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out of each subsequent payment made before January 1, 1984.

g–22. Q. Will the notice requirements of section 3405 apply before July 1, 1983, with respect to recipients of periodic payments that total less than $5400 per year?

A. No.

g–23. Q. Will the notice and withholding requirements of section 3405 apply before July 1, 1983, with respect to payments to nonresident alien individuals?

A. No.

g–24. Q. Does a payor or plan administrator who requested a delay prior to the publication of these procedures in the FEDERAL REGISTER *need to resubmit the request in light of these procedures?*

A. Yes. In order to be entitled to a delay, payors and plan adminstrators must follow the procedures required by these temporary regulations.

g–25. Q. Will the notice and withholding requirements of section 3405 apply before January 1, 1984, with respect to the exchange or complete or partial surrender of a commercial annuity under which the recipient had not irrevocably chosen, prior to January 1, 1984, to receive payments in the form of an annuity?

A. In the case of the exchange or complete or partial surrender of a commercial annuity under which the recipient had not irrevocably chosen, prior to January 1, 1984, to receive payments in the form of an annuity, the application of the notice and withholding provisions of this section may be delayed, so long as undue hardship exists, up to January 1, 1984. Prior approval from the Internal Revenue Service is not required for such delay, and should not be requested. For purposes of this delay, undue hardship will be presumed to exist, in the absence of bad faith, so long as the payor can establish that at least one of the conditions in question g–6 is present. The payor should prepare and retain a statement of undue hardship as described in question g–9 and should maintain any documents necessary to support the representations made in that statement.

[T.D. 7839, 47 FR 45868, Oct. 14, 1982; 47 FR 47241, Oct. 25, 1982; as amended by T.D. 7858, 47 FR 54066, Dec. 1, 1982; 47 FR 57021, Dec. 22, 1982; T.D. 7904, 48 FR 35091, Aug. 3, 1983; 48 FR 36449, Aug. 11, 1983. Redesignated by T.D. 8873, 65 FR 6007, Feb. 8, 2000]

EFFECTIVE DATE NOTE: By T.D. 8873, 65 FR 6007, Feb. 8, 2000, §35.3405–1T was redesignated from §35.3405–1, effective Jan. 1, 2001.

PART 35a—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE INTEREST AND DIVIDEND TAX COMPLIANCE ACT OF 1983

Sec.

35a.3406–2 Imposition of backup withholding for notified payee underreporting of reportable interest or dividend payments.
35a.9999–0 Effective date.
35a.9999–1 Questions and answers concerning the due diligence requirement and the certification requirements in connection with backup withholding and other related issues.
35a.9999–2 Questions and answers concerning due diligence and issues in connection with backup withholding.
35a.9999–3 Questions and answers concerning backup withholding.
35a.9999–3A Question and answer relating to exemption from backup withholding for certain principal payments made outside the United States by brokers on certain obligations.
35a.9999–4T Questions and answers relating to the application of information reporting and backup withholding to payments by foreign offices of United States and foreign brokers and by United States offices of banks and brokers, and other related matters (temporary).
35a.9999–5 Questions and answers relating to repeal of 30 percent withholding by section 127 of the Tax Reform Act of 1984 and to the application of information reporting and backup withholding in light of such repeal.

AUTHORITY: 26 U.S.C. 7805; §35a.3406–2 also issued under 26 U.S.C. 3406(c)(3)(D) and 3406(i).

§35a.3406–2 Imposition of backup withholding for notified payee underreporting of reportable interest or dividend payments.

