INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE PUBLIC MEETING

NOVEMBER 8, 2002
1111 CONSTITUTION AVENUE NW
WASHINGTON, DC

2002 ADVISORY GROUP
PUBLIC MEETING
1111 CONSTITUTION AVENUE
INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE
AGENDA
FRIDAY, NOVEMBER 8, 2002

Time	Topic	Presenters
8:30 - 9:00	Coffee/Refreshments	
9:00 - 9:15	Opening Remarks	David R. Williams Chief, Communications & Liaison
9:15 - 9:45	General Remarks	Robert E. Wenzel Acting Commissioner, Internal Revenue
9:45 - 10:15	General Report of the Committee	Michael O'Neill Chairman, Information Reporting Program Advisory Committee
10:15 - 10:30	BREAK	
10:30 - 11:30	Large & Midsize Business Subgroup Report	Keith Jones Director, Field Services, Large & Midsize Business Neal Givner, Chairman, Large & Midsize Business Subgroup
11:30 - 12:30	Tax Exempt & Government Entities Subgroup Report	Tom Terry Senior Technical Advisor, Tax Exempt & Government Entities Barbara Seymon-Hirsch, Chairman Tax Exempt & Government Entities Subgroup
12:30 - 1:45	LUNCH	TO BE PROVIDED (MEMBERS ONLY)
1:45 - 2:45	Small Business/Self Employed Subgroup Report	Bill Conlon Director, Reporting Compliance Policy, Small Business/Self-Employed Mary Javor, Chairman, Small Business/Self-Employed Subgroup
2:45 - 3:00	BREAK	

2002 ADVISORY GROUP
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INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE
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FRIDAY, NOVEMBER 8, 2002

Time	Topic	Presenters
3:00 - 4:00	Wage & Investment Subgroup Report	John Dalrymple Commissioner, Wage & Investment Connie Davis, Chairman, Wage & Investment Subgroup
4:00 - 4:15	Closing Remarks	Robert E. Wenzel Acting Commissioner, Internal Revenue
4:15	ADJOURN	

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

PUBLIC MEETING BRIEFING BOOK

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INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

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NOVEMBER 8, 2002

GENERAL REPORT
OF THE
INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE

The Information Reporting Program Advisory Committee (hereinafter the "IRPAC" or "Committee") was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989.[1] At that time, Congress recommended that the Internal Revenue Service (hereinafter "IRS" or the "Service") consider "the creation of an advisory group comprised of representatives from the payor community and practitioners interested in the information reporting program ... to discuss improvements to the system."[2]Congress believed such an advisory group would be helpful for purposes of discussing "problems and the feasibility of complying with, or the economic impact of, rules and regulations affecting the reporting industry."[3] Since its inception, the IRPAC has worked closely with IRS officials to provide recommendations on a broad range of diverse issues intended to improve the Information Reporting Program and achieve fair and equitable treatment of taxpayers.

The 2002 IRPAC completed the reorganization it began in 2001 by adopting a subgroup structure that aligns directly with the four Operating Divisions of the IRS. Accordingly, the Committee was subdivided into the following subgroups:

- Large & Midsize Business Subgroup (hereinafter the "LMSB Subgroup");
- Tax Exempt & Government Entities Subgroup (hereinafter the "TEGE Subgroup");
- Small Business/Self-Employed Subgroup (hereinafter the "SB/SE Subgroup"); and

[1] H.R. CONF. REP. NO. 101-386, at 662 (1989).
[2] *Id.*
[3] *Id.*

- Wage & Investment Subgroup (hereinafter the "W&I Subgroup").

The individual reports of the subgroups immediately follow this General Report.

Committee members were assigned to subgroups based on their backgrounds, and chairs were appointed to coordinate the activities of the subgroups. The new organizational structure significantly improved the effectiveness of the IRPAC and the timely resolution of issues by fostering increased interaction between IRS officials and Committee members.

As a function of the reorganization, the IRPAC adopted formal criteria for the purpose of establishing the Committee's project priorities. The criteria provide that, to the extent possible, issues addressed by the IRPAC should benefit a significant number of those stakeholders effected by the information reporting system, including the payor, practitioner, and taxpayer communities as well as the IRS.

During calendar year 2002, the Committee met at IRS headquarters in Washington, DC. five times in preparation for its public meeting. The IRPAC also worked with the Internal Revenue Service Advisory Council (hereinafter the "IRSAC") and the staff of the Office of National Public Liaison (hereinafter "NPL") to conduct focus groups at the four IRS Nationwide Tax Forum mega-sites. These focus groups provided important feedback from tax and payroll practitioners regarding the effectiveness of existing IRS programs, policies, and initiatives and changes that might improve the delivery of products and services.

The Committee also submitted written comments to the IRS Oversight Board regarding the operations of the National Taxpayer Advocate's Office and the implementation of several major IRS programs, including the Employer Identification

Number, Practitioner Priority Services, Centralized Authorization File, Offer-in-Compromise, and K-1 Matching programs.

The Committee will continue to coordinate with both the Oversight Board and the IRSAC in advancing payee, payor, and practitioner issues that promise to improve the IRS Information Reporting Program and increase voluntary compliance with the tax law.

As the year draws to a close, the IRPAC has completed its second year under the auspices of NPL, which has responsibility within the IRS to provide administrative support and direction for the Committee. Coordination provided by NPL is vital in arranging contacts between Committee members and appropriate levels of IRS management. The IRPAC wishes to acknowledge the excellent service it has received from the NPL staff in supporting the work of the Committee.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

LARGE & MIDSIZE BUSINESS SUBGROUP REPORT

JOAN M. DIBLASI
NEAL S. GIVNER, ESQ., SUBGROUP CHAIR
CAROL A. KASSEM
CARMELA LAWRENCE, CPA
MARK A. MERLO
ERNEST V. MOLINARI, ESQ.

NOVEMBER 8, 2002

INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE
LARGE & MIDSIZE BUSINESS
SUBGROUP REPORT

During the 2002 IRPAC term, the LMSB Subgroup worked with the IRS Office of Chief Counsel and Treasury representatives on a number of information reporting issues that were raised by various segments of the financial services industry. The following issues were completed by the LMSB Subgroup this year..

- **Paper** ***(Lawrence)*** – Tax Liability for Nonresident Aliens in Cross-Border Securities Lending Transactions and Related Form 1042-S Reporting Issues. Viewed as the first installment in a projected series of IRPAC papers that will address diverse issues arising in the context of securities loans, this paper discusses the legal rationale underlying Notice 97-66 that addresses situations involving cross-border securities lending transactions potentially giving rise to incremental withholding and reporting. The LMSB Subgroup has offered to work with the IRS to effectuate the legal rationale of Notice 97-66 in ways that are practicable and which lend themselves to information reporting.

- **Paper** ***(Molinari)*** – Request that the IRS Expand the IRS TIN Matching Program (hereinafter the "Program") to Allow Payors of Designated Distributions to Utilize the Program for the purpose of Curtailing Payee Bad Name/TIN Combinations.

- **Paper** ***(Kassem)*** – Request that the IRS Extend the Time Permitted to Refund Erroneous Backup Withholding Until the Later of the End of the Relevant Calendar Year or Prior to the Date that the Payor is Legally Required to Issue Form 1099 to the Payee (i.e., January 31 of the Immediately Succeeding Calendar Year).

- **Paper** ***(Givner)*** – Request that the IRS permit: (1) Use of Facsimile Signatures for Form 8868 (Application for Extension of Time to File an Exempt Organization Return); and (2) Filing of a "Consolidated" Form 8868 for the Ultimate Filing of Forms 990-T (Exempt Organization and Business Income Return) by IRA Trustees.

- **Paper** ***(Givner)*** – Request that the IRS Permit a Clearing Broker to Determine its Withholding Obligations under Internal Revenue Code Section 3405 by Reference to Representations from an Introducing Broker Based on a Payee's Form W-4P (Withholding Certificate for Pension or Annuity Payments).

- **Paper** ***(Givner)*** – Should Dispositions of Single Stock Futures be Subject to Gross Proceeds Reporting on Form 1099-B?

- **Letter** ***(Merlo)*** – Request that the IRS Issue a Directory Listing Widely Held Fixed Investment Trust Information or a Publication Similar in Content and Effect to Publication 938 (REMIC Reporting Information and Other Collateralized Debt Obligations (hereinafter "CDO")) to facilitate correct information reporting for Widely Held Fixed Income Trusts.

- **Letter** ***(Kassem)*** – Request the IRS to Clarify Uncertainty Surrounding the Treatment of Form 1042-S Filed with a Payee Address in the United States.

- **Letter** ***(Molinari & DiBlasi)*** – Request that the IRS: (1) authorize Electronic Delivery of Form 1099-R (Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.) and Form 5498 (IRA Contribution Information) Payee Statements; (2) treat as Timely Payee Statements Delivered Electronically by January 31 to Customers who Withdraw Consent to Receive Electronic Payee Statements by the Preceding December 31; and (3) allow an additional thirty days for mailing of paper statements to payees who withdraw electronic consent after December 31.

- **Letter** ***(Molinari)*** – The IRPAC's Comments and Recommendations on the Re-Proposed Regulations Issued in May 2002 that Address Information Reporting for Payments of Gross Settlement Proceeds to Attorneys.

EXECUTIVE SUMMARY

TITLE OF PAPER: Tax Liability of Nonresident Aliens in Cross-Border Securities Lending Transactions and Related Form 1042-S Reporting Issues

ISSUE STATEMENT: This paper addresses the tax liability incurred by nonresident aliens receiving U.S.-source substitute payments where the amount withheld by the payor does not satisfy the tax liability. The paper specifically addresses securities lending transactions entered into by principals (entities that engage in these transactions for their own portfolio, i.e., to cover short positions, and, for purposes of the transactions, are not acting as agents for other lenders). In addition, the paper discusses issues related to Form 1042-S with respect to the reporting of substitute payments made in a series of securities loans.

REMEDY SOUGHT: Regulation

IRPAC TEAM: Carmela Lawrence, Neal Givner, Mark Merlo, Joan DiBlasi, Ernest Molinari, and Carol Kassem

IRS PARTICIPANTS: Jeffrey Vinnik, Paul Epstein, Theodore Seltzer

BACKGROUND: New issue introduced by members of the 2002 IRPAC

SUMMARY OF RECOMMENDATIONS:

1. To eliminate the tax liability under Internal Revenue Code[1] sections[2] 881 and 882 on U.S.-source substitute dividends in cross-border securities loans that give rise to incremental withholding tax wherein a portion of the gross income should be recharacterized as *foreign*-source.

2. Where cross-border substitute payments yield no incremental withholding tax, such payments should be categorized as foreign-source and not subject to Form 1042-S reporting.

3. As representatives of the financial services industry, the LMSB Subgroup would be pleased to work with the IRS to

[1] 26 U.S.C. (1994) (as amended), hereinafter "I.R.C.".
[2] Hereinafter, unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended, and all citations to section or sections of the Internal Revenue Code shall be referred to as "§" or collectively "§§".

effectuate the withholding and Form 1042-S reporting requirements contemplated by Notice 97-66[3] in ways that are practicable for the industry.

TAXPAYERS / INDUSTRY AFFECTED: Financial service industry stakeholders (such as banks and brokers) that enter into securities lending transactions for their own portfolios.

BENEFIT TO TAXPAYERS (PAYORS & PAYEES): Tax liability for nonresident aliens would be completely satisfied. Payees would receive correct Forms 1042-S.

BENEFIT TO INTERNAL REVENUE SERVICE: The IRS would not generate and process discrepancy notices that result from incorrect Forms 1042-S that are filed by payors engaged in securities lending transactions.

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[3] I.R.S. Notice 97-66, 1997-48 C.B. 8.

DISCUSSION

I. CURRENT REGULATIONS AND NOTICES

a) Taxation of Substitute Payments in Cross-Border Securities Lending Transactions

On October 6, 1997, the IRS issued final regulations with respect to the *source and character* of substitute payments made in cross-border securities lending transactions between U.S. and non-U.S. persons. The regulations were issued to eliminate certain tax differences generated by similar economic investments.

Internal Revenue Code § 1058(a) describes a securities lending transaction as the transfer of securities made pursuant to a written agreement that: (i) provides for a return to the transferor of identical securities; (ii) requires substitute payments; and (iii) does not reduce the transferor's risk of loss or opportunity for gain on the securities transferred by allowing the lender to terminate the loan upon notice of not more than five business days.

The final regulations provide that a substitute payment made in connection with a securities lending transaction is **sourced** in the same manner as the distributions with respect to the transferred security for purposes of I.R.C. § 861 and Treas. Reg. § 1.862-1. This 'transparency' rule applies to payments made to both U.S. and foreign lenders. The source rule applies for all purposes of the I.R.C. in a cross-border securities lending transaction. Thus, a substitute payment made in connection with a U.S. securities loan is U.S.- source.

The final regulations provide that for purposes of determining tax liability under I.R.C. §§ 871 and 881, nonresident alien tax under Chapter Three, and for treaty purposes, a substitute payment made to a *foreign* lender is **characterized** using the transparency rule. Treasury Regulations §§ 1.871-7(b)(2) and 1.881-2(b)(2) state that a substitute dividend payment received by a foreign person pursuant to a securities lending transaction shall have the same character as the distribution received with respect to the transferred security. Thus, a substitute dividend payment made by a U.S. borrower of shares of a U.S. corporation to a foreign lender of the shares is considered a U.S. dividend and will be subject to U.S. withholding tax. However, the transparency rules do not apply when characterizing substitute payments made to U.S. lenders. These payments are considered 'other' amounts and not dividends. (This treatment ensures that both the recipient of the real dividend and the recipient of the substitute payment do not take a Dividend Received Deduction or other tax benefit.)

Treasury Regulation § 1.861-3(a)(6) defines a substitute dividend payment as a payment made to the transferor of a security in a securities lending transaction, of an

amount equivalent to any dividend distribution, which the owner of the transferred security is entitled to receive during the term of the transaction.

Shortly after these regulations were issued, taxpayers brought to the attention of the IRS and Treasury that, in certain circumstances, the total U.S. withholding tax paid with respect to a securities loan or a series of such transactions could be excessive due to the application of the final regulations (i.e., the cascading scenario). That is, if U.S. securities were loaned through tiers of borrowers within the same foreign country or within countries having the same dividend tax treaty rate, i.e., "foreign-to-foreign" loans, a U.S. withholding tax would potentially apply to **each** substitute payment in the chain of payments. The total withholding tax applied in a series of securities loans could possibly exceed the thirty percent statutory rate.

b) Withholding Tax Imposed on Foreign-to-Foreign Substitute Payments in Securities Lending Transactions (Notice 97-66)

On November 13, 1997, the IRS issued Notice 97-66 to clarify the amount of withholding tax imposed on *foreign-to-foreign* substitute payments made in securities lending transactions. As it relates to substitute dividend payments, the Notice is generally intended to limit the thirty percent U.S. withholding tax to the tax that would have applied had the underlying dividend been paid to the foreign payer of the substitute payment, or, if more, the tax that would have applied had the underlying dividend been paid directly to the foreign payee of the substitute payment. This amount may be reduced to the extent that the total U.S. tax actually withheld on the underlying dividend and previous substitute payments is greater than the amount of tax that would be imposed on U.S. dividends by a U.S. person directly to the payer of the substitute payment. The Notice mandates that the 'formula' above be used in foreign-to-foreign payments.

For example, if a U.S.-source dividend paid to foreign person, F, is subject to a fifteen percent rate and F then makes a substitute payment in respect of the dividend to foreign person G, F is not required to withhold provided the payment of the dividend to G would have been subject to withholding tax of not more than fifteen percent but must withhold an additional fifteen percent of the dividend amount if G was subject to a thirty percent tax rate (i.e., G is not eligible for any tax treaty reduction on the statutory thirty percent withholding tax rate). The Notice ensures that in a cascading scenario, no more than the statutory thirty percent is withheld across an entire chain of equity loans.

II. ISSUES WITH CURRENT REGULATIONS AND NOTICE 97-66

a) Withholding Tax Liability under I.R.C. §§ 871 and 881

With certain exceptions, I.R.C. §§ 871(a) and 881(a) impose a thirty percent tax on nonresident aliens receiving income from sources within the United States. The tax is imposed on the gross amount of "fixed or determinable, annual or periodical (FDAP)"

income. FDAP income includes all income described in I.R.C. § 61; i.e., generally all income.

Notice 97-66 addresses the calculation of the *withholding tax* amount for each substitute payment made in a series of securities loans. The Notice also limits the withholding agent's liability for withholding based on the formula in the Notice.

In general, the tax liability imposed under I.R.C. §§ 871 and 881 is satisfied by the actual withholding deducted from the U.S.-source substitute dividend paid to the nonresident alien. However, when there is a series of substitute payments made by principals in a securities loan, the nonresident alien's *tax liability* is not always entirely satisfied by applying the 'cascading' withholding formula in the Notice. (Note: principals are entities that utilize these transactions for their own portfolio, i.e., to cover short positions, and, for purposes of these transactions, are not acting as agents for other lenders.)

b) Form 1042-S

As stated above, Notice 97-66 sufficiently addresses possible overwithholding situations in foreign-to-foreign payments. However, the Notice does not specifically cover Form 1042-S reporting for **each** substitute payment made in a series of loans by different principals. It is not clear how the amount withheld by the upstream payor is to be reflected on the Form 1042-S prepared by the next payor in the chain. In accordance with current Form 1042-S Instructions, Forms 1042-S prepared in each foreign-to-foreign securities loan may generate Form 1042-S discrepancy notices from the IRS. Notices are generated by the IRS when certain required fields on Form 1042-S do not match, e.g., the actual withholding amount in Box 7 does not agree with the expected withholding amount for a particular payee based on the country code. The example below illustrates the problems with Form 1042-S reporting and the issue of tax liability discussed above.

c) Example of Multiple Securities Loans

Facts: A, a U.K. corporation, borrows securities of X, a U.S. corporation, from B, a Cayman entity. A borrows these shares to cover its short sale with C. A holds the securities over record date and thus receives the real dividend from X. X's paying agent pays a $100 dividend to A, who is subject to fifteen percent withholding tax. A receives an eighty-five dollar net payment. A makes a U.S. source substitute dividend payment to B, who is subject to thirty percent tax.

Dividend Payment From X to A: Tax Liability is Satisfied and Form 1042-S is Correct

A's tax liability under I.R.C. § 882(a) is fifteen dollars (fifteen percent withholding tax rate multiplied by $100 gross dividend). A receives eighty-five dollars net.

Since A's tax liability under I.R.C. § 882(a) is fifteen dollars and that liability is satisfied by the fifteen dollar withholding, A has no additional tax liability. X prepares Form 1042-S which includes $100 gross income in Box 2; fifteen dollars withholding in Box 7; fifteen percent tax rate in Box 5 and country code of U.K. (i.e., fifteen percent country) in Box 16. This Form 1042-S is correct. The IRS will not generate a Form 1042-S discrepancy notice because A is a U.K. entity that is subject to fifteen percent withholding rate per the U.S.-U.K. tax treaty. A tax of fifteen dollars was withheld on the gross amount of $100. Thus, Form 1042-S reflects the proper withholding at the proper rate for a U.K. entity.

Substitute Dividend Payment From A to B: Tax Liability is **Not** Satisfied Completely by Applying Notice 97-66, and Form 1042-S will be Incorrect

The substitute payment from A to B is treated as a U.S.-source dividend payment per the final regulations. A must withhold an *incremental* fifteen percent on this substitute payment per Notice 97-66. Note that as a Cayman entity, B should be withheld at a rate of thirty percent because there is no U.S. tax treaty with the Cayman Islands. However, X already withheld fifteen percent upstream from A and thus, B is only withheld the incremental fifteen percent. B receives a seventy dollar net payment. B's tax liability under I.R.C. § 882(a) is thirty dollars (thirty percent withholding tax rate multiplied by $100 gross dividend). However, B was only withheld fifteen dollars. B would be **liable** for an additional fifteen dollars under I.R.C. § 882(a). Notice 97-66 ensures that the *withholding* is proper but it does not eliminate B's *tax liability* entirely. Using Notice 97-66, the proper tax has been withheld in the entire transaction and thus, there should be no additional tax liability to any party in this example.

The Form 1042-S prepared by A to B will be **incorrect**. A will prepare a Form 1042-S that includes $100 gross income in Box 2; fifteen dollars actual withholding in Box 7; thirty percent tax rate in Box 5 and country code for Cayman Islands in Box 16.

Form 1042-S Instructions currently require the actual withholding amount to be reflected in Box 7 and the tax rate and country code of the recipient. With the exception of Form 1042-S reporting on Non-Qualified Intermediaries, Form 1042-S Instructions do not contemplate a situation where there is an upstream withholding on one entity and an incremental withholding on the next entity in the chain of payments. In the above example, the IRS' computers will multiply the withholding rate of thirty percent for the Cayman entity by the $100 gross income and expect thirty dollars to be in Box 7 as tax withheld. There is currently no mechanism to alert the IRS that fifteen dollars was withheld upstream and an incremental fifteen dollars is withheld on the Cayman entity, per Notice 97-66. This Form 1042-S will likely generate a notice from the IRS to the payor requesting the additional fifteen dollars in tax.

RECOMMENDATIONS

The LMSB Subgroup, as representatives of the financial services industry, would be pleased to work with the IRS to effectuate the legal rationale of Notice 97-66 in a manner that is practicable for the industry and susceptible to information reporting.

1. FOREIGN-TO-FOREIGN PAYMENTS WITH INCREMENTAL WITHHOLDING REQUIRED

   To eliminate the tax liability under I.R.C. §§ 881 and 882 in foreign-to-foreign U.S.- source substitute dividends where there is an incremental withholding tax, a portion of the gross income should be recharacterized as foreign source. In the example set out above, where a U.K. Corporation makes a substitute payment to a Cayman entity and withholds an incremental fifteen dollars, the gross income that should be considered U.S.-source and subject to withholding is the gross amount that yields the incremental fifteen dollar withholding tax, i.e., fifty dollars gross income. The foreign-source portion (fifty dollars, in this case) is not subject to Form 1042-S reporting. The fifty dollar U.S.-source income is reported on Form 1042-S in Box 2; the fifteen dollar withholding tax is reported in Box 7; and the thirty percent rate for Cayman entity. This Form 1042-S would not generate an IRS notice. The IRPAC suggests that the IRS include a formula to calculate the U.S.-source portion of these substitute payments.

2. FOREIGN-TO-FOREIGN PAYMENTS WITH NO INCREMENTAL WITHHOLDING REQUIRED

   With regard to foreign-to-foreign payments where no incremental withholding tax results, such payments should be foreign-source because no tax liability accrues to the nonresident alien receiving the payment and there is no tax withheld or required to be withheld. Thus, Form 1042-S should not be required in this situation.

TAXPAYERS / INDUSTRY AFFECTED

Financial service industry stakeholders (such as banks and brokers) that enter into securities lending transactions for their own portfolio.

BENEFITS TO TAXPAYERS (PAYORS & PAYEES)

Tax liability for nonresident aliens would be completely satisfied. Payees would not receive incorrect Forms 1042-S resulting from securities lending transactions.

BENEFITS TO INTERNAL REVENUE SERVICE

Generation and processing of discrepancy notices resulting from incorrect Forms 1042-S filed by payors in securities lending transactions would be significantly reduced.

EXECUTIVE SUMMARY

TITLE OF PAPER:	Expanded use of the IRS Taxpayer Identification Number (hereinafter "TIN") Matching Program to Payors of Designated Distributions.
ISSUE STATEMENT:	This paper seeks to expand the TIN Matching Program to allow payors of designated distributions to participate in the TIN Matching Program as described in Treas. Reg. § 31.3406(j)-1.
REMEDY SOUGHT:	The IRPAC recommends that the IRS pursue a statutory change authorizing the TIN Matching Program to be extended to reach payors of designated distributions under I.R.C. § 3405, as is currently permitted for payors of reportable payments under I.R.C. § 3406.
IRPAC TEAM:	Ernest Molinari, Neal Givner, Joan DiBlasi, Carol Kassem, Carmela Lawrence, and Mark Merlo
IRS PARTICIPANT:	George Blaine
BACKGROUND:	In 1997, the IRS issued Treas. Reg. § 31.3406(j)-1 that described the TIN Matching Program (hereinafter the "Program"). Promulgated under I.R.C. § 3406, this regulation limits the availability of the Program to payors of payments that are otherwise subject to backup withholding. When the Program was developed, the need to permit designated distribution payors to utilize the Program did not exist, as the penalty structure currently applicable to the reporting of designated distributions did not apply.
SUMMARY OF RECOMMENDATION:	This paper recommends that the IRS pursue a statutory change that would allow payors of designated distributions to utilize the Program.
TAXPAYERS / INDUSTRY EFFECTED:	All payors and recipients of designated distributions.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS):

Expanded use of the Program will reduce the number of required TIN solicitation mailings that payees receive which cause irritation and confusion.

Verifying account name/TIN combinations through the Program will permit payors to enhance compliance and reduce the time and resources expended to correct errors.

BENEFIT TO INTERNAL REVENUE SERVICE:

Expanded utilization of the Program will result in more accurate Form 1099 reporting and will reduce IRS' costs to administer the Information Reporting Program.

DISCUSSION

Under Treas. Reg. § 31.3406(j)-1, payors of reportable payments, as defined in I.R.C. § 3406(b)(1), are entitled to participate in the TIN Matching Program. This Program allows these payors to contact the IRS regarding TINs furnished by payees, who have received or are likely to receive reportable payments, for the purpose of determining whether the name/TIN combination provided matches a name/TIN combination maintained in the TIN database.

This, in turn, allows payors of reportable payments to reduce the potential for name/TIN combination mismatches and correspondingly reduce the penalties assessed for failing to file correct information returns under I.R.C. § 6721 and failure to furnish correct payee statements under I.R.C. § 6722.

When the on-line TIN matching prototype was originally initiated in March 1993, the need to include payors of designated distributions (as defined in I.R.C. § 3405(e)(1)) was not as significant as it is today, because information returns and payee statements filed by payors of designated distributions were *not* subject to the penalty provisions of I.R.C. §§ 6721 and 6722. However, in 1996 pursuant to the Small Business Job Protection Act, the scope of the penalty provisions described in I.R.C. §§ 6721 and 6722 was expanded to include information returns and payee statements required of payors of designated distributions (Forms 1099-R and 5498).

Further, both payors of reportable payments and payors of designated distributions are burdened by certain specified withholding rules when a payee provides an incorrect TIN. Payors of reportable payments are required to backup withhold if a payee fails to provide a correct TIN. Pursuant to I.R.C. § 3405, payors of designated distributions must withhold from any subsequent designated distributions that are subject to withholding if a payee fails to provide a correct TIN, and the payee may *not* elect out of withholding. Expanded utilization of the Program would reduce this burden for both groups of payors.

RECOMMENDATIONS

The IRPAC recommends that the IRS pursue a statutory change expanding the Program, as described in Treas. Reg. § 31.3406(j)-1, to include payors of designated distributions under I.R.C. § 3405, as is currently allowed for payors of reportable payments pursuant to I.R.C. § 3406.

TAXPAYERS/INDUSTRY EFFECTED

All payors and recipients of designated distributions.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS)

Expanding use of the Program will provide payees with statements that accurately reflect a payee's name/TIN combination and will allow such payees to elect out of I.R.C. § 3405 withholding, without hindrance, should they elect to do so. It will also reduce the number of required TIN solicitation mailings that tend to irritate and confuse recipient-payees.

Verifying account name/TIN combinations through the Program will permit payors of designated distributions to reduce and potentially avoid the labor-intensive process of searching for and reviewing Forms W-9 for every account identified on the IRS Notice 972CG (Penalty Notice). In addition, payors of designated distributions will minimize or eliminate the burden caused by having to satisfy the solicitation requirements of Treas. Reg. § 301.6724. Expanded use of the Program will enhance compliance and reduce the time and resources expended to correct errors.

BENEFIT TO INTERNAL REVENUE SERVICE

Expanded utilization of the Program will result in more accurate Form 1099 reporting. The reduction in name/TIN combination mismatches will reduce the IRS' costs to administer the Information Reporting Program.

EXECUTIVE SUMMARY

TITLE OF PAPER: Extension of Time to Refund Erroneous Backup Withholding

ISSUE STATEMENT: Provide additional time to process refunds of erroneous backup withholding and withholding from pensions, annuities, and other deferred arrangements until Forms 1099 are provided to payees.

