



IRS B Notices

A Survival Guide

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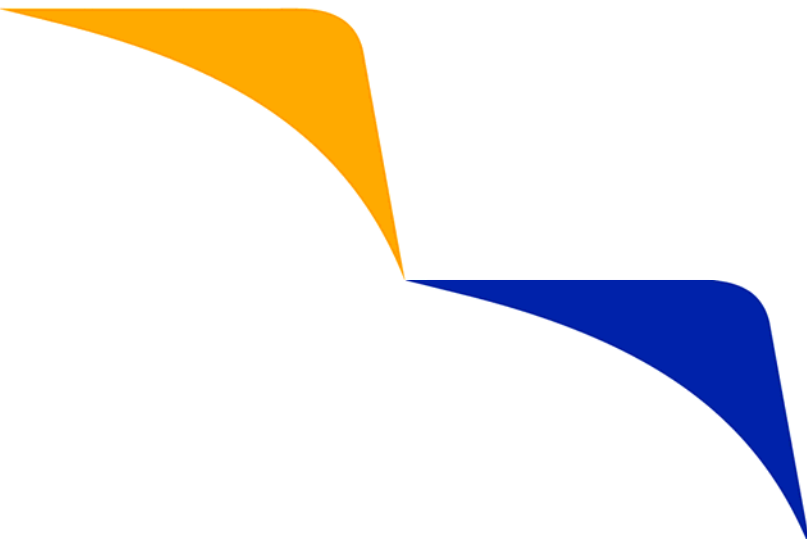


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1. Introduction

When a business pays someone for services, that business must report the payment to the federal government. If the payment is to an employee, it is reported on Form W-2; if the payment is to an independent contractor, it is reported on Form 1099-MISC. This Survival Guide focuses on one of the ramifications of inaccurate reporting on Form 1099-MISC, namely, the Internal Revenue Service (IRS) B Notice Program.

The IRS B Notice Program is required by Internal Revenue Code Section 3406. Specifically, IRC § 3406 (a)(1)(B) provides that a payor must begin backup withholding when notified by the IRS that a Taxpayer Identification Number (TIN) reported on an information return is incorrect. To provide the mechanism for that notification, the IRS created the B Notice Program.

This guide is intended to provide you with a comprehensive look at the IRS B Notice Program. It has a very practical orientation. You will find sections on all the major pieces of the B Notice puzzle. We hope the guide will make each step easier for you, and make the overall program seem a little more rational.

Visa U.S.A. and its consultant, Paula D. Porpilia of TIN Compliance Consultants, prepared this document for use by Visa Purchasing Issuers and their clients. It is intended to help Issuers become acquainted with the challenges of the IRS B Notice Program as it relates to purchasing card transactions, as well as Visa's efforts to address those challenges through its work with the IRS to obtain regulatory relief.

About the Author

Ms. Porpilia is a recognized expert in the field of tax reporting. She consults regularly with Visa on Form 1099, B Notices, and other related tax reporting issues. Visa has engaged Ms. Porpilia to bring these issues before the IRS and to help Visa and the IRS develop reporting guidelines for the bankcard industry as they relate to purchasing cards.

After receiving her law degree from the University of Chicago, Ms. Porpilia became Tax Counsel to the U.S. Senate Committee on Finance. Later, Ms. Porpilia joined the ABA (American Bankers Association) and, subsequently, was a director at one of the "big six" accounting firms. She continued her association with the ABA as a Core Faculty Member of the ABA's Skyline Satellite Network, for which she did over 50 training videos.

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Ms. Porpilia has extensive professional experience in analyzing the impact of IRS information reporting and withholding rules on the financial services industry. She assisted in the formation of, and was selected to serve on, "IRPAC" (the Information Reporting Program Advisory Committee), the first industry advisory panel commissioned by the IRS. A regular contributor to industry publications, Ms. Porpilia is a frequent and sought-after speaker at nationwide conferences and seminars dealing with reporting issues.

Ms. Porpilia's experience makes her a valuable asset to Visa and its Members. Visa is fortunate to be able to offer this expertise to our Membership as we continue to address the important regulatory challenges that we face together in the commercial card arena.

NOTE: Every effort has been made to ensure the accuracy of the material in this guide. However, neither Ms. Porpilia nor Visa make any warranty or representation as to the accuracy or completeness of the material contained herein, nor assume any liability or responsibility for claims or judgments which may result from reliance on such material. Readers are encouraged to seek the advice of a competent tax compliance professional.

2. Reporting on Form 1099-MISC

Internal Revenue Code Section 6041 has been around for over sixty years. It requires anyone in a trade or business, including tax exempt organizations and government agencies, to file information returns to report any payment. Regulations limit this duty to payments for services, excluding merchandise payments from the rule.

Another important exception provided in the regulations involves payments to corporations. Unless the payor is a federal government agency, the payor generally does not have to report payments to corporations. Federal government agencies do have to report such payments. All payors must report payments to medical or legal corporations. There are additional exceptions, including aggregate payments under \$600 and payments to tax-exempt entities.

While all of the above exceptions reduce the number of forms that have to be filed, they also impose a burden on the payor—who must now have systems in place to review each transaction to determine the status of the payee (e.g., corporation vs. non-corporation, legal or medical corporation, tax-exempt entity), the nature of the transaction (services vs. merchandise), and the total payments to that payee during the year (not each payment, but the total).

In addition to making the above determinations, the payor must solicit the payee's name and TIN, and provide these accurately on the Form 1099-MISC. If this information is not available at the time of payment, the payor is required to backup withhold a percentage of the payment and deposit that amount.

In the purchasing card arena, backup withholding is not possible. And soliciting the payee's TIN, segregating service transactions from merchandise transactions, and determining the corporate or tax-exempt status of the payee can prove difficult or, at least, cumbersome. To ease the burden on cardholders, Visa has devised a system for collecting payee information and providing it to cardholders through their issuing bank.

The Visa Merchant Profile Database (VMPD) is a data repository containing information about payees (merchants) that have accepted Visa Purchasing cards. When facing the prospect of filing a Form 1099-MISC, Visa Purchasing cardholders can obtain needed payee information from Visa through their issuing bank. Each merchant profile contains the name, complete address, TIN, corporate status, and market segment of the payee. This information can be used by the cardholder in determining which transactions are reportable, and in completing Form(s) 1099-MISC if necessary.

The information provided by Visa to the cardholder's issuing bank includes the following fields:

- **Transaction Merchant Name:** The “doing business as” (DBA) name of the merchant as contained in the original sales transaction.
- **Business Legal Name:** The business legal name of the merchant, which may be different from the DBA Name.

- **Alternate Merchant Name:** An alternate name for the merchant that may be more complete than the Transaction Merchant Name.
- **Transaction City, State, and ZIP Code:** The city, state, and ZIP code of the merchant location as contained in the original sales transaction.
- **Alternate Merchant City, State, and ZIP Code:** An alternate city, state, and ZIP code for the merchant location; may be used for reporting purposes in lieu of the transaction city, state, and ZIP code when values exist in these fields.
- **Merchant Street Address:** The street address of the merchant location (ties to the alternate city, state, and ZIP code when values exist in those fields; otherwise, ties to the transaction city, state, and ZIP code).
- **Mailing Street Address, City, State, and ZIP Code:** The mailing address (P.O. Box or street address) of the merchant location.
- **Taxpayer Identification Number (TIN):** The government-assigned number used by the merchant for federal tax reporting purposes; may be either a Social Security Number (SSN) or Employer Identification Number (EIN).
- **Incorporation Status Code:** Identifies the incorporation status of the merchant (e.g., sole proprietor, partnership, corporation, etc.)
- **Sole Proprietor Last Name, First Name, and Middle Initial:** The last name, first name, and middle initial of the owner, if the merchant is a sole proprietorship.
- **Merchant Category Code:** A four digit number used by the bankcard industry to classify merchants into market segments. This code may be used to determine whether a merchant deals in services or merchandise.

