

Part III. Administrative, Procedural, and Miscellaneous

Effective Date of Regulations Under Section 1441 and Qualified Intermediary Procedures

Notice 98-16

Section 1. Scope

This notice announces that the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “IRS”) will extend the effective date of the section 1441 withholding regulations. As extended, those regulations will apply to certain payments made to foreign persons after December 31, 1999. This notice also provides new transition rules for satisfying the withholding certificate or statement requirements under the withholding regulations. Finally, this notice describes the general procedure the IRS will follow in entering into qualified intermediary withholding agreements in order to expedite the process of making such agreements as widely available as possible.

Section 2. Background

On October 14, 1997, final Income Tax Regulations (the “final withholding regulations”) substantially revising and replacing existing regulations regarding the withholding of tax under chapter 3 (sections 1441-1464) of the Internal Revenue Code (the “Code”) were published in the Federal Register as T.D. 8734. Those regulations also significantly revise existing information reporting and backup withholding regulations under chapter 61 and section 3406 of the Code. As promulgated, the final withholding regulations will apply to all payments made after December 31, 1998.

Section 3. Extended Effective Date

Treasury and the IRS will amend the final withholding regulations to extend the date of applicability of those regulations to payments made after December 31, 1999. Treasury and the IRS recognize that the final withholding regulations contain substantial changes to existing rules and will likely require significant changes to business practices and information systems for many U.S. and foreign withhold-

ing agents. These changes come at a time when many of these entities are also attempting to make significant changes to business practices and information systems to conform to the Year 2000 date change and the European Monetary Union currency conversion.

Treasury and the IRS also must ensure that qualified intermediary withholding agreements are available to as many financial intermediaries as possible for the final withholding regulations to be effectively implemented. As described more fully below, Treasury and the IRS expect that the process for making qualified intermediary withholding agreements widely available will take several months from the date the process begins.

Accordingly, Treasury and the IRS believe it is in the best interest of tax administration to extend the date of applicability of the final withholding regulations to ensure that both taxpayers and the government can complete the changes necessary to implement the new withholding regime. As extended by this notice, the final withholding regulations will apply to payments made after December 31, 1999.

In addition, the IRS will regard the 1999 calendar year as a transition period for the administration of the withholding tax system. Accordingly, in enforcing compliance with current withholding rules for calendar year 1999, the IRS will take into account the extent to which a withholding agent makes a good faith effort during that period 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 to modify its account opening practices to conform to the new documentation requirements, obtain new documentation on existing accounts when new withholding certificates become available, and make appropriate systems changes to comply with the final withholding regulations and, if appropriate, Rev. Proc. 98-27 (relating to qualified intermediary withholding agreements). For foreign withholding agents, the IRS will also take into account whether or not the withholding agent makes an 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, 2000.

Section 4. Modified Transition Rules

The final withholding regulations provide transition rules for obtaining new withholding certificates and statements containing the necessary information and representations required by those regulations. The IRS released and requested public comments on draft new withholding certificates in Announcement 98-15, published in 1998-10 I.R.B. 36. The new withholding certificates would replace current Forms W-8, 1001, 4224, 8709, and 1078, and statements described in §1.1441-5 of the regulations in effect before January 1, 1999 (the “existing certificates or statements”).

Generally, under the transition rules contained in the final withholding regulations, a withholding agent holding a valid existing certificate or statement on December 31, 1998, may treat that certificate or statement as valid until the earlier of its expiration or December 31, 1999. In addition, the transition rules provide that any existing withholding certificate or statement that is valid on January 1, 1998, and that expires during 1998, remains valid until December 31, 1998. (These rules cannot operate together, however, to extend beyond December 31, 1998, the validity of a certificate that, without the transition rule, would expire in 1998.)

The IRS intends to modify the withholding certificate and statement transition rules of the final withholding regulations to provide that a withholding agent holding a valid existing certificate or statement on December 31, 1999, may treat that certificate or statement as valid until the earlier of its expiration or December 31, 2000. No existing certificates or statements will be effective after December 31, 2000. As under the final regulations, existing certificates and statements that expire in 1999 will not be effective after expiration. The existing transition rule providing that any existing withholding certificate or statement that is valid on January 1, 1998, and that expires during 1998 remains valid until Decem-

ber 31, 1998, will be retained. This rule should ensure that withholding agents will be able to replace existing withholding certificates or statements that expire in 1998 with new certificates that will be valid under the final withholding regulations when those regulations take effect. The IRS anticipates that new withholding certificates will be available before December 31, 1998.

