

Part III - Administrative, Procedural, and Miscellaneous

WHFIT Transition Guidance

Notice 2010-4

SECTION I: PURPOSE

This notice provides guidance to trustees, middlemen and trust interest holders (TIHs) of widely held fixed investment trusts (WHFITs) regarding the WHFIT reporting rules in § 1.671-5 of the Income Tax Regulations. Specifically, this notice provides (1) guidance on transition payments (as defined in Section III below) and limited penalty relief for trustees and middlemen required to file Forms 1099 and furnish written tax information statements under the widely held mortgage trust (WHMT) safe harbor in § 1.671-5(g); (2) guidance regarding the TIHs' treatment of the transition payments; (3) guidance regarding the inclusion of WHFIT interest, dividend, and miscellaneous income in the summary totals on Forms 1099; (4) guidance regarding the format of the written tax information statement provided to TIHs under § 1.671-5(e); and (5) guidance regarding the obligations of trustees and middlemen with respect to reporting under the WHFIT rules for certain non-mortgage WHFITs (NMWHFITs).

SECTION II: BACKGROUND

Section 1.671-5 provides the WHFIT reporting rules. A WHFIT is an arrangement classified as a trust under § 301.7701-4(c), provided that: (i) the trust is a United States person under § 7701(a)(30)(E); (ii) the beneficial owners of the trust are

treated as owners under subpart E, part I, subchapter J, chapter 1 of the Code; and (iii) at least one interest in the trust is held by a middleman. See § 1.671-5(b)(22). A WHMT is a WHFIT, the assets of which consist only of mortgages, regular interests in a REMIC, interests in another WHMT, reasonably required reserve funds, amounts received with respect to these assets, and during a brief initial funding period, cash and short-term contracts to purchase these assets. See § 1.671-5(b)(23).

Trustees of fixed investment trusts frequently do not know the identities of the beneficial owners of the trust interests because the trust interests are often held in the name of a middleman. Thus, trustees are unable to communicate tax information directly to the beneficial owners of the trust interests. The WHFIT reporting rules in § 1.671-5 provide rules that specifically require the sharing of tax information among trustees, middlemen, and beneficial owners of the trust interests. To accomplish this, § 1.671-5 generally requires trustees to make trust tax information available to middlemen. Sections 1.671-5(d) and (e) require middlemen, and in some cases, trustees, to file a Form 1099 with the IRS and to furnish a written tax information statement to a TIH for the trust interests that the trustee or middleman holds on behalf of, or for the account of, the TIH.

Section 1.671-5(n) provides that the WHFIT reporting rules are applicable January 1, 2007. The preamble to the final regulations under § 1.671-5 (T.D. 9308, 2007-8 I.R.B. 523 [71 FR 78351] (December 29, 2006)) informed trustees and middlemen that the IRS would not impose any penalties that would otherwise apply as a result of a failure to comply with the WHFIT reporting rules with respect to the 2007

calendar year in cases where the trustee or middleman was unable to change its information reporting systems to comply with the WHFIT reporting rules. In September of 2008, the IRS and the Treasury Department issued Notice 2008-77, 2008-40 I.R.B. 814, which informed trustees and middlemen of WHFITs that the IRS would not assert penalties as a result of a failure to comply with the WHFIT reporting rules with respect to calendar year 2008.

Except as provided in Section III below, trustees and middlemen must comply with the WHFIT reporting rules for calendar year 2009.

SECTION III: TRANSITION PAYMENTS AND LIMITED PENALTY RELIEF FOR TRUSTEES AND MIDDLEMEN REPORTING UNDER THE WHMT SAFE HARBOR

The WHMT safe harbor in § 1.671-5(g) provides safe harbor reporting rules for trustees of certain WHMTs. If a trustee reports WHMT items in accordance with the safe harbor, the information provided by a middleman or trustee with respect to WHMT items on the Forms 1099 required to be filed with the IRS and on the written tax information statement furnished to the TIH must be determined as provided in § 1.671-5(g)(2). For the purpose of determining the timing of when an item of trust income that is attributable to a TIH is included on the Form 1099 filed for that TIH, the WHMT safe harbor looks to the record date for the payment rather than the actual payment date. See § 1.671-5(g)(2)(ii). Further, the regulations require that a TIH be provided with information regarding the amount of the gross income and separately provided with information regarding the amount of the expenses of a WHMT that are attributable to the TIH. See § 1.671-5(g)(1)(iii)(C).

Prior to the effective date of the WHFIT reporting rules, many trustees and middlemen reported income from a WHMT to a beneficial owner based on payment dates and amounts rather than based on record dates and amounts as required under the WHMT safe harbor. As a result, when a trustee or middleman transitions to the new reporting rules, some income might not be reported to the IRS on Forms 1099 and some income and expense information may not be furnished to TIHs. These omissions could occur where the record date for a payment falls in a year prior to the first year of reporting under the WHMT safe harbor and the payment date falls in the first year of reporting under the safe harbor. For example, income received by many WHMTs for December 2008 and payable to record holders as of December 31, 2008, was paid on January 15, 2009. The income and expenses which relate to the December 31st record date and January 15th payment date were not included on the Form 1099 or written tax information statement for 2008 under the reporting method used by the trustees and middlemen for 2008 if the trustees and middlemen were reporting based on the payment date, which occurred in 2009. If the trustees or middlemen transition to the WHMT safe harbor for 2009, absent the rules contained in this Section III, the income and expenses also would not be included by trustees and middlemen in calculating trust income for 2009 under the safe harbor because they would be reporting based on the record date, which occurred in 2008.