REMEDY SOUGHT: Regulatory Change

IRPAC TEAM: Carol Kassem, Neal Givner, Carmela Lawrence, Joan DiBlasi, Mark Merlo, and Ernest Molinari

IRS PARTICIPANTS: George Blaine and John McGreevy

BACKGROUND: Treasury Regulation § 31.6413(b) requires that if a payor withholds in error under I.R.C. § 3406, the payor may refund the amount erroneously withheld if such refund is made prior to the end of the calendar year in which the withholding occurred *and* prior to the time the payor issues Form 1099 to the payee. These same refund requirements are also applicable to the treatment of erroneous withholding from distributions from pensions, annuities, and certain other deferred payments required under I.R.C. § 3405.

SUMMARY OF RECOMMENDATION[S]: The IRPAC recommends that a payor be permitted to refund erroneous backup withholding and withholding from distributions from pensions, annuities and other deferred arrangements if the refund is made prior to the end of the calendar year OR prior to the time the payor issues Form 1099 to the payee.

TAXPAYERS / INDUSTRY AFFECTED: All payors required to file information returns of reportable payment subject to backup withholding or withholding under I.R.C. §§ 3406 or 3405, respectively.

BENEFIT TO TAXPAYERS: (PAYEES & PAYORS) Payors would have the opportunity to identify and remedy errors prior to issuing Forms 1099 to payees. Certain transactions, such as broker proceeds or pension distributions,

may be significant in amount and would best be addressed in January prior to the issuance of the Forms 1099.

Payees would receive more accurate Form 1099 information, and fewer payees would be required to seek refunds from the IRS.

BENEFIT TO INTERNAL REVENUE SERVICE: Allowing payors to make refund adjustments prior to issuing Forms 1099 would reduce the number of refund requests submitted to the IRS.

DISCUSSION

Certain reportable payments, such as gross proceeds, dividends, interest, original issue discount, and miscellaneous income, are subject to backup withholding under I.R.C. § 3406. On occasion, backup withholding occurs due to payor error and should be returned to the payee. Under Treas. Reg. § 31.6413(b), if a payor withholds under I.R.C. § 3406 in error, the payor may refund the amount erroneously withheld if such refund is made prior to the end of the calendar year in which the withholding occurred *and* prior to the time the payor issues a Form 1099 to the payee. Given that most payors do not issue Forms 1099 until sometime in January, i.e., subsequent to the close of the calendar year, refunds must occur no later than December 31 of the calendar year.

Moreover, refunds for erroneous withholding from distributions made from pensions, annuities, and certain other deferred payments are also subject to the guidelines found in I.R.C. § 6413, as noted in Treas. Reg. § 35.3405-1T (Q&A G17).

Typically, most payors perform year-end processing in early January in preparation for issuing Forms 1099 to customers or payees. During this balancing/settlement period, the payor cannot immediately remedy the discovery of errors involving erroneous withholding. The payor is required to report the erroneous withholding on the appropriate Form 1099 and the payee is expected to include this credit in his personal tax return. However, issues arise for payees who are not required to file tax returns or who are not subject to federal taxation. These taxpayers are required to file Form 843 to request a refund, or file a tax return such as Form 1040 for U.S. persons. Moreover, a nonresident alien, incorrectly presumed to be a U.S. person, who receives a Form 1099 indicating that erroneous withholding occurred is now required to obtain an ITIN and must then file Form 1040NR to request the refund.

In contrast, excess withholding from certain payments of U.S.-source income made to nonresident aliens and foreign corporations may be refunded for a specified period of time subsequent to the end of the calendar year. Treasury Regulation § 1.1441-1(b)(8) allows a payor to refund withholding in accordance with procedures described in Treas. Reg. §§ 1.1461-2 and 1.1464-2(a). Under this guidance, refunds may be processed until the Form 1042-S (without extension) is filed. For most payors, this means that refunds may be processed until March 15 of the year subsequent to the year in which the erroneous withholding occurred.

RECOMMENDATIONS

The IRPAC recommends that a payor be permitted to refund erroneous backup withholding and withholding from distributions from pensions, annuities and other deferred arrangements if the refund is made prior to the end of the calendar year OR prior to the time that the payer issues Form 1099 to the payee.

TAXPAYERS / INDUSTRY EFFECTED

All payors required to file information returns of reportable payments subject to backup withholding or withholding under I.R.C. §§ 3406 or 3405, respectively.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS)

With regard to payors, the additional time from the end of the calendar year to the issuance of Forms 1099 would give payors the opportunity to identify and remedy errors prior to issuing Forms 1099 to payees. Certain transactions, such as broker proceeds or pension distributions, may be significant in amount and would best be addressed in January prior to the issuance of the Forms 1099.

Payees would receive more accurate Form 1099 information. The additional time would allow the payee to review year-end account statement information and contact the payor concerning withholding discrepancies prior to issuance of Forms 1099. This change would also help alleviate the filing burden placed on certain payees to obtain refunds of erroneous withholding resulting from payor error. Moreover, additional time to correct erroneous withholding applicable to nonresident alien payees incorrectly presumed to be U.S. persons would be beneficial to those who are reluctant to apply for an ITIN and file Form 1040NR to request a refund.

BENEFIT TO THE INTERNAL REVENUE SERVICE

Allowing payers to make refund adjustments prior to issuing Forms 1099 would reduce the number of refund requests made to the IRS.

EXECUTIVE SUMMARY

TITLE OF PAPER: Authorization to: (1) Use Facsimile Signature for Forms 8868 (Application for Extension of Time to File an Exempt Organization Return); and (2) Allow IRA Trustees to File a Consolidated Form 8868.

ISSUE STATEMENT: Individual Retirement Account trustees are permitted to use facsimile signatures on Form 990-T (Exempt Organization and Business Income Tax Return) provided certain conditions are satisfied. Given the potentially large volume of Forms 990-T that must be filed by Individual Retirement Account trustees, similar relief is needed for purposes of signing Form 8868.

REMEDY SOUGHT: Revised Instructions for, Addition of Checkbox to, and Expedited Processing of Forms 8868

IRPAC TEAM: Neal Givner, Joan DeBlasi, Carol Kassem, Carmela Lawrence, Mark Merlo, and Ernest Molinari

IRS PARTICIPANTS: George Blaine, Robert Erickson, Ed Mikesell, and Carlene Rollo* (*Ogden, Utah Service Center)

BACKGROUND: Because the official IRS Instructions to Form 8868 explicitly provide "No Blanket Requests", Individual Retirement Account trustees are required to submit a **separate** Form 8868 extension request for each IRA for which a Form 990-T potentially must be filed. This forces Individual Retirement Account trustees to file thousands of Forms 8868 for their Individual Retirement Account customers, notwithstanding that each discrete Form 8868 contains the same basic information (other than the name and employer identification number (EIN) of the Individual Retirement Account) and needlessly burdens the IRS with having to process each Form 8868 separately. To simplify this process, the IRPAC requests that the IRS allow an Individual Retirement Account trustee to file a consolidated Form 8868 consisting of a transmittal or cover Form 8868 together with an attachment containing all relevant information, such as the name, address and EIN of the affected Individual Retirement Accounts, tentative tax, balance due, etc.

SUMMARY OF

RECOMMENDATIONS:

1. Authorize use of facsimile signatures by Individual Retirement Account trustees for Forms 8868.

2. Authorize Individual Retirement Account trustees to file a consolidated Form 8868.

TAXPAYERS / INDUSTRY AFFECTED:

Segments of the financial services industry (banking, brokerage and insurance) that act as Individual Retirement Account trustees.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS):

Significant reduction of manually intensive and costly extension request procedure for filing Forms 8868.

BENEFIT TO INTERNAL REVENUE SERVICE:

Easier processing of multiple Form 8868 extension requests.

DISCUSSION

1. Individual Retirement Account trustees are permitted to use facsimile signatures on Form 990-T, provided certain conditions are satisfied. These conditions are listed on page fifteen of the 2001 Instructions to Form 990-T. Presumably, this special rule was carved out for Individual Retirement Account trustees to provide relief from having to sign (potentially) thousands of forms manually.

   Similar relief is needed for purposes of signing Form 8868. However, the Instructions to Form 8868 are silent regarding the use of facsimile signatures.

   In some respects, it is more important that Individual Retirement Account trustees be permitted to use facsimile signatures on Forms 8868 because Individual Retirement Account trustees may be required to file more Forms 8868 than Forms 990-T. For example, when Form K-1 information necessary to prepare Form 990-T is **not** available by April 15, an Individual Retirement Account trustee must file Form 8868 to request an Extension of Time to file Form 990-T. At that time, an Individual Retirement Account trustee may not know whether a particular Individual Retirement Account is required to file Form 990-T. The Individual Retirement Account trustee may know only that the Individual Retirement Account **may** have earned unrelated business taxable income (UBTI). In this circumstance, the Individual Retirement Account trustee would not know precisely how much UBTI was earned. When an Individual Retirement Account trustee is in this position, the trustee is forced to file a separate Form 8868 for each Individual Retirement Account that has the potential of having to file Form 990-T. Once the information is available to calculate taxable income, the number of Individual Retirement Accounts required to file Form 990-T could be (and usually is) less than the number of potential filers identified on April 15. For this reason, an Individual Retirement Account trustee would have to file more Forms 8868 than the number of Forms 990-T ultimately required to be filed. The requirement to manually sign each Form 8868 creates an undue burden on Individual Retirement Account trustees.

2. Individual Retirement Account trustees must file a **separate** Form 8868 extension request for each Individual Retirement Account. The Instructions to Form 8868 state explicitly: **"NO BLANKET REQUESTS."** File a separate Form 8868 for each return for which you are requesting an automatic extension to file." This rule forces Individual Retirement Account trustees to file thousands of Forms 8868 for their Individual Retirement Accounts, even though each Form 8868 contains the same basic information (other than the account name and EIN) and unnecessarily burdens the IRS with having to process each form separately. Individual Retirement Account trustees incur needless computer programming and printing costs to generate separate Forms 8868.

   A more workable approach all around would be to allow Individual Retirement Account trustees to file a consolidated Form 8868 in lieu of filing a multitude of

separate forms. Individual Retirement Account trustees should be authorized to file one transmittal or cover Form 8868, together with an attachment containing all the relevant pieces of information, e.g., name, address and EIN of the affected Individual Retirement Accounts, tentative tax, balance due, etc.

Precedent exists for allowing Individual Retirement Account trustees to file on a consolidated basis. For example, Notice 90-18,[1] describes a procedure where Individual Retirement Account trustees are permitted to file a composite Form 990-T to claim a refund on behalf of all their Individual Retirement Accounts of tax paid on undistributed long-term capital gain from regulated investment companies (RICs) (i.e., Individual Retirement Accounts that receive a Form 2439). The simplified procedure that the IRPAC is requesting with respect to multiple Form 8868 extension requests is consistent with Notice 90-18.

In other situations, the IRS **requires** the filing of consolidated extension requests. For example, filers are permitted to apply for an extension of time to file information returns for multiple payors by filing a **single** Form 8809 (Request for Extension of Time to File Information Returns) and attaching a list of the affected payors' names and EINs. If the number of payors exceeds fifty, the IRS requires that the information be provided on magnetic media or electronically.[2]

RECOMMENDATIONS

1. Authorize the use of facsimile signatures by Individual Retirement Account trustees for Forms 8868.

2. Authorize Individual Retirement Account trustees to file a consolidated Form 8868 extension request.

To effectuate this change in procedure, Form 8868 Instructions must be revised to state clearly that relevant information about the covered Individual Retirement Accounts, including the name, EIN and tax period, **MUST** be provided on an EXCEL spreadsheet or similar report and attached to the transmittal or cover Form 8868. Failure to provide the full complement of supplemental Individual Retirement Account information to augment the consolidated Form 8868 will result in denial of the consolidated extension request. In addition, check boxes must be added to Form 8868 to facilitate identification of a composite or consolidated Form 8868 upon initial "manual" review by a Tax Examiner at a submission processing center; the check box mechanism will serve to remind the manual reviewer that each Individual Retirement Account included in the consolidated Form 8868 extension request is eligible for an extended due date for filing Form 990-T.

TAXPAYERS / INDUSTRY AFFECTED

[1] I.R.S. Notice 90-18, 1990-1 C.B. 327.

Segments of the financial services industry (banking, brokerage, insurance) that act as Individual Retirement Account trustees.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS)

Reduction in paperwork connected with administration of Individual Retirement Accounts; cost containment.

BENEFIT TO INTERNAL REVENUE SERVICE

Paperwork reduction; more efficient processing of Forms 8868 and Forms 990-T.

EXECUTIVE SUMMARY

TITLE OF PAPER: Authorization to Allow a Clearing Broker to Determine its Withholding Obligations under I.R.C. § 3405 by Reference to Representations from an Introducing Broker as to a Payee's Form W-4P (Withholding Certificate for Pension or Annuity Payments).

ISSUE STATEMENT: Clearing Brokers should be permitted to determine their federal tax withholding obligations under I.R.C. § 3405 by reference to an Introducing Broker's representation, as opposed to obtaining a Form W-4P directly from the payee of a designated distribution. Clearing Brokers are currently required to obtain a Form W-4P directly from the payee of a designated distribution. This requirement interferes with normal business practices because it disregards the agency relationship that exists between an Introducing Broker and a payee. The IRS recognizes this agency relationship in the context of Forms W-9 and W-8BEN, yet not as applied to Form W-4P.

REMEDY SOUGHT: An IRS Announcement similar in force and effect to Announcement 2001-91, that allows a payor to receive Form W-9 (electronically or otherwise) from an investment advisor or Introducing Broker authorized to transmit such form as the payee's agent.

IRPAC TEAM: Neal Givner, Carmela Lawrence, Mark Merlo, Joan DeBlasi, Ernest Molinari, and Carol Kassem

IRS PARTICIPANTS: Pamela Kinard

BACKGROUND: This issue was first introduced as a Private Letter Ruling Request that was ultimately withdrawn.

Form W-9 and I.R.C. Section 3406. In P.L.R. 200107027, the IRS allowed an Introducing Broker to provide Form W-9 information provided by its client to a Clearing Broker without having to produce the hard copy of the client's original Form W-9. This allowed the Clearing Broker to determine its withholding obligations under I.R.C. § 3406 by reference to the Introducing Broker's representations, rather than having to obtain a separate Form W-9 from its clients. The IRS reasoned that the Introducing Broker serves as the client's agent for purposes of furnishing the client's taxpayer identification number and required certifications to the Clearing Broker, the payor. Pursuant to this reasoning, the IRS ruled that the Clearing Broker could rely on a faxed or electronically transmitted Form W-9 received from an Introducing Broker as if the form had been received directly from the client. In Announcement 2001-91, the IRS issued procedures allowing payors with electronic systems, compliant with the requirements of Announcement 98-27, to receive a Form W-9 certification from an

Investment Advisor or Introducing Broker authorized to transmit that form as agent for the payee. The Form W-9 certification so received by the payor may be either the original paper Form W-9 or an electronic version, including a fax. A payor receiving the Form W-9 may rely on such certification as if it had been received directly from the payee.

Form W-8BEN and I.R.C. Section 1441. Similarly, Treas. Reg. § 1441-1(e)(4)(ix)(C), included in the May 15, 2000 revisions, allows a Clearing Broker to determine its withholding obligations under I.R.C. § 1441 by reference to a U.S. Introducing Broker's representation as to the certifications received from a client on Form W-8BEN. This eliminated the need for an Introducing Broker to obtain multiple Forms W-8BEN from clients to provide to each Clearing Broker, i.e., withholding agent, with whom the Introducing Broker does business.

Form W-4P and I.R.C. Section 3405. The LMSB Subgroup recommends that the IRS extend the treatment accorded Forms W-9 and W-8BEN transmitted by an Introducing Broker to a Clearing Broker to Form W-4P (Withholding Certificate for Pension or Annuity Payments). Pursuant to industry practice, an Introducing Broker, because it has a direct relationship with the client, is responsible for obtaining a client's withholding tax election when the client requests a "designated distribution" from a qualified retirement plan or Individual Retirement Account. The Introducing Broker basically acts as an intermediary, relaying information between the client and the Clearing Broker. The Introducing Broker should be recognized as the client's agent with respect the client's Form W-4P. In turn, the Clearing Broker should be able to determine its withholding obligations under I.R.C. § 3405 by reference to the Introducing Broker's representation of its client's Form W-4P. Clearing Brokers should be able to treat the Introducing Broker's representation as if it had received the Form W-4P directly from the client requesting the "designated distribution."

SUMMARY OF RECOMMENDATIONS: Authorize a Clearing Broker to rely on the representations of an Introducing Broker with respect to the information contained on Form W-4P as if the Form W-4P had been received directly from the payee of the "designated distribution" for purposes of filing information returns and determining the Clearing Broker's withholding responsibilities under I.R.C. § 3405.

TAXPAYERS / INDUSTRY AFFECTED: Financial Services Industry (Clearing Brokers and Introducing Brokers).

BENEFIT TO TAXPAYERS (PAYORS & PAYEES): Simplified, less paper-driven process for Clearing Brokers to obtain Forms W-4P when making "designated distributions"; payees will be

ensured of enhanced customer service from Introducing Brokers who transmit Forms W-4P to Clearing Brokers.

BENEFIT TO INTERNAL REVENUE SERVICE: Excessive documentation will be eliminated; Forms W-4P obtained by Introducing Brokers and transmitted to Clearing Brokers will contain more accurate information thereby reducing potential refunds for overwithholding of tax.

DISCUSSION

CLEARING BROKERS SHOULD BE PERMITTED TO RELY ON REPRESENTATIONS OF INTRODUCING BROKERS TO DETERMINE THEIR WITHHOLDING OBLIGATIONS UNDER I.R.C. SECTION 3405

Due to the business model in which Clearing Brokers operate, they must be able to determine their withholding obligations under I.R.C. § 3405 by relying on representations from Introducing Brokers with respect to Form W-4P, as opposed to obtaining Forms W-4P directly from payees of designated distributions. Introducing Brokers act as agents for all aspects of their clients' accounts, including buying and selling securities, depositing and withdrawing funds and securities to and from client accounts, and furnishing certain withholding tax certificates (such as Forms W-9 and W-8BEN).

This agency relationship is an important aspect of a Clearing Broker's business model. The IRS currently recognizes this agency relationship for purposes of Forms W-8BEN and W-9, but not Form W-4P. Other regulatory agencies, such as the Securities & Exchange Commission, the New York Stock Exchange, and the National Association of Securities Dealers, also recognize the agency relationship between an Introducing Broker and a client/investor. The IRS should acknowledge this agency relationship in the context of Form W-4P; allow Introducing Brokers to act as agents for purposes of Form W-4P; and permit Clearing Brokers to determine their withholding obligations under I.R.C. § 3405 based on representations of Introducing Brokers.

CLEARING BROKER SERVICES

A common practice in the securities industry is for one firm to engage another firm to effectuate one or more functions integral to the conduct of the stock brokerage business. Thus, a "Clearing Broker" provides clearing and execution services for broker-dealers and other financial institutions (known as "Introducing Brokers"). These services include record-keeping and operational services such as settlement of securities transactions, custody of securities, cash balances, and extension of credit on margin accounts. Such clearing arrangements are very beneficial to small and medium size broker-dealers and other financial institutions by providing them with access to state-of-the-art technology, professional expertise, and economies of scale.

THE CLEARING AGREEMENT

The relationship between the Clearing Broker and the Introducing Broker is evidenced by a clearing agreement (hereinafter "Clearing Agreement"). Clearing Agreements are regulated by the New York Stock Exchange (hereinafter "NYSE") and must be submitted to and approved by the NYSE (pursuant to NYSE Rule 382) prior to becoming effective. The Clearing Agreement identifies and assigns various responsibilities between the Clearing Broker and the Introducing Broker.

THE INTRODUCING BROKER, ITS RESPONSIBILITIES AND ITS RELATIONSHIP TO THE PAYEE

The Introducing Broker is typically a domestic entity that is regulated as a broker-dealer by the U.S. Securities and Exchange Commission (hereinafter "SEC") and the National Association of Securities Dealers, Inc. (hereinafter "NASD") and, possibly, other self-regulatory organizations such

as the NYSE. The Introducing Broker maintains a direct relationship with the client/investor from whom it receives instructions to open or close accounts, buy and sell securities, and deposit or withdraw money or securities to or from an account. In addition, the Introducing Broker is responsible for obtaining the client/investor's necessary account documentation and for knowing the client/investor's financial resources and objectives.

Pursuant to the Clearing Agreement and general securities industry practice, the Introducing Broker is the client/investor's agent. The relationship between the Introducing Broker and the client/investor is respected under local agency law, the NYSE, NASD, the SEC, and the IRS, for purposes of furnishing Forms W-8BEN and W-9 (discussed below).

THE CLEARING BROKER, ITS RESPONSIBILITIES, AND ITS RELATIONSHIP TO THE PAYEE

The Clearing Broker is responsible for receipt, delivery and safeguarding of each of the Introducing Broker's client/investor's funds and securities and will credit a client/ investor's account with interest, dividends and gross sales proceeds. The Clearing Broker is responsible for following an Introducing Broker's instructions and will execute transactions and release or deposit money or securities to or for accounts only upon an Introducing Broker's instructions.

Although client/investor accounts are maintained on the books of the Clearing Broker[1], the Clearing Broker does not have a direct business relationship with the client/investor, rather, the relationship with the client/investor is established and maintained by the Introducing Broker. Client/investors typically contact the Introducing Brokers directly for all matters regarding their brokerage account. In practical effect, the Clearing Broker relies upon the Introducing Broker's representation as to all information concerning a particular client/investor.

RESPONSIBILITY FOR OBTAINING FORM W-4P FROM A PAYEE OF A DESIGNATED DISTRIBUTION

Payors of designated distributions are required to withhold federal tax. Unless the payee elects otherwise, the payor must withhold ten percent federal tax from non-periodic distributions tax as if the payee were a married individual claiming three withholding exemptions; the payee must treat a periodic distribution as if it were wages. Alternatively, payees may choose to have no income tax withheld. Payees use Form W-4P to direct payors regarding the correct amount of federal income tax to withhold from designated distributions.

Since Clearing Brokers carry Introducing Broker client accounts on their books, designated distributions are paid directly by the Clearing Brokers to the clients. Because the Clearing Broker is the party making the payment to the client, it is the payor (as defined in I.R.C. § 3405) that is currently responsible for obtaining Form W-4P directly from the payee.

Requiring a Clearing Broker to obtain a Form W-4P directly from the client interferes with normal business practice because it disregards the agency relationship between the Introducing Broker and the client. Although Introducing Brokers are respected as agents for all aspects of their clients' accounts, current federal tax law still requires that the Clearing Broker obtain Form W-4P directly from the client. This current policy is inconsistent with IRS' guidelines as applied to other

[1] The Clearing Broker may offer clearing services on a "fully disclosed" basis, meaning that an Introducing Broker contracts with the Clearing Broker to maintain or "carry" the individual client/investor accounts. The Introducing Broker discloses the identity of each client/investor to the Clearing Broker.

withholding certificates, i.e., Forms W-8BEN and W-9, and the position of other regulators, e.g., NASD, SEC, and NYSE.

LEGAL PRECEDENTS AUTHORIZING A CLEARING BROKER TO DETERMINE ITS WITHHOLDING OBLIGATIONS UNDER I.R.C. SECTION 3405 BY RELYING ON REPRESENTATIONS FROM AN INTRODUCING BROKER.

Precedent exists for allowing a Clearing Broker to determine its withholding obligations by relying on an Introducing Broker's representation as to the status of a withholding certificate. The practice of relying on an Introducing Broker's representation as to the status of a client's Form W-8BEN or W-9 is common and is permitted by regulation and other guidance issued by the IRS.

Form W-8BEN – I.R.C. Section 1441 On May 15, 2000 the IRS issued revisions to I.R.C. § 1441 U.S. nonresident alien withholding tax regulations.[2] Treasury Regulation § 1.1441-1(e)(4)(ix)(C) describes a special rule for brokers whereby a withholding agent may rely on the certification of a broker that the broker holds a valid beneficial owner withholding certificate (Form W-8BEN). This regulation is clarified with an illustrative example of a U.S. securities clearing organization providing clearing services for an Introducing Broker. The example indicates that the clearing organization may use the representations and beneficial owner information provided by the Introducing Broker to determine the proper amount of withholding (if any) due from beneficial owners and to file Forms 1042-S. Furthermore, the Introducing Broker, i.e., the party with the direct business relationship with the beneficial owner, is responsible for determining the validity of the withholding certificates or other appropriate documentation. The preamble to T.D. 8881 indicates that this rule was intended to prevent an Introducing Broker from having to obtain multiple Forms W-8BEN from its beneficial owner clients so that it could provide a separate form to each Clearing Broker with whom it does business. To eliminate this unnecessary paperwork and to be consistent with the business model in which Clearing Brokers operate, the IRS authorized the Clearing Broker to rely on beneficial owner information transmitted by the Introducing Broker, rather than from the beneficial owner itself.

Form W-9 – I.R.C. Section 3406 In P.L.R. 200107027, the IRS extended the inherent rationale and approved having an Introducing Broker provide Form W-9 information from its client/investor to a Clearing Broker absent the need to produce a hard copy of the client/investor's original Form W-9. The IRS reasoned that the Introducing Broker acts as the client/investor's agent for purposes of furnishing the client/investor's taxpayer identification number and required certifications to the Clearing Broker, who is the payor. Pursuant to its consistent agency analysis, the IRS ruled that the Clearing Broker may rely on a Form W-9 that is faxed or transmitted electronically from an Introducing Broker as if the form had been received directly from the client/investor.

A further expansion of this rationale, Announcement 2001-91 articulated procedures designed to allow a payor with an electronic system compliant with the requirements of Announcement 98-27 to receive Form W-9 certification from an Investment Advisor or Introducing Broker authorized to transmit that form as agent for the payee. The Form W-9 certification so received by the payor may be either the original paper Form W-9 or an electronic version, including a fax. A payor receiving the Form W-9 may rely on such certification as if it had been received directly from the payee.

[2] T.D. 8881.

Form W-4P – IRC Section 3405 The rationale espoused by the IRS to facilitate the flow of original documentation from beneficial owners and client/investors to Clearing Brokers has evolved to the point where its application is consistent in varied contexts. As the precedents cited above indicate, the IRS has adopted a uniform and pragmatic approach to address the vagaries of the documentation process that serves to enhance the effectiveness of the U.S. withholding tax regime overall. By eliminating an unnecessary level of administration, i.e., the duplicative requirement of providing an original tax form to the Clearing Broker, the system becomes more workable. The next frontier for the IRS to cross is I.R.C. § 3405 and the use of Form W-4P. Although, admittedly, the statutory context is dissimilar from that of backup withholding and nonresident alien withholding, the overriding principle to abet simplification of the documentation process remains a constant. Announcement 99-6,[3] wherein the IRS authorized payers to establish a system for electronically receiving Forms W-4P, seems to presage extension of the agency rationale to the usage of Forms W-4P.

RECOMMENDATION

The IRPAC recommends that the IRS extend the agency rationale adopted in Treas. Reg. § 1.1441-1(e)(4)(ix)(C), P.L.R. 200107027, and Announcement 2001-91 to the realm of Forms W-4P. Such an approach would allow an Introducing Broker to provide a Clearing Broker with Form W-4P information, or the actual Form W-4P, by fax or electronically, and would enable the Clearing Broker to rely on the information, or fax or electronic transmission of Form W-4P, as if the information or form had been received directly by the payee of the designated distribution.

TAXPAYERS / INDUSTRY AFFECTED

Segments of the financial services industry (Banking, Brokerage, Insurance) that act as Individual Retirement Account trustees.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS)

Less paperwork connected with administration of Individual Retirement Accounts; potential for enhanced customer service from Introducing Brokers and more accurate Form W-4P information being provided to Clearing Brokers; cost containment.

BENEFIT TO INTERNAL REVENUE SERVICE

Paperwork reduction; fewer requests for refund of over withholding on designated distributions, facilitation of electronic commerce and tax administration.

[3] 99-1 C.B. 352.

EXECUTIVE SUMMARY

TITLE OF PAPER: Whether Dispositions of Single Stock Futures Should Be Subject to Gross Proceeds Reporting on Form 1099-B?

ISSUE STATEMENT: Enactment of the Commodity Futures Modernization Act in December 2000 repealed the Shad Johnson Accord, thereby effecting a change in the U.S. regulatory environment and allowing U.S. investors to trade futures on individual stocks (hereinafter "single stock futures") and narrow-based stock indexes (hereinafter collectively, "securities futures contracts") for the first time on U.S. regulated exchanges. A single stock futures contract is an agreement to buy or sell shares of individual companies at some time in the future at an agreed upon price. Single stock futures require a reduced capital outlay up-front compared to trading on the traditional cash market in which the investor is required only to post margin. Single stock futures are expected to make equity trading available to a wider audience of investors, thus delivering greater efficiencies and liquidity to the underlying market.

