

Current Report

Cooperative Extension Service • Division of Agriculture • Oklahoma State University

Backup Withholding

by

Mike L. Hardin, Extension Economist

Provisions for Backup Withholding, effective January 1, 1984, were originally a part of the 1982 Tax Equity and Fiscal Responsibility Act (TEFRA). These provisions required 15% withholding on certain reportable payments if the payee did not supply to the payor a correct Social Security or Taxpayer Identification Number (TIN). However, the Interest and Dividend Tax Compliance Act of 1983 (Public Law 98-67) amended some of the provisions even before they became effective. Most importantly, the rate for backup withholding was increased from 15 to 20 percent.

In general, a payor of taxable interest, dividends, and payments for services or rents, must withhold 20% backup withholding from these payments if the payee fails to furnish a correct (TIN). A payor is any farmer, businessman, or person who, as a part of a trade or business, pays for a service. A payee is any independent contractor or other person that performs a service and is not considered as an employee of the payor. An employer may provide tools or equipment, set work hours and wages, and specifically define responsibilities for an employee. However, independent contractors usually provide their own equipment, set work schedules and are paid a lump sum amount to perform a job or service. In general, wage withholding is required for employees.

Backup withholding is now required on payments of \$600 or more for rents, salaries, wages, commissions, other determinable gains, payments to independent contractors and direct sellers. Any payment made by a farmer to an individual of more than \$600 per year, for any service (hay hauling, fence building, machine hire, etc.) is subject to backup withholding. The farmer must get the payee or service provider to give his Social Security number or TIN. If not, the farmer must withhold 20% of the payment.

If backup withholding is required, the payor is liable for the withholding whether or not the amount is withheld. Farmers and other

businessmen may be liable for the payee's backup withholding taxes if proper information, a correct (TIN), is not obtained from each payee.

The following discussion includes a description of the types of payments subject to backup withholding, when backup withholding is required, who is required to backup withhold, how to report and deposit backup withholding, how to avoid the penalty, and penalties for failure to withhold and report.

Definitions

Backup Withholding:

Backup Withholding is a 20% deduction from any reportable payments, which totals more than \$600 per year, made to a payee or person that does not provide the payor with a correct taxpayer identification number.

Reportable payment:

Reportable payments are divided into two classes.

- (1) any reportable interest or dividend payment,
- (2) any other reportable payment.

Other reportable payments include:*

1. Information at Source, (section 6041).
2. Payments of remuneration for services, section (6041A(a)).
3. Returns of Brokers, (section 6045).
4. Payments to fishing boat operators, (section 6050A).

Examples of payments subject to backup withholding include:

1. Payments of \$600 or more for rents, salaries, wages, commissions, other determinable gains, and payments to independent contractors and direct sellers.
2. Interest, dividend, and cash patronage dividends of more than \$10 per year.
3. Payments of fish boat operators and brokers.

*An exception is provided for payments made to U.S. or any Federal agency, state or political subdivision, tax exempt organization, Foreign

governments or international organizations, and corporations.

When Backup Withholding Is Required

Reportable payments:

Payors of reportable interest, dividends or patronage dividends paid in money are subject to backup withholding if any of the following four situations exist,

(1) You must backup withhold if the payee doesn't furnish you with a taxpayer identification number (TIN) or furnishes you with an incorrect TIN.

(2) You must backup withhold if the IRS notifies you that the payee furnished an incorrect TIN.

(3) You must backup withhold if the IRS notifies you to do so because a payee has failed to file a return as to interest, dividends, or patronage dividends, or has underreported them.

(4) You must backup withhold if a payee, who is required by the law to certify to you that he or she isn't subject to backup withholding, doesn't do so.