(a) *Requirement that a payor backup withhold due to a notified payee underreporting*—(1) *In general.* Except as otherwise provided in paragraph (a)(5) of this section, backup withholding under section 3406(a)(1)(C) applies to any reportable interest or dividend payment (as defined in section 3406(b)(2) and paragraph (a)(4) of this section) made to a payee, if the Internal Revenue Service or a broker (as defined in section 3406(h)(5) and paragraph (a)(7) of this section and pursuant to section 3406(d)(2)(B)(ii)(III)) notifies a payor (as defined in section 3406(h)(4) and in paragraph (a)(6) of this section) that

the payee is subject to backup withholding due to a notified payee underreporting (as defined in paragraph (a)(2) of this section). The payor is required under section 3406(c)(4) and paragraph (c)(1) of this section to inform the payee that backup withholding under section 3406(a)(1)(C) has begun. The requirements for the notice that a payor must send to a payee are set forth in paragraph (c) (2) and (3) of this section. The period for which backup withholding is required due to a notified payee underreporting is described in section 3406(e)(3)(A) and in paragraph (e) of this section. See section 3406(c)(3) and paragraph (g) of this section for the rules regarding how a payee may obtain a determination from the Internal Revenue Service that withholding under section 3406(a)(1)(C) be stopped or not started.

(2) *Definition of notified payee underreporting.* The term ''notified payee underreporting'' means that the Internal Revenue Service has—

(i) Determined that there was a payee underreporting as defined in paragraph (a)(3) of this section,

(ii) Mailed at least four notices to the payee (over a period of at least 120 days) with respect to the underreporting as prescribed in paragraph (f)(1) of this section, and

(iii) Assessed any deficiency attributable to the underreporting in the case of any payee who has filed a return.

(3) *Definition of a payee underreporting.* The term ''payee underreporting'' means that the Internal Revenue Service has determined, for a taxable year, that—

(i) A payee failed to include in his return of tax under chapter 1 of the Internal Revenue Code for such year any portion of a reportable interest or dividend payment required to be shown on such tax return, or

(ii) A payee may be required to file a return for such year and to include a reportable interest or dividend payment in such return, but failed to file such return.

See paragraph (a)(5) of this section for certain payments to be taken into account in determining whether there is payee underreporting even though those payments may not be defined as reportable interest or dividend payments in paragraph (a)(4) of this section or even though backup withholding under section 3406(a)(1)(C) may not apply to such payments.

(4) *Definition of a reportable interest or dividend payment*—(i) *In general.* See section 3406(b)(2), A–2 of § 35a.9999–1, A–5 of § 35a.9999–3, and A–15 of § 35a.9999–2 for the definition of reportable interest or dividend payment.

(ii) *Exceptions*—(A) *Patronage dividends.* Patronage dividends are treated as reportable interest or dividend payments for purposes of backup withholding under section 3406(a)(1)(C) only if 50 percent or more of the reportable amount is paid in money or by qualified check (as defined in section 1388(c)(4)), and then only to the extent that the payment is in money or by qualified check. See the second paragraph in A–10 of § 35a.9999–3 for an example of how this rule applies.

(B) *Window payments.* Pursuant to section 3406(b)(7), window payments as defined in A–42 of § 35a.9999–1 and A–9 of § 35a.9999–2 are not treated as reportable interest or dividend payments for purposes of backup withholding under section 3406(a) (1)(C).

(5) *Reportable interest or dividend payments excluded from backup withholding.* The following reportable interest or dividend payments are not subject to backup withholding:

(i) *Certain dividends.* Certain dividend payments as defined in A–9 of § 35a.9999–3.

(ii) *Minimal payments.* Minimal payments as defined in A–19 of § 36a.9999–2 if the payor elects not to impose backup withholding on such amounts.

(iii) *Original issue discount.* Original issue discount as defined in section 1273, unless there is a payment in cash. See A–15 of § 35a.9999–2.

(iv) *Payments subject to other withholding.* Payments already subject to withholding under another provision of the Internal Revenue Code.

Reportable minimal payments (to the extent reported on an information return), patronage dividends, original issue discount, and window payments shall be taken into account in determining whether underreporting (as defined in paragraph (a)(3) of this section) has occurred, even though those

payments may not be defined as reportable interest or dividend payments under paragraph (a)(4) of this section or even though backup withholding under section 3406(a)(1)(C) may not apply to such payments.

(6) *Definition of payor.* See section 3406(h)(4), A–41 of § 35a.9999–1, and A–1 of § 35a.9999–3 for the definition of payor. The term payor includes a broker who holds an instrument in street name.

(7) *Definition of broker.* See section 3406(h)(5) for the definition of broker.

