only be liable to the United States for the tax which was required to be withheld as provided in § 31.3403–1 of the Employment Taxes and Collection of Income Tax at Source Regulations.

Requirement to Withhold

Q–3. Is a payor required to withhold if the taxpayer identification number

furnished by a payee is an "obviously incorrect number"?

A–3. Yes. As provided in A–28 of § 35a.9999–1, a payee shall be treated as having failed to furnish a taxpayer identification number to the payor if the number furnished is obviously incorrect. An obviously incorrect number is any taxpayer identification number that does not contain nine digits or a number that includes one or more alpha characters.

Q–4. When are payments considered to be paid and thus subject to backup withholding?

A–4. With respect to reportable interest or dividends, backup withholding applies when the payor pays interest, dividends, or patronage dividends to a payee who is subject to backup withholding. Amounts are paid when they are credited to the account of or set apart for the payee. Amounts are not considered paid solely because they may be withdrawn by the payee, so long as they are not credited to the payee's account, until either actual withdrawal or a specified crediting date.

Amounts are considered paid, however, upon withdrawal or crediting. If a bank credits interest on savings accounts only on the last day of each month or when the account is closed, then backup withholding applies at the time interest is paid on the last day of each month and when the account is closed.

When bonds are sold between interest payment dates, the portion of the sales price representing interest accrued to the date of sale is not considered to be a payment of interest for purposes of section 6049, but will be considered a reportable payment under section 6045. Therefore, if the gross proceeds of the sale are subject to backup withholding under A–12 of § 35a.9999–2, 20 percent of the sales price, including the portion representing accrued interest, will be subject to backup withholding.

In the case of stock for which the record date is earlier than the payment date, the dividend is considered paid on the payment date. For example, if a corporation declares a dividend on September 1 to the record holders as of September 12, and the dividends are payable on October 12, backup withholding applies on October 12 (the payment date). 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 which 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 payment date without regard to when the payee actually exchanges the stock and receives the dividend.

If a payor (such as a money market fund) computes interest or dividends daily but credits the interest or dividends on the last day of each month, then backup withholding applies on the last day of each month. If a payor computes *and* credits interest or dividends daily, backup withholding applies daily.

With respect to any reportable payment other than reportable interest or dividends, backup withholding applies at the time the payment is made or in the case of a transaction reportable under section 6045 when the amount subject to backup withholding is determined. Except in the case of forward contracts, regulated futures contracts, and security short sales, the amount subject to backup withholding in the case of a transaction reportable under section 6045 is determined on the date of the sale or exchange. See § 1.6045–1 (d)(4) and (f)(3) of the Income Tax Regulations for the applicable sale or exchange date and A–23 through A–25 and A–27 for special rules applicable to forward contracts, regulated futures contracts, security short sales, and issuer payment of debt securities. The date by which the payor is required to make an information return is irrelevant for purposes of determining when the payment is made and thus subject to backup withholding.

In the case of a middleman required to withhold tax, rules similar to § 31.3453(b)–1 (b) of the Employment Taxes and Collection of Income Tax at Source Regulations shall apply. In the case of a United States savings bond, see § 1.6049–4(d)(9) of the Income Tax Regulations.

Payments and Amounts Subject to Backup Withholding

Q–5. Is interest paid on a mortgage escrow account with a financial institution or interest earned on certain premiums paid with respect to an insurance policy, subject to backup withholding?

A–5. Yes. Both a payment of interest to a mortgage escrow account with a financial institution and a payment that represents an increment in value of "advance premiums," "prepaid premiums," or "premium deposit funds" which is applied to the payment of premiums due on an insurance policy, or is made available for withdrawal by the policyholder, are subject to reporting under section 6049 and thus are subject to backup withholding.

Q–6. If a payor imposes a penalty for premature withdrawal of funds deposited in a time savings account, certificate of deposit, or similar class of deposit, is the payor required to calculate the tax to be withheld on the amount of the reportable interest payment (not reduced by any penalty)?

A–6. No. A payor may, at its option, take into account any penalty it actually imposes on a payee when it calculates the amount to be withheld. If the payor chooses to take the penalty into account, the amount subject to backup withholding would be the amount of interest the payee actually receives. The gross amount of the payment, however, is subject to information reporting.

Q–7. If a payor is able to estimate the portion of a distribution which is not a dividend, is the payor nevertheless required to impose backup withholding on the gross amount of the distribution?

A–7. If the payor is unable to determine the portion of a distribution which is a dividend, backup withholding applies to the entire amount of the distribution. If a payor is able reasonably to estimate the portion of the distribution which is not a dividend, however, backup withholding does not apply to such portion. 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 such payment which is not a dividend. An estimate of the portion of a distribution which is not a dividend shall be considered reasonable if the estimate does not exceed the proportion of the distributions made by the payor during the most recent calendar year for which Forms 1099 and 1087 were required to be filed which was not reported by the payor as a dividend.

Q–8. Are dividends which are reinvested in stock of the company subject to backup withholding?

A–8. Dividends which are reinvested pursuant to a qualified plan in stock of a public utility are not subject to backup withholding. For this purpose, the amount of the reinvested dividend paid to any person, the identity of the recipient, and whether the recipient makes the election required by section 305(e)(2)(B) are irrelevant. All other reinvested dividends are subject to backup withholding.

Backup withholding shall apply to the amount of any dividend available to the shareholder, or credited to the shareholder's account. At the discretion of the payor, backup withholding need not be applied: (1) 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 such shares (including additional shares acquired by the

shareholder at a discount in connection with the dividend distribution) or (2) to any fee which 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 such excess amounts and fees on a consistent basis for each calendar year. Thus, the payor is not required to impose backup withholding on any amount in excess of the actual cash value of the dividend declared which the payee would have received had the payee not been a participant in the dividend reinvestment plan.

Q–9. Are there any payments of dividends that are not subject to backup withholding?

A–9. Yes. Backup withholding does not apply to—

(i) Any amount treated as a taxable dividend by reason of section 302 (relating to redemptions of stock).

(ii) Any amount treated as a taxable dividend by reason of section 306 (relating to disposition of certain stock).

(iii) Any amount treated as a taxable dividend by reason of section 356 (relating to receipt of additional consideration in connection with certain reorganizations).

(iv) Any amount treated as a taxable dividend by reason of section 1081(e)(2) (relating to certain distributions pursuant to an order of the Securities and Exchange Commission).

(v) Any amount which is an exempt-interest dividend, as defined in section 852(b)(5)(A), of a regulated investment company.

(vi) Any amount paid or treated as paid during a year by a regulated investment company, provided that the payor reasonably estimates, as provided in A–7, that 95 percent or more of all dividends paid or treated as paid during the year are exempt-interest dividends.

(vii) Any dividend that is reinvested pursuant to a qualified plan in stock of a public utility as provided in A–8.

The foregoing exceptions do not apply to backup withholding on gross proceeds reportable under section 6045.

Q–10. What amount of a payment reportable under section 6044 is subject to backup withholding?

A–10. If a payee fails to provide his taxpayer identification number or, for relationships with or memberships in a cooperative that are established after December 31, 1983, fails to provide a taxpayer identification number under penalties of perjury, the amount subject to backup withholding is any amount subject to reporting under section 6044, but only to the extent that the payment is made in money or by qualified check (as defined in section 1388(c)(4)). Thus, the payor shall withhold 20 percent of the amount paid in money or by qualified check to a payee who has failed to provide a taxpayer identification number in the manner required. For example, if a cooperative pays a patronage dividend of $2,000, consisting of $200 in cash, $300 by a qualified check and $1,500 in a qualified written notice of allocation, the amount subject to backup withholding is $500 (the amount paid in money and by qualified check). Thus, if the payee failed to provide a taxpayer identification number in the manner required, the cooperative would be required to withhold 20 percent of the $500.

If a payee (whose relationship with or membership in a cooperative was established after December 31, 1983) fails to certify that the payee is not subject to backup withholding due to notified payee underreporting, the amount subject to backup withholding is the amount of any payment reportable under section 6044 that is paid in money or by qualified check, but only if 50 percent or more of the reportable amount is paid in money or by qualified check. Therefore, in the case where there has been a payee certification failure, if a payment is made 50 percent or more in cash and by qualified check, the payor is required to withhold 20 percent of the amount of the cash and qualified check. If less than 50 percent of the payment is paid in cash or by qualified check, no amount is subject to backup withholding. For example, if a cooperative pays a patronage dividend consisting of $350 in cash, $250 by a qualified check, and $400 in a qualified written notice of allocation, 20 percent of $600 (the amount paid in money and by qualified check) is required to be withheld if there is a payee certification failure. If $100 were paid in cash, $250 by a qualified check, and $650 in a qualified written notice of allocation, however, the payment would not be subject to backup withholding even though there is a payee certification failure because less than 50 percent of the patronage dividend is paid in cash or by qualified check.

Q–11. If a payor makes a reportable payment in property (other than money), is the payor required to impose backup withholding?