The Community Renewal Tax Relief Act of 2000, passed the same day as the Commodity Futures Modernization Act, provided new rules regarding the tax treatment of securities futures contracts. The overall legislative intent was to provide rules for securities futures contracts that are similar in effect to those applicable to exchange-traded equity options as regards the purchase or sale of stock. The tax treatment of securities futures contracts was an area in which it was deemed vital that a level playing field between products be created. The principal goal of the tax provisions was to achieve parity as between the taxation of equity options and securities futures contracts.

REMEDY SOUGHT: An Announcement or Notice from the IRS advising whether single stock futures should be subject to Form 1099-B reporting. If the IRS takes the position that single stock futures should be subject to Form 1099-B reporting, the IRPAC recommends that the IRS formally delay the onset of reporting for the initial year(s) that the product is traded.

IRPAC TEAM: Neal Givner, Joan DeBlasi, Carol Kassem, Carmela Lawrence, Mark Merlo, and Ernest Molinari

IRS/TREASURY PARTICIPANTS: George Blaine, Curt Wilson, Dale Collinson, and Mike Novey

BACKGROUND: This is a new issue raised by the 2002 IRPAC to coincide with the product going live in the fourth quarter of 2002.

With an announced launch date of October 25, OneChicago LLC became the first U.S.-based exchange to designate a start date for single stock futures trading. OneChicago LLC is a joint venture among the Chicago Mercantile Exchange, the Chicago Board of Options Exchange Inc. and the Chicago Board of Trade. It will offer futures contracts on eighty-five single stocks and fifteen narrow-based indexes.

On November 8, single stock futures trading will begin for users of the Nasdaq Liffe Markets Exchange (hereinafter "NQLX"). NQLX is a joint venture between the Nasdaq Stock Market Inc. and LIFFE, the London International Financial Futures and Options Exchange. It will initially list securities futures on both exchange-traded funds and the largest U.S. companies.

SUMMARY OF RECOMMENDATIONS: The IRPAC recommends that single stock futures not be subject to Form 1099-B reporting. If the IRS concludes that single stock futures should be subject to Form 1099-B reporting, IRPAC recommends that the IRS formally delay the onset of reporting for the initial year(s) that the product is traded.

TAXPAYERS / INDUSTRY AFFECTED: The securities industry.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS): Formal guidance by the IRS will facilitate a consistent industry approach with respect to whether or not to report.

BENEFIT TO INTERNAL REVENUE SERVICE: Consistent industry approach as regards whether or not to report.

DISCUSSION[1]

WHAT ARE SINGLE STOCK FUTURES?[2]

Single stock futures are exchange-traded contracts based on an underlying stock. They are similar to existing futures contracts for gold, crude oil, bonds, and stock indexes. In this way, they are considered to be derivatives. Like any futures contract, their value is *derived* from another instrument. The price movement of the single stock future is based on the underlying stock to which it is tied. As the stock price goes up and down, so too does the stock future.

A single stock futures contract is a standardized agreement between two parties to buy or sell 100 shares of a particular stock in the future at a price determined today. In legal terms, one party commits to buy a stock and the other party to sell a stock at a given price on a specified date. The contract is completed at expiration with physical delivery (the futures convert into the shares of stock at expiration) or by cash settlement, or, in most cases, by offset prior to the expiration date. Most investors do not hold futures contracts until expiration or actually make delivery but rather more typically offset the position before that time and realize a gain or loss on the trade.

Futures contracts are bought and sold on federally regulated exchanges. Single stock futures, which are a unique hybrid instrument borrowing features from both stocks and futures, are subject to regulation by both the Securities and Exchange Commission and the Commodity Futures Trading Commission.

Single stock futures contracts are written for a number of future delivery months, with expirations available for the first five calendar quarters (expiring in March, June, September and December) and in the first two non-quarter calendar months. For example, on July 1, single stock futures would be offered that expire in July, August, September, and December of the current year, and in March, June and September of the next year. By taking a position in a single stock futures contract, an investor can lock in a price today at which to buy or sell stocks as much as fifteen months from now. The minimum price movement, or "tick" size, of single stock futures is one cent per share, or one dollar per contract.

The mechanics of trading single stock futures are fairly straightforward. When an investor believes that the price of a particular stock will go up, the investor buys or "goes long" a single stock futures contract. If an investor thinks the price is headed down, the investor sells or "goes short" the futures contract. (In futures trading, an investor does not need to wait for an up-tick as is required when shorting stocks, which makes going short as easy as going long.)

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[1] This is not intended to be an exhaustive explanation of the nuances of single stock futures but rather is meant to facilitate exposition of the relevant information reporting issues.

[2] The description above highlighting some of the integral features of single stock futures is based on a set of materials entitled "The Basics of Single Stock Futures" issued by NASDAQ LIFFE Markets LLC.

For example, consider the case of an investor who bought an April futures contract on 100 shares of JKL at a price of fifty dollars during the first week of February. This obligates the investor to buy JKL at fifty dollars when the future expires on the third Friday of April unless the investor sells the futures contract beforehand. In other words, the investor can terminate his agreement to buy JKL by selling the April futures contract at any time before the contract ceases trading. If JKL's share price at the time is greater than fifty dollars, the investor will make a profit of $100 for each dollar it is higher, and will lose $100 for each dollar it is lower.

The procedure for selling is just the opposite. The investor can offset the obligation at any time on a short contract by buying it back before the investor must deliver JKL shares. If JKL's price at the time is less than fifty dollars, the investor will make a profit of $100 for each dollar that it is lower, and the investor will lose $100 for each dollar that it is higher.

Simply put, if an investor sells a futures contract at a price higher than that at which he purchased it, the investor will make a profit. If the investor sells the futures contract for less than that what he paid to purchase it, the investor will incur a loss. It does not matter whether the investor first went long or short. The formula is the same:

(Price Sold minus Price Paid) x 100 Shares x Number of Contracts = Profit or Loss

For example, if an investor went long (i.e., bought) five contracts of RST futures at fifty dollars and sold them one month later at fifty-five dollars, the investor's profit (excluding broker commissions) will be:

($55 - $50) x 100 shares x 5 = $2,500

If, however, the investor went short five contracts of RST at forty-eight dollars and bought them back at fifty-seven dollars, the investor's loss (excluding broker commissions) will be:

($48 - $57) x 100 shares x 5 = ($4,500)

In futures trading, whether an investor takes a long or a short position, the investor will be asked to post a sum of money with the broker known as "initial margin," which is a good faith deposit that provides assurance that the investor stands ready, willing, and able to make or take delivery of the underlying shares of stock at delivery time. If the market does not move in the investor's favor, the investor must post additional margin to ensure that the investor's promise of performance under the contract is still intact. The minimum initial margin level is set by government regulation but brokerage firms may require more than the minimum according to their own risk analysis or to provide more cushion before an investor's margin call is triggered.

Posting margin is not done for the purpose of making a down payment for or receiving payment for the underlying stock. In the world of futures trading, if an investor

has a long position, the investor has not bought anything yet; and if the investor has a short position, the investor has not sold anything yet.

"Going short," means that an investor takes a selling position on the underlying asset because the investor believes the value of that asset will decline and wants to profit from the decline. With stocks, a short seller who is betting on such a price decline needs to locate a supply of stock to borrow, borrow the shares, sell them, pay a high short-term interest rate called broker loan on the borrowing, and pay the dividend on the stock back to its owner. This can be a time-consuming and expensive process. When going short, single stock futures, arguably, have an advantage. In futures, an investor can bet on a price decline by selling the future. There are no special rules that prevent an investor from selling on a downtick, there are no stock borrowing procedures or situations where shares are difficult or unavailable to borrow, and there are no special, higher interest rates involved.

THE COMMODITY FUTURES MODERNIZATION ACT

The trading of futures on individual stocks and narrow-based stock indexes had been prohibited in the United States since 1982. The regulatory climate changed on December 21, 2000 with enactment of the Commodity Futures Modernization Act (hereinafter "CFMA"), that amended the U.S. securities and commodities laws to permit trading in futures contracts on single stocks and narrow-based stock indexes (hereinafter "securities futures contracts"). On the same day, the Community Renewal Tax Relief Act of 2000 (hereinafter the "Tax Relief Act") became law, providing new rules regarding the tax treatment of securities futures contracts.

The CFMA defines a security future as "a contract of sale for future delivery of a single security or a narrow-based security index, including any interest therein or based on the value thereof" (other than exempted securities such as U.S. government securities).

Securities futures contracts must be traded on a securities or commodities exchange and can be settled in one of three ways:

1. By purchase or delivery of the underlying stock;
2. By payment of cash based on the value of the underlying securities at maturity; or
3. As is the case with other futures contracts, by entering into a securities futures contract on the same securities or index and with the same maturity that offsets the securities futures contract held by the taxpayer.

The legislative intent was to provide rules for securities futures contracts that are similar in effect to those applicable to exchange-traded equity options to buy or sell stock. The tax treatment of securities futures contracts was one of the many areas in which it was considered vital that a level playing field be created. The principal goal of the tax provisions was to achieve parity between the taxation of equity options and securities futures contracts.

INFORMATION REPORTING ON GROSS PROCEEDS

Under I.R.C. § 6045(a), a broker is generally required to file an information return on Form 1099-B with respect to each sale effected by the broker on behalf of a customer in the ordinary course of a trade or business in which the broker stands ready to effect sales to be made by others[3]. A reportable sale includes a disposition for cash of: (1) securities; (2) commodities; (3) regulated futures contracts; and (4) forward contracts[4], and includes redemptions of stock, retirements of indebtedness, and entering into short sales. In the case of a regulated futures contract or a forward contract, a sale includes a closing transaction[5].

For purposes of reporting the gross proceeds from a sale of a security on Form 1099-B, the term "security" includes the following:

1. A share of stock in a domestic or a foreign corporation;
2. An interest in a trust;
3. An interest in a partnership;
4. A debt obligation;
5. An interest in or a right to purchase any of the foregoing in connection with its issuance from the issuer or its agent or an underwriter; or
6. An interest in a stock or a debt obligation (but not including options or executory contracts that require delivery of such types of securities[6]).

OPTIONS ON SECURITIES

Interests in a stock or a debt obligation (but not including options (emphasis added) or executory contracts that require delivery of such types of securities) fall within the definition of the term "security" for purposes of gross proceeds reporting.[7] As is manifest from the exclusionary language in the parenthetical delimitation, however, neither put nor call options on stocks or debt obligations are deemed to be "securities" for this purpose. Thus, sales of such options are not reportable by a broker under I.R.C. § 6045. Furthermore, since rights or warrants issued by a corporation with respect to its stock are treated as options for tax purposes, sales of rights or warrants are also not reportable. Other options, such as cash settlement options on stock indexes and options on futures, are not treated as "securities" for purposes of gross proceeds reporting because they do not constitute an interest in a stock or a debt obligation.

GROSS PROCEEDS REPORTING ON FORM 1099-B FOR SINGLE STOCK FUTURES

[3] Treas. Reg. § 1.6045-1(a)(2).
[4] Treas. Reg. § 1.6045-1(a)(9).
[5] *Id*.
[6] Treas. Reg. § 1.6045-1(a)(3).
[7] Treas. Reg. § 1.6045-1(a)(3)(vi).

In the case of single stock futures, a "sale" could potentially be defined in practical terms as: (1) the physical delivery of shares of stock upon settlement date; (2) cash settlement of the single stock futures contract upon settlement date; (3) entering into an offsetting single stock futures contract while the original contract is still held in the investor's futures account (i.e., offset); or (4) disposition of the single stock futures contract prior to settlement date for cash.

When there is a settlement of the single stock futures contract resulting in the physical delivery of shares of stock, no Form 1099-B reporting should be required until there is ultimately a sale of the stock since the rule of carryover of basis applies. For middlemen who provide capital gain/loss calculations, the challenge in this situation will be to capture the original trade date and price information from the investor's futures account, adjusted for intervening corporate actions, and then transferring the relevant cost basis to the shares.

To respect the congressional intent of achieving tax conformity between listed equity options and securities futures contracts, the IRPAC recommends that settlements via delivery of the underlying property (i.e., the securities) should not be reportable on Form 1099-B.

APPLICATION OF SECTION 1256 TO SECURITIES FUTURES CONTRACTS

Internal Revenue Code § 1256 generally provides that "any Section 1256 contract" held by a taxpayer at the close of a taxable year is treated as sold for its fair market value (the "mark-to-market" rule) and that any gain or loss with respect to a Section 1256 contract is treated as sixty percent long-term capital gain or loss and forty percent short-term capital gain or loss (the "60-40 rule"). These rules apply to Section 1256 contracts that are terminated during the year, whether by cash settlement or by making or taking delivery of the underlying property, including securities.

The term "Section 1256 contract" includes any option on a broad-based equity index and any "equity option" purchased or granted by a dealer in such options as part of the normal course of the dealer's business, provided in each case that the option is listed on a regulated securities exchange, regulated commodities exchange or other exchange or market designated by the Secretary of the Treasury. For this purpose, an options dealer is defined as a market maker or specialist in listed options. In the case of exchange-listed equity options, therefore, an option on a broad-based equity index is a Section 1256 contract for all taxpayers, while other equity options constitute Section 1256 contracts only for market makers or specialists therein. In the hands of other taxpayers, equity options on single stocks or narrow-based equity indexes are subject to the otherwise applicable rules of the Code.

The term "Section 1256 contract" also includes any "regulated futures contract." The term "regulated futures contract" is defined in part as a contract listed on an appropriate exchange "with respect to which the amount required to be deposited and the amount which may be withdrawn depends on a system of marking to market." This

language refers to the long-established margin rules for futures contracts, under which a taxpayer entering into a futures contract to buy or sell a commodity is required to post "initial margin" and then, on a daily basis, must either post additional "variation margin" if the contract loses value or is entitled to withdraw such variation margin if the contract increases in value. Futures contracts on broad-based equity indexes, which are subject to these margin rules like all other exchange-listed futures contracts, constitute Section 1256 contracts for all taxpayers[8].

INFORMATION REPORTING FOR REGULATED FUTURES CONTRACTS ON FORM 1099-B

Regulated futures contracts are subject to annual information reporting rules based on the aggregate profit or loss realized on all regulated futures contracts closed during the year and the aggregate unrealized profit or loss in all open contracts at the beginning and end of the reporting year.[9] The aggregate unrealized profit or loss on an open regulated futures contract is required to be reported only at the beginning and at the end of the relevant reporting year. The reporting rules do not require a broker to mark-to-market regulated futures contracts on a daily basis.

The reporting rules generally follow the taxation rules for regulated futures contracts held as capital assets. Under Section 1256, a taxpayer is required to report on his tax return the aggregate profit or loss realized on regulated futures contracts during his taxable year, and to mark-to-market all open regulated futures contracts at the end of his taxable year and report the unrealized profit or loss. Generally, gains and losses on regulated futures contracts held as capital assets are taxed at sixty percent long-term, forty percent short-term capital gains and losses, regardless of the holding period on the position.

A broker is required to report the net profit or loss realized in effecting a closing transaction, whether by entering into an offsetting contract or by making or taking delivery of the underlying property pursuant to the regulated futures contract. In the case of a cash settlement regulated futures contract, such as a regulated futures contract on a broad-based stock index, no other reporting is necessary. However, in the case of a regulated futures contract settled by the customer delivering a commodity or a security, the delivery of the commodity or security is a separately reportable sale.[10] In other words, when a closing transaction in a regulated futures contract involves making or taking delivery of property (other than money), the profit or loss on the regulated futures contract is a reportable sale and if delivery is made, the delivery is reportable as a separate sale.[11]

THE TAX RELIEF ACT AMENDMENTS

[8] I wish to thank Erika W. Nijenhuis, partner with Cleary, Gottlieb, Steen & Hamilton, for the use of her published article entitled "New Tax Rules for Securities Futures Contracts Enacted," 14 Journal of Taxation of Financial Institutions," May/June 2001.
[9] Treas. Reg. § 1.6045-1(c)(5).
[10] Treas. Reg. § 1.6045-1(c)(5).
[11] Treas. Reg. § 1.6045-1(a)(9).

It was generally assumed that, absent legislation, the tax treatment of securities futures contracts, including information reporting on Form 1099-B, would follow the rules described above for regulated futures contracts. However, the amendments to Section 1256 made by the Tax Relief Act explicitly reject the paradigm provided by the regulated futures contract rules (namely, that Section 1256 applies to all taxpayers) and adopt instead the paradigm provided by the securities futures contract rules (namely, that Section 1256 applies to dealers in securities futures contracts). This result flows directly from the amended definition of "Section 1256 contract" to include any "dealer securities futures contract" (which is defined for this purpose to include options on such contracts), and to exclude any securities futures contract or option thereon which is not a "dealer securities futures contract."

Given the exclusion of non-dealer securities futures contracts from the scope of Section 1256 treatment, specifically, the mark-to-market rules, there seems to be no compelling reason to require Form 1099-B reporting with respect to single stock futures. Since non-dealer holders of single stock futures, i.e., individuals, will themselves not be required to mark-to-market their securities futures contracts for purposes of calculating their aggregate profit or loss for the year, there does not seem to be a special need for brokers to report sales of single stock futures to their customers on Form 1099-B. The non-reportability feature applicable to options should prevail here as well.

SUBSTANTIVE TAX ISSUES REGARDING THE TREATMENT OF SINGLE STOCK FUTURES ARE AS YET UNRESOLVED

In Revenue Procedure 2002-11, the IRS announced that it would review letter ruling applications on a case-by-case basis to determine "dealer" status; if an exchange is one on which securities futures contracts are, or are expected to be traded, the exchange may request a letter ruling that persons trading the contracts on the exchange are "dealers" under Section 1256(g)(9) of the Internal Revenue Code. In the absence of certainty about who is a "dealer" of single stock futures, the industry is hamstrung logistically as to which reporting system to use to capture information regarding dispositions of single stock futures. Specifically, should the same system that houses mark-to-market information for Section 1256 regulated futures contracts be used, or the system that monitors sales of securities? Further what amount is potentially reportable on Form 1099-B? Is it the profit or loss realized on the single stock futures contract? In point of fact, losses are not susceptible to reporting on Form 1099-B. During this interim period, when the issue of "dealer" status is still evolving, and the resolution of practical issues impacting on potential Form 1099-B reporting for the product is still pending, it is important for the IRS and Treasury to provide certainty for taxpayers while at the same time not constraining the development of trading structures for new markets. In addition, there are outstanding substantive tax issues inherent in the treatment of single stock futures that still need to be addressed.

Consistent with the legislative intent to achieve tax parity between options and securities futures contracts, the IRPAC recommends that dispositions of single stock futures ultimately not be subject to Form 1099-B reporting.

The IRPAC is cognizant, however, that while tax rules for these products are still being resolved, the IRS might deem it premature to exclude definitively single stock futures from Form 1099-B reporting. While appreciating the IRS' position, the industry perceives a pronounced need for certainty in this gap period. At a minimum, the IRPAC recommends that the IRS issue interim guidance announcing that single stock futures will not be subject to Form 1099-B reporting for the initial calendar year(s) in which they are traded, i.e., a moratorium on information reporting. As a case in point, if a single stock futures contract was opened in 2002, and "dealer" status was not established until sometime in 2003, the IRPAC recommends that the Form 1099-B reporting requirement not be activated for calendar year 2002 upon inception of the contract but rather that it be delayed until 2003 upon closing of the contract. If the IRS ultimately decides that single stock futures should be subject to Form 1099-B reporting,[12] the financial services industry will have had more time to grapple with the typical issues – allocation of resources, juggling of priorities, lead time to program– that attend all information reporting innovations.

RECOMMENDATIONS

1. The IRPAC recommends that transactions involving single stock futures not be subject to Form 1099-B reporting in the same way that options are not subject to Form 1099-B reporting.

2. The IRPAC recommends that the IRS issue a Notice or Announcement advising whether or not transactions involving single stock futures should be subject to Form 1099-B reporting.

3. The IRPAC recommends that if the IRS concludes that transactions involving single stock futures should be subject to Form 1099-B reporting, the IRS grant a moratorium on reporting for the initial year(s) that the product goes live.

TAXPAYERS / INDUSTRY AFFECTED

The Securities Industry

[12] The term "sale" is defined in Treas. Reg. § 1.6045-1(a)(9) to include entering into a short sale. Consistent with industry practice, the gross proceeds on a short sale are reportable on the date the security is sold short rather than on the date the short position is covered. For purposes of information reporting, a short sale is treated as occurring on the date the short sale is entered on the books of the broker (namely, the trade date). Treas. Reg. § 1.6045-1(d)(4)(ii). In the case of an investor "going short" (i.e., selling) a single stock future, the IRS might apply the same rationale to require Form 1099-B reporting with respect to the transaction as of sale date.

Where there is a sale or closing transaction in an investor's futures account of a non-section 1256 contract, gross proceeds reporting is required on Form 1099-B. Therefore, the IRS may require Form 1099-B reporting for cash settlements of single stock futures or dispositions prior to settlement via offset.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS)

Formal guidance by the IRS will abet a consistent industry approach to report or not to report; absence of guidance can handicap introduction of new financial products

BENEFIT TO INTERNAL REVENUE SERVICE

Consistent approach by the industry whether to report or not to report; continued development and introduction of new financial products into the market.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 29, 2002

Faith Colson
Attorney-Advisor
CC:ITA:RU (REG-106871-00)
Room 5226
Internal Revenue Service
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Widely Held Fixed Investment Trusts

Dear Ms. Colson:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I am submitting these comments regarding the re-proposed regulations (Reg-106871-00) governing tax reporting for Widely Held Fixed Investment Trusts.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

IRPAC recommends that the IRS issue a publication that acts as a central repository of information to identify trusts affected by the final regulations, allow the reporting of only cash actually distributed with respect to sales, redemptions, or other exchanges, and not require separate reporting of dividends that are included in equity unit investment trust proceeds.

IRS Publication of Trusts

A Widely Held Fixed Investment Trust is defined by the IRS as an arrangement classified as a trust under Treas. Reg. section 301.7701-4(c), which applies specifically to Unit Investment Trusts, and to certain mortgage backed securities (e.g., Federal National

Mortgage Association ("FNMA") and Federal Home Loan Mortgage Corporation ("Freddie Mac")). However, there may be other investment vehicles that are organized as Grantor Trusts. These securities are known as "hybrid preferred" such as DECs (Debt Exchangeable Common Trusts), PRIDEs (Preferred Redeemable Increased Dividend Equity Securities), QUIPs (Quarterly Income Preferred Securities), ROCs (Receipts on Corporate Securities), SPERs (Secured Principal Energy Receipts), TARGETs (Targeted Growth Enhanced Term Securities), TIERs (Trust Investment Enhanced Return Securities), TOPRs (Trust Originated Preferred Securities) and others.

Payers do not know if the preferred trusts identified above or other types of securities are affected by the re-proposed regulations. Therefore, IRPAC recommends that the IRS either publish a directory listing of affected trusts or a publication that provides trust information. This listing could be similar to IRS Publication 938, Real Estate Mortgage Investment Conduits ("REMICS") Reporting Information and Other Collateralized Debt Obligations ("CDO"), and would be based on information submitted to the IRS by the issuer. The name and telephone number of the REMIC/CMO representative is contained in the publication for reference to obtain either tax related information or Committee on Uniform Securities Identification Procedures ("CUSIP") numbers. IRS Publication 1212, contains a List of Original Issue Discount Instruments and is another example of an existing publication that the IRS can reference when creating the new publication suggested above. Brokers and other middlemen use this publication to identify publicly offered original issue discount ("OID") debt instruments to facilitate filing of Forms 1099. Issuers provide the IRS with the required information, which is included in the publication by CUSIP number.

Reporting of Cash Distributed for Sales, Redemptions and Exchanges

Reporting of gross proceeds paid to individuals upon the sale, redemption, or other exchange of a security is reported by brokers on Form 1099-B. Rather than requiring Widely Held Fixed Investment Trusts to report amounts actually distributed to individuals, the re-proposed regulations will require a trust to report the amount of principal and redemption proceeds attributed to said individuals (this includes payments of both scheduled and unscheduled principal pay-downs as well as sales executed to meet investor redemptions). The beneficial owner must be provided with details of the sale, including date(s) sold, along with sufficient information to enable him or her to allocate a portion of his or her basis to the assets sold. This is required regardless of whether an actual cash distribution was paid to the investor. In addition to the confusion associated with this new information reporting requirement, it is our understanding in discussing this with brokers that "phantom gross proceeds" do not exist for the sale of any other security, and there is no current method to process this information. Therefore, IRPAC recommends that brokers be permitted to continue to report only the sales proceeds actually distributed.

Accrual of Dividends in Equity Unit Trust Proceeds

The regulations require that dividend income that is currently included within the proceeds of sales of unit investment trusts be reported on Form 1099-DIV. Brokers and trustees confirm that

dividend income has always been included in the proceeds from a sale of an equity unit investment trust on Form 1099-B. There is no current method to separate this information and process it. Therefore, since brokerage systems cannot be easily modified to extract the dividends from proceeds, IRPAC recommends that this provision be deleted from the final regulations.

In you have any questions concerning our recommendation, please call Mark Merlo at (718) 754-2542.

Sincerely,

Michael O'Neill
Chair, IRPAC

Cc: Nancy Thoma, Director, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 22, 2002

Carl Cooper
Office of the Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Forms 1042-S Filed with Payee Address in U.S.

Dear Mr. Cooper:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I am writing to request that the Internal Revenue Service ("IRS") clarify an issue surrounding the preparation and filing of Form 1042-S when the address of the recipient shown on the form is a U.S. address.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

During 2002, IRS personnel, when speaking at various conferences and industry meetings, have been advising payers and withholding agents that the use of a U.S. address for the recipient of Form 1042-S (Box 13, Recipient's Name and Address) is not acceptable. Relevant to the processing for tax year 2001, the IRS indicated that forms containing a U.S. address in Box 13 would be segregated by the Philadelphia Service Center which, in turn, would contact the filer to request that the Forms 1042-S be re-filed with foreign addresses. Payers and withholding agents are concerned and confused since this directive is contrary to the printed Instructions for the preparation of the form.

The Instructions for filing Form 1042-S for tax year 2001 clearly indicate that a U.S. address is acceptable. The guidelines for completing Box 13 of the form note the following: *"For addresses **within** the United States, enter the address in the following order: street address (number, street, apartment number, or rural route), city or town, state, and ZIP code. Use the U.S. Postal Service 2-letter abbreviation for the state name. Do not enter "United States" or "U.S."*

Moreover, Publication 1187 also notes that fields 334-335, Recipient's State, are required for U.S. addresses. Fields 340-348, Postal Zip Code, would also need to contain up to nine numeric characters for all U.S. addresses. In preparation for filing Forms 1042-S for tax year 2002, the Instructions continue to say that a U.S. address may be used in Box 13.

IRPAC is requesting guidance and clarification for payers and withholding agents who strive to file forms correctly based on published instructions from the IRS. If the IRS has adopted new procedures and policies relative to the filing of Form 1042-S, these changes should be officially disseminated expeditiously to minimize issues that will continue to arise amidst this current confusion.

If the procedures have changed and revised Instructions will be forthcoming in the future, the issue begs the question as to why the IRS cannot simply use the country code contained in Box 16 of Form 1042-S to allow the sharing of the information with the appropriate foreign country, at least until such time as the Instructions are revised. This is more practicable than requesting that new forms be revised and filed a second time.

Your assistance in clarifying this issue would be most appreciated. If you have any questions or need additional information, please call Carol Kassem at (225) 332-7296.

Sincerely,

Michael O'Neill
Chair, IRPAC

cc: Nancy Thoma, Branch Chief, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 22, 2002

Mr. George J. Blaine
Deputy Assistant Chief Counsel
Administrative Provisions &
Judicial Practice Division
Internal Revenue Service
Room 4050 CC:PA:APJP
1111 Constitution Avenue
Washington, DC 20224

Re: Electronic Delivery of Payee Statements

Dear Mr. Blaine:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I want to thank you for the opportunity to provide the Internal Revenue Service ("IRS") with comments regarding the electronic delivery of payee statements.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

The members of IRPAC are pleased to furnish you with the following information in support of the IRS issuing final Electronic Delivery of Payee Statement Regulations that include all applicable payee statements that correspond to information returns currently being filed with the IRS, including Forms 1098, the complete Form 1099 series and Form 5498 (with specific emphasis on Form 1099-R and 5498 type transactions).