(b) *Notice to payors and brokers regarding backup withholding*—(1) *Notice from the Internal Revenue Service.* The Internal Revenue Service will notify—

(i) Payors to begin backup withholding on reportable interest or dividend payments due to a notified payee underreporting pursuant to section 3406(a)(1)(C); and

(ii) Brokers pursuant to section 3406(c)(5) that a payee is subject to backup withholding under section 3406(a)(1)(C).

(2) *Notice from a broker.* A broker who receives a notice from the Internal Revenue Service that a payee is subject to backup withholding due to a notified payee underreporting and through whom the payee subsequently acquires a readily tradable instrument (as defined in section 3406(h)(6)) with respect to which the broker is not the payor is required to notify the payor of that instrument that the payee is subject to backup withholding under section 3406(a)(1)(C) in the time and manner provided in A–41 of § 35a.9999–1.

(3) *Accounts subject to backup withholding.* (i) *In general.* After receiving notice from the Internal Revenue Service or from a broker, as provided in section 3406(d)(2)(B) and paragraphs (b)(1)(i) and (2) of this section, that a payee is subject to backup withholding under section 3406(a)(1)(C), payors are required to withhold 20 percent of all reportable interest or dividend payments subject to backup withholding made with respect to all accounts of the payee.

(ii) *Joint accounts.* Payors are required to withhold on joint accounts if the payee subject to backup withholding under section 3406(a)(1)(C) is the first person listed on the account at the time the payor receives the notice to begin backup withholding. Backup withholding shall continue to apply to reportable interest and dividend payments made to that account even if the order of the names on the account is subsequently changed, provided that the name of the payee subject to backup withholding remains on the account.

(iii) *Exception.* Payors are not requied to withhold on reportable interest or dividend payments made with respect to an account of the payee that could not be located with reasonable care. The payor will be considered to have exercised reasonable care if the payor uses the name and taxpayer identification number (or names and taxpayer identification numbers if a joint return was filed by the payees) provided on the notice from the Internal Revenue Service or from a broker as prescribed in paragraphs (b)(1)(i) and (2) of this section and in certain circumstances identified in this paragraph (b)(3)(iii) any account numbers provided by the Internal Revenue Service in locating all accounts of a payee or payees. If a payee uses a different name on an account than the name stated on the notice from the Internal Revenue Service or from a broker (for instance, due to marriage or adoption) and the payor can associate both names with the payee using records kept in the ordinary course of business, the payor will be treated as exercising reasonable care if the payor uses both names to locate accounts of the payee. If the taxpayer identification number is not provided to the payor or broker by the Internal Revenue Service, or if the taxpayer identification number provided by the Internal Revenue Service does not match the taxpayer identification number of the payee on the records that the payor or broker maintains in the ordinary course of business, the payor or broker is required to use any account numbers provided by the Internal Revenue Service to identify the payee and the payee's taxpayer identification number. This information must be used by the payor to locate other accounts of the payee and by the broker to locate the payors with respect to whom the payee subsequently

acquires a readily tradable instrument through that broker.

(c) *Notice from payors of backup withholding due to a payee underreporting*—(1) *In general.* A payor is required under section 3406(c)(4) to notify the payee in accordance with paragraph (c)(2) of this section that backup withholding has begun because of a notified payee underreporting. Payors who are notified by a broker that a payee is subject to backup withholding under section 3406(a)(1)(C) are also required to send the notice in accordance with paragraph (c)(2) of this section. As a result, the notice requirements provided in A–39 of § 35a.9999–1 and in the appendix to § 35a.9999–2 shall not apply to those payors notified by a broker that a payee is subject to backup withholding under section 3406(a)(1)(C). The payor must send the notice required by paragraph (c)(2) of this section to the payee no later than 15 days after the date that the payor makes the first payment subject to backup withholding under section 3406(a)(1)(C). The payor must send the notice of backup withholding by first-class mail to the payee at his last known address. Rules similar to the rules in A–17, A–18, A–19, and A–20 of § 35a.9999–1 shall apply to the requirement to provide notice by first-class mail.