A–11. Yes. In the case of a payment that is made in property, backup withholding applies to the fair market value of the property determined on the date of payment except in the case of certain payments subject to reporting under section 6050A.

Q–12. If the payor is required to withhold on a payment made in property, in what manner may the payor withhold?

A–12. The payor may withhold on the principal amount being deposited with the payor, or the payor may withhold from another account or source maintained by the payor for the payee. The account or source from which such tax is withheld must be payable to at least one of the persons listed on the account subject to backup withholding. If the account or source is not payable solely to the same person or persons listed on the account subject to backup withholding, 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 the tax from such account or source. The payor electing to withhold from an alternative source may determine the account or source from which the tax is to be withheld. The payor is liable for any tax that is required to be withheld if the recipient of the payment is subject to backup withholding. A payor may not withhold from an alternative source except with respect to payments in property.

Amounts Subject to Reporting Under Section 6041 or 6041A(a)

Q–13. Under what circumstances will a payment of a type subject to information reporting under section 6041 be exempt from backup withholding?

A–13. An information return is not required to be made with respect to payments described in § 1.6041–3 of the Income Tax Regulations and, therefore, such payments are not subject to backup withholding. In addition, payments otherwise reportable under section 6041 that are made to the following persons will not be subject to backup withholding:

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

(ii) The United States,

(iii) A State, the District of Columbia, a possession of the United States, or any political subdivision of any of the foregoing,

(iv) A foreign government or political subdivision of a foreign government,

(v) An international organization,

(vi) Any wholly owned agency or instrumentality of any person described in (ii), (iii), (iv), or (v), or

(vii) A foreign central bank of issue.

The provisions of § 31.3452(c)–1 of the Employment Taxes and Collection of Income Tax at Source Regulations shall apply for the purpose of determining whether a payee to whom a payment is made is subject to information reporting and backup withholding. For example,

during 1984, payor K, in the course of its trade or business makes a payment of rent of $700 to R Inc. for the use of premises owned by R Inc. Under § 1.6041-3(c) of the Income Tax Regulations payments to a corporation are not subject to information reporting (except in the case of certain payments not relevant here). Under § 31.3452(c)-1(b)(2) of the Employment Taxes and Collection of Income Tax at Source Regulations, K may treat R Inc. as a corporation because its name contains the unambiguous expression of corporate status, "Inc." Because the payment of rent to R Inc. is not subject to information reporting, it is not subject to backup withholding. If, however, K made the payment of rent to S Company, K would not be authorized to treat S Company as a corporation because "company" is not an unambiguous expression of corporate status. *See* § 31.3452(c)-1(b)(2) of the Employment Taxes and Collection of Income Tax at Source Regulations. Accordingly, K would be required to make an information return with respect to the payment under sections 6041 and withhold 20 percent of the payment to S Company, if S Company did not furnish a taxpayer identification number to K.

Q-14. Do the exceptions under section 6041 and the regulations thereunder apply to payments subject to reporting under section 6041A(a)?

A-14. For purposes of both information reporting and backup withholding, the exceptions under section 6041 shall apply to payments of a type reportable under section 6041A until regulations are issued under section 6014A; the rules of A-13 shall apply to such payments. Thus, in general, payments of the type reportable under section 6041A(a) that are made to corporations or general agents are not subject to information reporting or backup withholding. (See A-15 relating to payments to certain medical corporations.)

Q-15. Does backup withholding apply to a payment reportable under section 6041 or section 6041A(a) that is paid to a corporation engaged in providing medical and health care services or engaged in the billing and collection of payments in respect of medical and health care services (other than certain tax-exempt or governmental facilities described in § 1.6041-3(c) (1) and (2) of the Income Tax Regulations)?

A-15. Yes. Such amounts are subject to information reporting under section 6041 and 6041A(a) and thus are subject to backup withholding. The exception from backup withholding for payments to exempt recipients (described in A-21 of § 35a.9999-2) does not apply in the case of payments that are subject to reporting under sections 6041, 6041A(a) or 6050A.

Q-16. Does backup withholding apply to oil royalty payments that are subject to reporting under section 6041?

A-16. Backup withholding does not apply to an oil royalty payment if windfall profit tax is actually withheld under section 4986. If windfall profit tax is not actually withheld from the oil royalty payment (because, for example, payment is made with respect to "exempt royalty oil" (as defined in section 4993(f)), the oil royalty payment is subject to backup withholding. The amount subject to backup withholding is the amount the payee receives (*i.e.*, the gross proceeds less production related taxes such as State severance tax). The payor shall not be liable to any person other than the United States for the amount of tax withheld.

Q-17. Does backup withholding apply to net commissions paid to an unincorporated special agent with respect to insurance policies that are subject to reporting under section 6041?

A-17. Backup withholding does not apply to commissions reportable with respect to such an unincorporated special agent, provided that no cash is actually paid by the payor to the special agent.

Q-18. Does backup withholding apply to "designated distributions" (as defined in section 3405(d)(1)) if the distribution is not subject to reporting under section 6041?

A-18. No. As specified in A-30 of § 35a.9999-1, backup withholding applies only to distributions from pensions, annuities, or other plans of deferred compensation that are subject to reporting under section 6041. Thus, the following distributions are among those exempt from backup withholding because they are not subject to reporting under section 6041: (1) Distributions from an individual retirement account (subject to reporting under sections 408(i) and 6047(d)); (2) distributions from an owner-employee plan (subject to reporting under section 6047(b)); (3) certain surrenders of life insurance contracts (subject to reporting under section 6047(e)); and (4) distributions from a qualified bond purchase plan (subject to reporting under section 6047(c)).

Q-19. Does backup withholding apply to payments of gambling winnings that are subject to reporting under section 6041?

A-19. Backup withholding does not apply to any portion of reportable gambling winnings with respect to which tax is actually withheld under section 3402(q). In any case in which the reportable gambling winnings are not withheld upon under section 3420(q), backup withholding applies. Thus, gambling winnings reportable under section 6041 are subject to backup withholding if the payee does not furnish a taxpayer identification number and the payment is not withheld upon under section 3402(q). Answer 11 of §35a.9999-2 does not apply to gambling winnings. Thus, the payor is not required to determine whether any of the three conditions specified therein applies with respect to the payee.

For purposes of information reporting and backup withholding, (1) the reportable gambling winnings is the amount paid with respect to the amount of the wager reduced, at the option of the payor, by the amount of the wager, and (2) amounts paid with respect to identical wagers are treated as paid with respect to a single wager for purposes of calculating the amount of proceeds from a wager. The determination of whether amounts paid with respect to a single wager are identical shall be made under the rules of § 31.3402(q)-(1,)(c)(1)(ii) of the Employment Taxes and Collection of Income Tax at Source Regulations. In addition, until further regulations are issued, gambling winnings in excess of $600 are reportable only if the payout is based on betting odds of 300 to 1, or higher. The applicability of the odds requirement to information reporting and backup withholding is being studied by the Service and is subject to change in further regulations. Notwithstanding the odds requirement, winning from bingo, keno, and slot machines are subject to backup withholding if reportable under § 7.6041-1 of the temporary Income Tax Regulations.

Definition of a pre-1974 Account

Q-20. Under what circumstances is an account or instrument treated as a pre-1984 account?

A-20. Answer 34 of § 35a.9999-1 describes generally the accounts and instruments that are treated as a pre-1984 account. In addition, the purchase of additional shares in a credit union, where a prime account existed before 1984, shall be considered 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 such date, however, the new account generally does not constitute a pre-1984 account. For example, with respect to a disposition of shares in a mutual fund and the purchase of shares of another fund within a group of mutual funds which occurs after December 31, 1983, the shares acquired in the second

fund are not treated as a pre-1984 account unless the payee owned shares in the second fund prior to January 1, 1984.

If a shareholder is enrolled before January 1, 1984, in a dividend reinvestment program to purchase additional shares of the corporation sponsoring the program, the shares acquired through the program are considered a pre-1984 account, in the discretion of the payor. In the case of a qualified employee trust that distributes instruments in kind, any instrument distributed from the trust will be considered a pre-1984 account with respect to employees who were participants in the plan before January 1, 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, shall be 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.

An instrument with respect to which a broker is the payor is a pre-1984 account if the brokerage account in which the instrument is held is not a "post-1983 account." Answer 41 of § 35a.9999-1 describes generally the manner of determining whether a brokerage relationship is a post-1983 account. In addition, a brokerage relationship will not be treated as a post-1983 account if (i) a broker redeems or repurchases securities which were acquired by the seller prior to January 1, 1984, and (ii) either (A) the issuer of the securities is the broker obligated to make an information return under section 6045 or (B) the broker was obligated during 1983 to redeem the securities.

Brokerage Accounts and Transactions

Q-21. Does backup withholding apply to bonds the interest from which is exempt from taxation under section 103?

