Backup Withholding Requirements

Policy 501.12

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4.1 IRS Requirements

4.1.1 The IRS 3406(a) requires payers under certain circumstances to withhold 28% for gambling winnings, and 31% for vendor payments as backup withholding taxes on payments of interest, rents, royalties, commissions, non-employee compensation, and certain other payments. Payments subject to backup withholding are defined in IRS sections 6041, 6041(a), 6042(a), 6044, 6045, 6049(a), 6050A, and 6050N.

4.1.2 Backup Withholding is required under three circumstances:

1. Backup withholding is required when the agency requests a Taxpayer Identification Number (TIN) from a vendor and one is not provided. The agency must backup withholding on any payments made to this vendor. Once backup withholding begins, the agency must continue to withhold until the vendor provides his or her TIN.

2. The IRS sends the agency a first B Notice (CP2100) and the vendor does not respond within 30 days to the agency's request for certification of the TIN. The agency must begin to backup withhold on any payment made to this vendor. Backup withholding continues until the vendor provides a TIN certified on IRS Form W-9.

3. The IRS sends the agency a second B Notice within a three year period. The agency must begin backup withholding immediately. Backup withholding continues until the IRS notifies the agency to stop withholding. This notification may be an IRS Letter 147C or SSA Form 7028.

4.1.3 IRS CP2100 Notices - Each year the IRS issues CP2100 Notices for prior year information returns that contained missing, incorrect and/or currently not issued taxpayer identification numbers. For instance, the 1992 CP2100 Notice was issued in October, 1993 and the 972CG Notice of Proposed Assessment which was based on these mismatches was issued in December 1994. Upon receipt of this CP2100, IRS procedure requires each agency/recipient to compare their records with the information furnished by the IRS.

4.1.4 There are two separate procedures that must be followed depending on whether the CP2100 listing agrees or disagrees with your records.

4.2 Procedures to Follow Once You Receive a CP2100 From the IRS

4.2.1 For account information that does not agree with your records, check to see if you gave the correct information on your return, if you changed the information after you filed, or if the IRS changed the information when processing the return. In these instances, you do not have to respond to the IRS, but you do need to do the following:

1. If you did not put the correct information on the return, correct your records and include that information on any future information returns that you file. Do not send a "B" Notice to the payee.

2. If your information changed after you filed your return include that information on any future information returns you file. Do not send a "B" Notice to the payee.

3. If the IRS changed your information, note in your records and take no further action.

4.2.2 For account information that agrees with your records, you must determine whether this is the "first" or "second" time within three calendar years the IRS has notified you that the TIN is incorrect. You must have procedures in place at your agency/university that allow you to determine whether this is the first or second notification since the procedure that you are required to follow is different for each notification.
4.3 First Notice

1. Send the first "B" Notice, a copy of Form W-9, and an optional reply envelope to the vendor within 15 business days from the date of the CP2100 notice or the date you received it (whichever is later). Date the "B" Notice no later than 30 business days from the date of the CP2100 notice or the date you received it. The outer envelope must be clearly marked "IMPORTANT TAX INFORMATION ENCLOSED" or "IMPORTANT TAX RETURN DOCUMENT ENCLOSED".

2. Allow the payee 30 calendar days to provide you with a newly signed Form W-9. Keep this W-9 for your records. Please note, once the IRS has informed you that the TIN of a vendor does not match, a telephone call is not sufficient documentation that you have followed procedures.

3. Update your record with the corrected information received from the vendor and include it on any future information returns you file.

4. Begin backup withholding on payments made to vendors who do not respond within 30 business days from the date of the CP2100.

4.4 Second Notice

1. Send the second "B" Notice and an optional reply envelope to the vendor within 15 business days from the date of the CP2100 or the date you received it (whichever is later). Date the "B" notice no later than 30 business days from the date of the CP2100 notice or the date you received it. The outer envelope must be clearly marked "IMPORTANT TAX INFORMATION ENCLOSED" or "IMPORTANT TAX RETURN DOCUMENT ENCLOSED". Do not send a Form W-9.

2. The vendor must contact the Social Security Administration (SSA) to have a social security number validated or the Internal Revenue Service (IRS) to validate an employer identification number (EIN).

3. Allow 30 business days from the date of your request to receive either SSA Form 7028, Notice to Third Party of Social Security Assignment from the SSA or a copy of IRS Letter 147C from the vendor.

4. Begin backup withholding on payments made to payees if you don't receive SSA Form 7028 or IRS Letter 147C within 30 business days. You must continue to backup withhold until you receive either validation.

4.4.1 Depositing and Reporting Backup Withholding - It is the agency's responsibility to deposit and report backup withholding. Once funds are withheld, the withholding agent must deposit the money using the same rules as those used for employment taxes. See the general instructions for information on when the taxes must be deposited (IRS Circular E or IRS Forms 941 or 945). It will vary from quarterly to semi-weekly depending on size of the deposit to be made. Most deposit situations will require that a deposit be made by the fifteenth day of the following month in which backup withholding occurred. Withheld taxes are deposited in a federal reserve bank using a Form 8109 Federal Tax Deposit Coupon. IRS Form 945 Annual Return or Withheld Federal Income Tax must be used to report backup withholding. This return is due by January 31 of the following calendar year.

4.4.2 Miscellaneous Backup Withholding Information - The Backup Withholding rules apply to taxable grants or agricultural payments reported on Form 1099-G; it does not apply to any other Form 1099-G type payment. Backup withholding rules apply even if the amount is less than $600 per year.

4.4.3 At present time the backup withholding rate is 31% of the payment amount.

4.4.4 Once begun, you must continue to withhold until the payee provides a TIN. Do not refund the amounts you withheld before the TIN was provided. You will reflect these amounts on Form 1099-MISC; the payee will get credit for the withholding just as employees get credit for the wages withheld from their paychecks.

4.4.5 If you are required to withhold but fail to do so, you are liable for the amount you should have withheld. You are relieved of that liability only by obtaining an affidavit (Form 4669) from the payee stating that the payee included the payment on a tax return.

4.4.6 Obtaining a Form W-9 allows you to stop withholding (at least until the second B Notice), but it does not relieve you of liability for missing withholding.

4.4.7 The Office of the State Controller's policies for Materials Management contains a discussion on the specialized processing of 1099 information, including backup withholding. Agencies on NCAS/DBS accounting system should refer to those policies for a discussion of how the new system handles these payments. Agencies and universities on other operating systems should adopt procedures to handle this reporting requirement consistent with the capabilities of their system.

5 Additional References