(2) *Form of the notice to the payee with respect to notified payee underreporting.* The notice to the payee required by paragraph (c)(1) of this section must state—

(i) That the Internal Revenue Service has given notice that the payee has underreported reportable interest or dividends;

(ii) That, as a result of such underreporting, the payor is required under section 3406(a)(1)(C) of the Internal Revenue Code to withhold 20 percent of reportable interest and dividend payments made to the payee no later than the close of the day 30 days after the date that the payor received the notice;

(iii) The date that the payor received the notice to begin backup withholding under 3406(a)(1)(C);

(iv) That the payee must obtain a determination from the Internal Revenue Service in order to stop the backup withholding under section 3406(a)(1)(C); and

(v) That while he is subject to backup withholding due to payee underreporting, the payee may not certify to a payor making reportable interest or dividend payments (or to a broker acquiring a readily tradable instrument for the payee) that he is not subject to backup withholding under section 3406(a)(1)(C). See section 3406(a)(1)(D) for the backup withholding rules with respect to a payee's failure to make the certification under section 3406(a)(1)(D).

(3) *Exceptions.* A notice provided to a payee on or before April 23, 1987, will be deemed to satisfy the provisions of paragraph (c)(2) of this section if it informs the payee that the payor has been instructed by the Internal Revenue Service to start backup withholding on reportable interest or dividend payments to the payee. If a payor who has started backup withholding due to notified payee underreporting on or before April 23, 1987, has not provided adequate notice to the payee on or before April 23, 1987, then the payor must provide notice to the payee in the manner prescribed in paragraph (c)(2) of this section by the date that is 45 days after April 23, 1987.

(d) *Notice to stop backup withholding*—(1) *In general.* The Internal Revenue Service will provide written certification to the payee that backup withholding is to stop and will notify the payors who were contacted pursuant to paragraph (b) of this section to stop withholding after the Internal Revenue Service makes a determination under paragraph (g) of this section that backup withholding with respect to a payee should stop. The Internal Revenue Service will also notify the brokers who were contacted pursuant to paragraph (b) of this section that the payee is no longer subject to backup withholding under section 3406(a)(1)(C) and that the brokers are no longer obligated to provide notices to payors under paragraph (b)(2) of this section. A broker who receives certification under this section from the Internal Revenue Service is not required to provide the certification to any payors to

which the broker has previously provided the notice required under paragraph (b)(2).

(2) *Date notice to stop withholding will be provided*—(i) *Underreporting corrected or bona fide dispute.* If the Internal Revenue Service makes a determination as set forth in paragraph (g)(1) (ii) or (iv) of this section during the 12-month period ending on October 15, of any calendar year, the Internal Revenue Service will provide the certification or notice required by paragraph (d)(1) of this section no later than December 1 of such calendar year.

(ii) *No underreporting or undue hardship.* If the Internal Revenue Service makes a determination as set forth in paragraph (g)(1) (i) or (iii), the Internal Revenue Service will provide the notices required by paragraph (d)(1) of this paragraph no later than the 45th day after the day on which the Internal Revenue Service makes its determination.

(e) *Period during which withholding is required*—(1) *In general.* Upon receiving notice from the Internal Revenue Service after April 23, 1987, to begin backup withholding under section 3406(a)(1)(C) or notification from a broker stating that the payee is subject to backup withholding under section 3406(a)(1)(C), the payor must impose backup withholding on all reportable interest and dividend payments made to the payee during the period beginning after the close of the 30th day after the day on which the payor receives the notice provided in paragraph (b) (1)(i) or (2) of this section and ending as of the close of the day before the stop date (as described in paragraph (e)(2) of this section). Pursuant to section 3406(e)(5)(C), the payor may elect to begin backup withholding at any time during the 30-day period described in this paragraph.

(2) *Stop date*—(i) *Underreporting corrected or bona fide dispute.* In the case of a determination that the underreporting has been corrected or that a bona fide dispute exists (as defined in paragraphs (g)(1)(ii) or (iv) of this section), the stop date is—

(A) January 1 following the 12-month period ending on October 15th of any calendar year in which the determination has been made or, if later,

(B) The day that is 30 days after the earlier of—

(*1*) The date on which the payor receives written notification from the Internal Revenue Service (under paragraph (d)(2) of this section) that withholding is to stop; or

(*2*) The date on which the payor receives a copy of the written certification provided to the payee by the Internal Revenue Service that withholding is to stop.