A-21. Interest on a tax-exempt obligation is not reportable under section 6049 if the payee provides a written certification to the payor (other than the issuer) that interest on the obligation is exempt from tax. See § 1.6049-5(b)(1)(ii) of the Income Tax Regulations. If the interest is not reportable under section 6049, it is not subject to backup withholding. A broker, however, is required to report the gross proceeds of a sale of a tax-exempt bond (including redemption of the bond at maturity) under section 6045. Thus, the gross proceeds from the sale of such a bond are subject to backup withholding. Any accrued and unpaid tax-exempt interest included in the sales proceeds is not reportable under § 1.6045-1(d)(3) of the Income Tax Regulations. Accordingly, backup withholding is not required with respect to the portion of the proceeds of the sale that represents accrued tax-exempt interest.

Q-22. Does backup withholding apply to a redemption of a share in a mutual fund?

A-22. Generally, yes. A redemption of shares of a mutual fund (other than a redemption at an issue price described in § 1.6045-1(c)(3)(iv) of the Income Tax Regulations) is a reportable payment under section 6045, and thus the gross proceeds are subject to backup withholding if the fund is considered a broker or a broker is otherwise involved.

Q-23. What amounts are subject to backup withholding upon the disposition of forward contracts or regulated futures contracts?

A-23. If a customer is subject to backup withholding with respect to an account containing forward contracts or regulated futures contracts, the broker must withhold 20 percent of the following amounts:

(i) All cash or property withdrawn from the account by the customer during the year. A withdrawal includes the use of money 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 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, the 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. Cash withdrawals do not include repayments of debt incurred in connection with a making or taking delivery that meets the requirements of the preceding three sentences. A withdrawal also does not include payments of variation margin, commissions, fees, a transfer of cash from the account to another futures account that is subject to the rules of this A-23, 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 the Income Tax Regulations).

(ii) The amount of cash in the account available for withdrawal by the customer at the relevant year-end (as described in § 1.6045-1(c)(5) of the Income Tax Regulations).

The payor must include the amount withheld and the amounts subject to withholding, in addition to the amounts otherwise reportable under section 6045, on the Form 1099-B filed with respect to a customer who is subject to backup withholding. The determination of whether the customer is subject to backup withholding should be made at the time of (1) the cash or property withdrawals or (2) the relevant year-end, whichever is applicable.

Q-24. What amount is subject to backup withholding with respect to security sales made through a margin account?

A-24. The amount subject to backup withholding in the case of a security sale made through a margin account (as defined in 12 CFR section 220 (Regulation T)) is the gross proceeds (as defined in § 1.6045-1(d)(5) of the Income Tax Regulations) on such sale. The amount required to be withheld with respect to such a 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. Thus, for example, if the broker forces a customer sale to meet the requirements of Regulation T (a maintenance call), none of the proceeds of such a sale are subject to backup withholding (except to the extent of the fractional amount of the last share sold which exceeds the amount needed to meet the Regulation T margin requirement).

Q-25. What amount is subject to backup withholding with respect to security short sales?

A-25. The amount subject to backup withholding with respect to a short sale of securities is ordinarily the gross proceeds (as defined in § 1.6045-1(d)(5) of the Income Tax Regulations) on such short sale. At the option of the broker, however, the amount subject to backup withholding may be the gain upon the closing of the short sale (if any) and the obligation to withhold can be deferred until the closing. A broker may use this alternative method of determining the amount subject to backup withholding

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 shall be assumed to have a basis of zero. The determination of whether a short seller is subject to backup withholding shall be made on the date (1) of the initiation or closing, as the case may be, or (2) that the initiating or closing, as the case may be, is entered on the broker's books and records.

Q–26. How does backup withholding apply to foreign currency contracts (as defined in section 1256(g))?

A–26. In general, brokers shall report with respect to foreign currency contracts in accordance with the rules for reporting with respect to regulated futures contracts (see § 1.6045–1(c)(5)). For purposes of § 1.6045–1(c)(5)(i)(*b*) of the Income Tax Regulations realized profit (or loss) from a foreign currency contract is determined—

(1) In the case of making or taking delivery, by comparing the contract price to the spot price for the contract currency at the time and place specified in the contract, and

(2) In the case of a closing by entry into an offsetting contract, by comparing the contract price to the price of the offsetting contract.

For purposes of § 1.6045–1(c)(5)(i) (*c*) and (*d*), unrealized profit in a foreign currency contract is determined by comparing the contract price to the broker's price for similar contracts at the close of business of the relevant year. Appropriate additions will be made to § 1.6045–1(c) of the Income Tax Regulations in the near future. For rules determining the amount subject to backup withholding under § 1.6045–1(c)(5), see A–23.

Q–27. When does backup withholding apply to payments arising as a result of the retirement or redemption of a debt security subject to reporting under section 6045?

A–27. In general, backup withholding applies on the sale date under § 1.6045–1(d)(4) of the Income Tax Regulations. Additionally, a broker that is also the obligor on a debt security may elect to apply backup withholding on the payment date. Such a broker must determine whether backup withholding applies on the same date (either sale date or payment date) with respect to all similarly situated payees.

Special Rules With Respect to Readily Tradable Instruments

Q–28. Do special rules apply if an account or instrument is acquired directly from the payor or reportable interest or dividends after December 31, 1983?

A–28. Yes. Special rules apply depending on the manner in which the instrument is acquired. In the case of a readily tradable instrument acquired directly from the payor by means of electronic transmission (*e.g.*, telephone or wire transfer), the payee, at the payor's option, shall be given 30 days after such acquisition to provide the certifications required in A–32 of § 35a.9999–1, before the payor is required to impose backup withholding on the reportable interest or dividends, *Provided* That the payee furnishes a taxpayer identification number to the payor at the time of the acquisition. If the payee withdraws any of the interest or dividends before the certifications are received, however, the payor must withhold 20 percent of the reportable amounts. For purposes of the preceding sentence, all cash withdrawals in an amount up to the reportable amounts are assumed to be interest or dividends. In addition, the payor must commence withholding on all reportable interest or dividends in connection with the instrument or account 30 days after the acquisition, if the payee has not provided the required certifications to the payor by such date.

The special rule described in the preceding paragraph shall also supply to acquisitions that are effected before January 1, 1985, by mail communication. With respect to accounts or instruments acquired by mail or after January 1, 1985, the payor is required to impose backup withholding on the reportable interest or dividend payments if the payee has not provided the required certifications at the time that the first reportable payment is made.

Q–28A. Do special rules apply if a broker sells securities for a customer pursuant to a telephone instruction, in circumstances in which the customer failed to provide a certified taxpayer identification number as required by A–12 of § 35a.9999–2?

A–28A. Yes. The customer, at the payor's option, shall be given 30 days after the date of the sale to furnish a certification as required by A–12 of § 35a.9999–2, provided that (1) the payee furnishes his taxpayer identification number before the sale and (2) the customer does not withdraw the proceeds of the sale prior to the time the required certification is provided (or backup withholding is applied). For purposes of the preceding sentence, an investment of the cash proceeds of the sale in other property shall be considered a withdrawal by the customer; however, investment in other property shall be permitted if, at all times, at least 20 percent of all gross proceeds reportable under section 6045 are held in cash by the broker. If the customer does not provide the required certification within 30 days after the date of the sale, the broker must withhold 20 percent of all reportable gross proceeds on the 31st day after the date of the sale.

Q–29. If a readily tradable instrument is transferred in a transaction between parties unrelated to the payor of the instrument without the assistance of a broker, is the transferee required to certify either the correctness of the taxpayer identification number or that the transferee is not subject to backup withholding due to notified payee underreporting?

A–29. No. Certification is not required in the case of a transfer of a readily tradable instrument between parties unrelated to the payor if the parties act without the assistance of a broker.

Q–30. If a bond in bearer form is redeemed by the obligor after December 31, 1983, is the payee required to certify under penalties of perjury the correctness of the payor's taxpayer identification number?

A–30. Yes. The redemption of such an obligation is subject ot reporting under section 6045 if a broker is otherwise involved. However, the reedemption of an interest coupon is considered a window transaction as provided in A–42 of § 35a.9999–1, so the payee is not required to certify the correctness of the taxpayer identification number.

Foreign Transactions

Q–31. What representations must a person make, on a certificate signed under penalties of perjury, to establish that the is an exempt foreign person under § 1.6045–1(g)(1) of the Income Tax Regulations and, consequently, that the gross proceeds of his broker transactions are not section 6045 reportable payments which may be subject to backup withholding?

A–31. In order to be treated as an exempt foreign person under § 1.6045–1(g)(1) of the Income Tax Regulations with respect to transactions effected by a broker during a calendar year, a customer will only be required to certify to the broker the following: (1) That the foreign person is neither a citizen nor a resident of the United States, (2) that the foreign person has not been, and at the time the statement is furnished

reasonably expects not to be, present, in the United States for a period aggregating 183 or more days during the calendar year, and (3) that the foreign person is not, and at the time the statement is furnished reasonably expects not to be, engaged in a United States trade or business with respect to which any gain derived from transactions effected by the broker during that calendar year is effectively connected. In lieu of making the certifications in (2) or (3) of the preceding sentence, the person may instead certify that he is a beneficiary of an income tax treaty to which the United States is a party and pursuant to which gains from his broker transactions are exempt from Federal income taxation. A person may make this latter certification only if all conditions to the exemption provided by the treaty are actually satisfied.

