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Backup Withholding – IRS Notices and Payor Responsibilities

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The IRS celebrated Tax Day by announcing on April 15th that backup withholding notices were on the way. Specifically, the IRS issued [IRS Newswire IR-2022-87](#), stating that it will be issuing CP2100 and CP2100A Notices to taxpayers that filed certain information returns with missing Taxpayer Identification Numbers (TINs), incorrect names, or a combination of both. The following information provides details about what these notices are and what taxpayers need to do if they receive one.

Note that the information below is focused on backup withholding requirements under § 3406(a)(1)(B), also known as the [IRS Backup Withholding “B” Program](#). For further information on backup withholding under § 3406(a)(1)(C), dealing with payees that fail to fully report the correct amount of interest and dividend income on their federal income tax return, see the [IRS Backup Withholding “C” Program webpage](#).

Background

In the turbulent days of the early 1980s, the US experienced a whiplash effect on tax withholding, particularly dividends and interest, as numerous bills were passed in a short period to attempt to head off the eventual recession caused by the 1979 energy crisis. To counteract rising oil costs, and subsequent inflationary concerns, Congress first passed the [Economic Recovery Act of 1981](#) (ERTA). ERTA contained a number of income tax reduction amendments, including a provision reducing the highest marginal tax rate on all types of income from

70% to 50%, as a way to encourage economic growth. However, tax revenue quickly plunged and deficits began to grow, causing concern within Congress, as the economy fell into the second dip of the early 1980s recession. To counter this issue, Congress passed the [Tax Equity and Fiscal Responsibility Act of 1982](#) (TEFRA), which contained revenue raisers, including tax rate raises and closed tax loopholes, to help reduce the budget gap. Notably, TEFRA instituted a 10% withholding requirement on payments of interest, dividends, and patronage dividends, with certain exceptions.

Less than a year later, Congress passed the [Interest and Dividend Tax Compliance Act of 1983](#), which repealed the interest and dividend withholding provisions introduced under TEFRA and instituted a new backup withholding system in its place. Under the new act, payors were required to withhold 20% on payments of dividends and interest paid to payees which had underreported dividend and interest income, or failed to provide accurate taxpayer information, essentially the current IRS Backup Withholding “C” Program. In addition, the new act contained a provision requiring payors to backup withhold on payees when the Secretary notifies the payor that the TIN furnished by the payee is incorrect, effectively the IRS Backup Withholding “B” Program.

The withholding rate was apparently not settled at the time the IRS was redesigning its Forms 1099 series, as evidenced by the 1983 [Form 1099-MISC](#). The form contained a new placeholder Box 4, with instructions noting that it was to be used the following year for backup withholding at a 15% rate. Ultimately, the Act passed with a statutory withholding rate of 20% that remained in place until 1992. Under the [Energy Policy Act of 1992](#), the rate jumped to 31%, matching the highest individual income tax rate at the time. Although two new brackets were added the following year, the backup withholding rate remained 31% until 2001, when the [Economic Growth and Tax Relief Reconciliation Act of 2001](#), tied the backup withholding rate to the fourth lowest income rate under § 1(c), the provision for unmarried individuals. The rate ranged from 25% to 28% over the following 15 years. Due to temporary amendments arising under the Tax Cuts and Jobs Act of 2017 (TCJA), the rate will remain at 24% through the 2025 tax year.

B Notices and Backup Withholding

Payors must generally request a TIN when a payee initially opens an account or conducts a transaction with the payor. For interest, dividends, and amounts subject to broker reporting, the payee must furnish a certified TIN on a Form W-9; however, the TIN may be furnished in any manner for other payments. If the TIN is not provided at this time, backup withholding is required immediately. Payors must then request a TIN by December 31 of the year the account is opened (the first annual solicitation) and again by December 31 of the following year (the second annual reconciliation). If the payee provided an incorrect TIN at account opening, the payor must make two annual solicitations following receipt of a CP2100 or CP2100A Notice, discussed below.

