under section 3406 on reportable payments to its grantors who are subject to such withholding.

Recently, the IRS issued proposed regulations under section 671 on the methods of reporting by grantor trusts. These proposed regulations provide two regimes for reporting, one for a grantor trust that is owned (or treated as owned) by one grantor and another for a grantor trust that is owned by two or more grantors. To avoid confusion and thereby promote simplification, the final backup withholding regulations are conformed to these regimes. Accordingly, under these final regulations a grantor trust with two or more grantors is considered a payor and must withhold on payments to its grantors who are subject to backup withholding. For purposes of determining the number of grantors, a husband and wife filing a joint return are considered one grantor. See § 31.3406(a)–2(b)(4).

B. *S corporations—proposed § 31.3406(a)–2(c)(3).* Under an exception in the proposed regulations defining payors, a partnership making a payment of a distributive share to a partner is not considered a payor. The exception does not include S corporations. Because the tax treatment of both entities is similar, the final regulations provide that an S corporation making a similar distribution is not a payor under section 3406. See § 31.3406(a)–2(c)(3).

C. *Transferred short-term obligations—proposed § 31.3406(b)(2)–2.* The proposed regulations provide that a subsequent holder of a short-term obligation with original issue discount may establish the purchase price at which the subsequent holder purchased the obligation. That purchase price is then treated as the original issue price for purposes of computing the amount of original issue discount subject to backup withholding. To reduce the paperwork of issuers and payors of these obligations, the final regulations provide that a payor may disregard the subsequent holder's purchase price if the payor's computer or recordkeeping system is not able to accept that price without substantial manual intervention. See § 31.3406(b)(2)–2(c)(1)(ii).

D. *Foreign provisions.* The proposed regulations contained several provisions on international transactions that are not included in the final regulations. For those international provisions relating to section 3406, the temporary regulations under § 35a.9999 remain in effect.

III. The C Trigger (Payee Underreporting)

A. *Identifying the account subject to the C trigger—proposed § 31.3406(c)–1(b)(3) (i) and (iv).* The proposed regulations provide that a payor must withhold under section 3406(a)(1)(C) on reportable interest or dividend payments to all existing accounts of a payee that the payor can identify exercising reasonable care. Commentators suggested several modifications to or clarifications of the reasonable care standard. For example, some commentators suggested that the procedures for locating and identifying an account of a payee subject to the C trigger should more closely resemble the procedures for identifying an account subject to the B trigger. In response to this comment, the final regulations modify the procedures for identifying accounts subject to the C trigger, and thus require a payor to identify those accounts by identifying accounts with the same TIN as the one provided in the notice from the IRS to the payor that advises the payor to commence withholding on accounts of a payee.

Commentators also informed the IRS that some computer systems use a universal account number that retrieves all accounts of a payee with that payor. In light of this information, the final regulations require payors with such systems to identify all accounts that can be so retrieved.

Some commentators also addressed the requirement under the proposed regulations that a payor search for accounts of a payee on the computer or other recordkeeping system for the region, division, or branch that serves the geographic area in which the payee's mailing address is located. These commentators questioned whether payors must search every such computer or record system. The final regulations clarify that a payor need not search a computer or other recordkeeping system if it is highly unlikely that the system contains an account of the payee that should be identified as one subject to the C trigger. See § 31.3406(c)–1(c)(3)(ii).

B. *Newly opened accounts—proposed § 31.3406(c)–1(b)(3)(ii).* Under the proposed regulations, if a payee subject to the C trigger has one account with a payor and subsequently opens another account, the payor may not rely on the subsequent Form W–9 on which the payee certifies that the payee is not subject to the C trigger, but only if the payor discovers while processing the Form W–9 or administering the account that the Form W–9 is false because the IRS previously notified the payor to

withhold on the payee under the C trigger. Commentators argued that this discovery standard was unclear and potentially burdensome. As a result, the final regulations clarify when a payor may not rely on a Form W–9 provided by the payee.

Under the final regulations, a payor has knowledge that a payee opening a new account with the payor is subject to withholding under section 3406(a)(1)(C), and thus must commence backup withholding on reportable interest and dividend payments to the new account, only if (1) the employee or individual agent of the payor receiving the Form W–9 knows at the time the payee opens the account that the payee's statement under section 3406(a)(1)(D) is not true; (2) at the time the payor processes the Form W–9 or in administering the account to which it relates, the payor discovers that the payee is currently subject to withholding under section 3406(a)(1)(C) on a pre-existing account with the payor; (3) the payor uses a single Form W–9 for multiple accounts of the payee; or (4) the payor uses a universal identifier to associate all of the payee's accounts with the payor and other accounts under that universal identifier have been identified as subject to withholding under section 3406(a)(1)(C). See § 31.3406(c)–1(c)(3)(iii).

C. *Including certain dates in the notice that the payor must send to a payee—proposed § 31.3406(c)–1(c)(2) (ii) and (iii).* A commentator objected to the proposed rule requiring a payor to include the following dates in the notice informing a payee that backup withholding for the C trigger has begun or will begin: (1) the last date before the payor must commence backup withholding, and (2) the date the payor received the notice from the IRS. The significant date for the payee is the date backup withholding begins on the payee's account. Therefore, to ease payors' administrative costs, the final regulations require the payor to include only the date the payor started (or plans to start) backup withholding in the notice to the payee. See § 31.3406(c)–1(d)(2)(iii).

D. *Monitoring accounts subject to withholding—proposed § 31.3406(c)–1(e).* Commentators asked the IRS to address how long a payor must monitor an account identified as one subject to the C trigger, if that account later becomes dormant. The final regulations provide that a payor is not required to backup withhold on dormant accounts. In this connection, backup withholding terminates no later than the close of the third calendar year ending after the later