In accordance with the foregoing, the Service will amend § 1.6045–1(g) of the Income Tax Regulations to indicate that a foreign person need make no express representations to a broker concerning the application of section 877 or section 6013 (g) or (h) (although a person with respect to whom a section 6013 (g) or (h) election is in effect may not make the representation in (1) above that he is not a resident of the United States). These amendments will apply with respect to substitute forms prepared by the broker, as well as to the Form W–8 (which is being developed by the Service for use under the requirements both of § 1.6049–5(b)(2)(iv) and § 1.6045–1(g)(1) of the Income Tax Regulations). Subject to A–32, all other provisions of § 1.6045–1(g) of the Income Tax Regulations will remain in effect.

Q–32. Must a foreign office of a United States broker obtain the statement described in § 1.6045–1(g)(1) of the Income Tax Regulations and A–31 from a foreign person having an account at that office in order to treat such person as an exempt foreign person under § 1.6045–1(g)(1) of the Income Tax Regulations?

A–32. As currently provided in § 1.6045–1(g)(1) of the Income Tax Regulations, a foreign office of a United States broker may treat a customer as an exempt foreign person if it receives a certificate, signed under penalties of perjury, in accordance with § 1.6045–1(g)(1) of the Income Tax Regulations. However, the Service will also permit a person to be treated as an exempt foreign person with respect to transactions effected on his behalf by a foreign office of the broker if either of the following conditions is satisfied: (1) During the calendar year in which such transactions are effected, the broker withholds tax on any amount, including interest and dividends, paid to such person under subchapter A of chapter 3 of the Code in accordance with the provisions of chapter 3; or (2) the broker, in accordance with § 1.1441–6 (b) or (c) of the Income Tax Regulations, has received from such person a Form 1001 (Ownership, Exemption or Reduced Rate Certificate) or special variation thereof that is in effect with respect to any amounts (including interest) that are or may be paid to such person during the calendar year in which the transactions are effected. These alternatives to obtaining the certificate described in § 1.6045–1(g)(1) of the Income Tax Regulations only apply, however, if payments the broker makes with respect to transactions effected on behalf of such person are made only outside the United States and if such person has no account with a branch of the broker in the United States. Section 1.6045–1(g) of the Income Tax Regulations will be amended to reflect this modification.

Q–33. With respect to payments of United States source original issue discount on obligations having maturities of six months or less from the date of original issue, must a payor obtain the statement described in § 1.6049–5(b)(2)(iv) of the Income Tax Regulations from a payee who is neither a citizen nor a resident of the United States in order to avoid section 6049 information reporting and the possible application of backup withholding?

A–33. Generally, when making payments of United States source interest or original issue discount to a payee who is a foreign person, the payor need not obtain the certificate described in § 1.6049–5(b)(2)(iv) of the Income Tax Regulations since the payor usually either withholds tax on the amounts paid in accordance with subchapter A of chapter 3 of the Code or obtains a Form 1001 from the payee with respect to such payments. See § 1.6049–5(b)(2)(i) and (ii) of the Income Tax Regulations. However, as original issue discount on obligations having maturities of six months or less from the date of original issue is not subject to United States tax when paid to a foreign person, there is neither withholding under subchapter A of chapter 3 of the Code nor the receipt of a Form 1001 with respect to such amount. In order to treat original issue discount on obligations having maturities of six months or less from the date of original issue the same under § 1.6049–5(b)(2) of the Income Tax Regulations as interest and original issue discount on other obligations, the Service will allow a payee who is a foreign person to substitute a Form 1001 for the statement described in § 1.6049–5(b)(2)(iv) of the Income Tax Regulations with respect to original issue discount on obligations having maturities of six months or less from the date of original issue. Despite the substitution of the Form 1001 for the Form W–8 or substitute form prepared by the payor, all other procedures of § 1.6049–5(b)(2)(iv) of the Income Tax Regulations will apply.

Section § 1.6049–5(b)(2) of the Income Tax Regulations will be amended to reflect the modifications made by this A–33.

Q–34. Are payments of foreign source interest made on deposits outside the United States by a foreign branch of a United States bank reportable payments that may be subject to backup withholding?

A–34. As provided in § 1.6049–5(b)(1)(ix) of the Income Tax Regulations, such payments are not required to be reported under section 6049. However, except to the extent such payments are less than $600 in a taxable year or are made to persons who are neither citizens nor residents of the United States, they are subject to information reporting under section 6041(a).

For purposes of section 6041(a), a foreign branch of a United States bank may treat a person as being neither a citizen nor a resident of the United States if the bank has evidence in its records to such effect (provided it does not have actual knowledge that the evidence is false). Such evidence may include a written indication from the payee (*e.g.*, appearing on an account application form) that the payee is neither a citizen nor a resident of United States or an affidavit from an employee of the United States bank stating that the employee knows that, or that the payee has represented orally that, he is neither a citizen nor a resident of the United States. The mere fact, however, that the payee has provided an address outside the United States is insufficient evidence to establish for this purpose that the payee is neither a citizen nor a resident of the United States.

Foreign source interest payments made on deposits outside the United States by foreign branches of United States banks to United States persons, although reportable payments under section 6041(a), will not be subject to backup withholding beginning January 1, 1984. However, the issue of whether backup withholding should be applied with respect to such payments is presently under further consideration. If backup withholding is subsequently

determined to be appropriate, such will be provided in future regulations. Backup withholding, in that case, would apply no earlier than July 1, 1984, and would apply on a prospective basis only. Payments of interest on deposits of United States persons with foreign branches of foreign banks similarly will not be subject to backup withholding beginning January 1, 1984.

Q–35. In the case of a payment to joint payees, must a payor obtain the statement described in § 1.6049–5(b)(2)(iv) of the Income Tax Regulations (or other verification of foreign status described in § 1.6049–5(b)(2) (ii) or (iii) of the Income Tax Regulations) with respect to each payee in order for such payment to be exempt from information reporting under § 1.6049–5(b)(1)(vi) of the Income Tax Regulations and from the possible application of backup withholding?

A–35. Yes. In order for a payment to be exempt from information reporting under § 1.6049–5(b)(1)(vi) of the Income Tax Regulations (and in order not to constitute a reportable payment to which backup withholding may apply), the payor must ascertain in accordance with the provisions of § 1.6049–5(b)(2) of the Income Tax Regulations that each payee is a foreign person. A broker similarly must verify the independent status of each person on a joint account as an exempt foreign person in accordance with the provisions of § 1.6045–1(g)(1) of the Income Tax Regulations, and of A–31 and A–32, in order to exempt transactions effected on behalf of such account from section 6045 information reporting and from the possible application of backup withholding.

If the first payee named on the account, but not every joint payee, provides the verification of foreign status referred to in this A–35, backup withholding shall commence unless any one of the joint payees has provided a taxpayer identification number to the payor in the manner otherwise required in §§ 35a.9999–1 and 35a.9999–2. This is contrary to the general rule of section 3406(h)(3), which would require backup withholding to commence unless a taxpayer identification number is obtained from the first payee listed in the payment.

Q–36. In order to avoid information reporting under section 6042 and the possible application of backup withholding, must a payor of United States source dividends to a person having an address outside the United States obtain from such person a statement, signed under penalties of perjury, that the person is neither a citizen nor a resident of the United States?

A–36. No. The regulations under section 6042 exempt from information reporting any United States source dividends that are subject to withholding under section 1441 or section 1442 or that would be subject to such withholding either but for the provisions of a treaty or but for the fact of the application of § 1.1441–4 (a) or (f) of the Income Tax Regulations (relating to income effectively connected with a United States trade or business). See § 1.6042–3(b)(2) of the Income Tax Regulations. The regulations under section 1441 indicate that, absent definite knowledge of the status of a payee, a payor of United States source dividends may determine whether withholding is required under section 1441 (absent the receipt of a Form 4224 evidencing effectively connected income) or whether a payee is entitled to exemption from such withholding under the applicable provisions of a treaty by reference to the address of the payee. See § 1.1441–3(b)(3) of the Income Tax Regulations. Therefore, provided a payor does not have definite knowledge that a payee is a United States person, the payor may treat payments of United States source dividends to a payee with a foreign address as exempt from information reporting under section 6042 and from the possible application of backup withholding. (Note, however, that the use of the address method for purposes of section 1441 is under reconsideration in accordance with the provisions of section 342 of the Tax Equity and Fiscal Responsibility Act of 1982. Future elimination of such a method could impact prospectively on the requirement of backup withholding with respect to dividends).

