

Part III

Administrative, Procedural, and Miscellaneous

Effective Date of Regulations Under Section 1441 and Qualified Intermediary Procedures.

Notice 99-25

The Department of the Treasury (Treasury) and the Internal Revenue Service (IRS) intend to extend the date of applicability of the regulations under section 1441 and related provisions to payments made after December 31, 2000. The reasons for this delay and its consequences are explained in this notice.

Section 1. Background

In Treasury Decision 8734 (62 FR 53387), as modified by T.D. 8804 (63 FR 72183) (the “new withholding regulations”) the Department of the Treasury and the Internal Revenue Service issued comprehensive regulations under chapter 3 (sections 1441-1464) and subpart G of subchapter A of chapter 61 (sections 6041-6050S) of the Internal Revenue Code (the “Code”). Qualified intermediaries are a key component of those regulations. A qualified intermediary is a foreign entity, or foreign branch of a U.S. entity, that obtains the benefit of establishing the foreign status of its account holders, and their entitlement to reduced rates of withholding, by using a single withholding certificate rather than having to provide documentation for each customer to a U.S. withholding agent. In addition, the qualified intermediary can report most of

its payments to the IRS on a pooled basis, rather than having to provide a Form 1042-S for each of its foreign account holders or investors. In exchange for these benefits, the qualified intermediary assumes certain compliance and information reporting responsibilities.

To be a qualified intermediary, an entity must enter an agreement with the IRS. The IRS has provided information on qualified intermediary agreements first in Rev. Proc. 98-27, 1998-15 I.R.B. 30, and Notice 98-16, 1998-15 I.R.B. 12, and subsequently in Notice 99-8, 1999-5 I.R.B. 26. The final provisions of qualified intermediary agreements have not yet been determined. Notice 99-8 also announced certain changes that Treasury and IRS are proposing to make to T.D. 8734.

Section 2. Delayed Effective Date

Commentators to Notice 99-8 stated that financial institutions are involved in substantial information systems changes that are required for their systems to become year 2000 compliant. To meet their objectives, financial institutions are imposing restrictions on systems changes to ensure a smooth year 2000 transition.

Commentators also indicated that certain aspects of the qualified intermediary regime were not apparent to some financial institutions when the new withholding regulations were first issued and that implementation of the regulations would require more time and effort from many institutions than had initially been expected. Further, because the terms of the qualified intermediary agreements have not been finalized, potential qualified intermediaries are not yet certain of all of their documentation, withholding, and reporting obligations. Therefore, commentators have stated that full compliance

with the regulations cannot be achieved if the 1441 regulations become effective on January 1, 2000.

Treasury and the IRS have concluded that it is in the best interest of tax administration to extend the date of applicability of the final withholding regulations to permit taxpayers to make the computer system modifications necessary to comply with the new withholding regulations without the impediments caused by year 2000 concerns. Therefore, T.D. 8734, as modified by T.D. 8804, will be amended to apply to payments made after December 31, 2000.

In Notice 98-16, the IRS stated that it would regard the 1999 calendar year as a transition period in enforcing compliance for the administration of the withholding tax system. The year 2000 will similarly be regarded as a transition period. Accordingly, in enforcing compliance with current withholding rules for calendar years 1999 and 2000, the IRS will take into account the extent to which a withholding agent makes a good faith effort to transform its business practices and information systems to comply with the final withholding regulations. For example, the IRS will take into account whether a U.S. withholding agent makes reasonable efforts during 1999 and 2000 to modify its account opening practices to conform to the new documentation requirements, obtain new withholding certificates on existing accounts, and make appropriate systems changes to comply with the final withholding regulations. For foreign withholding agents, the IRS will take into account whether or not the withholding agent makes a good faith effort to seek qualified intermediary status. The IRS will also take into account whether or not a withholding agent (whether U.S. or foreign)

effectively implements the final withholding regulations beginning on January 1, 2001.

Section 3. Documentation Transition Rules

The new withholding regulations contain transition rules affecting the documentation that must be obtained under the new withholding regulations. See, for example, §§1.1441-1(f)(2)(i), 1.1441-4(g), 1.1441-5(g), and 1.1441-6(g). Those documentation transition rules generally permit the use of Forms W-8, 1001, 1078, 4224, and 8709, or a statement under current regulation §1.1441-5 (“old documentation”) until December 31, 2000. The new withholding regulations will not extend the use of old documentation beyond December 31, 2000. An extension is not necessary because Forms W-8BEN, W-8ECI, and W-8EXP (“new withholding certificates”) which replace the old documentation, and which comply with the new withholding regulations, have been available since the end of 1998. Therefore, withholding agents will have had over two years to replace old documentation with new withholding certificates. The regulations incorporating the effective date change will continue to treat new withholding certificates as satisfying the documentation requirements of the regulations in effect prior to January 1, 2001.

The final regulations concerning certain payments made pursuant to a securities lending or sale-repurchase transaction provide that substitute interest payments made with respect to securities that give rise to U.S. source interest income may be characterized as portfolio interest if the transferor of the security complies with the documentation requirements of §1.871-14(c) of the final withholding regulations. Because §1.871-14(c) of the final withholding regulations was not to be effective before

January 1, 1999, Notice 97-66 contained a transition rule providing that the statement requirement of section 871(h)(5) would be satisfied with respect to substitute interest payments made after November 13, 1997, and before January 1, 1999, if any written, electronic, or oral statement that reasonably establishes that the payee is a foreign person is given or made to the payor before, or within a reasonable period after, the payment. In Notice 98-16, the IRS extended the transition rule of Notice 97-66 to apply to substitute interest payments made after November 13, 1997 (or after December 31, 1998 if elected) and before January 1, 2000. Because the IRS intends to make §1.871-14(c) of the new withholding regulations effective for payments made after December 31, 2000, as announced herein, the transition rule in Notice 97-66 is extended to apply to substitute interest payments made after November 13, 1997 (or after December 31, 1998, if elected) and before January 1, 2001. Without this extension, withholding agents would be limited to using Form W-8 or Form W-8BEN to apply the portfolio interest exemption. The remainder of Notice 97-66 remains unchanged.

Finally, in Announcement 99-24, 1999-14 I.R.B. 12, the IRS asked for comments on proposed changes to Form 1042-S that would be effective for forms to be filed in 2001. Because of the delay in the effective date of T.D. 8734, the suggested changes set forth in Announcement 99-24 are now proposed to apply to Forms 1042-S filed in 2002. The 2000 Form 1042-S will remain the same size and format as the 1999 forms. The 1999 form may, however, be revised to reflect changes in the law.

Section 4. Contact Information

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