As you can see, the process of determining whether a return must be filed—and completing the requisite forms—is greatly simplified by using payee information from the Visa Merchant Profile Database. You are, of course, free to duplicate these efforts and obtain the information on your own.

If you do file a Form 1099-MISC with the IRS, the IRS will attempt to match the payee's name and TIN with its own records. This process is described in "TIN Matching Process" on page 14. If the IRS determines that the name/TIN combination does not match its records, you will receive a notice that the information is flawed. This is called the "B Notice". The rest of this Survival Guide will discuss what is required when a B Notice is issued.

3. IRS B Notices – General Rules

Summary of Rules

The IRS sends a "B Notice" to a payor when it determines through its matching process that the name/TIN combination on the information return filed by the payor does not match the records for that TIN on the IRS master file. B Notices are sent for six types of returns: 1099-B, 1099-DIV, 1099-INT, 1099-OID, 1099-PATR, and 1099-MISC. This guide focuses primarily on the rules as they apply to transactions reported on Form 1099-MISC.

When a payor receives a B Notice (Form CP2100 or CP2100A and related listing) indicating that the name/TIN combination reported on an information return from a prior year is invalid, the payor must do the following:

1. Identify the account(s) subject to the B Notice.
2. Contact the merchant (payee) within 15 business days of the date on the notice.
3. If an appropriate response is not received from the merchant, begin backup withholding no later than 30 business days after the date on the notice.
4. Stop backup withholding for "first time" accounts when a properly executed Form W-9 is received from the merchant.
5. Track accounts "hit" by the B Notice for purposes of the 2-in-3 rule (see "The "2-in-3" Rule" on page 24).
6. Stop backup withholding on "second time" accounts after receiving an official Stop Notice from the IRS or SSA (Social Security Administration).

1. Identifying the Accounts

When a B Notice is received from the IRS, the payor must identify the account(s) to which the notice applies. A notice applies to an account according to the following rules:

- If the IRS lists an account number on the B Notice, the notice applies only to that account.
- If no account number is provided on the B Notice, the payor must make a reasonable search for all the accounts for the merchant named in the notice. The payor should search its own records by name and TIN for any accounts that may be associated with the payments reported. A certain amount of judgement may have to be exercised in determining whether the accounts found belong to the merchant listed on the B Notice.
- If you are an agent for a number of payors, the B Notice received by one payor does not apply to the accounts you maintain for another payor. If you must search for accounts held by a merchant, limit your search to the account base of the payor that received the notice. In a family of mutual funds, each fund is a separate payor; in a group of affiliated banks, each

bank is a separate payor; in a group of branches of the same bank, the B Notice extends to all branches.

Once the proper account(s) have been identified, the payor must undertake the prescribed actions *only if* the account contains the same TIN as identified on the B Notice. If the account has a different TIN, the notice does not apply, and no corrective action is required. For more information about TINs, see “Taxpayer ID Numbers” on page 11.

2. Contacting the Merchant

After determining which accounts are subject to the B Notice, the payor must contact the affected merchants within 15 business days from the date on the B Notice.

- Business days are defined in the regulations as any day other than a Saturday, Sunday, or holiday.
- Count business days from the date on the B Notice. Generally, the IRS sends B Notices two weeks prior to the date on the notice, giving the payor additional time to identify the affected accounts and prepare letters to be sent out.
- If the B Notice is received after the date on the notice, the 15-day notification and 30-day backup withholding periods begin on the date the notice is actually received. Be sure to keep a record of the late receipt of any B Notices to substantiate your actions.

After determining which accounts are affected and the time frame required for action, the payor must send an IRS prototype B Notice Letter to each merchant affected by the B Notice. A substitute letter may be used if it meets stringent requirements. See “First B Notice” on page 22 for those requirements.

3. Backup Withholding—First Notice

After receiving the first B Notice for an account, the payor should begin backup withholding:

- after 30 business days following the date on the B Notice if the merchant has not provided a properly executed Form W-9.
- at the payor's option, during the 30 business days following the date on the B Notice. If the merchant provides a valid certification during that period, any backup withheld amounts *may* be refunded by the payor.

For further information, see “First B Notice” on page 22.

4. Stopping Backup Withholding—First Notice

Once the payor has begun to backup withhold following the receipt of a first-time B Notice, the payor should continue to backup withhold until the merchant provides a TIN certified on Form W-9. If the account is one in which the TIN was not previously required to be certified (e.g., a vendor account), after the B Notice is

received, the TIN must be certified on Form W-9 to avoid backup withholding. For further information, see “First B Notice” on page 22.

5. 2-in-3 Rule

Each account affected by the B Notice must be marked for purposes of the 2-in-3 rule (see “The “2-in-3” Rule” on page 24). For this rule, it is irrelevant whether the merchant provides a certification after receiving the first B Notice from the payor. The receipt of the notice by the payor triggers the duty to mark the account and track the receipt of all B Notices for the next two calendar years.

6. Backup Withholding—Second Notice

If the payor receives a second B Notice for the same account within three calendar years, the payor must follow different rules than those prescribed for the first B Notice. After receiving the second B Notice, the payor must send a different letter to the payee and must begin backup withholding within 30 days. The payor may not stop backup withholding until receiving a Stop Notice from the IRS or SSA. Form W-9 will not suffice at this point. For further information, see “Second B Notice” on page 26.

7. Backup Withholding Owed

When the IRS sends B Notices, it is also seeking deposits of amounts which should have been backup withheld earlier, but were not. The notification to the payor includes a listing of accounts for which no TIN was reported. For those accounts, the IRS is (implicitly) asking the question¹: Should the payor have backup withheld on those accounts? If the payor did not obtain the TIN in the manner required (see “When is Backup Withholding Required?” on page 9) at the time of payment, the payor should have backup withheld 28 percent² of the payment. If the payor should have withheld, but did not, the payor is still liable to the IRS for the money. The payor must now use its own company’s money (instead of the merchant-payee’s) to satisfy this deposit liability.

If the payor failed to withhold previously when required, the IRS wants the payor to deposit the money now. The payor should determine how much is owed, deposit it, and file a corrected Form 945 and Form 941C. Details about how to deposit any backup withheld funds can be found in “Depositing the Amounts Backup Withheld” on page 30. The payor can expect to receive a late deposit penalty of (generally) 10 percent of the late deposit.

¹ When the payor receives a list of missing TIN accounts from the IRS, it should serve as a trigger to the payor to inquire whether it properly solicited the TINs from the payees. Since the missing TIN accounts will be subject to a penalty in the coming months unless the payor establishes that it properly solicited the TINs, the payor is encouraged to use this time to rectify any past mistakes made in TIN solicitation. For details about TIN solicitation rules and the IRS penalty program, see IRS Publication 1586.

² The backup withholding rate has changed three times over the past twenty years. The latest change occurred on May 38, 2003 retroactive to January 1, 2003. It currently is 28 percent.

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The only way to avoid this liability is to prove that the payee included the payments on his/her tax return. To do this, the payor must get an affidavit from the payee. Form 4669 is used for this purpose. The payor does not need to file this form with the IRS unless the payor is audited and the IRS assesses the amounts the payor failed to withhold.

4. When is Backup Withholding Required?

Internal Revenue Code Section 3406 requires payors of certain types of payments to backup withhold if one (or more) of the four triggers is activated; only two apply to merchant payments. The four triggers are:

1. Backup withhold when the TIN is not provided "in the manner required". For interest, dividend, original issue discount, and broker payments, the "manner required" is a certification on Form W-9. For payments reported on Form 1099-MISC (vendor payments, rents, etc.), a payor may obtain the TIN either orally or in writing; no Form W-9 is required.

If no TIN is obtained, or if a TIN is received, but not in the required manner, a payor must backup withhold beginning with the first reportable payment. There is *no* general grace period.

Exceptions:

Awaiting a TIN. For financial service payments, a special "awaiting-TIN" rule is given which provides a grace period. This provision does not apply to service payments reported on Form 1099-MISC.