Payments of dividends to United States persons by a foreign corporation which are not exempt from information reporting under § 1.6042–3(b)(1) (relating to payments by a foreign corporation that is not engaged in business in the United States and that does not have an office or place of business or a fiscal or paying agent in the United States) will nevertheless not be subject to backup withholding beginning January 1, 1984. However, the issue of whether backup withholding should be applied with respect to such payments is presently under further consideration. If backup withholding is determined to be appropriate, such will be provided in future regulations. Backup withholding, in that case, would apply no earlier than July 1, 1984, and would apply on a prospective basis only.

Q–37. With respect to a payment of interest that would be subject to information reporting under section 6049 but for the fact that it is made outside the United States, how is the place of payment to be determined?

A–37. For purposes of the reporting requirements of section 6049 and backup withholding, the place of payment of interest is considered to be the place where the payor or middleman completes the acts necessary to effect payment. The fact that payment is made from an account with a United States office of a United States or foreign bank by means of a draft drawn on the bank or by a wire or other electronic transfer from an account with the United States office of the bank is not alone determinative of the place of payment. Similarly, the fact that payment is made by means of a transfer into an account of the payee witha United States office of a United States or foreign bank, whether by means of a wire or other electronic transfer, is not determinative of the place of payment, unless such office is expressly authorized by the payee to act as agent for collection of the interest or unless the records of such office otherwise reasonably evidence the nature of the funds transferred as interest and the amount of such interest.

Subject to the foregoing provisions concerning the receipt of wire and other electronic transfers, a bank or similar financial institution is generally considered to complete the acts necessary to effect payment of interest on its deposits at the branch or office at which it credits the interest to the account of the payee or at which payment is made in cash. However, in no event shall interest be considered to be paid for purposes of section 6049 at a branch or office of the financial institution unless all the following conditions are met: (1) The branch or office is a permanent place of business which is regularly maintained, occupied, and used to carry on a banking or similar financial business, (2) the business is conducted by at least one employee of the branch or office who is regularly in attendance at such place of business during normal business hours, and (3) the branch or office receives deposits of funds from the public and in addition also engages in one or more of the other activities listed in § 1.864–4(c)(5)(i) of the Income Tax Regulations.

In the case of a coupon bond (including a certificate of deposit with detachable interest coupons), the acts necessary to effect payment of interest are considered to be completed within the United States either if: (1) A coupon is presented to a payor or middleman

within the United States (regardless of whether the funds paid are credited to an account of the payee maintained outside the United States); or (2) the coupon is presented at an office of a payor or middleman outside the United States but the interest on the coupon is credited to an account of the payee maintained with another office of the payor or middleman within the United States. The application of the provisions of this A–37 will be illustrated by examples to be published in future regulations.

Refund of Erroneously Withheld Amounts

Q–38. What action should a payor take if the payor erroneously imposes backup withholding?

A–38. If a payor, through its own error, withholds tax or withholds more than the proper amount of the tax, the payor may refund the amount erroneously withheld as provided in section 6413 and A–39. A payor shall be considered to have withheld erroneously only if the amount is withheld because of an error by the payor (*e.g.*, an error in "flagging" or identifying an account that is subject to backup withholding). If the payor requires a payee described in § 31.352(c)–(1) (b) through (p) of the Employment Taxes and Collection of Income Tax at Source Regulations (*e.g.*, a corporation) to certify as to its status as exempt from backup withholding, the payee fails to make the required certification, and the payor subsequently withholds the tax from a payment to such payee, the payor may, in its discretion, treat the amount withheld as an amount erroneously withheld and refund it to the payee. The result is the same if the payor does not require such a payee to certify as to its status and the payor withholds.

If a payor withholds from a payee after the payee provides a taxpayer identification number or required certification to the payor but before the payor has processed the number or required certification (*i.e.*, prior to the time that the payor is treated as having received the number or certification under A–17 of § 35a.9999–2), the payor may, in its discretion, treat the amount withheld as an amount erroneously withheld and refund it to the payee. If a payor withholds, however, because the payor has not received a taxpayer identification number or required certification and the payee subsequently provides a taxpayer identification number or the required certification to the payor, the payor may not refund the tax to the payee because the payor properly imposed backup withholding. The amount withheld is a credit against tax then the payee may take into account in computing estimated tax payments and may claim on the payee's income tax return.

Q–39. In what manner should a payor treat erroneously withheld tax?

A–39. If a payor withholds from a payee in error or withholds more than the correct amount of tax, the payor may refund the amount improperly withheld to the payee so long as the refund is made prior to the end of the calendar year and prior to the time the payor furnishes a Form 1099 to the payee with respect to the payment for which the improper withholding occurred. If the amount of the improper withholding is refunded to the payee, the payor shall keep as part of its records a receipt showing the date and amount of refund. For this purpose, a cancelled check or an entry in a statement, a copy of which is provided to the payee by the payor, will suffice for a receipt showing the refund of tax improperly withheld provided that the check or statement contains a specific notation that it is a refund of tax improperly withheld.

If the payor has not deposited the amount of the tax prior to the time that the refund is made to the payee, the payor shall not deposit the amount of the tax improperly withheld. If the amount of the improperly withheld tax has been deposited prior to the time that the refund is made to the payee, the payor may adjust any subsequent deposit of tax collected under chapter 24 of the code which the payor is required to make in the amount of the tax which has been refunded to the payee. A payor shall not report on a Form 1099 as tax withheld any amount of tax which the payor has refunded to a payee.

Q–40. If a "middleman" payor of reportable interest or dividends (*e.g.*, a broker holding stock in "street name") receives a payment a portion of which was improperly withheld upon prior to payment to the "middleman" payor, what action may the "middleman" take?

A–40. A middleman who receives a payment (referred to as a "receiving payor") from which tax has been improperly withheld may seek a refund of the tax withheld by the payor from whom the receiving payor received the payment (referred to as the "upstream payor") or, alternatively 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 collected under chapter 24 of the Code which the receiving payor is required to withhold and deposit. The receiving payor shall make 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 shall withhold the tax if any of the conditions for imposing backup withholding exist with respect to its payee.

When Backup Withholding Stops

Q–41. When may a payor stop withholding?

A–41. If a payee is subject to backup withholding because the payee failed to furnish a taxpayer identification number in the manner required, the payor is required to withhold until a taxpayer identification number is received from the payee in the manner required. Once the payor receives the payee's taxpayer identification number in the manner required, the payor must stop withholding. See A–17 of § 35a.9999–2 for determining when a payor is treated as having received a taxpayer identification number. The same rule applies with respect to a payee certification failure under section 3406(a)(1)(D). If more than one condition applies for imposing backup withholding, a payor is required to withhold until all of the conditions for imposing backup withholding cease to apply.

Confidentiality

Q–42. What use may a payor make of information obtained under the backup withholding rules?

A–42. A payor may use information obtained under the backup withholding rules (including any information with respect to any payee certification failure other than failure to certify the payee's taxpayer identification number) only for the purposes of complying with the backup withholding and information reporting requirements, or to the extent otherwise permitted by the Code. Any other use of this information may subject the payor to civil damages under section 7431 of at least $1,000 plus the cost of the action.

Q–43. May a payor impose a surcharge to cover the cost of backup withholding on an account?

A–43. No. If the payor imposes a surcharge on such an account, the payor is liable to the payee under section 7431 for an unauthorized use of information obtained by the payor under section 3406.

Q–44. If a payor imposes backup withholding on a payee, may the payor use this information in determining whether to extend credit to the payee?

A–44. No. If the payor uses this information in making its decision, the payor is liable to the payee under section 7431 for an unauthorized use of

information obtained pursuant to section 3406.

Q–45. If a payor is notified to begin withholding on payments made with respect to a payee and the payor provides notice to the payee of the withholding, has the payor made an unauthorized disclosure under section 7431?

A–45. No. If, for example, a payor receives a notice from a broker of the requirement to withhold with respect to a payee and the payor, pursuant to A–39 of § 35a.9999–1 and A–18 of § 35a.9999–2, provides notice to the payee of such withholding, the payor has no liability to the payee under section 7431.

Miscellaneous

Q–46. If a payor withholds on any payment and the payment is less than the minimum amount for which an information return is required, is the payor required to make an information return and furnish a statement to the recipient?

A–46. Yes. Whenever the payor imposes backup withholding, the payor is required to make an information return regardless of the amount of the payment. The information return shall show the payee's name, address, and taxpayer identification number, the amount of the payment (or aggregate payments to the payee during the calendar year), and the amount of tax withheld. The information return must be provided to the Service no later than February 28 of the year following the calendar year of payment. In addition, the payor is required to furnish a statement to the payee showing the same information, including the amount of tax withheld no later than January 31 of the year following the calendar year of payment.

Q–47. Does backup withholding apply to partnerships?

A–47. Backup withholding generally will apply to a payment to a partnership if the partnership does not provide its correct employer identification number to the payor in the manner required. In addition, the partnership will be required to withhold on all reportable payments that a partnership makes to a payee who is subject to backup withholding. Distributions by a partnership to its partners of their distributive share of partnership income, however, are not reportable payments, so that backup withholding does not apply to such distributions, except to the extent such distributions are reportable under section 6045.

Q–48. May payors require that a separate Form W–9 be filed for each account or instrument held by a payee?