In addition, due to operational and logistical issues, we request that recipients who withdraw their electronic consent after December 31 of the taxable year (and prior to February 1 of the year following the taxable year) for which the payee statement is required, be treated as having received their statements in a timely manner if the electronic statement is delivered on or before January 31.

provided an additional 30-days from the date the electronic payee statement is posted to furnish the payee statement by mail or in person to the recipient.

All Forms 1099-R and 5498 Furnished to Recipients Should be Included in the List of Payee Statements that May be Delivered Electronically:

The Internal Revenue Service has issued Temporary Regulations that set forth the requirements that permit electronic delivery of recipient copies of Forms W-2 (Wage and Tax Statements), Forms 1098-T (Tuition Payment Statements), and Forms 1098-E (Student Loan Interest Statements).

Earlier this year, Congress enacted Section 401 of the Job Creation and Worker Assistance Act ("Act"), which authorizes payers to deliver payee statements electronically under certain conditions. This provision permits payers to furnish payee statements required under IRC Sections 6041 through 6050S to recipients by use of electronic mail.

Prior to the Act, certain Form 1099 series payee statements (e.g., Forms 1099-DIV, Forms 1099-INT, etc.) required first class paper delivery. Under Section 401 of the Act, if specific requirements are met, this first class mailing requirement is no longer necessary.

Section 401 allows payers to utilize the Temporary Regulations issued under IRC Section 6051 when designing their procedures for delivering electronic payee statements for Form 1099 series statements.

However, IRS Publication of 2002 Instructions for Forms 1099, 1098, 5498 and W-2G, state electronic recipient statements can be furnished instead of paper for Forms 1098, 1098-E, 1098-T, 1099-A, B, DIV, INT, G, LTC, MISC, OID PATR, Q and S. The publication states that electronic payee statements may also be furnished for Forms 1099-R and 5498, **except for reporting contributions and distributions of pensions, traditional IRA's, Coverdell ESA's, Roth IRAs and Archer MSA's** (emphasis added).

It is IRPAC's belief that this restriction is due to certain IRC section provisions that are outside the range of IRC Sections 6041 through 6050S (e.g., IRC sections 408(i), 530(h), 404A(h), etc.) which require payee statements to be issued for certain Form 1099-R and 5498 transactions. It is the opinion of IRPAC that these IRC Section omissions were inadvertent and should have been included in the Act (especially since these Form 1099-R and 5498 transactions are not subject to the first class mailing requirements), and accordingly, all Forms 1099-R and 5498 furnished to recipients be included in the list of payee statements that may be delivered electronically.

Since all the business and taxpayer reasons for furnishing payee statements electronically under IRC Sections 6041 through 6050S also apply to the other sections, we suggest that the IRS allow all information reporting forms, without exceptions, to be delivered to payees electronically instead of on paper.

information reporting forms, without exceptions, to be delivered to payees electronically instead of on paper.

Consent Withdrawal:

Payers are required to use established consent procedures similar to those permitted under Temporary Regulations issued under IRC Section 6051 as guidance for what is necessary in order to furnish electronic payee statements.

For example, Section 31.6051-1T (j)(3)(v) of the Temp Regulations reads as follows:

(v) *Withdrawal of consent.* The recipient must be informed that--

(A) The recipient may withdraw a consent at any time by furnishing the withdrawal in writing (electronically or on paper) to the person whose name, mailing address, telephone number, and e-mail address is provided in the disclosure statement;

(B) The furnisher will confirm the withdrawal in writing (either electronically or on paper); and

(C) A withdrawal of consent does not apply to a Form W-2 that was furnished electronically in the manner described in this paragraph (j) before the withdrawal of consent is furnished.

This requirement causes operational problems if an individual consents to receive an electronic payee statement, and then withdraws consent during the month of January following the tax year for which the information return is to be filed. Since the recipient may withdraw consent at any time, this will cause problems with the payers' ability to send a paper form timely.

Many payers engage outside vendors to print forms, usually off-site. These payers send bulk data to the vendor at an agreed-upon date in January in order to facilitate the printing and mailing of the payee statements in a timely manner. The time required to send additional information to the vendor that was blocked during the initial data pass will likely cause the second (or following) sets of payee information not to be processed in a timely manner to meet the January 31 filing deadline.

For example, if a payer delivers electronic Forms 1099 on January 25 and paper copies on January 31 and a recipient notifies the payer on January 24 that it wants to withdraw consent, this will cause the recipient's paper statement to be delivered late, since the recipient's Form 1099 was included in the electronic mailing group, and not the paper copy group.

Therefore, IRPAC respectfully requests that the IRS provide for a cut-off date for withdrawal requests. We suggest that a recipient be permitted to withdraw consent only prior to January 1 of the following year. Payers will have fulfilled their legal requirements to furnish a payee statement by January 31 by delivering the electronic statement to the recipient. Payers would then be allowed 30 days, parallel to Temporary Regulation Section 31.6051-1T(j)(6)(ii) when a payee statement is returned "undeliverable," to furnish the paper payee statement by mail or in person to the recipient.

If you have any questions or need additional information regarding IRPAC's comments regarding the electronic delivery of paper statements or the withdrawal of consent to receive payee statements electronically, please call Ernest Molinari at (973) 802-4810.

Sincerely,

Michael O'Neill
Chair, IRPAC

cc: Nancy Thoma, Branch Chief, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 22, 2002

Mr. George J. Blaine
Deputy Assistant Chief Counsel
Administrative Provisions &
Judicial Practice Division
Internal Revenue Service
Room 4050 CC:PA:APJP
1111 Constitution Avenue
Washington, DC 20224

Re: Reporting of Gross Proceeds Payments to Attorneys

Dear Mr. Blaine:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I want to thank you for the opportunity to provide the Internal Revenue Service ("IRS") with comments on the re-proposed regulations relating to the Reporting of Gross Proceeds Payments to Attorneys published in the Federal Register on May 17, 2002.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

The members of IRPAC applaud the IRS's responsiveness to industry concerns regarding the first set of proposed regulations addressing reporting of gross proceeds payments to attorneys. IRPAC thanks the IRS for having withdrawn the problematic original set of proposed regulations, retooling them to reflect industry comments, and issuing the current set of proposed regulations (the re-proposed regulations). Although the re-proposed regulations generally provide a viable framework for reporting of gross proceeds paid to attorneys in connection with basic transactions, additional work is needed to deal with more complex situations.

Particularly troublesome for automated systems are circumstances in which reporting to multiple parties is required in connection with a single payment. In some instances

reports are required on different forms that may be prepared by different computer systems, and often the amounts reported to all parties total more than the payment made.

One possible approach to these problems would be to implement a new form that provides for these contingencies. Use of such a form would be optional, not mandatory, so that payers preferring annual aggregate reporting to attorneys would not need to modify their existing reporting systems. Below we will discuss how such a form could work. A mock-up with instructions for such a form, titled "Form 1099-SET", is attached.

In order to alleviate the burden placed on payers requiring them to determine the taxable portion of a settlement paid to a claimant (not including settlements involving physical personal injury), especially where state law may exclude the attorney fee portion of a settlement from the claimant's income (e.g., Alabama, Michigan and Texas), we recommend that the Service adopt a gross reporting requirement for all taxable settlement payments. The new Form would allow for payers to report the gross settlement amount to the claimant, thus eliminating the need for the payer to determine whether state law excludes a portion of the gross settlement payment from the claimant's income.

In addition, the Form would assist in backup withholding cases when an attorney and/or claimant does not furnish a taxpayer identification number ("TIN") to the payer. It is possible, in the case where a claimant and an attorney do not provide TINs, that a payer would be required to backup withhold twice on the same reportable payment. This Form would provide information as to who is eligible to claim credit for any amount backup withheld since it contains separate boxes for the claimant and the attorney showing who is eligible to claim credit for federal taxes withheld.

In cases where the attorney does not provide a TIN, the Form would disclose to the claimant that the payment was subject to backup withholding, and that the amount has been credited to his/her attorney. In addition, the Form would provide a paper trail to the claimant that would assist him/her in recuperating amounts credited as backup withhold to the attorney, that should have been credited and/or paid to the claimant.

While we recognize that adding yet another form to the 1099 series may be perceived as duplicative and unnecessary, we believe that the requirements of Section 6045(f) are unique and justify the creation of a single-purpose form that in the end will be less confusing to both payers and recipients and will provide the Service the information required by statute.

The attached Form 1099-SET is merely a starting point for discussions of what such a form might look like. Its primary utility is to report on individual transactions requiring reports to both a claimant and an attorney. Aggregate annual payments to a single attorney could continue to be reported on existing forms should the payer so choose.

One aim of the Form 1099-SET is to tie into a single form all reporting in connection with the settlement of a lawsuit, legal claim or other situation in which an attorney receives a payment from a payer by whom he has not been retained or employed. This will allow payers to establish and oversee a single system for payments to claimants and attorneys and provide for backup withholding, where required, if an attorney fails to furnish a TIN. (Keep in mind that although the gross amount of the settlement reportable to the attorney will be reported on Form 1099-SET, any amount reportable on a Form W-2 to a claimant will be reported on the Form W-2, with the balance of the settlement reported on the Form 1099-SET to the claimant).

The form differs from the Form 1099-MISC in a number of ways. It provides spaces for the names, addresses and TIN of both the claimant and the attorney. It also eliminates additional boxes now shown on Form 1099-MISC related to types of income that are not relevant to payments covered by Section 6045(f).

From the payer's standpoint, once necessary modifications are made to implement the systems required to utilize the form, all non-wage-related reporting required in connection with payments under Section 6045(f) will be automated and funneled through a single process, reducing the necessity for manual processing and also reducing the incidence of incorrect reports.

From the claimant's perspective, by being clearly identified with a single settlement transaction, any possible confusion about which "miscellaneous" income is covered will be removed. Providing more detailed information to claimants will assist in the accurate preparation of personal income tax returns for the year. If backup withholding has been made in the attorney's name, the claimant will have information available to determine whether any portion of the amount withheld was from the claimant's share of the payment.

For attorneys, the form when utilized will provide reporting on a transaction-by-transaction basis, eliminating the need to request itemization of aggregate reports from payers utilizing the form.

A final area of concern we have involves the effective date contained in the proposed regulations. The current proposal mandates that the final regulations are effective for all payments made during the first calendar year that begins at least two months after the date of publication of the final regulations in the Federal Register. Therefore, it is possible that a worst-case scenario would require payers, if regulations were finalized on October 31, 2003, to apply the final regulations to payments made on January 1, 2004.

For payers who plan on reporting on an aggregate basis this would seem to allow for a 13-month compliance window *(i.e.,* to January 31, 2005). However, this is not the case, since information needs to be captured in the reporting systems on day 1 for reports to be processed on an automated basis (January 1, 2004).

IRPAC appreciates the great improvements that the re-proposed regulations have made to the 1999 version of the proposed regulations, and the opportunity to present our comments. Many of the most pressing issues previously raised by the taxpayer community have been favorably resolved. If you wish to discuss these comments further, please contact Ernest Molinari at (973) 802-4810.

Sincerely,

Michael O'Neill
Chair, IRPAC

Attachments

Cc: Nancy Thoma, Branch Chief, National Public Liaison

Form 1099-SET

Instructions General:

A payer would use this form to report the payments made due to a legal settlement. The portion of the settlement that represents a benefit payment inclusive of Back Pay would be reported separately in the manner prescribed for the payment type.

Instructions Claimant/Plaintiff:

Box 1. Shows the gross amount of the settlement that represents damages, including payments made directly to an attorney on behalf of the claimant/plaintiff (excluding that portion of the settlement that is non-taxable under Internal Revenue Code Section 104). Consult your personal tax advisor about the appropriate tax treatment of your settlement award.

Box 2. Shows the amount of the settlement paid to the attorney/law firm as sole, joint, or alternative payee. Under the laws of some states, the portion of a legal settlement retained by the claimant's attorney may not be includible in the claimant's gross income. Consult your tax advisor about the appropriate treatment of attorney fees under the laws of your state.

Box 3. Shows the amount of interest on the damages that are included in Box 1.

Box 4. Shows income tax withholding or backup withholding. Generally, a payer must backup withhold at a 30% rate if it does not have the payee's taxpayer identification number. Enter this amount on the federal income tax withheld line of your return.

Box 5. Shows backup withholding from the amount reported in Box 2. Generally, a payor must backup withhold at a 30% rate if it does not have the payee's taxpayer identification number.

Boxes 6 through 11. Shows state and local tax information.

Instructions to Attorney/Law Firm

A payer may use this form to report the payment of a legal settlement to a claimant. A payer may also use this form to report any portion of a legal settlement paid to an attorney.

Box 1. Shows the gross amount of the settlement, including payments made directly to an attorney/law firm, plus any amounts withheld as income taxes for the claimant and/or the attorney/law firm (excluding that portion of the settlement that is non-taxable under Internal Revenue Code Section 104).

Box 2. Shows the amount of the settlement paid to the attorney/law firm as sole, joint, or alternative payee.

Box 3. Shows the amount of interest included in Box 1.

Box 5. Shows backup withholding from the amount reported in Box 2. Generally, a payor must backup withhold at a 30% rate if it does not have the payee's taxpayer identification number.

☐ CORRECTED (if checked) ☐ Void (if checked)

PAYER'S Name Street Address City , State, and ZIP		1 Gross Settlement Paid $ 2 Gross Amount Paid to Attorney/Law Firm $	OMB No. 1545- **2002** **Form 1099-SET**	**Settlement Proceeds** **1099-SET** Copy A For Internal Revenue Service
PAYER'S Federal identification number	CLAIMANT'S tax identification number	3 Interest Paid on Settlement $	ATTORNEY'S/LAW FIRM tax identification number	
CLAIMANT'S Name Street address (including apt. no.) City, State, and ZIP code Account Number (optional)		ATTORNEY'S / LAW FIRM Name Street Address City, State, and ZIP code		This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported.
4 Federal Tax Withheld/Claimant $	2nd TIN Not	**5 Federal Tax Withheld/Attorney** $	2nd TIN Notice	

6 State | Payer's state ID number	7 State Income	8 State tax withheld	9 Local Income	10 Local Tax Withheld	11 Locality Name
Claimant:	$	$	$	$	
Attorney/Law Firm:	$	$	$	$	

Form 1099-SET (keep for your records) Department of the TTreasury - Internal Revenue Service

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

TAX-EXEMPT/GOVERNMENT ENTITIES SUBGROUP REPORT

PAMELA EVERHART
LINDA M. LAMPKIN
BARBARA SEYMON-HIRSCH, SUBGROUP CHAIR

NOVEMBER 8, 2002

INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE
TAX EXEMPT & GOVERNMENT ENTITIES
SUBGROUP REPORT

During 2002, the TE/GE Subgroup worked with IRS representatives from the Tax-Exempt/Government Entities Operating Division on a number of information reporting issues, including improvements to pension reporting, increasing taxpayer awareness regarding pension tax law changes, and the elimination of barriers to electronic filing of returns. The projects included in this section were completed by the TE/GE Subgroup this year:

- **Paper** ***(Seymon-Hirsch & Everhart)*** – Tax Reporting Requirements for Required Minimum Distributions

- **Paper** ***(Lampkin)*** - Establishing Electronic Filing of the Form 990 Series as a Priority Because of its Far Reaching Impact on all Taxpayers

- **Article** ***(Seymon-Hirsch & Everhart)*** – Improve Flow of Information Provided by the IRS to Individuals Regarding Retirement Arrangements. The article, a copy of which is attached herein, was published in the 2002 Fall Edition of the SSA/IRS Reporter to educate employers of recent changes in the federal tax law necessitating updates to SEP, SARSEP, SIMPLE IRA, and Keogh Plan documents. The Article is also available on the SSA Web site. Thomas D. Terry, Senior Technical Advisor, and Roger Kuehnle, Tax Law Specialist, Guidance & Quality Review, Tax-Exempt/Government Entities, in addition to other representatives from the IRS, were instrumental in the publication of this Article.

In addition, the TE/GE Subgroup submitted written recommendations to the Tax-Exempt/Government Entities Operating Division suggesting that guidance be issued to modify the method for calculating the net income attributable to Individual Retirement Account contributions which are distributed as a returned excess contribution under I.R.C. § 408(d)(4) or recharacterized under I.R.C. § 401A(d)(6) to ensure that Individual Retirement Account trustees need only perform one calculation to determine net income

(or loss) attributable to returned excess contributions involving multiple regular contributions or recharacterizations to an Individual Retirement Account, with a delayed effective date requested. The subgroup's comments also outlined the IRPAC's support, with a few exceptions, for the changes proposed by the IRS in Notice 2000-39. The IRPAC also recommended that the method outlined in Notice 2000-39 replace the current method of calculation under Treas. Reg. § 1.408-4(c)(2).

On July 22, 2002, the IRS released proposed regulations that provide new rules for calculating net income (or loss) attributable to returned or recharacterized Individual Retirement Account contributions, incorporating the IRPAC's recommendations, including a delayed effective date for implementation.

The new rules will apply for all contributions made on or after January 1, 2004. Thomas D. Terry, Senior Technical Advisor, Tax-Exempt/Government Entities, Roger Kuehnle, Tax Law Specialist, Guidance & Quality Review, and Cathy Vohs, Attorney, Associate Chief Counsel Tax-Exempt/Government Entities, in addition to other representatives of the IRS, were instrumental in drafting this guidance and working with the IRPAC on this issue.

EXECUTIVE SUMMARY

TITLE OF PAPER: Clarify Reporting Requirements Applicable to Minimum Required Distributions

ISSUE STATEMENT: To recommend that additional guidance be issued to clarify IRS Notice 2002-27, to prevent confusion on the part of owners of Individual Retirement Arrangements under I.R.C. § 408 ("IRAs") with respect to payments from their IRAs, as well as to eliminate unnecessary and duplicative reporting requirements, in connection with the minimum distribution requirements of I.R.C. § 401(a)(9).

REMEDY SOUGHT: Notice and Modifications to IRS Publications, Forms and Instructions.

IRPAC TEAM: Barbara N. Seymon-Hirsch, Pamela Everhart, Linda Lampkin, and Michael O'Neill

IRS PARTICIPANTS: Thomas D. Terry, Senior Technical Advisor, TE/GE Roger Kuehnle, Tax Law Specialist, TE/GE, and Marjorie Hoffman, Senior Technician Reviewer, Associate Chief Counsel, TE/GE.

BACKGROUND: On April 17, 2002, in conjunction with the release of final, proposed, and temporary regulations under I.R.C. § 401(a)(9) regarding minimum required distributions (hereinafter "MRDs") from certain retirement arrangements (hereinafter the "MRD Regulations"), the Treasury Department and the IRS released an advance copy of Notice 2002-27,[1] (hereinafter the "Notice") imposing reporting requirements in connection with MRDs from Individual Retirement Accounts (hereinafter "IRAs").

The MRD Regulations generally require the trustee, custodian, or issuer of an IRA (referred to collectively herein as the IRA "issuer") to "report information with respect to the minimum amount required to be distributed from the IRA for each calendar year to individuals or entities, at the time, and in the manner, prescribed by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin ... as well as the applicable Federal tax forms and accompanying instructions."[2] Notice 2002-27

[1] 2002-18, I.R.B. 814.

[2] Treas. Reg. § 1.408-8, Q&A-10.

imposes two separate reporting requirements on IRA issuers, in addition to providing guidance on the new reporting requirements. Notice 2002-27 states that this new reporting requirement is intended to assist taxpayers in complying with the minimum distribution requirements.

Summary of Recommendations: The Service should issue guidance, and revise forms, instructions and publications as necessary, as follows:

Actuarial Value Requirement: Clarify the manner in which the Actuarial Value Requirement affects the determination of MRDs from a deferred annuity.

MRD IRA Annuity: Clarify that, because distributions from an MRD IRA Annuity are made automatically to the IRA owner, and necessarily satisfy I.R.C. § 401(a)(9) and the regulations thereunder, the Notice's IRA Owner Statement Requirement, under which the IRA issuer must provide the IRA owner with a statement containing certain information, would not apply in the case of an MRD IRA Annuity.

Similarly clarify that, because MRDs are distributed automatically from an MRD IRA Annuity, the IRS Reporting Requirement, under which the IRA issuer is required to indicate on Form 5498 that a minimum distribution is required from an IRA, would not apply in the case of an MRD IRA Annuity.

Automatic MRD Distribution Options: Clarify that, for reasons similar to those described above in connection with MRD IRA Annuities, the IRA Owner Reporting Requirement of the Notice would not apply with respect to any IRA during a period in which an automatic MRD distribution option is in effect.

Form 5498 Modifications: Modify Form 5498 in connection with the IRS Reporting Requirement. Revise Form 5498 related instructions to clarify the circumstances under which an IRA issuer is required to report that a taxpayer is required to take an MRD.

Electronic Filing for IRA Statement: Clarify that an issuer may satisfy the IRA Statement Requirement by providing the IRA Owner with the Statement via electronic means.

Increase Taxpayer Education and Awareness of MRD Requirements and Compliance: Expand the discussions of the IRA Owner Statement Requirement and the IRS Reporting Requirement in connection with MRDs in IRS Publication 590 and other related IRS publications and forms instructions.

Clarify the Manner in Which the Two Alternatives described in Notice 2002-27 Apply In Connection With the IRA Owner Statement Requirements: Confirm that an issuer is permitted to use, without limitation, either one of the two alternatives described in the Notice in meeting the IRA Owner Statement requirement.

TAXPAYERS / INDUSTRY AFFECTED: All IRA Issuers, Owners and Beneficiaries

BENEFIT TO TAXPAYERS (PAYEES AND PAYORS): To alleviate unnecessary confusion to IRA owners in connection with MRDs and the MRD reporting requirements applicable to issuers of IRAs. To assist IRA issuers in complying with the MRD reporting requirements applicable to IRAs and to lessen associated costs and administrative burdens / paperwork.

BENEFIT TO INTERNAL REVENUE SERVICE: To eliminate or lessen inaccurate, unnecessary and duplicative reporting requirements that would not assist the Service in monitoring compliance with the minimum distribution requirements applicable to IRAs.

Discussion

On April 17, 2002, in conjunction with the release of final, proposed, and temporary regulations under I.R.C. § 401(a)(9) regarding MRDs from certain retirement arrangements, the Treasury Department and the Internal Revenue Service released an advance copy of Notice 2002-27 regarding reporting MRDs from IRAs.

The MRD Regulations require an IRA issuer to "report information with respect to the minimum amount required to be distributed from the IRA for each calendar year to individuals or entities, at the time, and in the manner, prescribed by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin ... as well as the applicable federal tax forms and accompanying instructions."[3] The Notice provides guidance on the reporting requirements that apply under this provision of the MRD Regulations. The Notice and the preamble to the MRD Regulations state that while this new reporting requirement is intended to assist taxpayers in complying with the minimum distribution requirements, the Service and Treasury Department still have "concerns about the overall level of compliance in this area."[4]

The Notice imposes two separate reporting requirements on IRA issuers, referred to herein as the "IRS Reporting Requirement" and the "IRA Owner Statement Requirement," respectively. Each of these requirements is described below.

Under the IRS Reporting Requirement, beginning with MRDs for calendar year 2004, if a minimum distribution is required with respect to an IRA for a calendar year, the IRA issuer must indicate on Form 5498 for the immediately preceding year (i.e., on a 2003 Form 5498 for a 2004 MRD) that such a distribution is required. The IRA issuer does not need to report the amount of the MRD on the Form 5498.

Under the IRA Owner Statement Requirement, if a minimum distribution is required with respect to an IRA for a calendar year and the IRA owner is alive at the beginning of the year, the issuer is required to provide the owner with a statement by January 31 of the calendar year (beginning with MRDs for 2003, so that the first statements are due January 31, 2003). This Statement must provide the IRA owner with information regarding the MRD for that year by either (1) stating the amount of the MRD for the calendar year (using certain assumptions set forth in the Notice), or (2) stating that a minimum distribution is required for the year and offering to calculate the amount of such distribution at the IRA owner's request. If the IRA owner so requests, the issuer is then required to calculate the amount of the MRD and report that amount to the owner. In the statement that it provides pursuant to (1) or (2) above, the IRA issuer also must inform the IRA owner of the date by which the MRD must be taken, and that the issuer will be reporting to the Service that the owner is required to receive a minimum distribution for the calendar year.

[3] Treas. Reg. § 1.408-8, Q&A-10.
[4] 67 Fed. Reg. 18,993.

Under the Notice, the IRS Reporting Requirement and the IRA Owner Statement Requirement apply for required minimum distributions for calendar year 2003, and for calendar years after 2003 "except to the extent modified in federal tax forms and accompanying instructions."[5] In addition, the Notice states that at this time no reporting is required with respect to MRDs from I.R.C. § 403(b) contracts or IRAs of deceased owners.

CLARIFICATION IS REQUESTED REGARDING THE MANNER IN WHICH AN IRA ISSUER CALCULATES MRDS FROM A DEFERRED ANNUITY WITH REGARD TO THE ACTUARIAL VALUE REQUIREMENT FOR PURPOSES OF THE IRA OWNER STATEMENT REQUIREMENT

Temporary Treasury Regulation § 1.401(a)(9)-6T, Q&A-12, provides that in the case of an annuity contract under an individual account plan from which annuity payments have not commenced on an irrevocable basis (i.e., a "deferred annuity"), MRDs must be determined using the individual's "entire interest" in the deferred annuity and applying the rules of the MRD Regulations applicable to individual accounts. For this purpose, the individual's "entire interest" in the annuity contract is defined as "the dollar amount credited to the employee or beneficiary under the contract plus the actuarial value of any other benefits (such as minimum survivor benefits) that will be provided under the contract."[6]

However, the MRD Regulations do not define the terms "actuarial value" or "other benefits," for this purpose. Consequently, it is unclear what "other benefits" need to be taken into account, and how the "actuarial value" of such benefits is to be measured for this purpose and for purposes of calculating MRDs and satisfying the IRA Owner Statement Requirement under the Notice. Clarification of this issue, and allowing sufficient time to implement such clarification (including making any necessary changes to administration systems), would assist issuers in complying with the IRA Owner Statement Requirement.

The Service Should Clarify That Notice 2002-27 Should Not Apply In The Case of Certain Annuitized IRAs

A. In the case of certain annuitized IRAs, the IRA Owner Statement Requirement is redundant and does not provide the owner with information necessary to satisfy the minimum distribution requirements

The requirements of the Notice apply to all IRAs, even in cases where annuity payments have commenced irrevocably, except for acceleration, to the IRA owner under an individual retirement annuity in a form that meets the requirements of I.R.C. § 401(a)(9) and the regulations thereunder (hereinafter, an "MRD IRA Annuity"). The stated purpose of the Notice is "to assist taxpayers in complying with the minimum distribution requirement."[7] In order to assist taxpayers in this regard, the Notice's IRA Owner Statement Requirement requires an IRA issuer to (1) inform an IRA owner when minimum distributions are

[5] 2002-18 IRB at 815.
[6] Temp. Treas. Reg. § 1.401(a)(9)-6T, Q&A-12.
[7] Notice 2002-27, 2002-18 IRB 814.

required, and (2) either calculate the amount of the MRD for the owner, or offer to calculate such amount upon the owner's request. However, because, by definition, a stream of payments under an MRD IRA Annuity satisfies the minimum distribution requirements each year, an IRA owner does not need any such assistance in complying with the minimum distribution requirements in the case of an MRD IRA Annuity.

In this regard, the MRD Regulations provide that an IRA will not fail to satisfy § 401(a)(9) merely because distributions are made from an annuity contract purchased from an insurance company, if the payments satisfy the requirements of Temp. Treas. Reg. § 1.401(a)(9)-6T (hereinafter, a "permissible annuity form").[8] In addition, the MRD Regulations acknowledge that if distributions are being made in a permissible annuity form, the annuity payments for a year are treated as the MRD for the year.[9] Based on this treatment, the owner of an MRD IRA Annuity (which, as described above, provides annuity payments in a permissible annuity form) will receive annuity payments during the distribution calendar year that are equal to the MRD for the year.

As a result of the foregoing, the owner of an MRD IRA Annuity does not need to be notified that a minimum distribution is required for the year for purposes of ensuring that the owner takes distributions from the contract that comply with the minimum distribution requirements – the owner will receive the MRD amount automatically under the terms of the contract. Likewise, the owner of an MRD IRA Annuity need not request the IRA issuer to calculate the amount of the MRD for any distribution calendar year, because the IRA issuer must calculate and automatically distribute annuity payments from the contract for the year in a form that meets the minimum distribution requirements. Finally, informing the owner of an MRD IRA Annuity that the issuer will be reporting to the Service that the owner is required to receive a minimum distribution for the calendar year will not provide any additional assistance or useful information to the owner in complying with the minimum distribution requirements under the MRD IRA Annuity.