Accounts Opened Via Electronic Transmission or Mail. For financial service payments required to be certified on Form W-9, if the payee initiates the account by electronic transmission *and* provides a TIN (but no Form W-9) at that time, then the payor may give the payee 30 days in which to provide a certified TIN. This provision does not apply to service payments reported on Form 1099-MISC, since the payee's TIN is not generally required to be certified on Form W-9.

2. Backup withhold whenever the IRS notifies the payor on a B Notice that the name/TIN combination is incorrect. After the first notice, start backup withholding no later than 30 days after the date on the notice if the payee has not provided a certified TIN on Form W-9, and continue to backup withhold until the form is received. After the second notice within three calendar years, start backup withholding within 30 days of the date on the notice, and do not stop until the IRS/SSA sends a Stop Notice (see "The Stop Notices" on page 27).
3. Backup withhold whenever the IRS notifies the payor that the payee is an identified underreporter. This is called a "C Notice". Start backup withholding within 30 days of receipt of the C Notice, and stop within 30 days of receipt of a C Stop Notice (Forms 2434P, CP545, and CP544). This applies only to interest and dividend payments; it does not apply to payments reported on Form 1099-MISC.
4. Backup withhold if the payee fails to certify that he/she is an identified underreporter. This is required only for interest and dividend payments. It does not apply to service payment reported on Form 1099-MISC.

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If the payor must backup withhold, the rate for 2002 is 30 percent. The rate was 20 percent from 1984 through 1992. From 1993 to August 6, 2001, it was 31 percent. From August 6, 2001 to December 31, 2001, it was 30.5 percent. The rate is 30 percent for 2002 and 2003. For 2004 and 2005, it will be 29 percent. For 2006 to 2010, it will be 28 percent. In 2011, it returns to 31 percent, unless Congress acts before then.

5. Taxpayer ID Numbers

If a payment to a merchant is reportable³, the payor must backup withhold at the time of payment unless the payor receives the merchant's TIN by the time the payment is made. There are five types of TINs, but in the purchasing card environment the payor is likely to see only three of them. The five types of TINs are:

1. SSN—Social Security Number. This number is issued by the Social Security Administration to individuals who are U.S. citizens or residents. The application is IRS Form SS-5. An SSN consists of nine numeric characters and is hyphenated as follows: 123-45-6789. (Note: the hyphens are not used when reporting to the IRS.) If the payor makes payments to a sole proprietor, the payor should use the sole proprietor's SSN when reporting payments to the IRS.
2. EIN—Employer Identification Number. This number is issued by the IRS to any entity that applies for one using Form SS-4. Corporations, partnerships, associations, estates, trusts, tax-exempt organizations, and government agencies all are assigned an EIN. A sole proprietor may or may not have an EIN, depending on the nature of the business activities. If a sole proprietor has an EIN, the payor may use it when reporting on payments to that merchant; however, the IRS would prefer that the payor use the sole proprietor's SSN. The EIN consists of nine numeric characters, and is usually hyphenated as follows: 12-3456789. (Note: the hyphens are not used when reporting payments to the IRS.)
3. ITIN—Individual Taxpayer Identification Number. This type of TIN is issued by the IRS to individuals who are not U.S. citizens or residents, but who need a TIN in order to file a U.S. tax return. Form W-7 is used to apply for an ITIN. It consists of nine numeric characters and is hyphenated just like an SSN (123-45-6789). (As with the SSN, the hyphens are not used when reporting to the IRS.) An ITIN can be recognized because it begins with the numbers "98".
4. ATIN—Adoption Taxpayer Identification Number. This is a temporary Social Security Number issued in special circumstances involving the adoption of a child whose previously-assigned TIN is presently unknown by the adoptive parents. Form W-7A is used to apply for an ATIN. It expires after two years. It is unlikely to come up in the purchasing card context.
5. PTIN—Preparer Taxpayer Identification Number. This is a special number issued by the IRS to individuals involved in the business of preparing the tax returns of others. Form 1040 requires the preparer to provide his/her TIN. In order to protect the privacy of the preparer who may not want to disclose his/her SSN to a tax return client, the IRS issues these numbers. They may be used only on Form 1040 and are not valid for any information reporting activity. Since these numbers consist of the letter "P" followed by eight numeric characters, they are easy to spot. If a merchant gives the payor one of these numbers, the payor must reject it.

³ For more information about when a payment to a merchant is reportable, see Visa's guide to the reporting requirements, "Purchasing Cards and IRS Requirements."

In the case of business activity with a merchant, the payor must solicit the merchant's TIN before the payment is made. If payment is by cash, payment is considered to be made when the cash is tendered. If payment is by check, payment is made when the check is given, sent, or made available to the merchant. If payment is by purchasing card, payment occurs when the transaction is conducted, not later when the invoice is received or payment is made to the bank.

If the payor does not receive a valid TIN by the time payment is made, the payor must backup withhold 30 percent of the payment and timely deposit the withheld amount. A valid TIN is one that has nine numeric characters. The IRS is working on a system that will permit a payor to check the name/TIN combination provided by the payee with the IRS when an account is opened. It is expected to be available sometime in 2003. Until then, the payor must make sure only that the TIN is nine numeric characters.

Merchant TINs may be received by facsimile or electronic system, provided the IRS standard for such forms are met. Details may be found in "Instructions for Requestor of Form W-9", a copy of which is included at the end of this guide. Among other things, the payor must ensure that the information is provided by the correct party. TINs may be provided only by the party whose TIN is being furnished. For an individual, this means only that individual may sign the solicitation form or provide the TIN over the telephone. (For specific rules about how TINs may be solicited, see IRS Publication 1586.) A spouse or other relative may not provide the TIN (unless the payee is a minor child). For an entity, the correct party to provide the TIN is a partner (for a partnership), officer (for a corporation, association), or legal representative (for estates and trusts). Other persons may sign on behalf of another party only if a specific power of attorney has been signed and provided to the payor. For IRS rules about powers of attorney, see Form 2848 and its instructions.

If the payor is required to withhold, but fails to do so, the payor is liable for the amount that should have been withheld. If the payor fails to timely deposit, penalties of up to 15 percent of the late deposit may be imposed. More information on the deposit rules and possible penalties may be found in "Instructions for Requestor of Form W-9", a copy of which is included at the end of this guide.

In addition to the requirement to backup withhold on the initial payments if a correct TIN is not provided before payment is made, the payor must backup withhold on any future payments after a first B Notice is received, unless the payee provides a certified TIN on Form W-9. A "Certified TIN" is one sworn to under penalty of perjury. The Form W-9 must be properly executed as follows:

- The payor must use the most current version of Form W-9 (currently, the one revised in 2002). A qualified substitute Form W-9 is permitted. Details on how to create a qualified substitute can be found in "Instructions for Requestor of Form W-9", a copy of which is included at the end of this guide.
- Whether using the official form or a qualified substitute, the form must be signed by the person whose TIN is being certified. For a sole proprietor, this

means the sole proprietor only, not a spouse, relative, or friend. For a partnership, it means an authorized partner. For a corporation it means an officer, etc.

- The form must be dated.
- The form must include the person's name and TIN.

For additional information, consult regulation section 31.3406(h)-3(e) or the Requestor Instructions for Form W-9. A copy of the instructions and a sample properly executed Form W-9 are included at the end of this guide.

Of course, a TIN is valid only in conjunction with a name. For an individual (including a sole proprietor), the IRS matches information returns and tax returns against its master files using the first four letters of the individual's last name. For an entity, the IRS uses the first four letters of the first significant word of the name. Words such as "the", "trust for the benefit of", and "a" are not usually considered significant. Details about these rules can be found in IRS Publication 1220. More information about the TIN Matching Process follows in the next chapter.