A–48. Yes. See A–29 of § 35a.9999–1. However, a payor at its option, may require a payee to file only one Form W–9 for all accounts or instruments of the payee. For example, a bank may permit a payee to file one Form W–9 for all savings, interest-bearing checking, or other accounts the payee has with the bank. In addition, a payee of a mutual fund that has a common investment advisor or common principal underwriter with other mutual funds will 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.

Q–49. Do the general rules for deposit, payment, penalties, and reporting of taxes withheld from wages apply to backup withholding?

A–49. Yes. Section 3406(h)(1) provides generally that payments subject to backup withholding shall be treated as wages. Thus, the general procedures for withholding, deposit, payment, and reporting of Federal tax withheld shall apply to payments subject to backup withholding. For example, section 6205 provides that an employer (payor) who makes an undercollection of income tax required to be withheld shall correct such error for the return period in which the undercollection is ascertained. Accordingly, section 6205 requires the employer (payor) to withhold amounts from subsequent payments to the employee (payee) that should have been withheld from prior payments, whether or not such subsequent payments are subject to withholding. Thus, a payor who does not impose backup withholding when required must withhold from subsequent payment to the payee even though the conditions for imposing backup withholding may not exist at the time the subsequent payment is made to the payee.

Q–50. If a payor uses a single employer identification number to report the tax withheld by all its subsidiaries, must all tax withheld with respect to reportable payments by its subsidiaries be aggregated for purposes of determining when tax withheld by them with respect to reportable payments must be deposited under section 6302?

A–50. Yes. All tax withheld under a single employer identification number with respect to reportable payments must be aggregated for purposes of determining when such tax must be deposited.

Q–51. In order for a payor of a reportable interest or dividend payment to be considered to have exercised due diligence in furnishing the correct taxpayer identification number of a payee with respect to an account opened or an instrument acquired after December 31, 1983, what actions must the payor take?

A–51. In general, the payor of an account or instrument that is not a pre-1984 account (as defined in A–34 of § 35a.9999–1 and A–19) must use a taxpayer identification number provided by the payee under penalties of perjury to satisfy the due diligence requirement. Therefore, if, after 1983, a payor permits a payee to open an account without providing proper certification that the taxpayer identification number furnished is correct, and a Form 1099 is filed by the payor with a missing or incorrect number, the payor will be liable for the $50 penalty.

A payor also will be considered to have exercised due diligence with respect to a readily tradable instrument that is not a pre-1984 account if the payor (1) uses a taxpayer identification number furnished by a broker or (2) records on its books a transfer to which the payor was not a party. In addition, a payor with respect to an account or instrument that is not a pre-1984 account will be considered to have exercised due diligence if the payee has complied with the requirements of A–18 of § 35a.9999–2 (exception for a payee who is waiting for receipt of a taxpayer identification number), provided that the payor imposes backup withholding if the payee fails to provide a taxpayer identification number in the manner and within the period required by A–18 of § 35a.9999–2.

When a broker notifies the payor that a payee failed to cerfity or furnish a taxpayer identification number, the payor will be considered to have exercised due diligence if the payor: (1) Imposes backup withholding if the payee did not certify his taxpayer identification number to the payor, (2) provides notice to the payee as provided in A–39 of § 35a.9999–1 and A–18 of § 35a.9999–2, and (3) encloses a postage paid reply envelope.

In addition, to have exercised due diligence, a payor must use the same care in processing a certified taxpayer identification number provided by a payee that a reasonably prudent payor would use in the course of the payor's business in handling account information, such as account numbers and account balances. With respect to window transactions (as defined in A–42 of § 35a.9999–1 and A–9 of § 35a.9999–2), a payor shall be considered to have exercised due diligence only if it uses the taxpayer identification number provided by the payee. If no number is provided, the payor will not be considered to have exercised due diligence.

Q–52. Does the rule of A–5 of § 35a.9999–2 which allows a payor to deliver the mailings described in A–5 and A–6 of § 35a.9999–1 in person or by intra-office mail, apply with respect to mailings requesting a penalties of perjury statement from foreign payees described in A–52 and A–55 of § 35a.9999–1?

A–52. Yes. A payor or broker may deliver the mailings requesting the penalties of perjury statement from foreign payees described in A–52 and A–55 of § 35a.9999–1 provided the mailings are delivered by the same method used by the payor or broker in sending account activity and balance information and other correspondence to the payee.

§ 35a.9999–2 [Amended]

Par. 2. In FR Doc. 83–31748, found at page 53111 (Nov. 25, 1983) the second sentence of A–21 of § 35a.9999–2 is amended to provide as follows: Backup withholding also is not required with respect to any other reportable payment made to an exempt recipient described in § 31.3452(c)–1 (b) through (p) of the Employment Taxes and Collection of Income Tax at Source Regulations, except in the case of (1) payments with respect to barter exchange transactions reportable under section 6045, and (2) payments reportable under sections 6041, 6041A, and 6050A.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 3406 (a), (b), (c), (e), (g), (h), and (i), section 6041, section 6041A(a), section 6042(a), Secton 6044(a), section 6045, section 6049 (a), (b), and (d), section 6103(q), section 6109, section 6302(c), section 6676, and section 7805 of the Internal Revenue Code of 1954 (97 Stat. 371, 372, 373, 376, 377, 378, 379, 26 U.S.C. 3406 (a), (b), (c), (e), (g), (h), and (i); 68A Stat. 745, 26 U.S.C. 6041; 96 Stat. 601, 26 U.S.C. 6041A(a); 96 Stat. 587, 26 U.S.C. 6042(a); 96 Stat. 587, 26 U.S.C. 6044(a); 96 Stat. 600, 26 U.S.C. 6045; 96 Stat. 592, 594, 26 U.S.C. 6049 (a), (b), and (d); 90 Stat. 1685, 26 U.S.C. 6103(q); 75 Stat. 828, 26 U.S.C. 6109; 68A Stat. 775, 26 U.S.C. 6302(c); 68A Stat. 917, 26 U.S.C. 7805) and in sections 104, 105, and 108 of the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369, 371, 380, and 383).

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

Approved: December 16, 1983.

John E. Chapoton,

Assistant Secretary of the Treasury.

[FR Doc. 83–33848 Filed 12–16–83; 4:53 pm]

BILLING CODE 4830–01–M

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 35a

[T.D. 7933]

Temporary Employment Tax Regulations Under the Interest and Dividend Tax Compliance Act of 1983; Backup Withholding

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document supplements the temporary regulations relating to backup withholding. Changes to the applicable tax law were made by the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98–67, 97 Stat. 369). These regulations affect brokers with respect to reportable gross proceeds and provide them with the guidance necessary to comply with the law.

DATE: The temporary regulations are effective for payments made after December 31, 1983.

FOR FURTHER INFORMATION CONTACT: Diane Kroupa of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224, 202–566–3590, not a toll-free call.

SUPPLEMENTARY INFORMATION:

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 of the Internal Revenue Code of 1954 (26 CFR Part 35a.9999–1; 48 FR 45362). Additional temporary regulations were published in the **Federal Register** on November 25, 1983 (26 CFR Part 35a.9999–2; 48 FR 53104) and on December 20, 1983 (26 CFR Part 35a.9999–3; 48 FR 56330). Those regulations were published to conform the regulations to the statutory changes enacted by the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369). These regulations supplement 26 CFR Part 35a.9999–3 (December 20, 1983), by adding Question (Q) and A–28B.

These temporary regulations, presented in question and answer format, are intended to provide guidelines upon which brokers may rely in order to resolve questions specifically set forth herein. However, no inference should be drawn regarding issues not raised herein or reasons certain questions, and not others, are included in these regulations.

Explanation of Provisions

These regulations provide transition rules applicable to backup withholding on gross proceeds reportable by brokers under section 6045. In summary, the regulations provide that, for purposes of backup withholding on gross proceeds, the written certification requirement for post-1983 accounts may be delayed, at the broker's option, until March 31, 1984. Thus, a customer who opens an account after December 31, 1983, and who consummates a sale prior to April 1, 1984, will not be subject to backup withholding, provided that he furnishes a taxpayer identification number to the broker prior to the sale.

In addition, until March 31, 1984, a broker may give customers with pre-1984 accounts, who have not furnished taxpayer identification numbers, 30 days after a sale to provide their numbers, without being subject to backup withholding. Until such a customer provides a number, however, the customer is not permitted to withdraw the cash proceeds from the account. If no number is furnished within 30 days after the sale, the broker must withhold 20 percent of the reportable gross proceeds on the 31st day.

Nonapplicability of Executive Order 12291

The Treasury Department has determined that these temporary regulations are not subject to review under Executive Order 12291 or the Treasury and OMB implementation of the Order dated April 29, 1983.

Regulatory Flexibility Act

No general notice of proposed rulemaking is required by 5 U.S.C. 553(b) for temporary regulations. Accordingly, the Regulatory Flexibility Act does not apply and no Regulatory Flexibility Analysis is required for this rule.