(ii) *No underreporting or undue hardship.* In the case of a determination that no payee underreporting occurred or that an undue hardship exists or could exist (as defined in paragraph (g)(1)(i) or (iii) of this section), the stop date is that date specified in paragraph (e)(2)(i)(B) of this section.

(iii) *Payor election to shorten or eliminate grace period.* The payor with respect to any payee may elect to determine the stop date without regard to the grace period provided in section 3406(e)(5)(B) (*i.e.*, without regard to the words ''the day that is 30 days after'' in paragraph (e)(2)(i)(B) of this section) or by substituting a shorter grace period.

(iv) *Examples.* The provisions of paragraph (e)(2)(i) may be illustrated by the following examples:

Example 1. The Internal Revenue Service makes a determination by October 15, 1987, that any underreporting with respect to A has been corrected. X, a payor who has been notified to backup withhold on payments of interest to A due to notified payee underreporting, receives written notice from the Internal Revenue Service on December 1, 1987, informing X that A is no longer subject to backup withholding under section 3406(a)(1)(C) and that X must stop backup withholding as of the close of December 31, 1987, or if later, the earlier of the close of the day 30 days after receipt of the notice from the Internal Revenue Service or receipt of the copy of the written certification provided to the payee by the Internal Revenue Service. The stop date, as provided in paragraph (e)(2)(i)(A) of this section, is January 1, 1988, and the payor must stop backup withholding as of the close of December 31, 1987.

Example 2. Assume the same facts as in *Example 1* except that X, due to a change of address or for other reasons, does not receive the notice from the Internal Revenue Service to stop backup withholding until December 15, 1987. In addition, A does not provide X with a copy of the certification that was provided to A by the Internal Revenue Service until December 15, 1987. The stop date, as

provided in paragraph (e)(2)(i)(B) of this section, is January 14, 1988 (30 days after December 15, 1987), because that date is later than January 1, 1988. However, if a payor elects pursuant to section 3406(e)(5)(C) and paragraph (e)(2)(iii) of this section to determine the stop date without regard to that 30-day grace period, the stop date is January 1, 1987.

Example 3. Assume the same facts as in *Example 2* except that on December 10, 1987 (rather than on December 15, 1987), A provides X with a copy of the certification from the Internal Revenue Service. The stop date, as provided in paragraph (e)(2)(i)(B) of this section, is January 9, 1988 (30 days after December 10, 1987), because that date is earlier than January 14, 1988 (30 days after the day X received notice from the Internal Revenue Service), but later than January 1, 1988.

(f) *Notice to payees from the Internal Revenue Service*—(1) *Notice period.* After the Internal Revenue Service determines that a payee underreporting exists as defined in paragraph (a)(3) of this section, the Internal Revenue Service, pursuant to section 3406(c)(1)(B), will mail to the payee at least four notices over a period of at least 120 days (hereafter referred to as the ''notice period'') before payors and brokers will be notified that the payee is subject to backup withholding due to a notified payee underreporting as provided in paragraph (b)(1) of this section. The notices may be incorporated with other notices provided to the payee by the Internal Revenue Service.

(2) *Payee subject to withholding.* After the Internal Revenue Service provides the notices described in paragraph (f)(1) of this section, the Internal Revenue Service will send the notices required by paragraph (b) of this section unless—

(i) A payee obtains a determination under paragraph (g) of this section, or

(ii) In the case of a payee who has filed a tax return, the Internal Revenue Service has not assessed the deficiency attributable to the underreporting.

(3) *Disclosure of names of payors and brokers.* The Internal Revenue Service pursuant to section 3406(c)(5) may require a payee subject to backup withholding due to a notified payee underreporting to disclose the names of all of his payors of reportable interest or dividend payments and the names of all of the brokers with whom the payee has accounts which may involve reportable interest or dividend payments. To the extent required in the request from the Internal Revenue Service, the payee shall also provide his account numbers and other information necessary to identify the payee's accounts.