6. TIN Matching Process

When you file an information return with the IRS, the IRS tries to match it to a tax return filed by a taxpayer. This is done in order to make sure the taxpayer has included all income on the tax return filed. The IRS matches the information return and the tax return using the taxpayer's name and TIN. The name/TIN combination on file with the IRS must match the name/TIN combination on the information return. The steps in the matching process are as follows (see diagram on following page):

- Step 0. If no TIN is reported, the IRS immediately tags the return for a penalty. A match is attempted only if a TIN is reported. The missing TIN account will be included on the B Notice listing for backup withholding purposes.
- Step 1. The IRS searches for the TIN (SSN) in its Individual Master File. If no match is found, the IRS searches for the TIN in the BMF (Business Master File) for a possible match against the EIN (Employer Identification Number) records.
- Step 2. If Step 1 determines that the TIN was assigned to an individual, the IRS looks up the name control(s) assigned to that number.

A name control code consists of the first four characters of an individual's last name. (For an entity, the name control code is the first four letters of the first significant word in the title of the entity.) The first name control is assigned when the SSN is issued. If the holder of that TIN ever changes his/her name *and* informs either the IRS or SSA about the change, then additional name controls are developed for that TIN. The original name control is not removed; a name change results in *additional* codes against which the TIN can be matched.

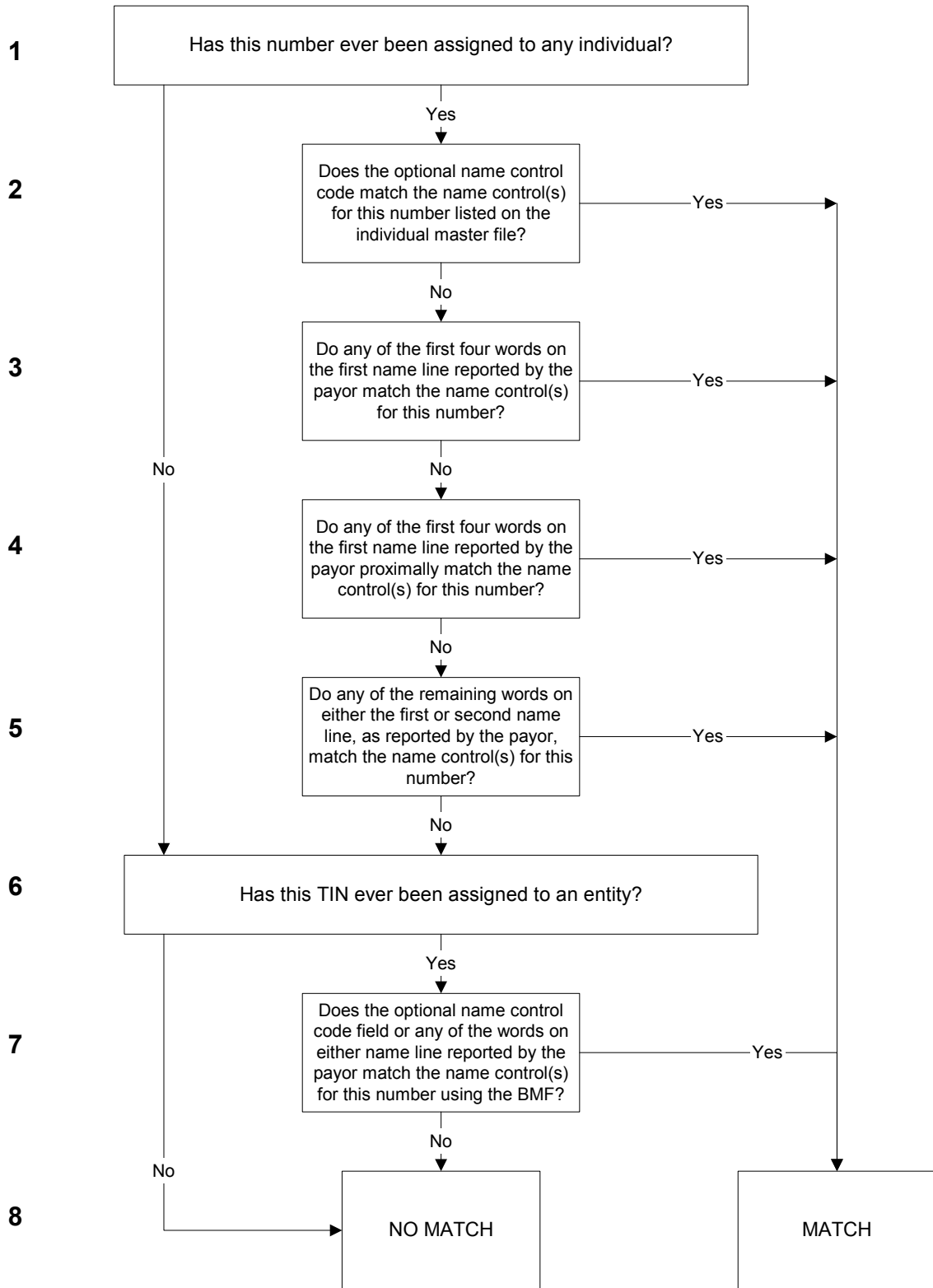
Example:

Mary Smith applies for a social security number in the name of "Mary Jane Smith". She is assigned number 333-44-5555. The SSA tells the IRS about Mary. The IRS assigns the name control "Smit" to number 333-44-5555.

Years later Mary marries Jack Johnson and changes her name to Mary S. Johnson. She tells the SSA about the change. The SSA informs the IRS about the additional name to be associated with SSN 333-44-5555. The IRS develops another control code for Mary. At this point, TIN 333-44-5555 will match against either "Smit" or "John".

With the number and name controls associated with it, the IRS checks the optional 4-character field provided in the information reporting magnetic media specifications for this purpose. If any of the name controls found in the IRS master file match the name control provided by the payor in this optional field, a match is found and the return will not receive a TIN penalty or B Notice.

IRS TIN Matching Process



Step 3. If no match is found in Step 2, the IRS next reads the first four words reported by the payor on the first name line. It develops name control codes for each word. (A "word" is a series of characters separated by a blank space.) It then tries to match each word against the control(s) on record for the TIN. If a match is found, no TIN penalty is assessed.

Step 4. If no match is found, the IRS tries to "proximally" match the words reported by the payor with the controls it has on file. To proximally match, the first letter of the name must match; in addition, either two of the remaining three letters must be correct, or they must all be correct, but in the wrong order.

Example:

Mary's bank reports her name as Mary "Simth". The IRS, in step 2, would not have found a match because "Simt" does not match "Smit". Here, however, the IRS will proximally match the two because:

- S matches S (the first letter is correct),
- "i", "m", and "t" are the same letters as "m", "i", and "t" (just in a different order), and
- only "m" and "i" were transposed ("t" was in the correct spot).

If Mary's payor had reported her name as "Sxith", a proximal match would also have been found because:

- S matches S,
- "i" and "t" are correct and in the correct spots, and
- only one letter ("x" instead of "m") is wrong.

If Mary's payor had reported her name as "Simht" or "Stimh", "Sixth", or "Msith", no match would have been found. In order to match, the first letter must be correct, and either two of the remaining three letters must be correct, with just one transposition or one incorrect letter.

Step 5. If no proximal match of the first four words is found, the IRS reads each remaining word on *both* the first and second name line, develops a name control for each, then tries to match each word (exactly, not proximally) against the control(s) on record for that TIN. If a match is found, no TIN penalty will be assessed.

Step 6. If Step 1 determines that the TIN was never assigned to an individual, the TIN is then matched against the BMF to see if it was ever assigned to an entity (e.g. corporation, partnership).

Step 7. If the IRS determines that the TIN has been assigned to an entity, it tries to match the words on the payee name lines against the name control(s) in the Business Master File for the TIN. The match must be exact.

Step 8. If no match is found, the return is flagged for a TIN penalty. In addition, for Forms 1099-B, -DIV, -INT, -OID, -PATR, and -MISC, the IRS flags the return for the B Notice Program.