Drafting Information

The principal author of these regulations is Diane Kroupa of the Legislation and Regulations Division of the Office of the Chief Counsel, Internal Revenue Service. Personnel from other offices of the Internal Revenue Service and the Treasury Department participated, however, in developing the regulations on matters of both substance and style.

List of Subjects in 26 CFR Part 35a

Employment taxes, Income taxes, Backup withholding, Interest and Dividend Tax Compliance Act of 1983.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 35a is amended as follows:

PART 35a—[AMENDED]

Section 35a.9999–3 is amended by adding new Question Q–28B and Answer A–28B immediately after A–28A of that section. These added provisions read as follows:

§ 35a.9999–3 Questions and answers concerning backup withholding.

* * * * *

Q–28B. Will transition rules apply to backup withholding on gross proceeds reportable by brokers under section 6045?

A–28B. Yes. The following transition rules will apply until April 1, 1984. First, for purposes of backup withholding on gross proceeds reportable by brokers, the penalties of perjury certification required by A–12 of § 35a.9999–2 (for post-1983 accounts) may be waived, at the broker's option, until April 1, 1984. A customer who opens an account after December 31, 1983, and who consummates a sale prior to April 1, 1984, will not be subject to backup withholding, provided that the customer furnishes a taxpayer identification number to the broker prior to the sale. The gross proceeds from sales made through post-1983 accounts after March 31, 1984, however, will be subject to backup withholding if the customer does not provide a taxpayer identification number certified under penalties of perjury. See A–28A for special rules applicable when a sale is made pursuant to a telephone instruction.

Second, until April 1, 1984, the gross proceeds from a sale made through a pre-1984 account, by a customer who has not provided a taxpayer identification number, will not be subject to backup withholding, at the broker's option, provided that (1) the customer furnishes his number to the broker within 30 days after the date of the sale, and (2) the customer does not withdraw the proceeds of the sale prior to the time his taxpayer identification number is furnished to the broker (or backup withholding is applied). For purposes of the preceding sentence, an investment of the cash proceeds shall be considered a withdrawal by the customer; however, investment of the proceeds in other property shall be permitted if, at all times during the 30-day period, at least 20 percent of all gross proceeds reportable under section 6045 are held in cash within the customer's account by the broker. If the customer does not furnish his taxpayer identification number within 30 days after the date of sale, the broker must withhold 20 percent of all reportable gross proceeds on the 31st day after the date of the sale.

If, with respect to forward contracts, regulated futures contracts, security short sales, or issuer payment of debt

securities, the broker applies backup withholding on a date other than the sale date (see A–23 through A–25 and A–27), the rules of this A–28B shall apply as if any date on which the broker determines whether backup withholding applies were a sale date.

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 3406 (a), (b), (c), (e), (g), (h), and (i) and section 6045 of the Internal Revenue Code of 1954 (97 Stat. 371, 372, 373, 376, 377, 378, 379, 26 U.S.C. 3406 (a), (b), (c), (e), (g), (h), and (i); 96 Stat. 600, 26 U.S.C. 6045) and in section 104 of the Interest and Dividend Tax Compliance Act of 1983 (97 Stat. 369, 371).

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

Approved:

Ronald A. Pearlman,

Acting Assistant Secretary of the Treasury.

December 29, 1983.

[FR Doc. 83–34234 Filed 12–29–83; 4:48 pm]

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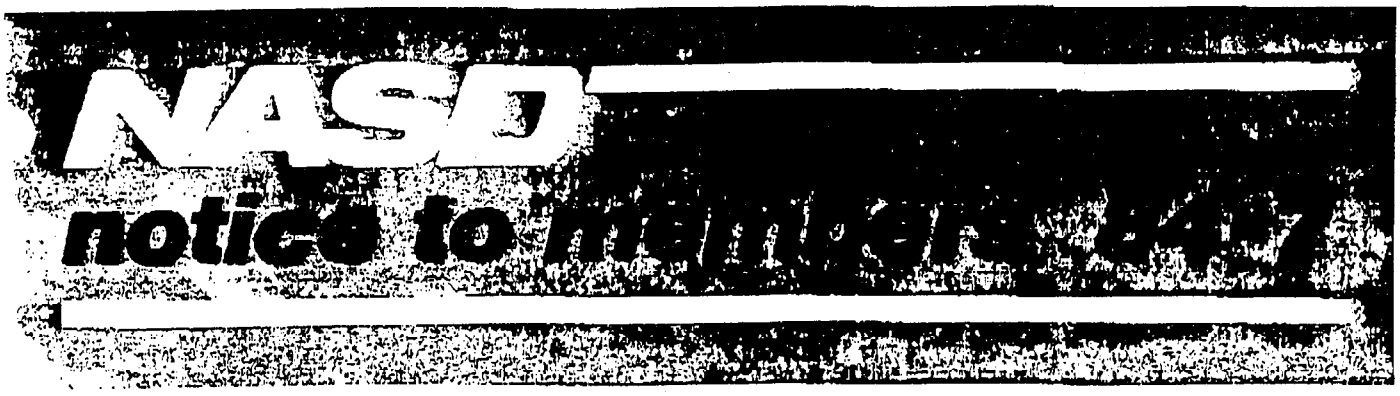

January 30, 1984 84-7

IMPORTANT

OFFICERS, PARTNERS AND PROPRIETORS

TO: All NASD Members and Other Interested Persons

RE: SEC Staff Interpretations of Rule 15c2-4

SUMMARY

In response to a request by the Association, the staff of the SEC's Division of Market Regulation has recently issued its views on frequently raised interpretive questions regarding Rules 15c2-4 (the "Rule") under the Securities Exchange Act of 1934 (the "Act"). The SEC staff's views are set forth in a question and answer format and are presented to assist Association members who are involved in best efforts, "all or none" or other contingency underwritings.

The Rule applies to best efforts distributions of securities. The Rule prescribes procedures for such distributions conducted on an "all-or-none" basis, or on any other basis on which payment will not be made to the issuer until some further event or contingency occurs (e.g., a "minimum-maximum" offering). It requires a broker-dealer participant either to promptly deposit investors' funds received into a separate bank account, as agent or trustee for those investors, or to promptly transmit such funds to a bank escrow agent, pending the occurrence of the contingency. The purpose of the Rule is to insulate offering proceeds from unlawful activities by, or the financial reverses of, the broker-dealer participating in the offering and thus to ensure that the issuer will receive the full proceeds promptly if the contingency occurs or that investors will receive a prompt reimbursement of all of their funds if the contingency does not occur. Under the Rule, a broker's obligation with regard to funds received depends on whether it is a "$5,000 broker-dealer" or a "$25,000 broker-dealer" under the SEC's net capital rules. Upon receipt of an investor's funds, a "$25,000 broker-dealer" has two options:

(1) To act as agent or trustee for a separate bank account until the contingency occurs; or

(2) To transmit the monies to an unaffiliated bank to hold in escrow for the investors until the contingency occurs.

Pursuant to Rule 15c3-1(a)(2) under the Act, a "$5,000 broker-dealer" may only receive and promptly transmit investors' checks which are payable to an unaffiliated bank escrow agent.

QUESTIONS AND ANSWERS

The SEC staff has prepared the following answers to a list of questions raised by the NASD concerning Rule 15c2-4.

(1) **Question:** Where a customer's check is payable to the issuer or the bank escrow agent, but is physically received by the broker-dealer, is money "received" within the meaning of the Rule?

Answer: Yes, this situation is governed by the provisions of the Rule. A check constitutes "money" under the Rule, and in the above situation money has been "received" for the purposes of the Rule. 1/ A "$5,000 broker-dealer" may only physically receive and promptly transmit checks payable to an unaffiliated bank escrow agent.

(2) **Question:** Where a customer's check is payable to the issuer (or an affiliate of the issuer) but a broker-dealer does not physically receive the check, is money "received" within the meaning of the Rule?

Answer: Direct receipt of an investor's funds by an issuer (or an affiliate of the issuer) is not a circumstance addressed by the Rule. 2/ Although a narrow construction of the Rule's provisions might arguably lead to the conclusion that direct receipt by the issuer does not violate the Rule, direct receipt by

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1/ Broker-dealers are also required by Rules 17a-3 under the Act to record by memorandum any receipt of customer funds for the purchase of a security even if the customer's check is payable to the issuer or bank escrow account.

2/ Direct receipt of investors' funds by the issuer in a best efforts contingent underwriting was not anticipated or addressed by the Commission when it adopted the Rule in 1962. See Securities Exchange Act No. 6737 (February 21, 1962) and Securities Exchange Act Release No. 6689 (December 21, 1961).

the issuer could result in difficulties with respect to the maintenance of required books and records by the broker-dealer. In addition, if funds are sent directly to the issuer, and the issuer converts the funds or goes bankrupt, the broker may expose itself to liability. The Commission's staff, therefore, believes that the better practice is to have investors' funds sent directly to the broker-dealer. 3/

(3) **Question:** Is the Rule complied with if an investor's check is made payable to the broker-dealer with the understanding that it will be held or not deposited in a separate bank account or transmitted into escrow until some later date (such as until shortly before the termination of the offering)?