(4) *Backup withholding certification.* Once a payee receives a final notice from the Internal Revenue Service notifying him that his reportable interest or dividend payments are subject to backup withholding due to notified payee underreporting under section 3406(a)(1)(C), the payee shall not certify to any payor or broker, under penalties of perjury, that he is not subject to backup withholding under section 3406(a)(1)(C). See paragraph (k)(2) of this section for the penalties that will apply to a payee who makes a false certification. The payee may not make the certification until the payee receives the certification provided in paragraph (d)(1) of this section from the Internal Revenue Service advising the payee that he is no longer subject to backup withholding under section 3406(a)(1)(C) (as provided in A–33 of § 35a.9999–1). See A–37 of § 35a.9999–1 for the rule applicable to a payor who makes reportable interest or dividend payments to a payee who fails to certify that he is not subject to backup withholding due to notified payee underreporting.

(g) *Determination by the Internal Revenue Service that backup withholding should not start or should be stopped*—(1) *In general.* A payee may prevent backup withholding from starting or stop it once it has started if, for the taxable year with respect to which there is a notified payee underreporting and any other taxable payee—

(i) Shows that there was no payee underreporting (as provided in paragraph (g)(2) of this section);

(ii) Corrects any payee underreporting (as provided in paragraph (g)(3) of this section);

(iii) Shows that backup withholding will cause or is causing an undue hardship (as defined in paragraph (g)(4) of this section) and that it is unlikely that the payee will underreport interest or dividend payments again; or

(iv) Shows that a bona fide dispute exists as to whether any underreporting has occurred (as provided in paragraph (g)(5) of this section).

(2) *No underreporting.* A payee may show that no underreporting of interest or dividends exists by presenting receipts or other satisfactory documentation to the Internal Revenue Service showing that all taxes relating to such payments were reported and paid timely or evidence showing that the payee did not have to file a return for the taxable year in question or that the underreporting determination is based upon a factual, clerical, or other mistake.

(3) *Correcting any payee underreporting*—(i) *Before issuance of a statutory notice of deficiency*. Before a statutory notice of deficiency is issued to a payee pursuant to section 6212, the payee may correct underreporting by filing a return if one was not previously filed and paying taxes, penalties, and interest due with respect to any underreported interest or dividend payments.

(ii) *After issuance of a statutory notice of deficiency*. After a statutory notice of deficiency is issued to a payee, the payee may correct underreporting at any time by filing a return if one was not previously filed and paying the entire deficiency and any other taxes including penalties and interest attributable to any payee underreporting of interest or dividend payments. Thus, for example, a payee may correct underreporting after assessment of a deficiency by paying the entire assessment with respect to that deficiency and any other taxes including penalties and interest attributable to any payee underreporting of interest or dividend payments for other taxable years.

(4) *Undue hardship.* A determination of undue hardship will be based on the overall impact to the payee of having 20 percent of reportable interest and dividend payments withheld. Factors that will be considered in determining whether backup withholding causes undue hardship include, but are not limited to, the following:

(i) Whether estimated tax payments, and other credits for current tax liabilities, or amounts withheld on employee wages or pensions, in addition to backup withholding, would cause significant over-withholding;

(ii) The payee's health, including the payee's ability to pay foreseeable medical expenses;

(iii) The extent of the payee's reliance on interest and dividend payments to meet necessary living expenses and the existence, if any, of other sources of income;

(iv) Whether other income of the payee is limited or fixed (*e.g.*, social security, pension, and unearned income);

(v) The payee's ability to sell or liquidate stocks, bonds, bank accounts, trust accounts, or other assets, and the consequences of doing so;

(vi) Whether the payee reported and timely paid the most recent year's tax liability, including interest and dividend income; and

(vii) Whether the payee has filed a bankruptcy petition with the United States Bankruptcy Court.

In addition to the above factors, the Internal Revenue Service must conclude that it is unlikely that any payee underreporting will occur again.