7. Understanding the IRS B Notice

The IRS will send the payor a package of material in a special envelope. The envelope will have an orange sticker on it with the words "Important Tax Information—TIN Notification" printed on it. This sticker will assist the mailroom in identifying the B Notices. This mailroom should be instructed that, upon seeing the orange sticker and legend, they should immediately deliver the package to the appropriate personnel.

Currently, the payor cannot specify a person or department to receive the notice; the IRS sends it to the most recent entity address listed on its business master file. The IRS has been asked to change this practice and give the payor an opportunity to specify a recipient for the package. The IRS indicated many years ago that it would consider this suggestion, but it has not acted on the recommendation.

Also, the payor cannot ask the IRS to send the notice to its agent or processor. Because of privacy considerations and the disclosure provisions of the Internal Revenue Code, the IRS must send the notice to the payor.

The package contains several items:

1. Form CP2100 or CP 2100A
2. Publication 1281 or Publication 1679
3. Listing of accounts

Form CP2100 (or CP 2100A) is the "B Notice". It provides the total number of accounts subject to the B Notice procedures and instructs the payor to notify its payees about the TIN mismatches identified by the IRS. The CP2100 instructs the payor to determine if it owes any backup withholding and to deposit that amount and file Forms 945 and 941C.

The package also includes a copy of Publication 1281 (or Publication 1679). It contains the magnetic tape specifications, a general description of the program, and copies of forms the payor may need. Publication 1679 is similar but does not contain the magnetic tape specifications; it is sent to those receiving a paper listing.

These materials are accompanied by a tape or paper listing of the accounts that need to be notified. If the payor has more than 250 such accounts, the payor will receive a tape and Notice CP2100; if fewer, the payor will receive Notice CP2100A and the paper listing. The payor cannot request the IRS to send a tape instead of the paper listing, or paper instead of tape; the media depends solely on the number of mismatched accounts.

To read the tape, follow the programming instructions that accompany it. Once the payor has "dumped" the tape and has a printout, the payor will be able to study the information provided. The payor's computer operations group may also be able to separate the accounts by department or location if the company has a department/location-specific account numbering system (and if the payor used those account numbers when filing Forms 1099-MISC with the IRS).

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The listing has 6 categories of accounts:

1. Missing TIN – backup withholding shown
2. Missing TIN – no backup withholding shown
3. TIN never issued – backup withholding shown
4. TIN never issued – no backup withholding shown
5. Invalid TIN – backup withholding shown
6. Invalid TIN – no backup withholding shown

A TIN is considered "missing" if no number is provided to the IRS or if the number provided has fewer than nine digits. A TIN is also considered missing if an alpha character is included as one of the nine digits.

The accounts are arranged by Transmitter Control Code (TCC). If the payor, or the payor's agent, uses more than one TCC to file the returns, the accounts reported under each code will be grouped separately. In addition, if the payor files more than one type of return, return types are grouped separately. This last element is important to financial institutions, which file many types of information returns. For businesses not in the financial services industry, it is generally not an issue.

Example:

Payor X files Forms 1099-DIV and 1099-MISC under two TCCs. Payor X's B Notice tape was grouped as follows:

TCC 12345

Forms 1099-DIV - Types 1-6

Forms 1099-MISC - Types 1-6

TCC ABCDE

Forms 1099-DIV - Types 1-6

Forms 1099-MISC - Types 1-6

Example:

Manufacturer Y files only Forms 1099-MISC, but does so from several locations using two different transmitters. Manufacturer Y's B Notice from the IRS was organized as follows:

TCC 21X37

Forms 1099-MISC

TCC 453A0

Forms 1099-MISC

The tape contains a listing of the accounts with a "missing TIN". Don't let this listing confuse you. These accounts do not get sent the B Notice letter. Since the purpose of the B Notice is to correct an invalid TIN to avoid backup withholding, and since the payor should already be withholding on missing TIN accounts, the letter would only serve to confuse the payee. Since this is not a B Notice for the missing TIN accounts, it is also not the first notice for them for the 2-in-3 rule.

The reason the IRS includes the missing TIN accounts in the B Notice listing is to identify accounts where the payor may be required to backup withhold. If the payor reported an account with no TIN, chances are the payor should be backup withholding on it. If the payor is not backup withholding, it is liable for the amount it should have backup withheld. Determine how much that is for the accounts on the list, deposit that amount (see “Depositing the Amounts Backup Withheld” on page 30), and file an amended Form 945 with a Form 941C with the IRS. The payor may receive a late deposit penalty for this failure to timely deposit.

While the payor does not need to send a B Notice letter to accounts with no TIN, the payor may need to solicit the TIN under the reasonable cause penalty program. More information about the IRS penalty program can be found in Publication 1586.

During the first few years of the B Notice Program, B Notices were combined with Penalty Notices. (Penalty Notices are now a separate program.) When they were combined, the payor had to respond to the IRS within 60 days with a certification of "due diligence". The payor no longer has to do that or to respond to the IRS in any way after receiving a B Notice. (The payor does have to respond to the IRS Penalty Notice if it receives one later. See IRS Publication 1586 for more information.) Instead, the payor must notify the merchant, begin backup withholding where appropriate, and code the accounts for the 2-in-3 rule. Of course, the payor must also code its year-end processing system to "check the 2-in-3 box" on the Forms 1099 when it has received a second notice within three calendar years.

8. When is a B Notice Not a B Notice?

Some of the invalid TIN accounts listed on the notice from the IRS are not really notices of invalid TIN and do not trigger the B Notice requirements. Generally, there are six exceptions; however, if the payor files only Forms 1099-MISC, not all of the following exceptions will apply. Financial institutions, which file many different types of information returns, will qualify for more of the exceptions than other types of businesses. Accounts listed on the B Notice listing are not considered subject to the requirements of the B Notice Program in the following situations:

1. Transposition or Other Data Entry Errors

If the TIN fails the matching test described above because the payor inadvertently transposed numbers in the TIN (or letters in the name), the notice is not a B Notice. Similarly, if for other reasons the payor failed to put the correct information on the information return, the B Notice rules do not apply. The payor should correct the error on its records and use the correct information on any returns filed in the future. The payor should not notify the payee, nor send the correction to the IRS.

2. Garbled Information

Some B Notices sent by the IRS may contain garbled information, particularly account numbers. If this happens, the notification is not a B Notice. Make a note of the misprinting by IRS, but do not contact the IRS about it.

3. Payments to Exempt Recipients

If the payor reports payments to exempt recipients which have been properly identified and documented (where necessary), and thereafter receives a B Notice for that account, it does not count as a B Notice and no notification to the account holder is required. Exempt recipients include:

- corporations (except medical and legal corporations)⁴
- tax-exempt organizations
- international organizations
- federal, state and local governments and their agencies
- foreign governments and foreign central banks

The B Notice does not trigger the TIN solicitations and backup withholding requirements because these payments are not reportable to begin with.

⁴ Federal Government agencies may not exclude payments to corporations from their information reporting programs.

4. Payments to Nonresident Aliens

If the payor makes payments to non-U.S. persons for independent contractor services performed in the U.S., generally the payor should report the payments on Form 1099-MISC, just as it would for services performed by a U.S. citizen or resident. However, for other types of payments subject to the B Notice requirements (especially bank interest and broker payments), the payments may not be reportable to IRS. If so, and if the payments are reported anyway and included on the B Notice listing, the B Notice requirements do not apply because the payment was not reportable to begin with. For this exception to be applicable, the payor **MUST** have received one of the four forms in the W-8 series when the payment was made, and the form must not have expired.

5. Fiduciary Accounts

The regulations exempt from the B Notice requirements notifications of invalid TIN for fiduciary accounts. Fiduciary accounts are those with one of the following "magic words" in the account title:

nominee	receiver
administrator	tutor
conservator	curator
custodian	committee
executor	guardian
trustee	

Other words signifying fiduciary capacity will also exempt the account from the scope of the B Notice Program.