Each year, the IRS reviews information in its own records, including the TIN, against information provided by payors reporting payments to payees. The IRS specifically looks for the name and TIN reported on Forms 1099-B, DIV, G, INT, K, MISC, NEC, OID, PATR, and Form W-2G. When a mismatch occurs, the IRS notifies payors through either a CP2100 or CP2100A Notice. Typically, payors classified as large filers, those with 250 or more error documents, receive a CP2100 Notice via a CD or DVD data file while mid-sized filers, those with between 50 and 249 documents, receive a paper CP2100 Notice. The CP2100A Notice is reserved for small filers, those with less than 50 error documents. Collectively, these notices are commonly, though incorrectly, referred to as B Notices (which is actually the name of the notice that the payor must send to the payee as a result of the CP2100). The IRS sends out an initial round of these notices in September and October, and a second round in April of the following year. The notices identify the payee (or payees, if there are multiple issues) where the information reported included a missing or incorrect TIN, an incorrect name, or a combination of both. The notice also informs the payor that it is responsible for backup withholding.

When a payor receives a CP2100 or CP2100A, it should first review the payee information that it has in its system against the information that it provided to the IRS to ensure that the mismatch wasn't the result of a simple mistake or unintentional omission. Note that the IRS also provides a [TIN matching service](#), which allows the payor to

determine whether the name and TIN combination that it has on file matches that in the IRS's records. Once the payor has received the notice of the incorrect information return, it has 15 business days from the date of the notice, or the date it was received, whichever is later, to send a B Notice to the payee(s) of the name/TIN mismatch and to solicit curing documentation. The payor should include Form W-9 for the payee to fill out and may, but is not required to, send a self-addressed stamped envelope. The IRS also specifies that the outside envelope must be clearly marked "IMPORTANT TAX INFORMATION ENCLOSED" or "IMPORTANT TAX RETURN DOCUMENT ENCLOSED." If the IRS notice was triggered by an error on the part of the payor, then the payor is not required to issue a B Notice to the payee.

To the extent a valid Form W-9 is not provided as a result of the B Notice solicitation, payors are instructed to begin backup withholding no later than 30 days after receiving the CP2100 Notice, though they may begin withholding at any point within that 30-day period. If the attempted delivery of the B Notice comes back as undeliverable, then the payor must immediately begin withholding. If the payee provides an updated Form W-9 after backup withholding has begun, the payor has 30 days to update its processes to stop backup withholding but may cease withholding at any point within that 30-day period.

Payors that have deducted and withheld under the backup withholding rules are responsible for remitting these amounts to the IRS. Taxpayers are typically required to remit via [EFPTS](#), though there are threshold exemptions. See section 11 of [Publication 15](#), for additional information on remitting federal tax payments. On an annual basis, payors must report this information to the IRS on [Form 945, Annual Return of Withheld Federal Income Tax](#).

If the payor receives a second CP2100 Notice within a three-calendar year period for the same payee, then the payor is instructed to send a second B Notice to the payee. Unlike the first B Notice, the payor does not include Form W-9, rather the payor must instruct the payee to contact the IRS (if the payee is an entity) or the Social Security Administration (SSA) (if the payee is an individual) to either request a TIN or resolve any errors it is encountering with its current TIN. Specific to this, an entity payee must provide the payor with a copy of IRS Letter 147C, *EIN Verification Letter*. A payee that is an individual must provide the payor with a copy of his/her social security card that contains a different number than the one in the payor's records or that has been issued less than 6 months prior to the date of the second CP2100. If the payor receives a third CP2100 Notice for the same payee containing a different name/TIN combination, then the payor should consider this as a new first CP2100 Notice with respect to its B Notice obligations. See [Publication 1281](#), for additional information and a sample template of each of the B Notices.

References

For information on the recent IRS issuance, see [IR-2022-87](#). For general information on the backup withholding, see [Publication 1281](#), or the [IRS Backup Withholding "B" Program webpage](#).

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