(5) *Bona fide dispute.* The Internal Revenue Service may make a determination under this paragraph if there is a dispute between the payee and the Internal Revenue Service on a question of fact or law that is material to a determination under paragraph (g)(1)(i) and, based upon all the facts and circumstances, the Internal Revenue Service finds that the dispute is asserted in good faith by the payee and there is a reasonable basis for the payee's position. See the example provided in paragraph (j)(2)(ii) of this section for an illustration of this provision.

(h) *Requests for determinations*—(1) *In general.* A payee may request a determination under one or more of the provisions of paragraph (g) of this section. Following its review of a request for a determination under paragraph (g) of this section, the Internal Revenue Service will either provide the payee with a written certification as prescribed in paragraph (d) of this section if the evidence presented warrants the requested determination or will provide the payee with a written notice informing him that a determination was not made.

(2) *Determinations made during the notice period.* In general, if a determination is made during the notice period as defined in paragraph (f)(1) of this section, then the payee will not be subject to backup withholding due to a notified payee underreporting with respect to any taxable year for which a determination was made.

(3) *Determinations made after the notice period.* If a determination is made after the notice period, as defined in paragraph (f)(1) of this section, the Internal Revenue Service will provide a notice to payors and brokers, and a certification to the payee as provided in paragraph (d)(1) of this section.

(i) [Reserved]

(j) *Payees filing a joint return*—(1) *In general.* For purposes of section 3406(a)(1)(C), if payee underreporting is found to exist with respect to a joint return filed by a husband and wife, then the provisions of this section shall apply to the payees collectively. As a result, both payees will be subject to backup withholding on accounts in their individual names as well as accounts in their joint names. Either or both payees may satisfy the criteria for a determination that no payee underreporting exists, that the underreporting has been corrected, or that a bona fide dispute exists (as provided in paragraphs (g)(1) (i), (ii), or (iv) of this section). Both payees, however, must satisfy the criteria for a determination that backup withholding will cause or is causing undue hardship (as provided in paragraph (g)(1)(iii) of this section).

(2) *Exceptions*—(i) *Innocent spouse.* A spouse who files a joint return may obtain a determination that withholding should stop or not start with respect to payments made to his or her individual accounts, if the spouse—

(A) Shows that he or she did not underreport income because he or she is an innocent spouse as described in section 6013(e), or

(B) Shows that there is a bona fide dispute as to whether he or she is an innocent spouse and hence did not underreport income.

(ii) *Example.* The provisions of paragraph (j)(2)(i) may be illustrated by the following example:

Example. H and W filed a joint return in 1986 on which H failed to include $2,000 of interest income. In 1987, the Internal Revenue Service determined that a payee underreporting exists with respect to H and W for the 1986 tax year. After properly notifying H and W of the underreporting and assessing the tax, the Internal Revenue Service sent notices to payors to begin backup withholding on the joint and individual accounts of H and W and to brokers informing them that H and W are subject to backup withholding under section 3406(a)(1)(C) on their joint and individual accounts. W claims that she is an innocent spouse and requests a determination that she did not underreport interest or dividend income so that her individual accounts will not be subject to backup withholding.

The Internal Revenue Service questions her status as an innocent spouse. If the Internal Revenue Service determines, based upon all the facts and circumstances, that there is a reasonable basis for W's claim to be an innocent spouse and that the claim is made in good faith, W will have a bona fide dispute with the Internal Revenue Service. Consequently, the individual accounts of W will not be subject to further backup withholding due to a notified payee underreporting as provided in paragraph (g)(5) of this section.

The Internal Revenue Service will notify payors to stop backup withholding under section 3406(a)(1)(C) and brokers that W is no longer subject to backup withholding under section 3406(a)(1)(C) on W's individual accounts. Backup withholding will not restart on those accounts unless the Internal Revenue Service ultimately determines that W is not an innocent spouse. In that event the Internal Revenue Service will notify the payors to start backup withholding under section 3406(a)(1)(C) and the brokers that W is subject to backup withholding under section 3406(a)(1)(C) with respect to the individual accounts of W.