Providing the owner of an MRD IRA Annuity with the statement described in the Notice would only result in unnecessary confusion, rather than assisting the owner in complying with the minimum distribution requirements.

For the foregoing reasons, the Service should clarify that the IRA Owner Statement Requirement of the Notice, under which the IRA issuer is required to provide the IRA owner with a statement that an MRD is required for the year or specifying the amount of the MRD, would not apply in the case of an MRD IRA Annuity.

[8] *See* Temp. Treas. Reg. § 1.401(a)(9)-6T, Q&A-4(a).
[9] *See* Treas. Reg. § 54.4974-2, Q&A-4(a); Temp. Treas. Reg. § 1.401(a)(9)-6T, Q&A-1(d)(2).

B. The IRS Reporting Requirement does not assist the Service in monitoring compliance with the minimum distribution requirements in the case of an MRD IRA Annuity

Although the stated purpose of the Notice is to assist taxpayers in complying with the minimum distribution requirement, the Notice also states that the Service and Treasury Department still have "concerns about the overall level of compliance in this area," and intend to "monitor the effect of the new reporting regime on compliance ...."[10] To this end, the Notice imposes the IRS Reporting Requirement, under which IRA issuers are required to indicate on Form 5498 that a minimum distribution is required from an IRA. In most cases, the IRS Reporting Requirement will help the Service to verify that an MRD has been made from an IRA. In addition, in most cases the IRS Reporting Requirement will notify the IRA owner that an MRD is required for the year.

However, information reporting requirements under current law already require IRA issuers to provide the Service with sufficient information to monitor compliance with the minimum distribution requirements in the case of an MRD IRA Annuity. For example, Issuers are required to file Forms 1099R Information Returns to report the amount of distributions from an IRA, including an MRD IRA Annuity. Moreover, because MRDs are distributed automatically from an MRD IRA Annuity, the IRA owner does not need to be notified that an MRD is required in any year with respect to that IRA.

Accordingly, IRPAC requests that the Service revise the instructions to Form 5498 to clarify that the IRS Reporting Requirement in Notice 2002-27, under which an IRA issuer is required to indicate on Form 5498 that a minimum distribution is required from an IRA, would not apply to the issuer of an MRD IRA Annuity.

The IRA Owner Statement Requirement Should Not Apply Where an IRA Owner Has Elected to Automatically Receive MRDs in Accordance with the Individual Account Rules

To assist their customers in complying with those requirements, some IRA issuers offer "automatic" MRD distribution options. Under such an option, the IRA owner makes a voluntary, revocable election to have the IRA issuer calculate the amount of the MRD from the designated IRA or IRAs every year, and to have that amount distributed automatically to the owner each year from the designated IRA, until such time that the owner revokes the election. This distribution option eliminates the need for an IRA owner to make any calculations or to take any action in order to receive MRDs from the IRA, other than making a revocable election.

As described above, the IRA Owner Statement Requirement is intended to assist taxpayers in complying with the minimum distribution requirements. However, for the same reasons described above in connection with MRD Annuity IRAs, the IRA Owner Statement

[10] 2002-18 IRB at 814.

Requirement is not necessary for this purpose where the IRA owner has elected an automatic MRD distribution option from an IRA individual account. For example, after making the election under the automatic MRD distribution option, the IRA owner does not need to receive any information, make any calculations, or take any action in order to receive MRDs from the IRA during the period that the option is in effect. In addition, the IRA issuer is required under current law to report all distributions made from an IRA, including those made as a result of an automatic MRD distribution election. Hence, informing the IRA owner that the issuer will be reporting to the Service that the owner is required to receive a minimum distribution for the calendar year will not provide any additional assistance to the owner in complying with the minimum distribution requirements and may unnecessarily confuse the owner.

Accordingly, IRPAC requests that the Service clarify that the IRA Owner Statement Requirement of the Notice does not apply to IRA issuers with respect to any IRA during a period in which an automatic MRD distribution option is in effect.

Form 5498 and Related Instructions Should be Modified In Connection With the IRS Reporting Requirement

Notice 2002-27 requires that the IRA issuer "must indicate that a minimum distribution is required with respect to the IRA" on Form 5498. In this regard, IRPAC recommends that a new check-off box be included on Form 5498. Additionally, the instructions to the new check-off box on Form 5498 should clarify the circumstances under which the box would and would not be checked. For example, the instructions should clarify that the box must be checked if the IRA owner has attained age 70 ½ by the end of the calendar year for which the Form 5498 is being filed. For purposes of checking this box, an IRA issuer may reasonably rely on information provided to the issuer by the IRA owner that indicates that, the owner is age 70 ½ or older.

Provide Additional Guidance in Connection with the IRA Owner Statement Requirement as follows:

1. The Service should clarify the manner in which the two alternatives described in Notice 2002-27 apply. In allowing an IRA issuer to satisfy the IRA Owner Statement requirement through use of one of two alternative methods, the Service provides IRA issuers with much needed flexibility in satisfying this requirement. Therefore, the Service should confirm, through the issuance of official guidance or through revisions to the instructions to various information returns that, (1) at its option, an issuer is permitted to use, without limitation, either one of the two alternatives described in the Notice in meeting the IRA Owner Statement requirement, (2) the issuer is not required to make any election or notify the Service as to which of the two alternatives it is using, and (3) the issuer may change the alternative it uses without limitation and is not required to use the same alternative with respect to all of the IRAs it issues.

2. The Service should clarify that an issuer may satisfy the IRA Owner Statement Requirement by providing the IRA owner with the Statement via electronic means. In recent years, the Service has addressed the manner in which certain retirement arrangement notice and consent requirements under the Internal Revenue Code may be satisfied by employers and plan administrators via electronic means. The Service should clarify that an IRA issuer may satisfy its statement requirements to IRA owners either electronically or via a written statement.

The Service Should Expand Various IRS Publications and Forms Instructions to Provide Issuers and IRA Owners With Detailed Information Regarding the IRA Owner Statement Requirement and the IRS Reporting Requirement in Connection With MRDs

To assist IRA issuers in meeting their obligations and to increase the understanding of IRA owners regarding their rights and obligations regarding the MRD requirements, it is recommended that the Service expand certain publications it issues and the instructions to certain IRS Forms, to discuss the new MRD IRS reporting and IRA Owner Statement requirements. For example, it is recommended that a new section be added to IRS Publication 590 which discusses these new requirements, including what notification an IRA owner must receive from an issuer under the Notice, when an owner should receive the required statement, and under what circumstances the owner will not be receiving such a statement. This section should also address the two alternatives that an issuer may use and that if an individual owns more than one IRA, the issuer is not required to use the same alternative. In addition, this section should indicate that the MRD attributed to an IRA need not come from that particular IRA, so that IRA owners are educated on their options in complying with the MRD rules.

EXECUTIVE SUMMARY

TITLE OF PAPER:	Electronic Filing of Exempt Organizations' Returns
ISSUE STATEMENT:	Electronic Filing of Exempt Organizations' Returns should be established as a Priority because of its Far Reaching Impact on All Taxpayers
REMEDY SOUGHT:	The IRS maintain its plan to implement an electronic filing system for the Form 990 series in 2004, for fiscal year 2003.
IRPAC TEAM:	Linda Lampkin, Presenter; Barbara Seymon-Hirsch, Pamela Everhardt, Michael O'Neill
IRS PARTICIPANTS:	Thomas Terry, Midori Morgan-Gaide
BACKGROUND:	The universe of exempt organizations includes both charitable (public charities and private foundations) and non-charitable organizations. These organizations are generally required to file an annual information return. Because these returns are subject to public disclosure, individual and corporate taxpayers, grant makers, state regulators, research and oversight groups and the public at large use these returns as the primary source of information on these organizations. There are approximately 600,000 exempt organizations that file annual returns. Implementing an electronic filing (e-file) system for these returns will accomplish the following: improve customer service to exempt organizations by reducing filing errors and customer burden; enhance service to the general public through a more rapid and accurate release of disclosable information; and, increase governmental efficiencies in processing exempt organizations' returns.
SUMMARY OF RECOMMENDATION[S]:	The IRS should remain on its current schedule to implement an electronic filing for Forms 990 and 990-EZ by January 2004 (for fiscal year 2003). It should also continue its plan to introduce e-filing for Forms 990-PF and 990-T by January 2005 (for fiscal year 2004).
TAXPAYERS / INDUSTRY AFFECTED:	All exempt organizations with annual filing requirements (approximately 600,000), all individual and corporate taxpayers who make charitable contributions and exempt organizations that make grants or donations to other exempt organizations.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS):

Form 990 Filers: The key benefits are improved customer service to exempt organizations by reducing filing errors and customer burden and cost savings from the reduction of return preparation time as well as copying, assembly and mailing costs.

Individual and corporate taxpayers: These taxpayers have the opportunity to make tax-deductible contributions to Form 990 filers exempt under I.R.C. § 501(c)(3). Therefore, having full information easily and quickly available as decisions about donations are made will help improve tax compliance, as these donations are filed as deductions on other tax forms.

State regulators: Exempt organization returns are used by states that have annual filing requirements for exempt organizations to satisfy their filing requirements as well. Electronic filing of exempt organization returns will enable the IRS to share information with state regulators and help them regulate more quickly and efficiently.

General Public: Forms 990, 990-EZ and 990-PF are unique in that they are information returns – not income tax returns. (Only a few organizations file a Form 990-T, a tax return for income of an exempt organization that is earned from activities unrelated to that organization's exempt purpose.) The Internal Revenue Code mandates that these information returns be widely available for public inspection. Electronic filing of exempt organization returns will permit enhanced service to the general public through a more rapid and accurate release of disclosable information.

BENEFIT TO INTERNAL REVENUE SERVICE:

The primary benefit is increased efficiency in the processing of exempt organization returns. Implementation of e-file of exempt organizations' returns will reduce the amount of paper returns processed. Steps in the processing system that will be reduced include mail handling, editing, numbering, transcribing, imaging and filing. Reduction of these functions will lead to quicker and more cost effective processing. There are also cost savings from reducing the photocopying, mailing and re-filing that are required when

responding to public disclosure requests as well as costs associated with storing paper returns.

Another key benefit is the improved sharing of return data among IRS employees. E-file will make return data available to auditors and customer service representatives electronically thereby eliminating the need for the paper return. Electronic return information will assist the IRS in shifting resources from data collection to enforcement and compliance activities.

DISCUSSION

The Internal Revenue Service Restructuring and Reform Act of 1998 states that "the policy of Congress is to promote paperless filing, with a long-range goal of providing for the filing of at least eighty percent of all tax returns in electronic form by the year 2007." This mandate applies to exempt organization returns.

Exempt Organization Filing Requirements

Internal Revenue Code § 501 describes those organizations that are exempt from federal income tax. There are currently approximately 1.5 million exempt organizations. This universe of exempt organizations includes charitable organizations (churches, schools, social service groups, foundations, etc.) as well as other non-profit organizations (labor unions, professional associations, social clubs, etc).

Churches and certain church-affiliated organizations are statutorily exempt from annual reporting requirements. Organizations with less then $25,000 of gross receipts are also not required to file. These two categories of organizations, in addition to those that fall under other limited exceptions, total almost one million. That is, approximately only 600,000 exempt organizations file annual information returns.

Exempt organizations with less than $250,000 of assets and gross receipts between $25,000 and $100,000 file a Form 990-EZ. Exempt organizations with greater than $250,000 of assets and gross receipts in excess of $100,000 are required to file Form 990. Private foundations, a subset of charitable organizations, are required to file Form 990-PF, generally, regardless of gross receipts or assets. These forms are all information returns – not tax returns – as there is generally no income tax imposed on exempt organizations.

Exempt organizations that conduct activities that are unrelated to their exempt purpose are subject to corporate income tax on the income from those unrelated activities. The income from and tax on these activities are reported on Form 990-T.

Unique Nature of the Form 990 Series

The Internal Revenue Service' responsibility with respect to exempt organizations is different from the responsibility it has for other taxpayers. Its responsibilities are regulatory in nature – not revenue collecting. As such, the primary purpose of the Form 990 series of returns is to collect information on the programs and activities of exempt organizations to ensure that they are operating in accordance with their stated exempt purpose and are not running afoul of the rules and regulations governing their tax exempt status. In simple terms, the Form 990 series of returns function as a medium for ensuring that exempt organizations are doing what they are permitted to do and are not doing what they are not permitted to do.

Information requested includes a balance sheet, statement of revenues and expenses, program accomplishments, board of directors list, and executive salaries. Schedule A, required for all I.R.C. § 501(c)(3) charitable organizations, contains information on an

organization's sources of support, political and lobbying activities, transactions with related parties and racial discrimination in private schools. Schedule B provides the name and addresses of major contributors as well as the amount and character of the contribution.

This series of returns is also unique because exempt organizations are required by I.R.C. § 6104 to make the returns widely available for public inspection. This means that organizations may be requested to provide copies of the returns that were filed with the IRS. If the organization refuses to provide a copy, they are subject to IRS penalties. The IRS may also be requested to provide copies of the returns. It is important to note that current regulations provide that the posting of an organization's return on the Internet, either on its own Web site or another Web site, satisfies the organization's obligation to make its return widely available. In other words, if the return is posted on the Internet, the organization does not have to provide paper copies of its returns.

The number of people taking advantage of the ability to access and review the exempt organization returns on the Internet is large and constantly growing. Since 1999, PDF images of most 501(c)(3) charitable organizations have been available at GuideStar's Web site. A product of collaboration between the Internal Revenue Service, the National Center for Charitable Statistics (NCCS) at the Urban Institute, and GuideStar (also known as Philanthropic Research, Inc.), [1] the Web site now receives about 6 million hits per week.

Finally, the Form 990 series of returns are unique because they are multi-jurisdictional forms – forms used by state regulators as well. Because exempt organizations are not subject to income tax, jurisdiction of exempt organizations within the states generally falls under the secretary of state or office of attorney general as opposed to the state revenue departments. About twenty years ago, the IRS and the National Association of Attorneys General/National Association of State Charity Officials (NAAG/NASCO) reached an agreement whereby the NAAG/NASCO states agreed to use the IRS forms to satisfy some or all of their information needs. Thus, the NAAG/NASCO member states do not have separate annual filing requirements.[2]

The Form 990 series of returns essentially facilitates regulation of exempt organizations not only by the IRS but also by the general public and state regulators.

Form 990 and Philanthropy

In 2001, overall giving to charity in the United States was estimated at $212 billion, over 2 percent of GDP. About 76 percent of this total – almost $161 billion[3] – was contributed by individual U.S. taxpayers. Giving by foundations was estimated at $25.90 billion, while corporate giving in 2001 was $9.05 billion. An enormous amount of otherwise taxable income is being used for charitable purposes. It is vitally important that

[1] NCCS funded the purchase of scanning equipment for the IRS. The IRS then committed to creating PDF images of all 501(c)(3) returns. The images are then downloaded to a compact disc (CD) on a monthly basis and provided to GuideStar and other interested parties. GuideStar then uploads these images to its Web site.

[2] Many states require charities and other nonprofits to complete an annual registration form. An application to solicit contributions may also be required.

[3] AARFC Trust for Philanthropy, *"Giving USA 2002: The Annual Report on Philanthropy for the Year 2001*." "Sources of Contributions", pp. 57-103.

individual, institutional, and corporate donors have access to better information on the charities they support. Electronic filing will greatly improve the timeliness, completeness, and ease of availability of charity data.

After its generous outpouring of over $1 billion to help those affected by the tragedy of September 11, the public raised hard questions about nonprofit sector transparency and use of funds. With information available from e-filing of Form 990, enhanced on-line repositories of information about charities could be created that enable donors and volunteers to quickly and more accurately identify organizations that support their particular concerns, for example, homeless shelters in a specific geographic area or organizations providing information to mothers with AIDS. Not only will potential donors be able to better identify the charities of interest, but also evaluate their capacities and program effectiveness, based on the financial and programmatic information included in the Form 990 filing.

The Government as a User of Form 990 Information

According to the Forms 990 filed in 1999, almost $60 billion was received in government grants alone (not including Medicare, Medicaid, and contracts to provide specific services to the government itself). Each government program collects its own information from grantees, thus incurring huge administrative costs to create and maintain separate databases.

As a result of the Federal Financial Assistance Management Act of 1999 (P.L. 106-107), the Interagency Electronic Grants Committee (IAEGC), and the Bush Administration's eGovernment initiatives, there are now ongoing efforts to streamline the federal grants application and management process. E-filing for the nonprofit sector is an integral part of this process, as the Form 990 is the standard in the sector that should serve as a basis for the development of the electronic system.

The Nonprofit Sector is Willing

About seventy-five percent of all Forms 990 are prepared by outside preparers, most frequently local or regional CPA firms with a nonprofit practice. Currently, many nonprofits defer to their preparers' judgment on all issues relating to Form 990. Yet, many CPA firms assign Form 990 preparation to less experienced staff, as a way to contain costs and have their services remain affordable for their nonprofit clients. In order for e-filing to succeed, both nonprofits and their accountants will need to be aware of the benefits, cost-effectiveness and ease of Form 990 e-filing.

In February and March 2002, The Urban Institute's National Center for Charitable Statistics (NCCS) conducted a telephone survey of a randomly selected sample of Form 990 filers stratified by size, type and geographic location with 490 responses. In addition, the same survey was posted on the GuideStar web site as a link to an article on e-filing and 360

responses were tabulated. Among the topics explored in the surveys was the likelihood of a charity to e-file its Form 990, or to recommend e-filing to its external preparer.

Interest in e-filing was high across all sizes and subsectors of nonprofit organizations. In the NCCS survey, seventy-three percent of all financial executives surveyed said that they would be very likely or somewhat likely to electronically file their Form 990, or to recommend e-filing to their professional preparers, as long as there were free, easy-to-use software available to do so. Those who file their Form 990 internally, and those whose organizations have fifty or more employees, were even more enthusiastic. The GuideStar survey confirmed charities' propensity to try e-filing. Over fifty-seven percent of respondents reported that they were very likely, and twenty-eight percent were somewhat likely to electronically file their Form 990, if the option were readily available.

In addition to its surveys of nonprofit organizations, NCCS asked a random sample of CPA firms with a nonprofit practice in Pennsylvania (a representative state with a mix of large and small cities and rural areas) whether they have experience electronically filing any returns (1040, 941), and whether they planned to continue to e-file the returns that they have e-filed in the past. Seventy-six percent of respondents have already e-filed an IRS return. Ninety-six percent of CPAs with e-filing experience plan to continue e-filing returns in the future, and 47 percent of CPAs who have not previously e-filed responded that they anticipate they will begin e-filing returns for their clients in the near future. This encouraging statistic shows conclusively that once CPAs have electronically filed a return, they continue to do so.

Software developers contacted by the IRS have indicated that they will build the infrastructure required for electronic filing for Form 990, once the specifications have been developed by the IRS. According to IRS data, about twenty percent of all Forms 990 are still prepared without the use of software or computer – either by individuals who don't have computers or who do not want to use software. It will take time for these preparers to adjust to the e-filing.

RECOMMENDATIONS

First, the IRS should maintain its current plan to implement an electronic filing system for Forms 990 and 990-EZ by January 2004, for fiscal year 2003. E-file for Form 990-PF and 990-T should be available in the following year.

The Internal Revenue Service should also work with the sector and regulators at the state level to help integrate the filings and registration documents required of nonprofits. An e-filing system can easily allow filers to fulfill multiple reporting requirements with one document and one transmission. The Urban Institute's National Center for Charitable Statistics has been working on such a pilot system with the charity offices of twelve states and these experiences should be instructive as the IRS develops an e-filing system.

Internal Revenue Service officials have indicated their interest in simplifying Form 990 in order to make e-filing more efficient, specifically in the area of attachments. In order to facilitate the process, we recommend that the IRS continue to communicate with stakeholders on simplifying the Form. No change to Form 990 may be made lightly — the Form has been constructed over the years in consultation with various stakeholders. State charity offices were involved in the creation of Form 990 over 20 years ago, and many require it today to regulate charitable solicitations. Web sites like GuideStar publish the Forms 990 of over 400,000 organizations, and an increasing number of funders and individual donors are learning to read the relevant sections in making their giving decisions. All proposed changes should be brought before the public for comment before being implemented.

We recommend that the IRS consider creating standard structures for all attachments that can be integrated into preparation software. Rather than discard the attachments, or reduce them to a recordkeeping requirement, IRPAC would like to see precise instructions on what should and should not be included in attachments. In this way, electronic Form 990 files will be easily exported into the IRS database; yet, important disclosures will not be lost to public scrutiny.

TAXPAYERS / INDUSTRY AFFECTED

The approximately 600,000 organizations that file Form 990 would be directly affected, but the impact would be much greater, as the information is essential to lines on tax returns for all taxpayers.

Every individual taxpayer and every corporate taxpayer must make choices about charitable giving – and then fill out the appropriate tax forms if they are to receive a deduction from income. E-filing would enable these taxpayers to better comply with requirements of giving to charities appropriately registered with the IRS.

BENEFIT TO TAXPAYERS (PAYEES & PAYORS)

Form 990 Filers: The key benefits are improved customer service to exempt organizations by reducing filing errors and customer burden and cost savings from the reduction of return preparation time as well as copying, assembly and mailing costs.

Organizations that file electronically will receive an electronic acknowledgement of receipt by the IRS. Such an acknowledgement will reduce correspondence between the organization and the IRS for late filed or lost returns. Organizations that file electronically may be exempt from the requirement to provide copies of their returns upon request. The IRS would assume the responsibility for posting public information from these returns on the internet.

As software vendors will be participants in the development of the e-filing program, there will be improvements in the existing software packages, for examples, more help

functions and more diagnostics to alert preparers to incorrect computations or missing information. Such changes will ensure quicker, more efficient and more accurate return preparation. These additional validity and consistency checks reduce correspondence between the organization and the IRS and ensure that information on the IRS master file is current and correct.

Thus, e-filing will reduce burden in preparing and filing returns as well as complying with public disclosure requirements while providing for more complete and accurate returns

Individual and corporate taxpayers: These taxpayers have the opportunity to make tax-deductible contributions to Form 990 filers exempt under I.R.C § 501(c)(3). Therefore, having full information easily and quickly available as decisions about donations are made will help improve tax compliance, as these donations are filed as deductions on other tax forms.

E-filing will ensure quicker and more accurate publishing of exempt organization returns, which will assist donors in their decision making. Such publishing will expedite research on nonprofits, allowing taxpayers to easily identify organizations that qualify for receipt of tax-deductible donations.

State regulators: The primary method of regulating nonprofit organizations within a state's borders is through mandatory annual registration, which generally requires a copy of Form 990. Currently, about 40 states require such registration, which results in a costly and time-intensive process of document and data gathering, file storage, and creation of databases by keypunching required data variables. Roughly half of the budgets of each state charity office are dedicated to registration management, which leaves limited resources for enforcement, public education, and other regulatory duties. Typically, it is difficult and inefficient for compliance officers to access and analyze information.

Dan Moore, former president of the National Association of State Charity Officials (NASCO), explained, "We want to make a shift from data entry to data analysis. We want to move from clerical work to investigative and analytical work."[4] Electronic data will help regulators be proactive by building profiles of problem returns and quickly identifying common errors.

A number of states are moving ahead with e-filing of state registration documents as part of a pilot project spearheaded by NCCS and NASCO. Electronic registration is already a reality in Pennsylvania and Colorado. E-filing at the federal level will reassure states that are interested in pursuing this form of e-government that they are in step with federal initiatives.

[4] Dan Moore, "It's a New Age of Accountability," *Foundation News & Commentary* 42, no. 2 (March/April 2001): 28.

General Public: Forms 990, 990-EZ and 990-PF are unique in that they are information returns – not income tax returns. (Only a few organizations file a Form 990-T, a tax return for income of an exempt organization that is earned from activities unrelated to that organization's exempt purpose.) The Internal Revenue Code mandates that these information returns be widely available for public inspection. E-filing will ensure quicker and more accurate publishing of exempt organization returns, assisting donors and grant makers in their decision processes. Such publishing will expedite research on nonprofits, allowing large, sophisticated funders such as governments, foundations and the United Way to make giving decisions more in line with their stated objectives. It will be easier to identify organizations that do not fit their criteria, and also enable better measures of effectiveness using objective data from their grantees. Both foundations and government will be able to reduce expenses related to researching potential grantees, and grantees will be able to easily provide needed information. Burdensome costs of assembly, copying, and storage will also be eliminated.

E-filing will also enable other exempt organizations, primarily research and oversight groups, to create the more efficient and effective databases they require. For example, state associations and nonprofit umbrella groups rely on data in planning and conducting their membership and public policy programs and sector research. More accessible data will allow them to understand the consequences of changes in public policy and to research issues such as nonprofit salary levels and program outcomes. Chapters or franchises will be able to exchange and standardize the information they provide to each other.

More comprehensive and accessible data will also assist legislators and other policy makers to better evaluate the impact of proposed changes. Such information on the non-profit sector will also encourage the development of government programs and policies to support the sector and improve research on the impact of proposed changes and existing programs

BENEFIT TO INTERNAL REVENUE SERVICE

The current system for processing paper returns is inefficient, costly, and labor intensive. Approximately forty percent of exempt organization returns are rejected from processing. Reasons for rejection include absence of required schedules, incorrect name or identification numbers, missing signatures, and mathematical errors. While IRS personnel correct many of these errors, just as many result in the issuance of correspondence to the exempt organization. This creates significant delays in the processing of these returns. E-filing will reduce many of the steps associated with paper processing including mail handling, editing, data entry, error resolution, and imaging.

There are also inefficiencies in the public disclosure process for exempt organization returns. Current procedures require requests for copies of returns to be submitted in writing. Staff is assigned to this function on a full-time basis. They answer these requests by retrieving the returns from storage, photocopying them, mailing the photocopies, and then returning the files to storage. E-filing will provide a large number of

returns in an electronic format. These returns can be stored in a database that will be accessible to personnel responding to requests for copies of returns.

Another area in which inefficiencies exist is the examination process for exempt organization returns. First, personnel responsible for selecting returns for audit do not generally have copies of the returns and, therefore, work with limited information. Providing these individuals with more data electronically should decrease the number of examinations resulting in no changes to the return. Second, revenue agents who actually audit the returns often do so without a copy of the return filed with the IRS. This is because it generally takes 10 to 12 weeks for the Files unit to process a request. E-filing will ensure more efficient exams by permitting agents quicker access to returns.

Finally, inefficiencies exist in the studies completed by the Statistics of Income (SOI) division. This group transcribes (keypunches) almost 100% of the data from a sample of returns. The information is used to compile statistics about exempt organizations. E-filing will reduce the resources needed to transcribe the required data.

The resources saved can be allocated to converting more data from paper returns into an electronic format. The Data Entry unit currently only transcribes about twenty percent of the data from paper returns. Resource savings resulting from e-file can be redirected to the Data Entry unit to enable 100% of the data from paper returns to be captured electronically. This will again increase the efficiencies in processing, public disclosure and audits of returns.

Social Security Administration

Internal Revenue Service

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Reporter

Fall 2002

A Newsletter for Employers

IRPAC Reminds Employers to Update SEP, SARSEP, SIMPLE IRA, and Keogh Documents

Employers and other filers of information returns are represented on an IRS advisory committee known as the Information Reporting Program Advisory Committee (IRPAC). IRPAC was created at the request of Congress and has been working closely with the IRS to provide input concerning information reporting requirements.

Earlier this year, the IRS released Revenue Procedure 2002-10, which provides guidance with respect to amending SEP, SARSEP, and SIMPLE IRA plan documents to incorporate changes under EGTRRA (the Economic Growth and Tax Relief Reconciliation Act of 2001) and the new minimum required distribution regulations. Most of these changes are effective beginning January 1, 2002.

The plan documents in need of amendment by the employer include:

1. SEP 2. SARSEP 3. SIMPLE IRA

If your company maintains a Keogh plan or other qualified plan (e.g., money purchase, profit-sharing, or 401(k) plan) you must amend your plan by the end of the 2002 plan year to comply with various statutory changes. For more information on these types of plans, see IRS Publication 560 *(Retirement Plans for Small Business).*

SEPs and SARSEPs

For a SEP or a SARSEP, the document that the employer uses to establish the plan can be either a Model Plan (Form 5305-SEP or Form

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Did You File Your 2001 W-2s on Magnetic Media?