Other reportable payments:

However, payors of other reportable payments, relating to information at source, section 6041 and payments relating to remuneration for services, section 6041A(a) are required to backup withhold under the following conditions:

(1) A payor must backup withhold, if the payee fails to furnish a TIN to the payor or IRS notifies the payor that the TIN furnished by the payee is not correct; and

(2) Any one of the following three conditions is satisfied:

- (a) Reportable payments to the payee aggregate \$600 or more during the calendar year;
- (b) The payor was required to file an information return, the previous year;
- (c) The payor was required to impose backup withholding on payments made to the payee during the preceding calendar year.

Who Must Backup Withhold

Banks and other financial institutions that must file a return as to interest paid, brokers who act as nominees and who must file returns as to dividends or interest payments, cooperatives that must file returns as to patronage dividends paid, tenants who pay rents in the course of their business, direct sellers of consumer products, employers who must file returns as to payments of salaries, wages, compensation, commissions, and fees during the course of business, corporations that pay interest and dividends, fishing boat operators, service recipients who made payments to independent contractors, and patentees who pay

royalties during the course of business are all subject to Backup withholding.

How to Report and Deposit Amounts Withheld

Reports required:

For agricultural employees the withholding of FICA and income tax are reported on Form 943, Employee's Annual Tax return for Agricultural Employees. This return is due one month after the calendar year ends or January 31. If employers withhold backup withholding, it must be reported on Form 941, Employers Quarterly Federal Tax Return. These Quarterly returns are due April 30, July 31, October 31, and January 31. Agricultural Employers generally have not in the past used form 941. Whether or not Backup Withholding was required, if any payment or payments to an individual exceed \$600 for the year, a form 1099 must be prepared. This form contains 3 copies, one for the individual who received payment, one copy for the payor, and one copy for IRS. 1099 forms should be filed before the last day of February. The IRS copies of Form 1099 should be summarized on Form 1096 and filed with IRS before March 1.

Deposit requirements:

FICA, income tax, and backup withholding should all be deposited using form 8109, Federal Tax Deposit. Form 8109 deposit booklet may be obtained by writing the IRS. The request must include your name, address, employer identification number and the month your tax year ends. IRS has imposed a 5% penalty for sending FICA tax deposits directly to IRS. Deposits must be made to a qualified depository for federal taxes. Most banks are a qualified depository. If total withholding at the end of the month exceeds \$500 you must deposit that amount by the 15th of the next month. If withholding is less than \$500 it may be carried forward and added to next month. Caution, if the accumulated withholding from past months exceeds \$500 it must be deposited. If total withholding exceeds \$3000 on the 3rd, 7th, 11th, 15th, 19th, 22nd, 25th or last day of the month, then the withholding amount must be deposited within 3 banking days of the end of the applicable period. For more information see IRS publication 539 Employment Taxes. These forms, 941, 1099, 8109, and SS-4, may be obtained by calling the IRS toll free number 1-800-424-1040 or write to:

IRS
200 N. W. 4th
Oklahoma City, OK 73102

60-Day Exception to Backup Withholding

In general, if a payee does not provide a TIN to a payor, the payor must withhold 20% of all payments made to the payee on or after January 1, 1984. However, the payee will not be subject to backup withholding for a period of 60 days, if the payee is waiting for receipt of a TIN.

A payee is treated as if a certified TIN had been provided for a period of 60 days following the day the payor receives a certificate signed under penalties of perjury (an "awaiting TIN certification"). If the payor does not receive a TIN within 60 days after the payee delivers the awaiting TIN certification to the payor, the payor must withhold 20% of all payments made to the payee, until the payee provides a TIN to the payor.

The awaiting TIN certification must contain statements (1) that the payee has not been issued a TIN, (2) that the payee has applied for a number or intends to apply for a number in the near future, and (3) that the payee understands that if the payee does not provide a TIN to the payor within 60 days, the payor is required to withhold 20% of any payments made thereafter to the payee until a number is provided. Payees may get a (TIN) by filing Form SS-4 at the IRS Service Center.

Non-Resident Aliens Exempt

Non-resident aliens are subject to a 30% withholding on all payments. As a result, non-resident aliens are exempt from backup withholding. The 30% withholding is required regardless of the type or amount of payment.