New withholding certificates that are valid under the final withholding regulations will be deemed to satisfy the requirements under the regulations in effect before January 1, 2000, to obtain Forms W-8, 1001, 4224, 8709, or a statement under section 1.1441-5. Therefore, in situations where existing certificates and statements are not outstanding, or new certificates or statements must be obtained because of a change in circumstances, a withholding agent may obtain new withholding certificates. New withholding certificates will be valid for the period specified in section 1.1441-1(e)(4)(ii) of the final withholding regulations, regardless of when they are obtained.

Notice 97-66 (1997-48 I.R.B. 1) provides a related transition rule that is affected by the extended effective date of the final withholding regulations. Notice 97-66 relates to final Income Tax Regulations on the source and character of substitute interest and dividend payments published in the **Federal Register** on October 14, 1997 as T.D. 8735 (the "final substitute payment regulations"). The notice provides guidance on complying with the statement requirement of section 871(h)(5) for substitute interest payments made after November 13, 1997, or, if an election is made under section 6 of the notice, for substitute interest payments made after December 31, 1998. Substitute interest payments made by a foreign person that are U.S. source interest must satisfy the statement requirement of section 871(h)(5) to qualify as portfolio interest.

The final substitute payment regulations referred taxpayers to §1.871-14(c) of the final withholding regulations for guidance on the statement requirement of section 871(h)(5). Because §1.871-14(c) of the final withholding regulations was not to be effective before January 1, 1999, however, Notice 97-66 provides a transition rule providing that the statement re-

quirement of section 871(h)(5) will 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.

Because the IRS intends to make §1.871-14(c) of the final withholding regulations effective for payments made after December 31, 1999, 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, 2000. The remainder of Notice 97-66 remains unchanged.

On January 26, 1998, a notice of proposed rulemaking (REG-209322-82) was published in the **Federal Register** that would amend regulations under sections 6031 and 6063 regarding the filing of returns of partnership income (a "partnership return"). Under §1.6031(a)-1(b)(2) of the proposed regulations, a partnership return is not required of a foreign partnership if it meets certain conditions and Forms 1042 and 1042-S are filed under §1.1461-1(b) and (c), as amended by the final withholding regulations, either by the partnership or by another withholding agent (or agents). The proposed date of applicability for the exception is taxable years of a partnership that begin on or after January 1, 1999. If §1.6031(a)-1(b)(2) is finalized, Treasury and IRS intend to amend the date of applicability for that section to reflect the extended date of applicability of §1.1461-1(b) and (c) of the final withholding regulations.

Section 5. Qualified Intermediary Procedures

As indicated above, for the final withholding regulations to be most effectively implemented, it is desirable for qualified intermediary withholding agreements to be available to as many foreign financial intermediaries as possible. A qualified intermediary is a foreign person, or a foreign branch of a U.S. person, that agrees with the IRS in a qualified intermediary withholding agreement to collect information regarding its account holders and to make that information available as may be required under the agreement. It is an-

anticipated that the qualified intermediary regime will reduce the collection of information and reporting required of withholding agents under the current rules.

Simultaneously with this notice, Treasury and the IRS are releasing Revenue Procedure 98-27, which provides guidance on entering into a qualified intermediary withholding agreement with the IRS. Although the revenue procedure is designed to provide specific guidance on the application process for persons described in §1.1441-1(e)(5)(ii)(A) and (B) (i.e., foreign financial institutions, foreign clearing organizations, and foreign branches of U.S. financial institutions and U.S. clearing organizations), any person desiring a qualified intermediary withholding agreement may submit a draft agreement in the general manner described in the revenue procedure.

This notice announces that, although any person is permitted to apply for and negotiate an individual qualified intermediary withholding agreement with the IRS, the IRS intends to issue a series of model agreements of broad applicability to make qualified withholding agreements as widely available as possible. It is contemplated that, upon release of one of these model agreements, any person falling within the class of persons covered by the model agreement would be able to accept, sign, and submit the agreement to the IRS, without the need for individual negotiations. The IRS currently contemplates that each model agreement will be specific to a particular country, or group of countries with similar laws and practices, and will be specific to a class of persons conducting similar intermediary businesses in a similar manner. Such an approach enables each model agreement to cover as broad a class of persons as possible, while allowing uniform application of all material provisions among all persons in the identified class.

Because of its intent to issue a series of model agreements of broad applicability, the IRS invites submissions of proposed model agreements by groups or associations of potential qualified intermediaries. As part of the submission, the IRS requests a description of the class of persons the proposed model agreement is intended to cover and why that class of persons could operate under a single model agreement.