Also keep in mind that, even though the B Notice requirements do not extend to these fiduciary accounts, TIN solicitation requirements do. See IRS Publication 1586 for complete information about when and how to solicit TINs.

6. Window Transactions

The B Notice rules do not apply to bank "window transactions", such as savings bond redemptions.

If the payor receives any of the above types of accounts on its B Notice listing, the payor should not send the payee a B Notice letter. If it is a fiduciary account, the payor should do a regular annual mailing. If it is a transposition error, the payor should correct its records. If it is any other type described, no action is required.

9. First B Notice

The IRS has published a prototype B Notice (the letter sent to the payee), which the payor must use. The payor is entitled to modify this prototype in only two ways:

1. The payor may add to it material relevant to its operations. For instance, if in addition to the Form W-9 the payor requires a payee providing name change information to fill out one of its own forms, the payor may provide information about this procedure in the B Notice letter.
2. Delete irrelevant material. For example, if the payor is not mailing to a sole proprietor, the payor may delete the relevant paragraph from the prototype, since it would not provide any useful information to the recipient.

Other than these two changes, no alternations of the prototype are permissible. Prior to September 1993, any substitute was acceptable so long as it met the substitute requirements in the regulations. However, the April 1992 regulations state that, after September 1993, only the limited modifications described above are acceptable.

The payor should use the latest IRS prototype. Earlier versions should not be used. The prototype letter has been changed a number of times to accommodate changes in the backup withholding rate and other modifications to IRS program requirements.

Be sure to include in the letter to the payee the date, which is 30 days after the date on the IRS letter to the payor. This is the date by which the payor must begin to backup withhold.

In addition to the letter, the payor should send the payee a Form W-9. The official form or a qualified substitute may be used. If using the official form, the payor should be sure it is using the most recent version issued by IRS (currently, the version released in January 2002).

If the payor is using a substitute Form W-9, the requirements that need to be met can be found in "Instructions for Requestor of Form W-9", a copy of which is included at the end of this guide. Generally, the payor must have space for the payee's name, address, and TIN, and the appropriate certification language from the official form. Instructions are helpful, but not required.

The letter, Form W-9, and a postage-prepaid return envelope (optional) should be sent to the payee in an envelope on which one of the following legends is clearly printed: "IMPORTANT TAX INFORMATION ENCLOSED" or "IMPORTANT TAX RETURN DOCUMENT ENCLOSED".

The payor should set up a procedure for handling any responses it receives from payees. This may include a "hotline" telephone number, which may be used by payees who have questions. If the payor has a hotline, any TIN information the payor receives from the payee over the telephone will not suffice to stop or prevent backup withholding from being imposed. The payor must get the TIN certified in writing.

Forms W-9 may be received by facsimile or electronic system provided the IRS standard for such forms is met. The details may be found in “Instructions for Requestor of Form W-9”, a copy of which is included at the end of this guide. Among other things, the payor must ensure that the information is provided by the correct party. Certifications may be provided only by the party whose TIN is being certified. For an individual, this means only that person may sign the Form W-9. A spouse or parent may not sign the Form W-9 (unless the payee is a minor child). For an entity, the correct party to sign the Form W-9 is a partner (for a Partnership) or officer (for a corporation, association) or legal representative (for estates and trusts). Other persons may sign on behalf of another party only if a specific power of attorney has been signed and provided to the payor. For IRS rules about powers of attorney, see Form 2848 and its instructions.

10. The "2-in-3" Rule

If the payor receives a second B Notice for the same account within three calendar years, the payor must undertake different actions than for the first notice. To determine whether it is a second notice, the payor must keep track of the B Notices it receives over a rolling three-year period. The IRS does not keep track for the payor.

The first step in determining whether a notice is a second notice is to make sure the notice is a B Notice. If the payor receives a B Notice for an account, but the TIN on the notice does not match the TIN on the account, it is not a B Notice. This is true for both the first and second times.

After that, every second notice received within three calendar years of the first is a second notice, unless either:

1. The second notice was received *in* the same year as the first notice; or
2. The second notice was received *for* the same year as the first notice.

Through 2002, only the first item above is the rule. That is, up through 2002, a second notice is not a second notice if it is received in the same year as the first notice. In July 2002, the IRS released proposed regulations which would expand the exception for notices received in the same year to also include notices received for the same year. This change is expected to start in 2003. The change was proposed in response to suggestions made by the IRS Information Reporting Program Advisory Committee (IRPAC), an industry group that advises the IRS on information reporting matters.

The IRS sends out B Notices every October and March for a filing year. The October mailing usually covers 95 percent of the timely returns filed for a year; the March mailing covers the other returns, as well as returns filed late and corrections. Most large filers who file on time receive B Notices in October. Although far more filers receive notices in the March "second pass" mailing, they are mostly small filers who file on paper, or are filers who filed late or had bad TINs on corrections.

Rules to follow through 2002:

1. If the payor receives an October notice in year X and a March notice in year X+1, the March notice is a second notice. This rarely happens. It could happen if the payor timely filed an incorrect original and later filed an incorrect correction. The incorrect original will show on the October list, and the incorrect correction on the March list.
2. If the payor receives a March notice for year Y and an October notice for year Y+1, the October notice is a first notice. This is far more common than rule 1. It could happen if the payor corrected the return for year Y, and then filed year Y+1 with the same (invalid) TIN.

Examples of the expanded rules for 2003:

1. If for Merchant L the payor receives an an October notice in year X for year A, and a March notice in year X+1 for year A, that is one notice because the March notice is for the same year as the October notice.
2. If for Merchant M the payor receives an October notice in year X for year A, and another notice for Merchant M in October of year X+1 for year B, that is a second notice because it was received in a different year (X vs. X+1) and is for a different year (A vs. B).
3. If for Merchant N the payor receives a March notice in year X for year A, and another notice for Merchant N in October of year X but for year B, that October notice is still a first notice because, although it is for another filing year (B vs. A), it was received in the same year as the March notice (both received in year X).

By the way, it is not necessary that the TIN noted as invalid on the second notice be the same TIN found invalid the first time. It is only necessary that the invalid TIN on the notice be on the account when the notice is received.

Example:

Payee J has account 555 at Payor W. J's TIN on account 555 is 777-88-9999. Payor W receives a B Notice for account 555 listing TIN 777-88-999 as invalid. Payor W solicits a new TIN from J who provides a Form W-9 certifying TIN 999-88-7777. Payor W reports the TIN for account 555, but receives another B Notice the next year for account 555 listing TIN 999-88-7777 as invalid. This is a second notice. Although the two notices listed two different TINs as invalid, Payor W received two B Notices for account 555 within three calendar years.

Example:

Payee F has account 987 at Payor V. F's TIN on the account is 333-44-5555. Payor V receives a B Notice for account 987 listing TIN 333-44-5555 as invalid. Payor V solicits a new TIN from F, who doesn't respond. Payor V files Form 1099-MISC for another year with invalid TIN 333-44-5555. Subsequently, F provides a Form W-9 certifying TIN 555-44-3333. Payor V then receives another B Notice for account 987 listing TIN 333-44-5555 as invalid. This notice, although received within three calendar years of the first, is not a second notice because the TIN on the notice does not match the TIN on the account when the notice was received. Only a first notice has been received for this account.

11. Second B Notice

If the payor receives a second B Notice for an account within three calendar years, it must send a letter notifying the payee that it has been instructed by the IRS to begin backup withholding. This letter is different from the letter sent to the payee after receiving the first B Notice, but like the first letter, it should identify the date by which backup withholding will begin. The IRS has provided a prototype second B Notice letter, which the payor should use. The payor should make certain it is using the most recent version.