(iii) *Divorced or legally separated payee.* A payee who, at the time of the request for a determination under paragraph (g) of this section, is divorced or legally separated under state law may obtain a determination that undue hardship exists (or would exist) under paragraph (g)(1)(iii) of this section with respect to reportable interest and dividend payments made to his or her individual accounts if the divorced or legally separated payee satisfies the

criteria for a determination under paragraph (g)(4) of this section.

(k) *Penalties*—(1) *Failure to withhold.* See A–2 of § 35a.9999–3 for rules relating to penalties applicable to a payor who fails to withhold on reportable interest and dividend payments made to a payee subject to backup withholding.

(2) *False certification*—(i) *Criminal penalty under section 7205(b).* If any individual willfully makes a false certification under section 3406(d) (1) or (2), then that individual shall, in addition to any other penalty provided by law, upon conviction thereof, be fined not more than $1,000, or imprisoned not more than 1 year, or both.

(ii) *Civil penalty under section 6682*—(A) *In general.* In addition to any criminal penalty provided by law, if any individual makes a statement under section 3406 which results in a decrease in the amounts deducted and withheld under chapter 24 of the Internal Revenue Code and, as of the time the statement was made, there was no reasonable basis for the statement, the individual shall pay a penalty of $500 for the statement. The penalty is due upon notice and demand and pursuant to section 6682 collection is not subject to the deficiency procedures of subchapter B of chapter 63 of the Internal Revenue Code. See section 6682.

(B) *Waiver of penalty*. The payee may obtain a waiver (in whole or part) of the penalty imposed under section 6682(a) and paragraph (k)(2)(ii)(A) of this section if it is established to the satisfaction of the Internal Revenue Service that the taxes imposed under subtitle A of the Internal Revenue Code with respect to the payee for the taxable year in which the false certification was made are equal to or less than the sum of—

(*1*) The credits against taxes allowed by part IV of subchapter A of chapter 1 of the Internal Revenue Code, and

(*2*) The payments of estimated tax which are considered payments on account of such taxes.

(C) *Procedure for seeking a waiver.* To request a waiver under section 6682(b) and paragraph (k)(2)(ii)(B) of this section, the payee must submit to the Internal Revenue Service a written statement with supporting documents to establish all the facts necessary in order to obtain the waiver. The statement must be signed by the person that otherwise would be subject to the penalty imposed by section 6682(a) and paragraph (k)(2)(ii)(A) of this section and must contain a declaration that it is made under penalties of perjury.

(3) *Delay of assessment.* If a payee institutes or maintains a suit with the United States Tax Court primarily to delay assessment and the payee's position is frivolous or groundless, or the payee unreasonably failed to pursue available administrative remedies, the court may award up to $5,000 in damages under section 6673. The damages will be assessed against and collected from the payee in the same manner as the underlying tax.

(l) *Effective Date.* This section is effective until December 31, 1996.

[T.D. 8137, 52 FR 13432, Apr. 23, 1987, as amended at 60 FR 66134, Dec. 21, 1995; 61 FR 11308, Mar. 20, 1996]

§ 35a.9999–0 Effective date.

See § 31.9999–0 of this chapter for applicability dates for §§ 35a.9999–1 through 35a.9999–5.

[T.D. 8734, 62 FR 53494, Oct. 14, 1997]

EFFECTIVE DATE NOTE: By T.D. 8734, 62 FR 53494, Oct. 14, 1997, § 35a.9999–0 was added, effective Oct. 14, 1997, through Jan. 1, 1999. At 63 FR 72183, Dec. 31, 1998, the effective date was extended until Jan. 1, 2000. By T.D. 8856, 64 FR 73408, Dec. 30, 1999, the effective date was extended until Jan. 1, 2001.

§ 35a.9999–1 Questions and answers concerning the due diligence requirement and the certification requirements in connection with backup withholding and other related issues.

The following questions and answers principally concern the due diligence exception to the penalty on payors of reportable interest or dividend payments for failure to provide the payee's correct taxpayer identification number on certain information returns and the certification requirements in connection with backup withholding under the Interest and Dividend Tax Compliance Act of 1983 (Pub. L. 98–67, 97 Stat. 369):