In the interest of ensuring that as many financial intermediaries as possible can become qualified intermediaries well in advance of the effective date of the final withholding regulations, the IRS intends to give submissions of proposed model agreements of broad applicability first consideration. Consequently, except in unusual circumstances, proposed agreements by individual intermediaries, while also invited, will not likely lead to negotiations with the IRS until sufficient progress has been made in the process of issuing model agreements. Moreover, persons who are clearly within a class of persons covered by an existing model agreement will not be permitted to negotiate an individual agreement absent unusual circumstances.

The IRS currently contemplates releasing a group of model agreements simultaneously, rather than issuing them one-by-one, and expects that this release will occur before December 31, 1998. Additional model agreements and individual agreements may be issued after that first release of model agreements. Due to time constraints, however, groups or associations of intermediaries desiring to submit a proposed model agreement on behalf of a class of persons should make such a submission on or before July 3, 1998, to ensure that such model agreement can be released and individual agreements can be concluded prior to December 31, 1998.

Persons submitting proposed model agreements are advised that these submissions will be made available to the public.

Section 6. Contact Information

The principal author of this Notice is Carl Cooper of the Office of the Associate Chief Counsel (International) within the Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. For further information regarding this Notice contact Mr. Cooper at 202-622-3840 (not a toll-free call).

Extension of the Effective Date of the Classification Settlement Program

Notice 98-21

The Internal Revenue Service is extending the Classification Settlement Pro-

gram or "CSP" until further notice. The CSP is an optional settlement program that allows businesses and tax examiners to resolve worker classification cases as early in the administrative process as possible, thereby reducing taxpayer burden. In the CSP, examiners can offer a business under audit a worker classification settlement using a standard closing agreement developed for this purpose. The CSP procedures also ensure that the taxpayer relief provisions under section 530 of the Revenue Act of 1978 are properly applied.

The Service implemented the CSP in March 1996 on a two-year trial basis. Review of the program and feedback from the public have indicated that the program is successful in facilitating early resolution of cases.

Taxpayer participation in the CSP is entirely voluntary. A taxpayer declining to accept a settlement offer retains all rights to administrative appeal that exist under the Service's current IRS procedures and all existing rights to judicial review.

DRAFTING INFORMATION

The principal author of this notice is Greg Christensen of the Office of Employment Tax Administration and Compliance. For further information regarding this notice, please contact Mr. Christensen at 202-622-3650 (not a toll-free number).

26 CFR 601.201: Rulings and determination letters.

(Also Part I, Sections 25, 103, 143; 1.25-4T, 1.103-1, 6a.103A-2.)

Rev. Proc. 98-28

SECTION 1. PURPOSE

This revenue procedure provides guidance concerning the United States and area median gross income figures that are to be used by issuers of qualified mortgage bonds, as defined in § 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in § 25(c), in computing the housing cost/income ratio described in § 143(f)(5).

SECTION 2. BACKGROUND

.01 Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or

local bond. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond that is not a "qualified bond" within the meaning of § 141. Section 141(e) provides that the term "qualified bond" includes any private activity bond that (1) is a qualified mortgage bond, (2) meets the volume cap requirements under § 146, and (3) meets the applicable requirements under § 147.

.02 Section 143(a)(1) provides that the term "qualified mortgage bond" means a bond that is issued as part of a "qualified mortgage issue". Section 143(a)(2)(A) provides that the term "qualified mortgage issue" means an issue of one or more bonds by a state or political subdivision thereof, but only if (i) all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences; (ii) the issue meets the requirements of subsections (c),(d),(e),(f),(g), (h),(i), and (m)(7) of § 143; (iii) the issue does not meet the private business tests of paragraphs (1) and (2) of § 141(b); and (iv) with respect to amounts received more than 10 years after the date of issuance, repayments of \$250,000 or more of principal on financing provided by the issue are used not later than the close of the first semi-annual period beginning after the date the prepayment (or complete repayment) is received to redeem bonds that are part of the issue.

.03 Section 143(f) imposes eligibility requirements concerning the maximum income of mortgagors for whom financing may be provided by qualified mortgage bonds. Section 25(c)(2)(A)(iii)(IV) provides that recipients of mortgage credit certificates must meet the income requirements of § 143(f). Generally, under §§ 143(f)(1) and 25(c)(2)(A)(iii)(IV), these income requirements are met only if all owner-financing under a qualified mortgage bond and all certified indebtedness amounts under a mortgage credit certificate program are provided to mortgagors whose family income is 115 percent or less of the applicable median family income. Under § 143(f)(6), the income limitation is reduced to 100 percent of the applicable median family income if there are fewer than three individuals in the family of the mortgagor.

.04 Section 143(f)(4) provides that the term "applicable median family income"