Please note the following requirements:

1. Add the payee's name, address, and TIN at the top of the letter. This should be the information provided by the IRS on the second B Notice. It should be printed in bold and conspicuous type.
2. Add the payee's account number at the top of the letter, also in bold and conspicuous type. If an account number was provided by the IRS, use it. If not, insert the number(s) of the account(s) located for this payee, using reasonable care.
3. Send the letter to the payee in an envelope with the following legend on the outside in bold and conspicuous type: "IMPORTANT TAX DOCUMENT ENCLOSED".
4. No return envelope or Form W-9 need be sent with the letter.

Since September 1, 1993, the payor has been required to use the IRS prototype letter. As with the prototype letter for the first B Notice, the only changes allowed are those to eliminate extraneous instructions (e.g., delete instructions for non-individuals if the letter is being sent only to an individual), or to add instructions necessary for the payee to comply with the payor's specific business practices (e.g., inform the payee to come to a particular office instead of his/her local office).

The payor must begin backup withholding within 30 business days after receiving the second B Notice for the payee account. The payor may not stop until it receives an official Stop Notice from the IRS or SSA. Receipt of another Form W-9 from the payee will not suffice to stop backup withholding under these circumstances.

In addition to backup withholding, the payor must encode the account for the "2nd TIN not." box on any future forms filed for this account. Once the payor has received a second B Notice for an account, the payor should check this box on future Forms 1099-MISC filed for the same account. The IRS uses this information to delete the account from any future B Notice listings. The theory is that since the payor has received a second notice, it is already backup withholding and therefore does not need to receive a third or fourth B Notice.

12. The Stop Notices

Once the payor has begun backup withholding after receiving the second B Notice for an account within three calendar years, the payor must continue to backup withhold until it receives an official Stop Notice from the government. The regulations specify two notices as Stop Notices: IRS Letter 147C for non-individuals, and SSA Form 7028 for individuals. Nothing else (including Form W-9) will suffice to stop backup withholding after a second B Notice is received for the same account within three calendar years.

The Stop Notice must be official. Make sure it is an actual IRS Letter 147C or SSA Form 7028. Other correspondence, even on IRS or SSA stationery, does not qualify as a Stop Notice.

In addition, non-individuals must provide the payor with a Form W-9. Letter 147C without a Form W-9 is not sufficient to stop backup withholding.

Individuals do *not* need to provide a Form W-9 in addition to SSA Form 7028.

SSA Form 7028

If the payee is an individual, the payor will receive Form 7028 from the SSA. After receiving the letter from the payor stating that it has been instructed to backup withhold, the taxpayer/payee must contact the SSA to resolve the problem. When the matter has been resolved, the SSA will issue Form 7028. The payor may receive a copy in the mail, or the payee may deliver a copy to the payor's office. When received, the payor must stop backup withholding within 30 days.

SSA Form 7028 is fairly simple. In fact, it is probably too simple. It does not have space for an account number, or for the payee's old name/TIN (for those cases where the SSA is validating something other than what the payor has on its records). These omissions can cause problems when the payor is trying to figure out which accounts are affected by the Stop Notice. Suggestions have been made to the SSA to revise Form 7028, or to devise a new Stop Notice just for this program. Unfortunately, after fifteen years, the SSA still has not incorporated the suggested changes.

Letter 147C

If the payee is not an individual, the payor will receive Letter 147C from the IRS. After receiving a second B Notice letter from the payor, the payee is instructed to contact the IRS to resolve the problem. When the matter is resolved, the IRS will issue Letter 147C. The payor may receive it either in the mail from the payee (not the IRS) or when the payee's representative stops by in person.

IRS Letter 147C is used for many purposes and was around long before the backup withholding program began. As a result, it may not be exactly what the payor is expecting. It has no specific language that says the payor should stop backup withholding. Rather, it confirms to the taxpayer which name/TIN combination the IRS has on file for that taxpayer. It instructs the taxpayer to attach a copy of the letter to the

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B Notice letter the taxpayer received from the payor and to return both items to the payor.

Like Form 7028, Letter 147C does not list an account number or the payee's old name/TIN. The payor will have to figure out which accounts are affected. Of course, since Letter 147C comes to the payor from the payee, the payor can ask the payee which accounts are affected.

In addition to Letter 147C, the payee must send the payor a new Form W-9, properly executed. Once the payor has received Letter 147C and Form W-9, the payor must stop backup withholding within 30 days. The payor should not refund any amounts already backup withheld.

13. Penalties

Failure to fulfill any of the B Notice requirements will result in a loss of "reasonable cause". If the payor files an information return with a bad name/TIN combination, the payor may be subject to a penalty of \$50 per failure⁵, with a maximum of \$250,000 per year per payor. The penalty is waived if the payor can establish for the IRS that it met the reasonable cause standards of the code and regulations. To meet this standard, the payor must not only properly solicit the merchant's TIN before payment is made, but also properly re-solicit the TIN upon receipt of the B Notice from the IRS. Failure to perform any of the elements set forth in the reasonable cause regulations will result in a loss of the defense to the penalty.

Penalty notices are sent out about ten months after the B Notices. Any account on the B Notice will be duplicated on the penalty notice. The penalty notice also includes any other errors the payor committed, such as late filing, filing with other incorrect information, or failure to use magnetic media. Penalty notices include a larger number of forms than the six included in the B Notice Program (i.e., Forms 1099-B, 1099-INT, 1099-DIV, 1099-MISC, 1099-OID, and 1099-PATR); penalty notices also include errors occurring on Forms 1099-A, 1099-C, 1099-R, 1099-S, and W-2G.

When a penalty is proposed by the IRS (using Form 972CG), the filer must respond with an explanation of how the filer met reasonable cause. Full details can be found in IRS Publication 1586. However, if the payor has not fulfilled the B Notice requirements, the payor will not be able to have the penalty waived.

⁵ The penalty is \$50 per return, but may be reduced to \$15 if the error is corrected within 30 days of the filing deadline, or \$30 if corrected by August 1. At those levels, the maximum penalty is \$75,000 and \$150,000, respectively. The penalty may also be increased to the greater of \$100 per return or 10 percent of the amount not properly reported, with no maximum, if intentional disregard is shown.

In addition to these penalties for errors committed when filing information returns with the IRS, there are separate penalties of \$50 per failure for each error the payor commits on a statement sent to the payee. A maximum of \$100,000 applies unless intentional disregard is shown. Details can be found in IRS Publication 1586.

14. Depositing the Amounts Backup Withheld

The mechanism and timing rules for depositing backup withholding have changed over the years. The rules in effect at the beginning of 2002 are described below. For rules for earlier years, the payor should consult its tax advisor.

When to Deposit

At the beginning of each year, the payor must determine whether it is a small, monthly depositor or a regular, semi-weekly depositor. To do this, the payor should look at the Form 945 filed with the IRS for the "lookback" or "base" period.

Base Period. Since 1995, the lookback period for determining how frequently the payor must deposit backup withholding has been the second preceding calendar year. For 2002, look at the amount of the total tax liability (backup withholding, pension, and gambling) shown on Form 945 (Annual Return of Withheld Federal Income Tax) filed for 2000. If the total is \$50,000 or less, the payor is a small, monthly depositor; if it is more than \$50,000, the payor is a regular, semi-weekly depositor.

Monthly Depositors. If a payor is a small depositor, deposits are made monthly and must be made no later than the 15th day following the close of the calendar month in which the withholding took place. For example, if the withholding took place on the 12th of May, the deposit must be made no later than the 15th of June.

A payor may be a regular depositor for wages and a small depositor for backup withholding. The payor should look at its own records to see if it qualifies as a small depositor for backup withholding purposes.

Semi-weekly Depositors. A regular depositor is anyone other than a small depositor. A regular depositor must make deposits on a semi-weekly basis. Under the semi-weekly rules, any amounts withheld on a Wednesday, Thursday, or Friday must be deposited by the following Wednesday. Any amounts withheld on a Saturday, Sunday, Monday, or Tuesday must be deposited by the following Friday.