Avoiding the Penalty

A payor is not subject to a penalty for failure to provide the payee's correct TIN on an information return, if the payee has certified, under penalties of perjury, that the number provided to the payor was the correct number, and the payor included each number on the information return.

But a payor may be penalized if the TIN of a payee provided on an information return is determined not to be the payee's correct number, unless the payor exercised due diligence in soliciting the payee's correct TIN and in furnishing the number on the information return.

The due diligence standard applies only to payors of reportable interest and dividends. However, payors should take care that they do not have in their possession, information that could indicate that the (TIN) given may not be correct. For example, if a farmer requires that the independent contractor fill out the W-9 form and the payee certifies that the (TIN) given is correct, and then the contractor sends a bill or statement that has a different (TIN) or social security number, then the farmer should exercise due care in determining the correct number. The Form W-9 on page 4 consists of the top half of the IRS form W-9. Payor's of reportable payments must have each payee certify the accuracy of the (TIN) to avoid liability for backup withholding. Space is provided on the W-9 to record elements of the contract between the payor and payee. Additional forms are available through the Extension County Office.

Failure to Withhold

A payor, or farmer, is subject to the same requirements and penalties for failing to impose backup withholding as an employer making a payment of wages. So, a payor is liable for the tax whether or not the payor withholds the tax from the payee who is subject to withholding. A payor may be relieved of liability for the tax required to be withheld if the payor can show that the tax has been paid by the payee. In addition to liability for the tax, a payor who fails to withhold when required may be subject to civil and criminal penalties.

Partnerships

Backup withholding usually applies to a payment to a partnership if the firm does not provide its correct TIN to the payor. In addition, the partnership must withhold on all reportable payments that a partnership makes to a payee who is subject to backup withholding. Distributions by a partnership to its partners of their distributive share of income, however, are not reportable payments. Backup withholding does not apply to these distributions, except to the extent such distributions are reportable by fishing boat operators under Sec. 6045.

Oil Royalties

There is no backup withholding on an oil royalty payment if windfall profit tax is actually withheld. If windfall profit tax is not withheld from the oil royalty payment (because, for example, payment is made with respect to "exempt royalty oil"), the oil royalty payment is subject to backup withholding. The amount subject to withholding is the amount the payee receives (i.e., the gross proceeds less production-related taxes such as State severance tax).

Property Payouts

For a payment that is made in property, backup withholding applies to the fair market value of the property determined on the date of payment.

Penalties

In addition to the backup withholding liabilities, penalties can be assessed.

Penalty for failure to furnish TIN:

If you (as payee) fail to furnish your TIN to a payor, you are subject to a penalty of \$50 for each such failure unless it is due to reasonable cause and not to willful neglect. Also, unless a failure to include your TIN on any return, statement, or other document on which it is required, is shown to be due to reasonable cause and not due to willful neglect, there is a \$5 penalty for each such failure.

Payer's Request for Taxpayer Identification Number

Please print or type

Name as shown on account (if joint account, also give joint owner's name) _____

Address _____

City, State, and ZIP code _____

List account number(s) here (See Instructions) ▶ _____

PART I.—Taxpayer Identification Number

Enter the taxpayer identification number in the appropriate box. For most individual taxpayers, this is the social security number.
Note: If the account is in more than one name, see the chart on page 2 for guidelines on which number to give the payer.

Social security number

| | |
|--|--|
| | |
|--|--|

OR

Employer identification number

| | |
|--|--|
| | |
|--|--|

**PART II.—Backup Withholding On
 Accounts Opened After
 12/31/83**

Check the box if you are NOT subject to backup withholding under the provisions of section 3406(a)(1)(C) of the Internal Revenue Code. (See Highlight below.)

Certification.—Under the penalties of perjury, I certify that the information provided on this form is true, correct, and complete.