Answer: Under the Rule, such a delay is inappropriate. The monies must be deposited or transmitted "promptly" (as defined in Answer 6). The broker-dealer may not delay depositing or transmitting checks.

(4) **Question:** In a contingent offering of limited partnership interests, is money "received" within the meaning of the Rule under the following arrangement?

> A broker-dealer receives an investor's check accompanied by a signed subscription, which it forwards to the general partner for acceptance. Pending acceptance, the broker-dealer is authorized by the investor to invest his funds in a money market fund registered under the Investment Company Act of 1940. Upon acceptance of the subscription by the general partner, the broker-dealer, pursuant to a revocable letter of authorization, will sell a number of shares of the money market fund equal in value to the subscription price and forward the proceeds to the general partner.

Answer: In this situation, because the customer's check is accompanied by a signed subscription agreement,

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3/ However, a "$5,000 broker-dealer" may not receive customer funds unless the customer's check is payable to a bank escrow agent. See Rule 15c3-1(a)(2).

money is "received" within the meaning of the Rule and the broker-dealer must "promptly deposit" it in a separate bank account or "promptly transmit" it to a bank to be held in escrow. The broker-dealer is not permitted to temporarily invest the funds in a money market fund.

(5) **Question:** Is the Rule complied with if an investor writes a check payable to a "$25,000 broker-dealer" who, in turn, promptly writes its own check or wires funds to a separate bank account or escrow account?

Answer: Yes, this complies with Rule 15c2-4. However, Rule 10b-9 would also have to be considered. 4/ In "all-or-none" or minimum-maximum" offerings, investors' funds may not be forwarded to the issuer until the required minimum number of securities has been sold and fully paid for in customer funds that have cleared the banking system. A broker-dealer may not substitute its own good check for the check of a customer that has insufficient funds in order to satisfy the contingency. See SEC No-Action Letter issued to Brodis Securities Incorporated (November 14,1983).

(6) **Question:** What do the terms "promptly deposited in a separate bank account" and "promptly transmitted" mean under the Rule?

Answer: Absent unusual circumstances, funds should be deposited or transmitted as soon as practicable after receipt. In contingent offerings not requiring suitability determinations by the issuer or the general partner, funds should be deposited or transmitted by noon of the next business day. In contingent offerings requiring suitability determinations by the issuer or general partner (for example, most direct participation programs) where investors' checks are made payable solely to the bank escrow agent but delivered to the broker-dealer, prompt transmittal may be accomplished by forwarding the checks to the escrow agent either by noon of the

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4/ Under Rule 10b-9 a representation that an offering is on an "all or none" or "minimum-maximum" basis constitutes a manipulative or deceptive device prohibited by Section 10(b) unless prompt refunds are made to purchasers if the represented number of securities are not sold in bona fide transactions at the specified price within the specified time and if the total amount due the seller is not received by it by the specified date.

next business day or by noon of the second business day after receipt of the subscription by the issuer or general partner. If the latter option is used, the subscription must be forwarded to the issuer or general partner by noon of the next business day after receipt of the funds. See SEC Interpretive Letter issued to Lowell H. Listrom & Company, Inc. (April 27, 1983).

(7) **Question:** How is compliance with the Rule affected where the issuer (or general partner of the issuer) and a broker-dealer participating in the distribution are affiliated?

Answer: Where an investor sends his check directly to an issuer that is affiliated with a participating broker-dealer, "receipt" of the funds is considered to be made by the broker-dealer when the issuer receives the check. Therefore, the Rule applies and the broker-dealer is responsible for ensuring that the issuer promptly transmits the funds to an independent escrow account.

Since the Rule imposes an obligation on a broker-dealer to ensure that funds received by it are not dissipated in any fashion and not disbursed to the issuer unless the contingency has been fully satisfied, where an issuer and a broker-dealer are affiliated, the broker-dealer should not act as agent or trustee for the funds. See Securities Exchange Act Release No. 11532 (July 11, 1975). Instead, an escrow agent should be used that is a bank unaffiliated with both the issuer (or the general partner of the issuer) and the broker-dealer.

(8) **Question:** In an offering of securities (such as limited partnership interests) where an "all-or-none" or "minimum-maximum" is involved, how does a requirement that the issuer or general partner personally approve each prospective investor or limited partner for suitability affect compliance with either Rule 15c2-4 or Rule 10b-9?

Answer: In an "all-or-none" or "minimum-maximum" offering, Rule 10b-9 must be considered if the issuer or general partner is required to approve the investor for suitability or otherwise. The specified minimum or total will be not be considered "sold" in bona fide transactions until such minimum or total has been accepted for subscription by the issuer or general partner.

(9) **Question:** Does the Rule apply to private placements done on a best efforts basis in light of the use of the term "distribution" in the Rule?

Answer: Yes, the Rule does apply to such private placements. This issue was addressed by the SEC in a recent decision. See Baikie & Alcantara, Inc., Securities Exchange Act Release No. 19410 (January 6, 1983). To the extent a private placement meets the definition of a distribution under Rule 10b-6, a private placement would be a distribution under Rule 10b-6(c)(5) under the Act, which defines the term "distribution."

(10) **Question:** May some person other than a bank (e.g., an attorney for the broker-dealer) act as an escrow agent within the meaning of the Rule?

Answer: No, the escrow agent must be a bank that is unaffiliated with either the issuer or the broker-dealer.

(11) **Question:** May the lawyer for the broker-dealer be the "agent or trustee" for the separate bank account established pursuant to paragraph (b)(1) of the Rule?

Answer: No, the lawyer of the broker-dealer or some other person could not act as agent or trustee of the separate bank account. The phrase "as agent or trustee" in the Rule refers to the broker-dealer. Among other things, this affords the SEC and the NASD clear examination authority of the separate bank account. Also, only a "$25,000 broker-dealer" may be the agent or trustee of the separate bank account.

(12) **Question:** If a "$25,000 broker-dealer" establishes an escrow account or separate bank account to hold customer funds received in connection with an "all-or-none" or other contingency-type offering in accordance with Rule 15c2-4(b)(1) or (2), must the broker-dealer include the customer funds so held as "Item 1" credits for purposes of computing the reserve formula requirements under Exhibit A to Rule 15c3-3 under the Act?

Answer: No.

(13) **Question:** What are the permissible investments that may be made by an agent, trustee or bank escrow agent under Rule 15c2-4?

Answer: Rule 15c2-4(b)(1) and (2) specify that funds must be deposited in, or transmitted to, a bank by such persons. Therefore, bank accounts, including saving

accounts and bank money market accounts, are the types of investments permitted under Rule 15c2-4. [5/] The monies must be held in a bank account that enables the agent, trustee, or escrow agent to "promptly" or "directly" transmit or return such funds to the person entitled thereto when the appropriate event or contingency has occurred or failed to occur. The definition of a "bank" is contained in Section 3(a)(6) of the Act and does not, for example, include a savings and loan association. [6/]

In addition, with respect to offering proceeds transmitted to a bank escrow account pursuant to Rule 15c2-4(b)(2), the staff of the Division of Market Regulation will not recommend that the SEC take enforcement action under the Rule if the bank escrow agent invests offering proceeds in either short-term certificates of deposit issued by a bank, or short-term securities issued or guaranteed by the United States Government.

Any such investment in time deposits, short term bank certificates of deposit, or short term U. S. Goverment-backed securities must be made in recognition of the Rule's requirement that offering proceeds held in a separate bank account or escrow be transmitted promptly to the issuer or the investor once the contingency has or has not occurred. Thus, it would be inappropriate for a bank escrow agent to invest in an otherwise permissible instrument under the Rule if that instrument's maturity date extends beyond the anticipated contingency occurence date, unless such instrument can be readily sold or otherwise disposed of for cash by the time the contingency occurs without any dissipation of the offering proceeds invested.

The following securities are not permissible investments within the meaning of Rule 15c2-4:

(a) money market funds;
(b) corporate equity or debt securities;
(c) repurchase agreements;

5/ A trustee may also be restricted to certain investments by the fiduciary laws of a particular state.

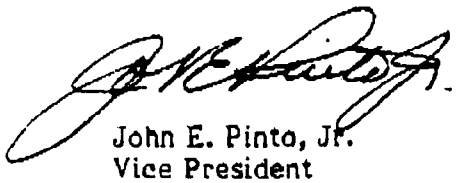
6/ But cf., Investment Company Act Release No. 13666 (December 12, 1983).

(d) banker's acceptances;
(e) commercial paper; and
(f) municipal securities.

* * * *

Questions or comments with regard to the interpretations in this Notice should be addressed to William Schief, Director of Regional Attorneys, Surveillance Department at (202) 728-8229 or the SEC's Division of Market Regulation (Office of Trading Practices) at (202) 272-2848.

Sincerely,



John E. Pinto, Jr.
Vice President
Surveillance