Other Rules. In addition to the above general rules for small and semi-weekly depositors, there are some special rules:

1. If at any time the payor has withheld more than \$100,000, the deposit is required to be made the next business day.
2. If at any time a small depositor is required to make a deposit under this \$100,000 rule, that payor is immediately disqualified from the small depositor rule and must observe the general (semi-weekly) rules beginning with the next withholding activity.
3. A deposit is required only on banking days. If a regularly scheduled deposit day falls on a Saturday, Sunday or holiday (state or federal), the payor is not required to make the deposit until the next banking day.
4. A payor always has a minimum of three banking days to make a deposit (except, of course, under the \$100,000 rule). Therefore, if a payor withholds on

a Friday, and Monday is a holiday, the deposit, normally due on Wednesday, is not due until Thursday.

5. If a semi-weekly deposit period straddles the end of one year and the beginning of another, the payor should segregate the amounts withheld at the end of the year from the amounts withheld at the beginning of the following year, and should deposit them separately. For example, if December 31 is a Thursday, the amounts withheld on Wednesday and Thursday (December 30 and 31) should be deposited separately from the amounts withheld on Friday, January 1st.
6. A payor must deposit 98 percent of the amount owed in order to be considered to have timely deposited. If the shortfall is less than \$100 for any single deposit, the deposit is considered timely regardless of the percentage deposited. In order to qualify for these "shortfall" provisions, the shortfall must be made up in a timely fashion. For small, monthly depositors, the shortfall must be made up by the due date of the return (January 15). For regular, semi-weekly depositors, the shortfall must be made up by the first Wednesday or Friday that occurs on or after the 15th of the month following the month in which the shortfall occurred. For example, if the withholding occurred on Monday, May 12th, a semi-weekly depositor must deposit by Friday, May 16th. If 98 percent of the amount owed is deposited by that time, the deposit is considered timely if the remaining two percent is deposited by the following June 18th. If the shortfall happens in December, the shortfall must be made up by the time the payor files Form 945 (by January 15th).
7. If the total shortfall for the year is less than \$2500, the deposit is due no later than the date the payor files the Form 945 for the year.
8. Regular depositors and accelerated depositors must file Form 945 Schedule A (along with Form 945 itself) to indicate their liability for backup withholding; only small depositors will note their liability figures on Form 945 itself.

How to Make a Deposit

In addition to the above rules for when the payor must deposit, there are also rules for how the payor must make its deposits. Since 1995, most large payors have been required to deposit taxes electronically. The IRS has released regulations describing the requirement to electronically deposit backup withholding, wage withholding, pension withholding, and nonresident alien withholding, along with corporate estimated tax payments and various excise taxes. These requirements were mandated by the North American Free Trade Agreement (NAFTA) passed in 1993.

The requirement to make deposits electronically was phased in over several years in the second half of the 1990's. Currently, if the payor must deposit at least \$200,000 in any year of all taxes together (backup withholding, pension withholding, wage withholding, and corporate estimated tax payments), the payor must make all of its depos-

its electronically. As a result, most, if not all, users of purchasing cards will be in the group of payors which must make deposits electronically.

If the payor is not required to make deposits electronically, the payor may use Form 8109 (Federal Tax Deposit Coupon) and make its deposits in person at an authorized financial institution. The payor may make deposits electronically even if not required to do so.

Once a depositor is required to deposit electronically, all taxes, including corporate estimated income taxes, must be deposited electronically. If the depositor slips below the threshold in a subsequent year, it does not revert to paper deposits.

The deposits themselves are made by either a debit or credit option. A debit option involves authorizing the government's agent to withdraw requisite amounts from the depositor's account or accounts at financial institutions. The credit option involves the depositor initiating an electronic funds transfer from the depositor's account to the government's agent. More information about the mechanics of making deposits electronically can be found in IRS Publication 966. The payor may also call the IRS at 800-829-5469.

All deposits must be made according to the current schedule, e.g., generally Wednesday-Friday for backup withholding. A depositor must begin the electronic deposit process sufficiently in advance of the due date to ensure that the deposit is made by the due date. Penalties will continue to apply for late deposits.

If a depositor's agent fails to make a timely deposit after receiving timely and adequate instructions, no penalties are imposed on the depositor. However, there must be proof available to establish that timely and adequate instructions were given.

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Each year, a payor must file Form 945 to report its backup withholding liabilities. If the payor is a regular, semi-weekly depositor, it must also file Schedule A with Form 945. The purpose of the form(s) is to identify for the IRS the payor's backup withholding liabilities. The IRS will compare the liabilities reported with the deposits the payor actually made to determine whether a late deposit penalty is warranted.

Penalties

Late deposit penalties range from two percent (up to 5 days late) to five percent (up to 15 days late) to ten percent (more than 15 days late) of the deposit amount. If the payor fails to make payment after being notified of the failure, the penalty may increase to 15 percent. Filing on time, but using paper coupons when electronic deposited is mandated, is subject to the 10 percent penalty.

The IRS automatically sends a late deposit penalty notice when it determines that a late deposit occurred, based on comparison of the Form 945 statement of liabilities with IRS records of actual deposits. It is difficult to obtain a waiver of these penalties. More information about the deposit rules can be found in IRS Notice 1028 and Publication 15.

15. IRS B Notice Program Action Checklist

1. Designate the person(s) responsible for implementing the B Notice process.
2. Train designated personnel to answer questions from payees.
3. Instruct the mailroom how to identify a B Notice package and where to send it within the organization.
4. Once received by the response team, review the package contents. Be sure the material received is for your organization. If you receive some other entity's materials, you are not required to forward them or otherwise inform the IRS.
5. Instruct computer personnel to read the magnetic tape if one is received.
6. Have the magnetic tape data or paper listing sorted by department/location (if your company's records are contained at more than one site).
7. Have each department eliminate "non-B Notices".
8. Determine which are second B Notices.
9. Send out second B Notice letters within 15 days of the date on the notice.
10. Send out first B Notice letters within 15 days of the date on the notice.
11. Start backup withholding on second B Notice accounts within 30 business days of the date on the notice.
12. Start backup withholding on first B Notice accounts within 30 business days of the date on the notice if no certified TIN is received on a properly executed Form W-9.
13. Code second B Notice accounts for continued backup withholding until a proper IRS/SSA Stop Notice is received.
14. Code first B Notice accounts for continued backup withholding until a properly executed Form W-9 is received.
15. Code first B Notice accounts for the 2-in-3 rule.
16. Code second B Notice accounts for Form 1099 2-in-3 checkbox (titled "2nd TIN not." on the 2002 returns).
17. Process Forms W-9 returned for first B Notice accounts. Stop any "notified invalid TIN" withholding which you may have initiated earlier.
18. Set up a procedure to process Stop Notices from the IRS.
19. Make sure any backup withholding done in the accounts payable system is deposited.
20. (Optional) Refund amounts backup withheld during the 30 day wait period if a Form W-9 was received during that period.
21. Retain any research materials related to B Notice mailings for use when penalty notices are received in a few months.

16. Visa Efforts to Obtain IRS Relief for Its Cardholders

As is readily apparent from a reading of the requirements of the B Notice Program, payors have an enormous responsibility to the IRS, which includes TIN solicitation, identifying payments subject to information reporting, filing Forms 1099-MISC, backup withholding, depositing, responding to B Notices, and dealing with penalty notices. For the past few years, Visa has been working diligently with the IRS to obtain cardholder relief from these burdens. If Visa's plan is adopted, Visa cardholders will have an easy way to identify reportable payments and will be excused from TIN solicitation rules, B Notice procedures, and depositing concerns. They will also be exempted from penalties when using Visa-provided data.

The IRS has been receptive to Visa's proposed relief provisions and is on the verge of issuing guidance generally in line with Visa's suggestions. Once adopted, these relief provisions will significantly ease the burden on Visa cardholders (check-writers will still have to meet all the requirements). When the IRS guidance has been released, Visa will inform its member banks and work with them to implement any processing changes necessary to enable cardholders to benefit from these relief provisions.

For information about the IRS relief provisions, contact your Visa Member bank representative.