Signature ▶ _____ Date ▶ _____

**Failure to provide correct taxpayer identification number will require the payer to withhold 20% backup withholding from payments.

INDEPENDENT CONTRACTOR SERVICE AGREEMENT

Payer: Name _____

Address _____

City, State, and ZIP Code _____

Contractor: Name _____

Permanent Address _____

Information City, State, and ZIP Code _____

Service to be provided: _____

Amount and timing of payments: _____

For Additional Copies and Partial W-9 Instructions See Back Page.

Purpose of Form

Use this form to report the taxpayer identification number (TIN) of the record owner of the account to the payer (or broker).

Beginning January 1, 1984, payers must generally withhold 20% of taxable interest, dividend, and certain other payments if you fail to furnish payers with the correct taxpayer identification number (this is referred to as backup withholding). For most individual taxpayers, the taxpayer identification number is the social security number.

To prevent backup withholding on these payments, be sure to notify payers of the correct taxpayer identification number and, for accounts you open after December 31, 1983, properly certify that you are not subject to backup withholding under section 3406(a)(1)(C).

You may use this form to certify that the taxpayer identification number you are giving the payer is correct and, for accounts opened after December 31, 1983, that you are not subject to backup withholding.

If the payer provides a different form than Form W-9 to request the taxpayer identification number, please use it.

Backup Withholding

You are subject to backup withholding if:

- (1) You fail to furnish your taxpayer identification number to the payer, OR
- (2) The Internal Revenue Service notifies the payer that you furnished an incorrect taxpayer identification number, OR
- (3) You are notified that you are subject to backup withholding (under section 3406(a)(1)(C)), OR
- (4) For an interest or dividend account opened after December 31, 1983, you fail to certify to the payer that you are not subject to backup withholding under (3) above, or fail to certify your taxpayer identification number.

For payments other than interest or dividends, you are subject to backup withholding only if (1) or (2) above applies.

(See the section on the back titled "Payees Exempt from Backup Withholding.")

Account Numbers

If you have more than one account with the same payer (for example, a savings account and a certificate of deposit at the same bank), the payer may request a separate Form W-9 for each account depending on how the payer's records are kept.

What Number to Give the Payer

Give the payer the social security number or employer identification number of the record owner of the account. If the account belongs to you as an individual, give your social security number. If the account is in more than one name or is not in the name of the actual owner, see the chart on page 2 for guidelines on which number to report.

Obtaining a Number

If you don't have a taxpayer identification number or you don't know your number, obtain Form SS-5, Application for a Social Security Number Card, or Form SS-4, Application for Employer Identification Number, at the local office of the Social Security Administration or the Internal Revenue Service and apply for a number. Write "applied for" in Part I in place of your number. When you get a number, submit a new Form W-9 to the payer.

Penalties

(1) Penalty for Failure to Furnish Taxpayer Identification Number.—If you fail to furnish your taxpayer identification number to a payer, you are subject to a penalty of \$50 for each such failure unless your failure is due to reasonable cause and not to willful neglect.

(2) Failure to Report Certain Dividend and Interest Payments.—If you fail to include any portion of an includible payment for interest, dividends, or patronage dividends in gross income, such failure will be treated as being due to negligence and will be subject to a penalty of 5% on any portion of an underpayment attributable to that failure unless there is clear and convincing evidence to the contrary.

(3) Civil Penalty for False Information With Respect to Withholding.—If you make a false statement with no reasonable basis which results in no imposition of backup withholding, you are subject to a penalty of \$500.

(4) Criminal Penalty for Falsifying Information.—Falsifying certifications or affirmations may subject you to criminal penalties including fines and/or imprisonment.