If you did, and your file was formatted according to SSA's Magnetic Media Reporting and Electronic Filing (MMREF), perhaps you didn't know just how easy it is to file electronically under the new MMREF. It saves time and money because there's no need to create and mail a tape or diskette. Plus, it offers:

- **an extended filing deadline (until the end of March versus the end of February for all other filing methods),**
- **an electronic proof of filing, and**
- **the ability to track the status of your report as it's processed within SSA.**

Just go to SSA's website, *www.ssa.gov/employer,* anytime between January 6, 2003 and March 31, 2003. Select Business Services Online and use the same PIN you entered in Code RA of the Submitter Record. You'll be prompted for a password. You should have received a

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2002 Filing Update for Accountants, CPAs, Third-Party Preparers

We've made our electronic filing services even better for Tax Year 2002. The improvements will go into effect January 6, 2003. Electronic filing is now considered the industry's "best practice" when it comes to submitting Form W-2 data to SSA. More than 104 million W-2s were transmitted electronically to SSA during the 2001 filing season! It's ideal for any submitter (employers, accountants, tax practitioners, service bureaus, etc.). There are two ways to file electronically:

Submit a Wage File

This option allows you to upload a wage report to SSA using the Internet. Format your wage report according to SSA's Magnetic Media Reporting and Electronic Filing (MMREF-1) publication. In many cases, your software provider has done this for you. The TY 2002 MMREF-1 is available at *www.ssa.gov/employer,* select *Forms and Publications.*

or

Use W-2 Online

This option also uses the Internet but instead of uploading an MMREF formatted report, it allows you to create Forms W-2 on your computer. For TY 2002 filing, you can complete and submit up to 20 Forms W-2 (increased from 10 W-2s for TY 2001). You also have the option to print Form W-2 statements suitable for employee distribution and your client's records. You'll need Adobe Acrobat Reader to print the forms.

Registration is required. You can register at anytime. Just follow these simple steps:

1. Go to the web site, *www.ssa.gov/employer* and select *Business Services Online* (formerly Employer Services Online).
2. Follow the "Registration Screen" prompts.
3. You'll be issued a Personal Identification Number (PIN) immediately. We'll mail you a password within 10 to 14 days. You'll want to change the password right away to one you personally select. Also, change your password at least once a year to keep your PIN from expiring.

Some important points to remember:

- Each person who files Form W-2 reports needs a PIN; use that same PIN for all your clients.
- As of January 6, 2003, you can register online even if you are self-employed and do not have an Employer Identification Number.
- The Business Services Online (formerly the Employer Services Online) will accept TY 2002 electronic submissions starting January 6, 2003.

The March 31 filing deadline gives your clients an extra month to identify errors and notify you. After corrections are made, you can print and give your clients or the employee a *new* original Form W-2, and re-save the file before submitting it to SSA. This reduces the number of Form W-2c corrections and saves you and your client time and money.

The *Business Services Online User Handbook* dated June 2002 contains complete step-by-step instructions to file your 2002 wage report electronically and also phone numbers for technical support. The Handbook is available at *www.ssa.gov/employer,* select *Forms and Publications.*

If you wish to register early or take advantage of other services prior to January 6, 2003, see the 2001 *Employer Services Online User Handbook*, available at the website above. SSA

SSA/IRS Reporter

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Did You File Your 2001 W-2s on Magnetic Media? **continued from page 1**

password in the mail about 2 weeks after you registered for the PIN. If you can't find your password, call 800-772-6270 and we'll issue you a new one. With your PIN and password, follow the prompts for Submit a Wage File. It takes literally seconds to file electronically.

Diskette Filers **Diskette filers who are now filing electronically, or plan to do so this year, should make sure their W2REPORT is uploaded as a single file submission. This is important because if you produce large W-2 files, your software may be set up to create breaks to accommodate multiple diskettes. This is because of the space limitations of diskettes. If your software does not create one file, you must combine the files into a single wage submission before you transmit it to SSA electronically. Software that offers the option of filing electronically is already set up to create the single file for you.**

If you file multiple submissions on behalf of employers, just remember that each file must be complete (i.e., contain an RA or RCA through to, and including the RF or RCF record.) These records are specifically identified in the MMREF format.

If you have questions, please refer to the MMREF for Tax Year 2002 or contact our electronic filing technical assistance personnel at 888-772-2970. For TDD/TTY call 800-325-0778. SSA

Fast Track Mediation Dispute Resolution Available for Businesses and Individuals

The Internal Revenue Service Small Business/Self-Employed Division (SB/SE) has available Fast Track Mediation, a new service to assist taxpayers to more quickly resolve disputes that arise from examination or collection actions. Fast Track Mediation was developed by SB/SE and the IRS Appeals Division.

Fast track mediation can be offered to taxpayers with disputes not yet before a court. The program is designed to assist in resolving tax disputes arising from an examination, an offer in compromise, or a trust fund recovery penalty.

Taxpayer may choose fast track or normal appeals process

The taxpayer can choose either fast track mediation or the normal appeals process. The taxpayer does not forgo any appeal rights during mediation and can withdraw from mediation. If a taxpayer withdraws from mediation, the dispute would follow the normal appeals process. Either the taxpayer or IRS can request mediation, but both must agree to mediate. On average, the mediation process should be started and completed within about 30-40 days. The normal appeals process can take months.

Specially trained mediator conducts mediation

A specially trained IRS mediator from the Appeals Division will conduct the mediation session at a mutually agreed upon site. The mediator will discuss the dispute with both sides and can request additional information from either side. The mediator will not decide anything regarding the dispute. The mediator cannot impose a resolution and will not have settlement authority. The mediator will work to resolve the dispute between the taxpayer and the IRS. The taxpayer and IRS must both agree to any proposed resolution.

Additional information available

For additional information about Fast Track Mediation, see IRS Publication 3605 *(Fast Track Mediation—A Process for Prompt Resolution of Tax Issues)* and the Fast Track Mediation Web site at *www.irs.gov.* Click on *"Businesses"* on the left side. From the Businesses page, select *"Small Business/Self-Employed"* on the left. From the Small Business/Self-Employed page, scroll down and select *"Fast-Track Mediation."*

Publication 3605 may be ordered by calling 800-829-3676. IRS

Reminding Employers to Update Documents continued from page 1

5305A-SEP) or an IRS-approved Prototype SEP or SARSEP. This document identifies the employer, establishes conditions for participation, and describes the contributions that will be made under the plan. (Note that new SARSEPs are prohibited, but exiting ones can continue.)

The revised Model SEP or SARSEP must be adopted by the employer no later than **December 31, 2002** (for calendar year plans).

An employer using a Prototype SEP or SARSEP must adopt a revised document within **180 days** after the date the IRS issues a new favorable opinion letter to the financial institution that provided the plan. The financial institution should notify its customers of the applicable deadlines and provide updated documents.

Simple IRAs

Like SEPs and SARSEPs, the document that the employer uses to establish a SIMPLE IRA plan can be either a Model Plan (Form 5304-SIMPLE or Form 5305-SIMPLE) or an IRS-approved Prototype SIMPLE IRA plan.

The revised Model SIMPLE IRA plan must be adopted by the employer no later than **December 31, 2002**. The deadlines for an employer using a Prototype SIMPLE IRA Plan are the same as those for Prototype SEPs and SARSEPs.

Disclosures to Employees

All participating employees must be notified of the EGTRRA changes with respect to the Model or Prototype Plans no later than **October 1, 2002**, regardless of when the plan is adopted.

Remember that you must *operate* your SEP, SARSEP or SIMPLE IRA plan in compliance with the statutory requirements applicable to these plans for 2002 even though your plan has not been updated yet. IRS

NOTE FROM THE EDITOR

Your feedback is a way I keep in touch with the type of information you like and need in this publication. My e-mail address *SSA.IRS.REPORTER@irs.gov is available for you to send comments. You may also contact me at 303-446-1664 or by fax at 303-446-1764.

Quick Reference Chart for Updating Employer Documents

Model SEP/SARSEP/SIMPLE Documents

Document (Rev. March 2002)	Use for New Plans	Adopt for Existing Plans
Form 5305-SEP (Regular SEPs)	After Oct. 1, 2002	By Dec. 31, 2002
Form 5305A-SEP (SARSEPs)	Not Applicable	By Dec. 31, 2002
Form 5304-SIMPLE (Without DFI)	After Oct. 1, 2002	By Dec. 31, 2002
Form 5305-SIMPLE (With DFI)	After Oct. 1, 2002	By Dec. 31, 2002

Prototype SEP/SARSEP/SIMPLE Documents

Document Type	Adopt By
SEP/SARSEP	180 Days After Letter Issued to Financial Institution
SIMPLE IRA Plan	180 Days After Letter Issued to Financial Institution

Special Requirements for all SEPs and SIMPLEs

Document Type	Provided To	Provide By
SEP/SARSEP— Description of Changes	Participant	Oct. 1, 2002
SIMPLE IRA Plan — Description of Changes	Participant	Oct. 1, 2002

Tax Incentives for Distressed Communities

IRS and HUD partner to educate taxpayers on tax incentives

The Internal Revenue Service and the Department of Housing and Urban Development formed a new partnership to promote the tax incentives available to small businesses located in economically distressed areas. The special tax incentives afforded these areas are designed to promote economic development, create affordable housing and stimulate job growth. The renewal community incentives, enacted in the Community Renewal Act of 2000, represent the latest legislative efforts to use tax incentives to attract business and investment to distressed urban and rural areas.

The goal of the IRS is to educate local development officials and tax practitioners and give them the tools to work with local businesses that want to move into or expand their operations in a designated zone. The IRS is very excited about this partnership and sees it as a way to promote tax incentives aimed at improving economic conditions in needy communities throughout the United States.

The IRS has a keen interest in working with HUD on this initiative due to the wide range of tax implications the new legislation has, and the impact the law will have on small business owners. This new partnership with HUD is an excellent opportunity to proactively work with another government agency, jointly leverage resources and service the affected communities.

IRS participated in the HUD-sponsored Community Renewal Implementation Conference held in May 2002, where the new "Renewal Community and Round III Empowerment Zone" designations were introduced. Tom Dobbins, Director, IRS, Taxpayer Education and Communication, Partnership Outreach, gave a presentation to the delegates outlining IRS's commitment to energize and educate small business owners on potential renewal opportunities and tax incentives available to them.

Some of the initiatives currently underway include: Working with HUD to update and carry on their Tax Incentive Guide for Businesses; creating a Community Renewal/ Empowerment Zone area on the IRS website *www.irs.gov;* and developing educational and outreach materials for small business owners, university professors, tax practitioners and other professionals.

Direct questions about tax incentives to e-mail address *communityrenewal @irs.gov.* IRS

HELP Telephone numbers and Web addresses to use when you have questions:

- **Information Reporting Program Customer Service Section toll free at 866-455-7438, or non-toll free at 304-263-8700, Monday through Friday, 8:30 A.M. to 4:30 P.M., ET. Telecommunications Devices for the Deaf (TDD) may be reached non-toll free at 304-267-3367. Taxpayers can contact this unit via e-mail at *mccirp@irs.gov*.**
- **General IRS Tax Law Questions and Account Information, 800-829-1040**
- **SSA Tela Service Center, 800-772-1213**
- **SSA Employer Reporting Service number is 800-772-6270**
- **IRS Employer Identification Number (EIN) Request Number, 866-816-2065. (Form SS-4 may be faxed to Brookhaven, NY at 631-447-8960, Cincinnati, Ohio at 859-669-5760, or Philadelphia, PA at 215-516-3990).**
- **EFTPS assistance is available at 800-645-8400 or 800-555-4477.**
- **IRS Forms may be ordered at 800-829-3676.**
- **Forms and help information is also available on the IRS Digital Daily Web Site at *www.irs.gov* and the Social Security Web Site at *www.ssa.gov/employer***
- **IRS Tax Fax Service offers faxed topical tax information, 703-368-9694**
- **Information Reporting Program Web Page: *www.irs.gov/smallbiz.* Scroll down to "Quick Links" and click on "Information Returns Reporting Program " in the right column.**
- **IRS On-Line Filling Program for Form 941 and Form 940 Filing Austin Submission Center 512-460-8900 (not toll-free)**
- **Employee Plans Taxpayer Assistance Telephone Service, toll free, 877-829-5500.**
- **Questions about wage reporting (submitting Copy A of Form W-2 to SSA) should be referred to the Social Security Administration.**
- **Tax questions (even Social Security Tax questions) should be referred to the IRS.**

Question and Answers

Q. I receive a Package 941 in the mail each quarter but I do not have any employees. How do I stop the mailing of the packet?

A. Send a signed note to the IRS center to which you send other IRS business returns. (Addresses below.) Indicate you do not have employees and are requesting the Form 941 requirement be removed from your business entity. Be sure to include your Employer Identification Number. (##-#######)

Q. I receive a Package 941 in the mail each quarter and my company has gone out of business. What do I do?

A. Send a note to the IRS center you have sent your business returns to (addresses below) and tell them you have gone out of business and your account is no longer required. Include your Employer Identification Number. (##-#######) Be sure that you have sent final returns to the IRS Center and have indicated you do not have to file returns in the future.

Business Return Submission Processing

Beginning in 2002, all processing of business returns was centralized into two IRS sites – Cincinnati and Ogden.

Business-entity related correspondence should be directed to the center at which the last return was filed.

The addresses are:

Internal Revenue Service,
Cincinnati, OH 45999

Internal Revenue Service,
Ogden, UT 84201

Some compliance and customer service work on business accounts is also performed in Brookhaven, Memphis and Philadelphia. Check notices and correspondence received from IRS for the correct telephone numbers and addresses for responses.

State and Local Government Employers:

NEW! Federal-State Reference Guide Now Online

The new 2002 revision of Publication 963, *Federal-State Reference Guide,* is now available online at *www.irs.gov/govts.* This is the first revision of the publication since 1997. The publication provides the nation's 90,000 public employers with a comprehensive reference guide for Social Security and Medicare coverage and Federal Insurance Contributions Act (FICA) tax withholding issues. It covers such topics as Section 218 Agreements, the mandatory FICA provisions, determining worker status, public retirement systems and public employer responsibilities. It also provides federal and state contact information. Copies may be ordered by calling 800-829-3676. SSA

Online Filing of Forms 940 and 941 Questions and Answers

Were you aware that business taxpayers could file their unemployment tax returns as well as perform other payroll related reporting completely online? All you need is a computer, modem, and Web-based Internet access and you can electronically file your Form 940 and/or 941 through an Approved IRS *e-file* for Business Provider. You can find a listing of companies who offer this service by visiting the Approved IRS *e-file* for Business Providers page at *www.irs.gov.* You'll also want to visit the IRS *e-file* for Business Partners page that contains special offers from our IRS *e-file* for business partners.

Business filers who've been taking advantage of filing their employment tax returns online using the 940/941 On-Line Filing Program and who may have changed providers have recently asked the following questions. In an effort to reduce confusion, we're providing answers to those frequently asked questions. You can find more information on 940/941 On-Line Filing by visiting *www.irs.gov* — just click on the *e-file* logo.

Q. What is a Personal Identification Number (PIN)?

A. A PIN is a number assigned by the IRS to the Authorized Signatory for the purpose signing an electronically filed Form 940 or 941 making it paperless. The same PIN is used to sign your 940 and 941 return.

Q. If I change providers, do I need a new Personal Identification Number (PIN)?

A. No. The PIN is issued to the taxpayer, and identifies the taxpayer to the IRS. A new PIN is required only if the PIN has been compromised, or if the signatory identified on the original PIN application changes. You do not need to send another Letter of Application (LOA) to the IRS to receive a new PIN. Notify your new online provider of your intent to switch to their company.

Q. What else can I file online?

A. In addition to 940/941 *e-file*, other payroll related reporting can be done online using the Internet, and an approved provider. The business return filer visits an approved provider's Web site and enters the required information online. The approved provider then sends the information such as Forms QWF and 1099-Misc. Correction to the IRS using the FIRE (Filing Information Returns Electronically) system.

continued on page 6

Online Filing of Forms 940 and 941 Questions and Answers

continued from page 5

- **Questionable Form W-4 (QWF)**
- **LOA to apply for 941/940 *e-file* PIN**
- **941 Quarterly Return**
- **940 Annual Return**
- **W-2's (reported to the SSA through an online provider)**
- **W-2 Corrections (reported to the SSA through an online provider)**
- **1099-Misc. Correction**

Q. What is a Letter of Application (LOA)?

A. An LOA is a paper or electronic request that is submitted to the IRS through an Approved IRS *e-file* for Business Provider. The LOA is required for all prospective online business filers who wish to participate in the 940 or 941 online programs, and is submitted by an Authorized Signatory to receive a Personal Identification Number (PIN).

Q. How do I submit an LOA?

A. A prospective online business filer must submit an electronic LOA through an Approved IRS *e-file* for Business Provider to participate in the 940/941 On-Line filing program. The prospective online business filer must use the electronic LOA provided in the commercial tax preparation software they intend to use.

Q. Where can I find information about developing software for the 940 and 941 On-Line filing programs?

A. If you're interested in developing software for yourself, or in developing a commercial software product, please contact the IRS. You may contact us by sending an e-mail to our Employment Tax Development Team at *efileemptax@irs.gov.*

File Smart…File Electronic IRS

SSA Announces Social Security Agreement with Australia

Do you have U.S. employees working in Australia or Australian personnel working in the United States? If so, you may be able to realize substantial savings under a new Social Security agreement that goes into effect October 1, 2002.

The new agreement helps reduce business costs by eliminating double Social Security taxation. Before the agreement, U.S. companies that employed U.S. citizens in Australia were often required to pay contributions on their employees' salaries to both U.S. Social Security and to Australia's mandatory private retirement program known as the Superannuation Guarantee. Frequently, Australian companies with Australian personnel in the United States also paid contributions to both countries. The combined U.S. and Australian contribution rate could amount to almost 25 percent of salary. Under the agreement, these workers and their employers will contribute to either the U.S. or the Australian program, but not to both.

The agreement also helps fill gaps in benefit protection for people who spend part of their working lives in both countries. Under the agreement, workers and their families may qualify for partial U.S. or Australian Social Security benefits based on combined credits from both countries.

In addition to the new agreement with Australia, the U.S. has Social Security agreements with 19 other countries. If you want to know more about any of these agreements, please visit our web site at *www.ssa.gov/international*, or call SSA's Office of International Programs at 410-965-3548 or 410-965-0377. SSA

IRS *e-file* for Employment Taxes— NEW for January 2003

Beginning January 2003, taxpayers who use a preparer to file their Form 940 and 941 may file them electronically. Now, whether you prepare your returns yourself (on your home or business computer) or use a tax professional (payroll service, bookkeeper, CPA, or paid tax preparer), your federal employment and unemployment tax returns may be filed electronically.

Why File Electronic?

It's Fast

- Information is quickly available to IRS Customer Service sites
- Processing time is reduced to one week
- Electronic acknowledgement within 48 hours

Convenient

- Tax preparation work is automated with return preparation software that does calculations, and highlights needed forms and schedules
- Pay tax liability and file the tax return at the same time *(NEW for 2003!)*

Safe

- Tax information is secure
- Only authorized users have access to the system

Paperless

- Personal Identification Number (PIN) is used as the business filer's signature

Talk to your tax professional about filing your Forms 940 and 941 electronically. For more information, visit *www.irs.gov* and click on the *e-file* logo.

File Smart...File Electronic IRS

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

SMALL BUSINESS & SELF-EMPLOYED SUBGROUP REPORT

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NOVEMBER 8, 2002

INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE
SMALL BUSINESS/SELF EMPLOYED
SUBGROUP REPORT

The SB/SE Subgroup addressed a number of information reporting issues during 2002, including standardized format and indicators for non-matching Schedules K-1, establishing a procedure for small case Offers-in-Compromise, cash basis taxpayer use of the Schedule C (Form 1040) bad debt line, non-conforming format of Wage and Tax Statements (Form W-2) issued by the U.S. Post Office, simplification of the distribution codes on Form 1099-R, guidance to employers for reporting health insurance premiums paid by Subchapter S corporations, electronic filing issues related to the Form 1040 series, tax classification identifier for limited liability companies, taxpayer burden reduction, disclosure of information, continuing professional education, two power of attorney forms issues, National Research Project (hereinafter "NRP") contact letters, and the multitude of IRS mailing addresses. In addition, the SB/SE Subgroup surveyed their professional associations and gathered input on the President's E-Government Initiative and responded to a request from the IRS Oversight Board for input on the Centralized Authorization File, Employer Identification Number, Offer in Compromise, Practitioner Priority Service, and other programs, including the Schedule K-1 Matching and the NRP programs.

The following SB/SE Subgroup projects are included in this section:

- **Paper** ***(Javor)*** - Schedule K-1 Enhancements
- **Letter** ***(Adelstone)*** - Schedule C (Form 1040) Bad Debt Line
- **Letter** ***(Whitlock)*** - Tax Classification for Limited Liability Companies
- **Letter** ***(Moonin)*** - President's E-Government Initiatives

- **Letter *(Conklin)*** - Nonconforming Substitute Form W-2
- **Letter *(Whitlock)*** - Subchapter S Health Insurance Premium Reporting
- **Letter *(Javor)*** - Where to File, Pay, Correspond & Service Center Descriptors
- **Letter *(Javor & O'Neill)*** – Comments to IRS Oversight Board

In the coming year, the SB/SE Subgroup will pursue a procedure to address small case offers in compromise, work with Large & Mid-Size Business ("LMSB") Subgroup on streamlining the information reported on Form 1099-R, ensure that all tax forms can be electronically filed, work with Taxpayer Education and Communication on various electronic commerce issues, and keep a watchful eye on NRP communications to taxpayers.

EXECUTIVE SUMMARY

TITLE OF PAPER: Schedule K-1 Enhancements

ISSUE STATEMENT:

(1) To provide standardization and uniformity of the reporting information on Forms K-1; to increase payee awareness of the reporting requirements for the Forms K-1 information; to provide payors with alternative schedule format;
(2) To alert the IRS to information items reported by payors that do not match information reported by payees; and
(3) To enable the IRS to allow substitute Forms K-1 that address the needs of taxpayers and simultaneously meet the needs of the payor community.

REMEDY SOUGHT: Standardize Form K-1, rewrite Instructions accompanying K-1, and review Schedule E to maximize K-1 Matching compliance.

IRPAC MEMBER: Mary Javor

IRS PARTICIPANT: Joseph Brimacombe

BACKGROUND: Estates, Trusts, Partnerships, and Subchapter S Corporations are required to provide pass-through information to beneficiaries, partners, and shareholders on Schedule K-1 of Forms 1041, 1065, and 1120S. Revenue Procedure 2000-19 defines the requirements for all substitute Schedules K-1. The minimum standards for substitute Schedules K-1 allow payors to design forms that are confusing to taxpayers and foster a failure to properly report Schedule K-1 information.

SUMMARY OF RECOMMENDATION: The IRS should modify future revenue procedures, beginning for the tax year 2003, or as soon as is practicable, addressing the criteria for all substitute Schedules K-1 that are provided to taxpayers and modify forms used by taxpayers to alert the IRS of "non-matching" information return items.

TAXPAYERS / INDUSTRY AFFECTED: Taxpayers required to report pass-through information or taxpayers required to report income from Estates, Trusts, Partnerships, and Subchapter S Corporations as beneficiaries, partners, shareholders, or investors are affected by the K-1 Matching Program, and, by inference, Schedules K-1.

BENEFIT TO TAXPAYERS (PAYORS & PAYEES):

Payors will be able to provide quality service and maintain long-term relationships with beneficiaries, partners, and shareholders while spending less time explaining Schedule K-1 information and how such information relates to the particular taxpayer's return. Recipients will be provided with comprehensible information that will be properly reported on their income tax return. As a result, beneficiaries, partners, and shareholders will receive fewer notices from the IRS.

BENEFITS TO INTERNAL REVENUE SERVICE:

The IRS will perform in conformance with its Mission Statement, "Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities" and, as a result, will receive more accurate income tax returns from beneficiaries, partners, and shareholders.

1. SUBSTITUTE SCHEDULES K-1

DISCUSSION

Instructions for substitute Schedules K-1 are contained in Revenue Procedure 2000-19. This paper addresses the need for all substitute Schedules K-1 (Forms 1041, 1065, and 1120S) that are provided by payors to taxpayers.

Currently, Revenue Procedure 2000-19 does not require prior IRS approval for substitute Schedules K-1 that accompany the payor's tax return provided the substitute Schedule K-1 meets the following criteria:

- The schedule contains the payor's name, and the taxpayer's name, address, and SSN/EIN.
- The schedule contains all items required for use by the taxpayers.
- The line items are in the same order and arrangement as those on the official IRS form.
- Each taxpayer's information is on a separate sheet of paper.
- Schedules for taxpayers have instructions attached for required line items.
- The amount of each taxpayer's share of each line item is identified. Furnishing a total and a percentage or factor to be applied to the total does not satisfy these requirements.

These minimum standards have allowed payors to become creative in designing the Schedule K-1. The varied layouts continue to confuse and frustrate taxpayers that attempt to comply in good faith with their income tax reporting obligations.

Instructions for substitute Schedules K-1 are not written with the taxpayer's use of the information in mind. Inconsistent labeling, inclusion of non-tax related information, insertion of marketing material, fine print and hard-to-read font styles and sizes used in important tax instructions, as well as graphic layouts which mirror non-tax related statements, confuse and bewilder taxpayers. In particular, the use of form titles, such as "tax information letter", that do not clearly indicate that the form/schedule is intended to be a substitute Schedule K-1, should be discouraged.

In the absence of a statement that the amounts shown on the substitute Schedule K-1 are being reported to the IRS, taxpayers may not realize the significance of the communication from the payor and may not report the information on their income tax return.

Supporting the theory that many taxpayers do not properly report the substitute Schedule K-1 information on their income tax return, in May 2001 the IRS began to test for compliance by matching Schedule K-1 information to the taxpayers' personal income tax returns.

At the IRS Nationwide Tax Forums this year, practitioners from around the country voiced concern about the confusion in "where" various items reported on a Schedule K-1 should be reported on the individual taxpayer's income tax return (Form 1040). In particular, various Schedule K-1 line items are not necessarily reported on the Form 1040 schedules as directed in the Schedule K-1 Instructions. In addition, practitioners voiced concern about the "matching" of Schedule K-1 information in cases when amounts "just cannot be matched". For instance, net income from passive activities when the taxpayer has passive activity loss carryover.

RECOMMENDATION

The IRS should modify future revenue procedures, beginning for the tax year 2003 or as soon as practicable, addressing the criteria, including minimum and maximum paper sizes for substitute Schedules K-1 that are provided to taxpayers, so that:

- more stringent substitute form requirements are mandated, and
- uniform visual standards provide for instant recognition of a substitute Schedule K-1.

The IRPAC recommends that the general substitute form requirements now in place for Forms 1098, and 1099 series, as contained in Revenue Procedure 2000-28, be adopted for all Schedules K-1 that are provided to taxpayers/recipients. These rules were developed with the recipient in mind to assure the understanding of appropriate tax return compliance for the forms.

The present instruction in Revenue Procedure 2000-19 should be supplemented by the following requirements:

- The tax year, the schedule number (K-1), the related form number (1041, 1065 or 1120S), and the official schedule name must be indicated on the substitute.
- All applicable amounts and information required to be reported must be titled and numbered in substantially the same manner as the official IRS schedule. Line numbers are to be in the same order as those on the official schedule.
- The substitute schedule must contain all items required for use by the taxpayer, but the substitute schedule is not required to list line items where there would be no entries required for the particular taxpayer. If line items are omitted or skipped, the alpha and/or numeric sequence order of the official IRS schedule must nonetheless

be followed. If line items are omitted, instructions to the schedule must clearly indicate that the number and order of the items relate to the official IRS schedule.

- Instructions to the taxpayer, that are substantially similar to those on the official IRS schedule, must be provided to aid in the proper reporting of the items on the taxpayer's income tax return. Where items have been omitted as not being required for use by a taxpayer, the related instructions may also be omitted.

- The quality of the ink or other material used to generate the taxpayer's schedules must produce clearly legible documents. In general, black chemical transfer inks are preferred.

- To assure uniformity of substitute Schedules K-1, the following paper size is recommended:

  Minimum/Maximum dimensions: 8.5" x 11"
  (The international standard (A4) of 8.27" x 11.69"
  may be substituted for the minimum/maximum dimensions)

- The paper weight, paper color, font type, font size, font color and page layout must be such that the average taxpayer can easily make sense of and decipher the information on each page.

- Payor logos should be permitted on a substitute schedule provided the placement of the logo does not interfere with the purpose of the schedule.

- Inclusion of federal, state and/or local tax-related information on the substitute schedules should be allowed. All non-tax-related information furnished at the same time as the substitute schedule should be segregated from the substitute schedule in a manner that avoids confusion for the taxpayer.

- Substitute Schedules K-1 should contain the following legend in close proximity to the required tax items: "This important tax information is being furnished to the Internal Revenue Service as Schedule K-1, (Form 1041/Form 1065/Form 1120S)".

2. FORMS AND PUBLICATIONS

DISCUSSION

Earlier this year, the IRS began the process of matching Schedules K-1 (Form 1041, Form 1065, and Form 1120S) information received from Estates, Trusts, Partnerships, and Subchapter S Corporations to information reported by taxpayers on their individual income tax returns (Form 1040). The matching program was to be initiated in two stages. Initially, notices were mailed to taxpayers under the Automated Under-reporter Program that involved primary discrepancies other than Schedules K-1. The Schedule K-1 discrepancy was a secondary issue; but was included in the notices issued. Beginning June 24, 2002, the IRS

began to issue notices where the primary discrepancy was in the matching of Schedules K-1. From the very beginning, the IRS recognized that there was a potential for the "system" issuing erroneous notices to taxpayers and was committed to refining the process to minimize the number of erroneous notices issued. In an effort to perfect the matching program, specially trained Revenue Agents were utilized as part of the screening process to ensure issues such as passive loss limitations were considered. Before notices were sent, returns showing Schedule K-1 matching discrepancies were manually screened to ensure that all income/loss was reported on an attached Schedule E and Passive Loss Form 8582 were taken into consideration.

The IRS is currently compiling data generated by the Schedule K-1 Matching Program and, as a result, ceased issuing notices on August 1, 2002 for tax year 2000. The Service anticipates refinements to the program will be implemented sometime after November, 2002.

Currently there is no requirement for Schedule K-1 (Form 1041, Form 1065, and Form 1120S) to include a "check box" for information reported by the payor that may or may not be reported by the taxpayer for the current tax year. Items reported by payors that could cause the IRS to issue a "mismatch" notice to a taxpayer include, but are not limited to:

- Passive activity loss carryover
- Basis adjustments
- Section 179 depreciation
- At-risk limitations

In addition, Schedule E (Supplemental Income and Loss) and Form 8582 (Passive Activity Loss Limitations) and the Instructions accompanying same, do not provide guidance regarding how to alert the IRS that a tax return does not mirror the information reported on the Schedule K-1 (Form 1041, Form 1065 and Form 1120S).

RECOMMENDATION

The IRPAC recommends that the IRS review and revise, where appropriate, all forms and publications affected by information reported on Schedules K-1 (Form 1041, Form 1065, and Form 1120-S). The IRPAC also recommends that revisions to the affected forms include a "check box" to indicate that the Schedule K-1 information will not "match" the information reported by the taxpayer. In addition, related publications, such as Publication 17 (Your Federal Income Tax) and Publication 925 (Passive Activity and At-Risk Rules) should be revised to include guidance to taxpayers affected by "non-matching" Schedules K-1 (Form 1041, Form 1065, and Form 1120S) information returns.

TAXPAYERS / INDUSTRY AFFECTED

Taxpayers required to report pass-through information or taxpayers required to report income from Estates, Trusts, Partnerships, and Subchapter S Corporations as beneficiaries, partners, shareholders, or investors are effected by the K-1 Matching Program, and, by inference, Schedules K-1.

BENEFITS TO TAXPAYERS (PAYORS & PAYEES)

Payors will be able to provide quality service and maintain long-term relationships with beneficiaries, partners, and shareholders while spending less time explaining Schedule K-1 information and how such information relates to the particular taxpayer's return. Recipients will be provided with comprehensible information that will be properly reported on their income tax return. As a result, beneficiaries, partners, and shareholders will receive fewer notices from the IRS.

BENEFITS TO THE INTERNAL REVENUE SERVICE

The IRS will perform in conformance with its Mission Statement, "Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities" and, as a result, will receive more accurate income tax returns from beneficiaries, partners, and shareholders.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 22, 2002

Kathy Rusiecki
Office of Taxpayer Burden Reduction
Internal Revenue Service
1111 Constitution Ave., NW
Washington, DC 20224

Re: Schedule C (Form 1040) Bad Debt Line

Dear Ms. Rusiecki:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I am submitting these comments regarding the elimination of the Bad Debt Expense line on Schedule C of Form 1040.

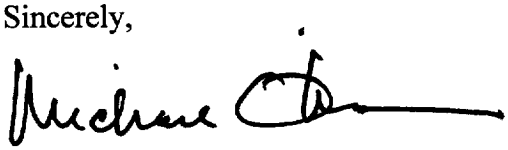
IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

IRPAC recommends the elimination of the Bad Debt Expense line appearing on the current Schedule C, unless there is evidence that this line serves an important purpose. Because the line is used by only 6% of Schedule C filers, IRPAC feels that it misleads cash basis taxpayers into believing they are entitled to a deduction by using this line.

It is our understanding that you will determine if the line is vital to any statistical gathering project of the Service, and finding none, you will then coordinate with Forms Chief Bob Erickson in order to effect this change.

On behalf of IRPAC, please accept our thanks for your assistance in pursuing a solution to this matter. In you have any questions concerning our recommendation, please call Jeff Adelstone, EA, at (520) 885-6735, or you may send him e-mail at Afstax@Aol.com.

Sincerely,



Michael O'Neill
Chair, IRPAC

Cc: Nancy Thoma, Branch Chief, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 23, 2002

Joseph R. Brimacombe
Internal Revenue Service
1111 Constitution Avenue NW
Washington, DC 20224

Re: Tax Classification Identifier for Limited Liability Companies

Dear Mr. Brimacombe:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I am writing to provide you with comments regarding Form 8832, Entity Classification Election, as it pertains to the information reported on Form 1040, specifically schedules C, E and F, and Forms 1120, 1120S and 1065.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

With the exception of Form 1065, tax returns filed by Limited Liability Companies ("LLCs") do not contain a separate description line or checkbox to identify the taxpayer as an LLC entity. For tax purposes, LLCs can use the default tax classification (i.e., sole proprietor or partnership, depending on the number LLC members) or can elect another Federal tax classification. In addition, LLCs can change their Federal tax classification as frequently as every five years. For instance, an LLC that elects to be taxed as a regular corporation can elect to change its tax classification to a sole proprietor in five years. For tax and information reporting purposes, a Federal tax classification change does not alter the LLC entity.

IRPAC recommends that Schedules C, E and F (Form 1040), Forms 1120, 1120S and 1065 be revised to include a checkbox and date for use by LLCs to alert the IRS that the filing of a specific tax form reflects the tax classification and date of the tax classification election rather than the legal status of the LLC entity.

If you wish to discuss these comments further, please contact Beanna J. Whitlock, EA at (800) 465-2767.

Sincerely,

Michael O'Neill
Chair, IRPAC

cc: Nancy Thoma, Branch Chief, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 23, 2002

Michael R. Chesman
Director, Office of Taxpayer Burden Reduction
New Carrollton Federal Building
5000 Ellin Rd.
Lanham, MD 20706

Re: President's E-Government Initiative

Dear Mr. Chesman:

On behalf of the Information Reporting Advisory Committee (IRPAC), I am writing to provide these comments on the President's E-Government Initiative.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

Employers are currently required to use multiple Federal and state employer identification numbers. Some states utilize the same tax identification number assigned by the IRS, while others assign a special number for use in reporting state sales, use, withholding, unemployment, and corporate taxes. As an example, the State of New Jersey uses a special number for employment tax purposes while the Commonwealth of Pennsylvania use a "box number" to identify its corporations.

By allowing employers to use a single identification number for all transactions with the IRS, Social Security Administration, and other Federal and state agencies, employers would realize a significant reduction in their administrative burden. In addition, employers would reduce their administrative efforts if the Federal Government and the states adopted consistent filing and payment dates.

IRPAC recommends that the Office of Taxpayer Burden continue to work with Federal and state tax agencies to develop consistent filing and payment date policies. The electronic exchange of information among and between Federal and state agencies would provide the IRS and taxpayers with increased accuracy of and faster

access to the exchanged information. Federal and state agencies would also benefit by reducing administrative expenses associated with processing shared information needed to effectively and efficiently administer the tax laws.

If you wish to discuss these comments further, please contact Ronald Moonin, CPA, at (609) 882-2733.

Sincerely,

Michael O'Neill
Chair, IRPAC

cc: Nancy Thoma, Branch Chief, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 22, 2002

Joseph R. Brimacombe
Internal Revenue Service
1111 Constitution Avenue NW
Washington, D. C. 20224

Re: Nonconforming Substitute Form W-2

Dear Mr. Brimacombe:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I am writing to provide these comments regarding the US Postal Service's ("USPS") nonconforming Form W-2.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

The attached 2001 Employee Copy of USPS Form W-2 clearly demonstrates the vast differences between the official IRS Form W-2 (OMB No. 1545-0008) and the Wage and Tax Statement format used by the Postal Service. For example, Box 14 is not in the appropriate location for reporting miscellaneous entries. Likewise, the official Form W-2 does not contain any boxes numbered 30 through 40. State and Local Wage information (boxes 15 through 20) are to be located at the bottom of the substitute form. Similarly, box 12 items, such as imputed income associated with group life insurance and pretax pension contributions are not reported in box 12 as specified in the instructions for substitute Forms W-2. Lastly, the name of the Department of Treasury has been omitted from the USPS substitute Form W-2.

Taxpayers, practitioners and the IRS share an interest in the approximate 800,000 Forms W-2 issued annually by the USPS. IRPAC recommends, therefore, that you advise the USPS of the requirements for substitute Forms W-2.

If you wish to discuss these comments further, please contact Carole Conklin, EA at 810-227-8364.

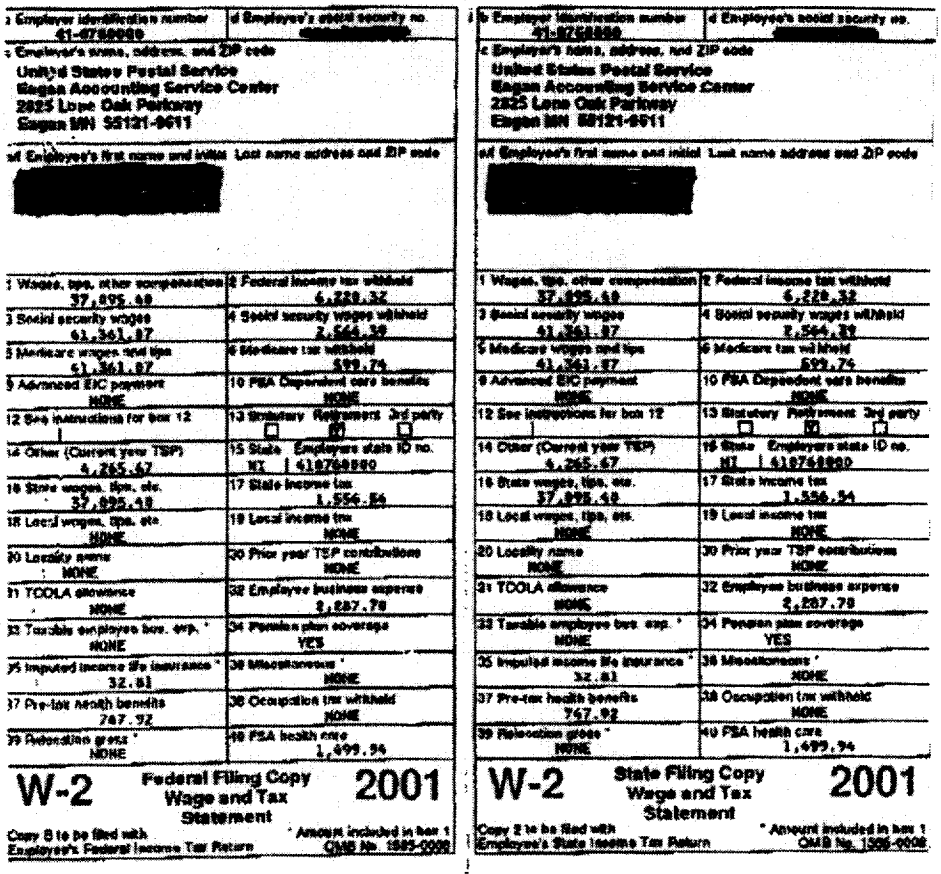
Sincerely,

Michael O'Neill
Chair, IRPAC

Attachment

Cc: Nancy Thoma, Branch Chief, National Public Liaison

Attachment



b Employer identification number 41-6788888	d Employee's social security no. [redacted]
c Employer's name, address, and ZIP code United States Postal Service Eagan Accounting Service Center 2825 Lone Oak Parkway Eagan MN 55121-9611	
e Employee's first name and initial Last name address and ZIP code [redacted]	
1 Wages, tips, other compensation 37,895.48	2 Federal income tax withheld 6,228.32
3 Social security wages 41,361.87	4 Social security wages withheld 2,564.38
5 Medicare wages and tips 41,361.87	6 Medicare tax withheld 599.74
7 Advanced EIC payment NONE	10 FSA Dependent care benefits NONE
12 See instructions for box 12	13 Statutory Retirement 3rd party ☐ ☒ ☐
14 Other (Current year TSP) 4,265.67	15 State Employers state ID no. NJ 618788888
16 State wages, tips, etc. 37,895.48	17 State income tax 1,556.84
18 Local wages, tips, etc. NONE	19 Local income tax NONE
20 Locality name NONE	20 Prior year TSP contributions NONE
21 TCOLA allowance NONE	22 Employee business expense 2,287.78
23 Taxable employee bus. exp.* NONE	24 Pension plan coverage YES
25 Imputed income life insurance* 32.81	26 Miscellaneous* NONE
27 Pre-tax health benefits 747.92	28 Occupation tax withheld NONE
29 Relocation gross* NONE	40 FSA health care 1,499.94

W-2 Federal Filing Copy Wage and Tax Statement **2001**

Copy B to be filed with Employee's Federal Income Tax Return

* Amount included in box 1

OMB No. 1545-0008

b Employer identification number 41-6788888	d Employee's social security no. [redacted]
c Employer's name, address, and ZIP code United States Postal Service Eagan Accounting Service Center 2825 Lone Oak Parkway Eagan MN 55121-9611	
e Employee's first name and initial Last name address and ZIP code [redacted]	
1 Wages, tips, other compensation 37,895.48	2 Federal income tax withheld 6,228.32
3 Social security wages 41,361.87	4 Social security wages withheld 2,564.38
5 Medicare wages and tips 41,361.87	6 Medicare tax withheld 599.74
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12 See instructions for box 12	13 Statutory Retirement 3rd party ☐ ☒ ☐
14 Other (Current year TSP) 4,265.67	15 State Employers state ID no. NJ 618788888
16 State wages, tips, etc. 37,895.48	17 State income tax 1,556.84
18 Local wages, tips, etc. NONE	19 Local income tax NONE
20 Locality name NONE	20 Prior year TSP contributions NONE
21 TCOLA allowance NONE	22 Employee business expense 2,287.78
23 Taxable employee bus. exp.* NONE	24 Pension plan coverage YES
25 Imputed income life insurance* 32.81	26 Miscellaneous* NONE
27 Pre-tax health benefits 747.92	28 Occupation tax withheld NONE
29 Relocation gross* NONE	40 FSA health care 1,499.94

W-2 State Filing Copy Wage and Tax Statement **2001**

Copy 2 to be filed with Employee's State Income Tax Return

* Amount included in box 1

OMB No. 1545-0008

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 29, 2002

Michael Chesman
Director
Office of Taxpayer Burden
Internal Revenue Service
New Carrollton Federal Building
5000 Ellin Rd.
Lanham, MD 20706

Re: Subchapter S Corporation Health Insurance Premiums

Dear Mr. Chesman:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I am writing to provide you with these comments regarding the e-mail distribution of "Reporting of Health & Accident Insurance Premiums for Greater than 2% S Corp Shareholder-Employees" education campaign material scheduled for release in December 2002.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

While paragraph 2 of the education campaign material appropriately warns, "The Form K-1 (Form 1120S) may not be used as an alternative to the Form W-2 to report this additional compensation," that statement needs to be supplemented by adding a warning that the additional compensation is also not to be reported on Form 1099.

Additionally, there should be a warning that health and accident insurance payments paid on behalf of a shareholder, regardless of the ownership in the Subchapter S corporation, are not considered compensation if the shareholder does not engage in providing services to the corporation. These payments would be deemed a distribution of shareholder profits and reported on Schedule K-1.

IRPAC recommends that the above items be addressed before the "Reporting of Health & Accident Insurance Premiums for Greater than 2% S Corp Shareholder-Employees" information is released to the public in December 2002. In addition, the American Payroll Association, National Payroll Association, payroll reporting agencies, and related entities should receive the "IRS Stakeholder Headliner...and more" education campaign material and be asked to post this material on their respective websites. Additionally, IRPAC recommends that the education campaign material be included in such IRS publications as Circular E, Publications 17, 525, 535, 542, and 1066 as well as the IRS/SSA Reporter and Tax Alerts and be provided to the Social Security Administration for publication.

If you wish to discuss these comments further, please contact Beanna J. Whitlock, EA at (800) 465-2767.

Sincerely,

Michael O'Neill
Chair, IRPAC

cc: Nancy Thoma, Branch Chief, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 23, 2002

James C. Gaither
Internal Revenue Service
Field Director, Submission Processing & Chairperson
IRS Governance Structure Oversight Council
Brookhaven Submissions Processing
1040 Waverly Avenue
Brookhaven, New York 11742

Re: Where to File, Pay, and Correspond and Service Center Descriptors

Dear Mr. Gaither:

On behalf of the Information Reporting Program Advisory Committee (IRPAC), I am writing to provide you with comments regarding the IRS reorganization.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

IRPAC recommends that the IRS initiate simplified contact addresses for use by taxpayers in sending their tax returns, payments, and correspondence to the Service. In addition, the IRS should revisit the renaming of the Service Centers, which were renamed as a result of the Revenue and Restructuring Act of 1998 ("RRA 98").

First, we call your attention to the enclosed schedule of addresses to which taxpayers send their individual income tax returns, balance due, and estimated income tax payments. The information contained in the attached schedule was compiled from not one, but various IRS publications.

As the schedule indicates, a taxpayer residing in Utah, for instance, files his or her income tax return with Kansas City, Missouri, but would remit a balance due to P.O. Box 660308, Dallas, Texas, and send estimated tax payments to P. O. Box 660406, Dallas, Texas, even though IRS maintains an office in Ogden, Utah. A taxpayer in Michigan files his or her return with Andover, Massachusetts, but would remit

balance due and estimated income tax payments to two separate Post Office boxes in Philadelphia, Pennsylvania. IRS correspondence received by this taxpayer would come from the IRS office in Kansas City, Missouri.

As illustrated above, today taxpayers e-file or mail their returns to one IRS Service Center, send their balance due payments to a Post Office box typically in a different state, remit their estimated income tax payments to a different Post Office box, and receive IRS correspondence from a different IRS location. This has put a heavy burden on taxpayers to sort, assign, classify, and distribute all incoming and outgoing IRS correspondence.

Second, after more than four years since the enactment of RRA 98, there is still confusion about the various names assigned to the Service Centers, including Campus, Computing Center, Processing Center, and Area Office, which continue to confuse taxpayers, practitioners, and even IRS employees. The name Service Center, however, is still used for some, but not all of the functions performed for the four IRS Operating Divisions at various locations throughout the United States.

IRPAC recommends that the IRS establish a single address within each Service Center for the four Operating Divisions. A single contact-point address for all incoming and outgoing paper filings, payments, and correspondence would assist taxpayers in alleviating the confusion involved in interacting with the IRS. IRPAC also recommends that the IRS reexamine the benefits, if any, derived by taxpayers as a result of the renaming of the Service Centers.

If you wish to discuss these comments further, please contact Mary L. Javor, EA, at (313) 386-4840.

Sincerely,

Michael O'Neill
Chair, IRPAC

Enclosure

cc: Nancy Thoma, Branch Chief, National Public Liaison

State/Commonwealth	Mailing address for Form 1040 WITHOUT payments	Mailing address for Form 1040 WITH payments	Mailing address for Estimated Income Tax Vouchers
Alabama	Memphis, TN	P O Box 105017 Atlanta, GA	P O Box 105225 Atlanta, GA
Arkansas	Memphis, TN	P O Box 105017 Atlanta, GA	P O Box 105225 Atlanta, GA
Arizona	Austin, TX	P O Box 660308 Dallas, TX	P O Box 660406 Dallas, TX
Alaska	Fresno, CA	P O Box 7704 San Francisco, CA	P O Box 51000 San Francisco, CA
California	Fresno, CA	P O Box 7704 San Francisco, CA	P O Box 51000 San Francisco, CA
Colorado	Austin, TX	P O Box 660308 Dallas, TX	P O Box 660406 Dallas, TX
Connecticut	Philadelphia, PA	P O Box 1187 Newark, NJ	P O Box 162 Newark, NJ
Delaware	Philadelphia, PA	P O Bo x1187 Newark, NJ	P O Box 162 Newark, NJ
District of Columbia	Philadelphia, PA	P O Box 80101 Cincinnati, OH	P O Box 80102 Cincinnati, OH
Florida	Atlanta, GA	P O Box 105093 Atlanta, GA	P O Box 105900 Atlanta, GA
Georgia	Atlanta, GA	P O Box 105093 Atlanta, GA	P O Box 105900 Atlanta, GA
Hawaii	Fresno, CA	P O Box 7704 San Francisco, CA	P O Box 51000 San Francisco, CA
Idaho	Austin, TX	P O Box 660308 Dallas, TX	P O Box 660406 Dallas, TX
Iowa	Kansas City, MO	P O Box 970011 St. Louis, MO	P O Box 970006 St. Louis, MO
Illinois	Kansas City, MO	P O Box 970011 St. Louis, MO	P O Box 970006 St. Louis, MO
Indiana	Philadelphia, PA	P O Box 80101 Cincinnati, OH	P O Box 80102 Cincinnati, OH
Kansas	Kansas City, MO	P O Box 970011 St. Louis, MO	P O Box 970006 St. Louis, MO
Kentucky	Memphis, TN	P O Box 105017 Atlanta, GA	P O Box 105225 Atlanta, GA
Louisiana	Memphis, TN	P O Box 105017 Atlanta, GA	P O Box 105225 Atlanta, GA
Maine	Philadelphia, PA	P O Box 13757 Philadelphia, PA	P O Box 7350 Philadelphia, PA

Maryland	Philadelphia, PA	P O Box 13757 Philadelphia, PA	P O Box 7350 Philadelphia, PA
Massachusetts	Andover, MA	P O Box 13757 Philadelphia, PA	P O Box 7350 Philadelphia, PA
Michigan	Andover, MA	P O Box 13757 Philadelphia, PA	P O Box 7350 Philadelphia, PA
Minnesota	Kansas City, MO	P O Box 970011 St. Louis, MO	P O Box 970006 St. Louis, MO
Missouri	Kansas City, MO	P O Box 970011 St. Louis, MO	P O Box 970006 St. Louis, MO
Mississippi	Memphis, TN	P O Box 105017 Atlanta, GA	P O Box 105225 Atlanta, GA
Montana	Austin, TX	P O Box 660308 Dallas, TX	P O Box 660406 Dallas, TX
Nebraska	Ogden, UT	P O Box 60840 Los Angeles, CA	P O Box 54919 Los Angeles, CA
Nevada	Fresno, CA	P O Box 7704 San Francisco, CA	P O Box 51000 San Francisco, CA
New Hampshire	Philadelphia, PA	P O Box 13757 Philadelphia, PA	P O Box 7350 Philadelphia, PA
New Jersey	Holtsville, NY	P O Box 1187 Newark, NJ	P O Box 162 Newark, NJ
New Mexico	Austin, TX	P O Bo x660308 Dallas, TX	P O Box 660406 Dallas, TX
New York (New York City and counties of Nassau, Rockland, Suffolk and Westchester)	Holtsville, NY	P O Box 1187 Newark, NJ	P O Box 162 Newark, NJ
New York (all other counties)	Andover, MA	P O Box 13757 Philadelphia, PA	P O Box 7350 Philadelphia, PA
North Carolina	Atlanta, GA	P O Box 105093 Atlanta, GA	P O Box 105900 Atlanta, GA
North Dakota	Ogden, UT	P O Box 60840 Los Angeles, CA	P O Box 54919 Los Angeles, CA
Ohio	Cincinnati, OH	P O Box 80101 Cincinnati, OH	P O Box 80102 Cincinnati, OH
Oklahoma	Kansas City, MO	P O Box 105017 Atlanta, GA	P O Box 105225 Atlanta, GA
Oregon	Fresno, CA	P O Box 970011 St. Louis, MO	P O Box 970006 St. Louis, MO
Pennsylvania	Philadelphia, PA	P O Box 80101 Cincinnati, OH	P O Box 80102 Cincinnati, OH

Rhode Island	Andover, MA	P O Box 13757 Philadelphia, PA	P O Box 7350 Philadelphia, PA
South Carolina	Atlanta, GA	P O Box 105093 Atlanta, GA	P O Box 105900 Atlanta, GA
South Dakota	Ogden, UT	P O Box 60840 Los Angeles, CA	P O Box 54919 Los Angeles, CA
Tennessee	Memphis, TN	P O Box 105017 Atlanta, GA	P O Box 105225 Atlanta, GA
Utah	Kansas City, MO	P O Box 660308 Dallas, TX	P O Box 660406 Dallas, TX
Texas	Austin, TX	P O Box 660308 Dallas, TX	P O Box 660406 Dallas, TX
Virginia	Memphis, TN	P O Box 105017 Atlanta, GA	P O Box 105225 Atlanta, GA
Vermont	Philadelphia, PA	P O Box 13757 Philadelphia, PA	P O Box 7350 Philadelphia, PA
Wisconsin	Kansas City, MO	P O Box 970011 St. Louis, MO	P O Box 970006 St. Louis, MO
Wyoming	Austin, TX	P O Box 660308 Dallas, TX	P O Box 660406 Dallas, TX
West Virginia	Atlanta, GA	P O Box 105093 Atlanta, GA	P O Box 105900 Atlanta, GA
Washington	Ogden, UT	P O Box 60840 Los Angeles, CA	P O Box 54919 Los Angeles, CA

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, D.C. 20224

September 4, 2002

Steve Nickles
Chair, Personnel and Organization Committee
IRS Oversight Board
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Mr. Nickles:

Thank you for the opportunity to provide comments on the changes to the Internal Revenue Service (IRS) programs identified in your July 2, 2002 e-mail to me.

As you know, the Information Reporting Program Advisory Committee (IRPAC) was established to bring together representatives from various industries affected by the IRS information reporting requirements. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies. IRPAC works closely with the IRS on information reporting issues of mutual concern to the payer community, taxpayers, and the Federal Government.

The following comments are based on responses we received from Members of the National Association of Enrolled Agents:

Employer Identification Number (EIN)

Although there seems to be a general improvement in the processing time required to receive an EIN, many practitioners reported lengthy delays in obtaining a number. More than a few practitioners reported difficulty in receiving a timely response to the Forms SS-4, Application for Employer Identification Number, submitted by fax to the IRS. Practitioners reported that EINs frequently are not provided over the phone or by fax, but rather by mail, resulting in further delays. Practitioners also expressed concern over the apparent disregard of the third party authorization on Form SS-4.

Practitioner Priority Services (PPS)

The level of service provided to practitioners using the PPS appears to vary greatly by region. Some practitioners reported that the system is working well, but others said it is an abysmal failure. IRS personnel staffing some calls do not appear to have

sufficient training or an understanding of the issues important to practitioners and their clients. Many practitioners prefer the old Practitioner Hotline that seemed to be more customer-oriented and reliable. In many instances, practitioners must contact a Taxpayer Advocate or make a Freedom of Information Act request in order to obtain a Master File Transcript of Account, which was previously obtainable through the Practitioner Hotline.

Centralized Authorization File (CAF)

Comments we received about the CAF were mixed, as well. While the limited experience practitioners have had with the CAF appears positive, many reported significant delays in getting a faxed power of attorney (POA) entered into the system. The IRS needs to standardize its procedures with respect to the processing of POAs. The lack of standardization has also created further delays and duplication of effort when practitioners are asked by the IRS to resubmit a POA.