Payees Exempt from Backup Withholding

Payees specifically exempt from backup withholding on ALL payments include the following:

- A corporation.
- A financial institution.
- An organization exempt from tax under section 501(a), or an individual retirement plan.
- The United States or any agency or instrumentality thereof.
- A State, the District of Columbia, a possession of the United States, or any subdivision or instrumentality thereof.
- A foreign government, a political subdivision of a foreign government, or any agency or instrumentality thereof.
- An international organization or any agency or instrumentality thereof.
- A registered dealer in securities or commodities registered in the U.S. or a possession of the U.S.
- A real estate investment trust.
- A common trust fund operated by a bank under section 584(a).
- An exempt charitable remainder trust, or a non-exempt trust described in section 4947(a)(1).
- An entity registered at all times under the Investment Company Act of 1940.
- A foreign central bank of issue.

Payments of **dividends** and **patronage dividends** not generally subject to backup withholding include the following:

- Payments to nonresident aliens subject to withholding under section 1441.
- Payments to partnerships not engaged in a trade or business in the U.S. and which have at least one nonresident partner.
- Payments of patronage dividends where the amount received is not paid in money.
- Payments made by certain foreign organizations.

Payments of **interest** not generally subject to backup withholding include the following:

- Payments of interest on obligations issued by individuals. **Note: You may be subject to backup withholding if this interest is \$600 or more and is paid in the course of the payer's trade or business and you have not provided your correct taxpayer identification number to the payer.**
- Payments of tax-exempt interest (including exempt-interest dividends under section 852).
- Payments described in section 6049(b)(5) to nonresident aliens.
- Payments on tax-free covenant bonds under section 1451.
- Payments made by certain foreign organizations.

Exempt payees described above should file Form W-9 to **avoid possible erroneous** backup withholding. Because certain payments exempt from backup withholding are nevertheless subject to information reporting, if you file this form with the payer, furnish your taxpayer identification number, write "exempt" on the face of the form, and return it to the payer. If the payments are interest, dividends, or patronage dividends, also sign and date the form.

Certain payments other than interest, dividends, and patronage dividends that are not subject to information reporting are also not subject to backup withholding. For details, see the regulations under sections 6041, 6041A(a), 6045, and 6050A.

Privacy Act Notice.—Section 6109 requires most recipients of dividend, interest, or other payments to give taxpayer identification numbers to payers who must report the payments to IRS. IRS uses the numbers for identification purposes. Payers must be given the numbers whether or not recipients are required to file tax returns. Beginning January 1, 1984, payers must generally withhold 20% of taxable interest, dividend, and certain other payments to a payee who does not furnish a taxpayer identification number to a payer. Certain penalties may also apply.

Dr. Mike L. Hardin
Extension Economist
515 Agricultural Hall
Oklahoma State University
Stillwater, OK 74078
405-624-6081

Failure to report certain dividend and interest payment:

If you fail to include any portion of an includible payment for interest, dividends, or patronage dividends in income, the failure will be treated as being due to negligence and subject to a penalty of 5% of any portion of an underpayment attributable to that failure unless there is clear and convincing evidence to the contrary.

Civil penalty for false information with respect to withholding:

If you make a false statement with no reasonable basis that results in no imposition of backup withholding, you are subject to a penalty of \$500.

Criminal penalty for falsifying information:

Falsifying certifications or affirmations may subject you to criminal penalties including a fine of up to \$1,000 and/or imprisonment.

Other penalties include:

(a) a penalty of \$500 for each willful failure by a broker to provide notice to a

payor; and (b) civil damages for unauthorized disclosure or use of backup withholding information.

Farmers and other businessmen who make payments in excess of \$600 to an independent contractor or other person who provide services (hay hauling, custom hire, fence building) are subject to backup withholding. Farmers are liable to pay to IRS 20% of these payments if the payee or contractor does not give to the farmer or payor a correct taxpayer identification number. The farmer must pay even if the 20% was not withheld from the payee's payment.

Farmers can transfer this liability to the payee by requiring the payee to sign a W-9 Form that includes the payee's correct (TIN). The payor must also include this TIN on the annual 1099 information return.

For more information about backup withholding contact your Area Farm Management Specialist or Farm Management Association Fieldman.