Offer in Compromise Program (OIC)

Comments concerning the OIC were uniformly negative. The centralization of this program has compounded the already difficult process of obtaining timely resolutions. Offers also take so long to be approved that often times the taxpayer's financial condition has changed such that he or she no longer has the resources to execute the offer. In addition, practitioners report that the Bureau of Labor Standards statistics used by the Service to compute a taxpayer's maximum ability to pay are too arbitrary, resulting in inequity and unfairness.

K-1 Matching

Practitioners reported several problems with the K-1 matching program. Supplemental information reported on K-1 worksheets frequently is not taken into account by the IRS, creating a mismatch between the amount of income reported on the K-1 and the corresponding amount reported on the Form 1040. The matching program also does not consider depreciation when matching income or accommodate K-1's prepared on a fiscal year, rather than a calendar year, basis. Practitioners reported that standardization of the Form 1065 itself would significantly increase the ability of the IRS to match K-1 income to the 1040. In this regard, IRPAC is preparing recommendations on K-1 standardization for submission to the IRS later this year.

If you wish to discuss these comments further, please call Mary Javor, EA, at (313) 386-4840.

Sincerely,

Michael O'Neill
Chair, Information Reporting Program Advisory Committee

cc: Nancy Thoma, Director, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

WAGE & INVESTMENT SUBGROUP REPORT

DOROTHY ATCHISON
JAMES R. BURKLE
KAREN CARTER
CONNIE L. DAVIS, SUBGROUP CHAIR

NOVEMBER 8, 2002

INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE
WAGE & INVESTMENT
SUBGROUP REPORT

During 2002, the W&I Subgroup worked with IRS representatives from the various units on several information reporting issues of interest to the payroll and employment tax community. The projects included in this section were completed by the W&I Subgroup this year:

- **Letter** ***(Davis & Carter***) – A recommendation which initially urged that an employer be given more authority to see an employee's Social Security card evolved, through discussions with Chief Counsel, Penalty and Interest, and others, to become a recommendation that an employer be given access to the TIN Matching Program. Additionally, the letter encourages prompt release of "reasonable cause" guidelines for use by employers in avoiding or abating proposed penalties for reporting an incorrect name or Social Security Number on Form W-2.

- **Letter** ***(O'Neill)*** – A recommendation to develop a new Form W-4 for nonresident aliens, including specific instructions on how to complete the form.

- **Letter** ***(Atchison, Carter, & Davis)*** – A proposal that during the review and update of Form W-2, consideration be given to the need for additional room in Box twelve for more items as well as room for the reporting wage information for more states. Also, revision of Publication 1141 to consider the ramifications of the electronic delivery of forms W-2 to employees.

The W&I Subgroup continues to maintain a strong relationship with the Forms and Publications branch and regularly communicates suggestions and requests to enhance various publications, instructions, and forms.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 29, 2002

Doug Rogers
Director, Penalty Administration
Internal Revenue Service, Room 6422
1111 Constitution Avenue, NW
Washington, DC 20224

George Blaine
Deputy Assistant Chief Counsel
Internal Revenue Service, Room 4050
1111 Constitution Avenue, NW
Washington, DC 20224

Margaret Owens
Chief Counsel Attorney
Internal Revenue Service, Room 4050
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Forms W-2 Penalty Notices

Dear Mr. Rogers, Mr. Blaine, and Ms. Owens:

I am writing on behalf of the Information Reporting Program Advisory Committee ("IRPAC") to provide comments regarding penalty notices that will be sent to employers for name and Social Security Number ("SSN") mismatches reported on Forms W-2.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payor community, including major professional and trade associations, colleges and universities, and state taxing agencies.

According to announcements made by IRS staff at various industry conferences and meetings, penalties will be first assessed on Forms W-2 for tax-year 2002, with penalty notices to be sent to employers in June 2004. Penalty notices will also be issued for failure to file timely Forms W-2 and failure to meet proper media filing requirements.

The following comments are based on comments and communications from various sectors of the payer community, including the American Payroll Association ("APA") and the American Society for Payroll Management ("ASPM").

Need for Written Guidance from IRS as to "Reasonable Cause"

There is much confusion as to what will constitute "reasonable cause" and what will demonstrate "due diligence" for purposes of abating a penalty assessed because of an incorrect name or SSN reported on a Form W-2. While verbal interpretations have been helpful, employers need written guidance from the IRS setting forth the procedures for the avoidance or abatement of penalties. The IRS had previously indicated that such a document would be issued by July 2002, but, to our knowledge, it has not yet been produced. When this guidance is issued, IRPAC, as well as other stakeholder groups, would welcome the opportunity to comment before the rules are made final.

The guidance should address the following issues:

- That employer records containing valid paper or electronic Forms W-4 will satisfy reasonable cause for abatement of these penalties. The IRS has verbally responded affirmatively to this question.

- That for employees who never complete a Form W-4, because the employer uses other means of obtaining the name and SSN from its employee, such action will constitute reasonable cause. For example, a "New Employee Information Form" designed by an employer and completed with the employee's signature, or a secure information system accessible electronically by employees, using a sign-on and password, would satisfy reasonable cause. (This assumes that employees who do not complete a valid Form W-4 are subject to Federal income tax withholding according to a marital status of "single" and zero withholding allowances (Reg. Sec. 31.3402(f)(2)-1(a)).

- In instances where an employer has reason to believe that the name and/or SSN provided on Form W-4 is incorrect, the employer has the authority to withhold at "single and zero." Means by which the employer might learn that the information is incorrect include a no-match letter received from the Social Security Administration ("SSA"), a penalty notice from the IRS, and SSA's Social Security Number Verification Service ("SSNVS"). The IRS has affirmed this verbally.

  In instances where an employer has reason to believe that an SSN is inaccurate, the employer must ask the employee to provide a correct number by December 31 of the year in which the employer becomes aware of the inaccuracy, so that the correct number can be reported on that tax year's Form W-2. However, in instances where the employee does not provide a correct SSN, what actions will be required of the employer? For example, will the employer action to document the solicitation and refusal, and a formal request of the employee for a corrected number by December 31 every year be required until a corrected number is provided?

In this regard, the regulations provide for an initial solicitation for the correct name and SSN upon hire, another solicitation by the end of the year (or by January 31 of the following year if the employee was hired during December) if the employer knows that the information is missing or inaccurate, and one more solicitation in the following year, if the employer will have an information return requirement with regard to that employee. The regulations also state that "no more than two annual solicitations are required . . . in order for a filer to establish reasonable cause."

The regulations, therefore, impose a less burdensome requirement for solicitation of an employee's correct name and SSN than does the position suggested by the IRS.

The documentation of solicitation and refusal does not require a signature or any other cooperation on the part of the employee, according to prior IRS announcements. If a procedure that imposes a greater burden than the regulations is to be endorsed by the IRS, we strongly urge that it be documented and widely publicized before it is imposed on employers.

IRPAC believes that clarification of this issue will benefit the payer community.

- For employers that use the SSNVS, whether a system identification of no match would invalidate the reasonable cause treatment of an employer's receipt and maintenance of a valid, signed Form W-4 or other mechanism by which the employee's name and SSN are obtained.

Current Regulations for Forms 1099 Should Not Apply to Forms W-2

It has been suggested that the IRS will not issue new guidelines, but will rely on the existing regulations issued under Internal Revenue Code ("IRC") section 6721 for the filing and correction of information returns. IRPAC has the following concerns regarding the reliance on these regulations:

- De Minimis Waiver

  The regulations associated with IRC section 6721 require that all information returns, including Forms W-2 and 1099, be considered in the aggregate. "The number of returns to which the de minimis exception applies for any calendar year shall not exceed the greater of 10 or one-half of one percent of the *total number of all information returns* the filer is required to file during the year." (Reg. Sec. 301.6721-1(d)(2)) (emphasis added).

  By applying the regulation, an employer would be advantaged or disadvantaged, depending upon the number of information returns it files in addition to the Forms W-2. Thus, an employer's payroll office would be unable to calculate whether or not the number of erroneous returns is under the de minimis limit based solely on the forms that it files.

For example, an employer filing 1,000 Forms W-2 with errors on 15 has exceeded the de minimis limit of 10 returns, or one-half of one percent of the total of the W-2s (1,000 x .005 = 5). However, if the employer also files 3,000 Forms 1099, the de minimis limit increases to 20 (4,000 x .005). If the same employer made an error on more than five 1099s, it fails the de minimis exception (6 1099s + 15 W-2s = 21 incorrect information returns). For these reasons, we recommend that any de minimis waiver for Forms W-2 be calculated on the volume of Forms W-2 alone.

To complicate matters further, the de minimis waiver applies only to forms that have been corrected by August 1 of the originally required filing year: "The penalty . . . is not imposed for a de minimis number of failures to include correct information if the filer corrects such failures on or before August 1 of the year in which the required filing date occurs." (Reg. Sec. 301.6721-1(d)(1)) Basically, this stipulation will negate any possibility that employers may benefit from the de minimis waiver as (i) SSA will not have passed information to IRS by August 1, (ii) IRS will not have sent out Notices 972CG by August 1, and (iii) payers will not have reviewed the listed errors by August 1. Therefore, corrections will not meet the August 1 deadline and cannot be considered for purposes of the de minimis waiver.

Because of this timing problem, when Notices 972CG are issued that include proposed penalties for erroneously filed Forms W-2, the IRS must anticipate a high volume of inquiries and confusion as a new host of recipients (payroll administrators) are notified of the errors and brought into the review and correction process.

- Discrepancies Between Forms W-2 and 1099 Procedures

  Without modification, the existing procedures will cause confusion on the part of employers filing Forms W-2 since there are discrepancies between the procedures for collecting data for W-2 reporting vs. 1099 reporting. Some examples include:

  - Form W-9 is used to solicit the taxpayer identification number ("TIN") from a payee for 1099 reporting, yet an employer is required to solicit the SSN and name using Form W-4.

  - When a TIN is missing, the payor is instructed to begin backup withholding on reportable payments, yet wages reportable on a Form W-2 are not subject to backup withholding.

  - Incorrect TINs are those that cannot be found on the IRS files of employer identification numbers and SSNs. However, employers who are currently allowed to verify SSNs on the SSNVS are not allowed to use the IRS' TIN Matching Program.

Reports from the SSA Office of the Inspector General ("OIG")

The OIG has issued two reports addressing the issue of errors and irregularities in wage reporting that IRPAC feels should be considered before the IRS launches a penalty assessment program against all employers.

Patterns of Reporting Errors and Irregularities by 100 Employers with the Most Suspended Wage Items (A-03-98-31009) identifies the patterns of errors and irregularities for the 100 employers who had the most suspended wage items from 1993 through 1996. The report describes the growth of the Earnings Suspense File ("ESF") containing wage items (Forms W-2) that failed to match SSA's name and SSN records by an average of 5 million items and at least $17 million annually since 1990. A relatively small number of employers account for a disproportionate number of suspended wage items ($1/20^{th}$ of 1 percent of all employers in 1996, for example, accounted for 30 percent of all such items). The report found that the 100 employers with the most suspended Forms W-2 from 1993 to 1996 accounted for 5.4 percent of the total number of suspended wage items for the period.

The Social Security Administration's Earnings Suspense File Tactical Plan and Efforts to Reduce the File's Growth and Size (A-03-97-31003) evaluates and reviews the SSA's Earnings Suspense File ("ESF") Tactical Plan and reports the progress in reducing the file's growth and size. The report states that the SSA has "neither linked such information [in its employer wage data base] year-by-year to identify chronic problem employers nor aggressively targeted for corrective action the relatively small number of employers who have been responsible for a disproportionate share of the ESF for several years." The report emphasizes that projects intended to reduce the size of the ESF "require help from other federal agencies, especially the IRS."

IRPAC believes that focusing on the relatively small number of employers who account for a disproportionate number of errors and irregularities in wage reporting would be the most effective way to reduce the number of suspended wage items. Assessment of penalties on the vast number of employers who are essentially in compliance with wage reporting requirements will do far less to alleviate the problem. The IRS should assist the SSA and other agencies to aggressively target the most egregious employers.

Identifying Accurate Data from the Beginning

The IRS TIN Matching Program should be made available to employers at the time a job offer is being prepared, so that employers may have a tool that would give them the ability to take proactive steps to avoid a penalty from occurring, and, just as importantly, to confirm accurate data before the tax reporting step is taken, thereby preventing the need for any corrective action on the part of employers, the IRS, and the SSA.

If you wish to discuss these comments further, please contact Karen Carter at (615) 595-7763.

Sincerely,

Michael O'Neill
Chair, IRPAC

cc: Nancy Thoma, Branch Chief, National Public Liaison

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 22, 2002

Laurie Hatten-Boyd
Office of the Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Separate Form W-4 for Nonresident Alien Employees

Dear Ms. Hatten-Boyd:

On behalf of the Information Reporting Program Advisory Committee ("IRPAC"), I am writing to recommend that the Internal Revenue Service ("IRS") publish a separate Form W-4, Employee's Withholding Allowance Certificate, for use by nonresident alien employees. Attachment 1 contains a copy of a proposed "Form W-4NR" and instructions prepared by IRPAC for your review.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

As you know, special rules apply to nonresident alien employees when completing Form W-4 since the number of personal allowances a nonresident alien may claim is limited and a nonresident alien is not allowed to claim the standard deduction when completing his or her tax return. These rules are set forth in Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Corporation, which directs nonresident aliens to use the following special instructions in completing the Form W-4 *instead* of the instructions on the form itself:

- Indicate single marital status on line 3, regardless of actual marital status.

- Claim only one personal allowance on line 5 unless a resident of Canada, Mexico, Japan, South Korea, or a U.S. national (i.e., a citizen of America Samoa or a Northern Mariana Islander who chose to become a U.S. national).

- Request an additional tax of $7.60 per week be withheld on line 6, depending on the individual's payroll period, e.g., if the pay period is biweekly, an additional $15.30 must be withheld.

- Do not claim exempt withholding status on line 7 (a Form 8233 must be completed for this purpose).

Special withholding rules also apply to students and business apprentices from India who are eligible for benefits under the tax treaty between the United States and India.

IRPAC believes that the publication of a separate Form W-4NR and instructions would significantly increase the awareness of both employers and nonresident alien employees about the unique and complex withholding rules applicable to non-citizens temporarily working in the U.S. In addition, a new form would reduce taxpayer burden by consolidating crucial nonresident alien withholding information in one document. A separate form dedicated to nonresident alien employees would also improve compliance by preventing such employees from claiming an excessive number of withholding allowances.

Last year, at the request of IRPAC, the American Payroll Association conducted an informal survey of its members on the need for a separate Form W-4 for nonresident aliens. Over 30 responses to the survey were received, which are detailed in Attachment 2. Nearly half of the responses were from for-profit employers, with the remainder from university, non-profit, and governmental employers. The number of nonresident aliens hired by the for-profit employers ranged from as few as 3 to over 600. These individuals were present in the U.S. under a number of visa categories, including E-1, F-1, J-1, H-1B, and O-1. The comments received from the survey participants were very supportive of the need for a Form W-4NR.

I understand that your office, in coordination with Steve Becker in Forms and Publications, will be undertaking a review of all of the forms that affect nonresident aliens. IRPAC would welcome the opportunity to assist the IRS in this important effort and hopes that you will seriously consider the publication of our proposed Form W-4NR.

Please call me at (510) 987-0905 if you need any additional information concerning this matter.

Sincerely,

Michael O'Neill
Chair, IRPAC

Attachments

cc: Nancy Thoma, Branch Chief, National Public Liaison
Steve Becker, Forms and Publications

Form W-4NR (2002)

Purpose: If you are a nonresident alien complete Form W-4NR so your employer can withhold the correct Federal income tax from your pay. Whenever your personal income tax withholding status changes, you should submit a new form. Since the tax withholding requirements for nonresident aliens are different than those for U.S. citizens and resident aliens, it is essential to establish your residency status with your employer prior to completing this form. Additional information regarding the completion of this form is contained in the General Instructions.

Personal Allowances Worksheet (keep for your records)

A.	Enter "0" or "1" for yourself.	A _____
B.	If you are a resident of Canada, Mexico, Japan, or South Korea, or a U.S. national (i.e., a citizen of America Samoa or a Northern Mariana Islander who chose to become a U.S. national) you may claim an allowance for your spouse and each dependent.	B _____
C.	If you are a student or an business apprentice who is eligible for the benefits of Article 21(2) of the United States-India Income Tax Treaty, you may claim additional withholding allowances on line C for the standard deduction and your spouse. In addition, you can claim an additional withholding allowance for each dependent who has become a resident alien. Furthermore, you do not have to request additional withholding tax on line 6 below.	C _____
D.	Add lines A through C and enter total here.	D _____

..... **Cut here and give Form W-4NR to your employer. Keep the top part for your records.** .....

Form **W-4NR** Department of the Treasury Internal Revenue Service	**Employee's Withholding Allowance Certificate** For Privacy Act and Paperwork Reduction Act Notice, see page 2.	OMB No. XXXX-XXXX **2002**

1. NAME (Last, First, Middle)	2. Social Security Number
Home Address (number and street or rural route)	3. ☐ Single (Nonresident aliens may only claim "Single" marital status.)
City or town, state, and zip code	4. **If your last name differs from that on your social security card, check here and call 1-800-772-1231 for a new card.** ▶ ☐

5. Total number of allowances you are claiming (from line D above. | 5. |

6. Nonresident aliens must request an additional tax be withheld from their pay. (See General Instructions for Additional Tax Withholding chart.)

6.	$

Under penalties of perjury, I certify that I am entitled to the number of withholding allowances claimed on this certificate.

Employee's signature ▶ _____ Date ▶ _____
(This form is not valid unless you sign it.)

7. Employer's name and address (Employer: Complete lines 7, 8 and 9 only if sending to the IRS.)	8. Office Code (optional)	9. Employer identification number

General Instructions

Complete Form W-4NR so your employer can withhold the correct Federal income tax from your pay.

The Internal Revenue Code restricts a nonresident alien's filing status, limits the number of allowable exemptions, and requires additional tax to be withheld from wage payments because a nonresident alien cannot claim the standard deduction. Refer to IRS Publication 515, Withholding of Tax on Nonresident Aliens and Foreign Corporations, for more information.

Whenever your personal income tax withholding status changes, you should submit a new form to your employer.

Who May Use This Form

This form is intended for use by nonresident alien individuals who are employed in the U.S.

Any individual who is not a citizen or resident of the United States is a nonresident alien. An alien individual meeting either the "green card test" or the "substantial presence test" for the calendar year is a resident alien for tax purposes. Any person not meeting either test is a nonresident alien for tax purposes.

To insure that the proper amount of Federal tax is withheld. It is essential to establish your residency status with your employer prior to completion of this form.

A resident alien should complete the Form W-4.

For more information on resident and nonresident alien status, the tests for residence (including the substantial presence test), see Publication 519, U.S. Tax Guide for Aliens.

You can get Publication 519 by calling 1-800-TAX-FORM (1-800-829-3676).

Specific Instructions for Form W-4NR

The following instructions are for those items that are not self-explanatory:

1. Nonresident aliens may only claim "Single" marital status on line 3 (regardless of your actual marital status).
2. Claim "0" (zero) or "1" withholding allowance on line A.
3. If you are a resident of Canada, Mexico, Japan, or South Korea, or a U.S. national (i.e., a citizen of America Samoa or a Northern Mariana Islander who chose to become a U.S. national) you may claim an allowance for your spouse and each dependent on line B.

Please note that nonresident aliens cannot claim "Exempt" withholding status. (See Tax Treaties below.)

Students and business apprentices from India

If you are a student or an business apprentice who is eligible for the benefits of Article 21(2) of the United States-India Income Tax Treaty, you can claim additional withholding allowances on line C for the standard deduction and your spouse. In addition, you can claim an additional withholding allowance for each dependent who has become a resident alien.

Furthermore, you will not have the additional withholding tax taken from your pay.

Enter the total number of Allowances on line D.

Additional Tax Withholding

An additional tax of $7.60 per week will be withheld from your pay based on your payroll period. (See the chart below):

Payroll Period	***Additional Withholding Tax***
Weekly	7.60
Biweekly	15.30
Semimonthly	16.60
Monthly	33.10

Enter the additional tax on line 6.

Tax Treaties

The U.S. has income tax treaties with a number of foreign countries under which teachers, researchers, professors, trainees, and scholar-ship recipients of those countries are exempt from Federal tax on income received from teaching and research activities. If you are eligible to claim tax treaty benefits you must give your employer a Form 8233 and a tax treaty statement to obtain these benefits.

For more information on U.S. tax treaties see Publication 901, U.S. Tax Treaties.

You can get Publication 901 by calling 1-800-TAX-FORM (1-800-829-3676).

Privacy Act and Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. The Internal Revenue Code requires this information under sections 3402(f)(2)(A) and 6109 and their regulations. **Failure to provide a properly completed form will result in your being treated as a single person who claims no withholding allowances; providing fraudulent information may also subject you to penalties.** Routine use of this information include giving it to the Department of Justice for civil and criminal litigation, to cities, states, and the District of Columbia for use in administering their tax laws, and using it in the National Directory of New Hires.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.

The time needed to complete this form will vary depending on individual circumstances. The estimated average time is **Recordkeeping,** 46 min.; **Learning about the law or the form,** 13 min.; **Preparing the form,** 59 min. If you have comments concerning the accuracy of these estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Tax Forms Committee, Western Area Distribution Center, Rancho Cordova, CA 95743-0001. **Do not** send the tax form to this address. Instead, give it to your employer.

American Payroll Association
Nonresident Alien Survey

Questions:
1. Type of employer
2. Number of nonresident aliens on the payroll
3. Type of worker and visa status

Employer	*NRA Employees*	*Type of Worker*	*Visa Status*
Government			
01. Government	4	Engineer and Computer Technology	H-1B and J-1
Non Profit			
01. Non Profit	20	Engineers	F-1
02. Non Profit	9 to 40	Student Employees	F-1
03. Non Profit	5 to 10	Scientists and Animal Care Professionals	H-1B and J-1
04. Non Profit	25		E-1
05. Non Profit	1 to 5	Musicians	F-1 and J-1
Profit			
01. Profit	6 to 10	Technical and Professional	F-1 and J-1
02. Profit	643		E-1, F-1, H-1B, J-1, and O-1
03. Profit	42		F-1
04. Profit	5	Interns	F-1
05. Profit	8	Scientists, Specialists and Product Manager	F-1 and H-1-B
06. Profit	40 to 60		F-1, J-1, and H-1B
07. Profit	50 to 100	Information Systems	F-1, J-1 and H-1B
08. Profit	20		F-1, J-1 H-1B
09. Profit	200	Grocery Clerks	J-1
10. Profit	3	Technical and Computer Specialist	H-1B
11. Profit	6	Information System	H-1B
12. Profit	10	Student Employees and Trainees	F-1 and J-1
13. Profit	8	Training	F-1
14. Profit	3		F-1 and H-1B

American Payroll Association
Nonresident Alien Survey

Employer	*NRA Employees*	*Type of Worker*	*Visa Status*
University			
01. University	20	Student Employees and Faculty	F-1
02. University	2000		
03. University	750	Student Workers and Visiting Professors	F-1 and J-1
04. University	120		H-1B
05. University	75-100	Student Employees	F-1 and J-1
06. University	1200 to 1500	Teaching or Research Assistants	F-1, J-1 and H-1B
07. University	1000	Teaching, Research Assistants Post Graduate Researchers and Post Doctoral Fellows	F-1, H-1B, J-1, O-1and TN
08. University	35	Student Employees	F-1 and J-1
09. University	25		E-1
10. University	93		F-1and J-1
11. University	6		F-1 and J-1
12. University	9	Student Employees	F-1 and J-1

American Payroll Association
Nonresident Alien Survey

Visa Status	Definition
E-1	Treaty Trader
F-1	Student Visa
J-1	Exchange Visitor or Student
H-1B	Alien in Specialty Occupation
O-1	Alien with extraordinary ability in sciences, arts, education, business or athletics
TN	NAFTA Professional

Unedited Comments

- There are many IRS forms serving the specific needs of a narrowly defined group of taxpayers, and it's hypocritical to preach taxpayer education and voluntary compliance while resisting development of a basic and highly beneficial compliance tool. My take on the issue is that until a separate W-4 is developed (and made mandatory) many employers will not even be aware of the fact that there are restrictions for the NRAs. We have 6, which doesn't sound like a lot but each is from a different country which have different W4 requirements. I would love to see something more user friendly.

- We are a public utility, with regulated and non-regulated business areas with an average of six to ten nonresident aliens. Most are here with a student visa (F-1) or (J-1). They include technical IT (computer related), professional (engineering or business administration) etc. In the past we only had one or two at a time, but the trend seems to be on the up side. I think it would be a good idea to have a separate W-4 dedicated to non-resident aliens with instructions since there are some restrictions on completing the form. I recently had a meeting with our HR department to educate them on what a non-resident alien may claim on a W-4 and also what is needed to be exempt from FICA and Medicare.

- This area is so complex and completing W-4 forms in general even for US citizens is difficult, let alone trying to assist foreign nationals in the process.

- We are a University and we would love to see a W-4NR. We have 750 nonresidents on Payroll. Most of them are on F visa's and are either Graduate or Undergraduate Students. We have quite a few visiting professors and others on various visas. I just hired 27 high school students for a summer program, 2 of them were on F-1 visas and almost half are resident aliens. We have an employee in our Service Center whose full time job is working on all of the paperwork for aliens.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

1111 Constitution Avenue, NW, Room 7557, Washington, DC 20224

October 29, 2002

Denise Fayne
Acting Director
Tax Forms and Publications
W:CAR:MP:FR
IR/6460
1111 Constitution Ave.
Washington, DC 20224

Re: Redesign of Forms W-2 and W-3 and Revisions to Publication 1141

Dear Ms. Fayne:

I am writing on behalf of the Information Reporting Program Advisory Committee ("IRPAC") to provide you with these comments regarding revisions to Forms W-2 and W-3 and Publication 1141, General Rules and Specifications for Substitute Forms W-2 and W-3.

IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the Internal Revenue Service ("IRS") to provide recommendations on a range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

Redesign of Forms W-2 and W-3

IRPAC recommends that box 12 of the Form W-2 be expanded to accommodate more than four items. Many employers require more than four spaces to report items in this box, which necessitates issuing additional Forms W-2 to individual employees. Also, we recommend that more state lines be added at the bottom of the form, since currently there is only room to report applicable wages and taxes for two states. In today's mobile economy, employees frequently change jobs and may be subject to taxation in multiple states during the tax year.

Additionally, we recommend that when the Form W-3 is next revised, blank boxes be added that may be used by employers to recap those items in box 14 that are for employers' use. Employers typically use the W-3 as a recap for their internal use and therefore need to sum all boxes on the form.

Revision of Publication 1141

With the recent publication of temporary regulations under Internal Revenue Code sections 6041 and 6045 relating to the electronic delivery of Forms W-2 to employees, several requirements specified in Publication 1141 are beyond an employer's control when the employer is not printing and mailing paper W-2s to its employees.

The following are examples of specific requirements set forth in Rev. Proc. 2002-53 (which will be reprinted as the next revision of Publication 1141), Part B, Specifications for Substitute Forms W-2 and W-3, Section 2, Requirements for Substitute Forms Furnished to Employees (Copies B, C and 2 of Form W-2):

01. All employers (including those who file on magnetic media or electronically) must furnish employees with at least two copies of Form W-2 (three or more for employees required to file a state, city, or local income tax return).

04. The paper for all copies must be **white**. The substitute Form W-2 (Copy B), which employees are instructed to attach to their Federal income tax return, must be at least 12-pound paper (basis 17 x 22-500). The other copies furnished to the employee must be at least 9-pound paper (basis 17-22-500).

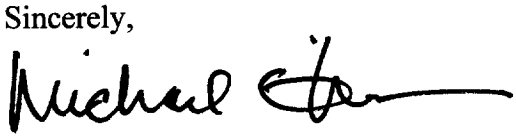
05. Employee copies of Forms W-2 (Copies B, C, and 2), including those that are printed on a single sheet of paper, must be easily separated. Including perforations between individual copies satisfies this requirement, but using scissors to separate Copies B, C, and 2 does not.

11. The tax year (2002) must be clearly printed in **nonreflective black ink** on all copies of substitute Forms W-2.

In the electronic delivery setting, employers have no control over how many copies of the Form W-2 an employee may print, the color or quality of the paper on which an employee chooses to print, or the type of ink used. IRPAC recommends, therefore, that Publication 1141 be revised to exclude electronically delivered Forms W-2 from these paper-based requirements.

If you wish to discuss these comments further, please contact Connie Davis at 972-239-8881 x 116.

Sincerely,



Michael O'Neill
Chair, IRPAC

cc: Nancy Thoma, Branch Chief, National Public Liaison