To address this problem, trustees and middlemen must report as provided in this Section III in the first year that the trustee or middleman transitions from reporting based on payment dates to reporting based on record dates under the WHMT safe harbor.

For purposes of this Notice, a Transition Payment is any payment (gross income less applicable expenses) that has (1) a payment date in the first year that the trustee or middleman transitions to reporting under § 1.671-5(g)(2) of the WHMT safe harbor (“transition year”); and (2) a record date in a year prior to the transition year. Trustees and middlemen that are transitioning to reporting under the WHMT safe harbor must include information with respect to Transition Payments on Forms 1099 filed with the IRS for the transition year, if information for these payments has not previously been included on a Form 1099 for a prior year. Additionally, the trustee or middleman must include information with respect to Transition Payments in the written tax information statement furnished to the TIH for the transition year. Although § 1.671-5(g)(1)(iii)(C) requires middlemen and trustees reporting under the WHMT safe harbor to provide TIHs with information regarding gross income and separately provide information regarding the expenses of the WHMT attributable to the TIH, trustees and middlemen may report net amounts with respect to Transition Payments. The trustee or middleman need not separately identify the information with respect to the Transition Payments on the Form 1099 or on the written tax information statement.

Trustees and middlemen also must provide the TIH with a statement that explains that (i) the WHFIT is transitioning from reporting based on payment dates to reporting based on record dates to comply with the newly applicable WHFIT reporting rules; (ii) to effect this transition, the information reported on the statement and to the IRS includes information with respect to Transition Payments and that a Transition Payment is a payment that had a record date in a prior year and payment date in the

current year, which was not previously included on a prior Form 1099; and (iii) the TIH must include the Transition Payment in computing its taxable income for the transition year as a § 481(a) adjustment to prevent omission of income caused by the reporting transition (see Section IV below).

The IRS and the Treasury Department recognize that trustees and middlemen may not have adequate time to modify their reporting systems to report Transition Payments that span the 2008 and 2009 calendar years as required under this Section III. Accordingly, the IRS will not impose any penalties on trustees and middlemen for 2009 for a failure to comply with §§ 1.671-5(d), (e), and (g)(2) with respect to TIHs in a WHMT. However, trustees and middlemen must continue to comply with §§ 6041 through 6050W to the extent applicable, and this Notice does not provide penalty relief with respect to a failure to comply with those reporting sections. In addition, a trustee or middleman must report Transition Payments as required under this Section III in the first year that the trustee or middleman transitions to reporting under the WHMT safe harbor, regardless of whether the trustee transitions for 2009 or 2010.

SECTION IV: TREATMENT OF TRANSITION PAYMENTS BY THE TIHs

A change from recognizing trust income in the year of the payment date to the year of the record date in accordance with the transition to record date reporting under the WHMT safe harbor is a change in method of accounting under § 446(e) and § 1.446-1(e)(2)(ii)(a). A taxpayer generally must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 446(e) and § 1.446-1(e)(2)(i). Section 1.446-1(e)(3)(ii) authorizes

the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting. Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year.

In accordance with § 1.446-1(e)(3)(ii), the Commissioner hereby grants consent to a cash method TIH who included income on its individual income tax return consistent with the amount reported on a Form 1099 for the year prior to the transition year, to change its method of accounting for trust income from recognizing the income based on the payment date to recognizing the income based on the record date in accordance with the transition to record date reporting under the WHMT safe harbor. The Transition Payment reported on a TIH's Form 1099 and written tax information statement for the transition year is an adjustment required under § 481(a). The entire amount of the § 481(a) adjustment (i.e., the Transition Payment) must be taken into account in computing a TIH's taxable income for the transition year. A TIH who changes its method of accounting for the trust income in accordance with this section does not need to file a Form 3115, Application for Change in Accounting Method.

SECTION V: WHFIT INTEREST AND DIVIDEND INCOME MAY BE INCLUDED IN THE SUMMARY TOTALS PROVIDED TO THE IRS ON FORMS 1099

Middlemen and trustees have also indicated that they provide the IRS with a summary total for interest, dividends and miscellaneous payments made to a TIH during

the calendar year on the relevant Form 1099. These middlemen and trustees have questioned whether including WHFIT items of income in these summary totals is permissible under § 1.671-5(d) or whether a separate Form 1099 must be filed to report WHFIT income to the IRS. This notice informs middlemen and trustees that WHFIT income that is appropriately reported on a Form 1099-INT, a Form 1099-DIV, or a Form 1099-MISC under § 1.671-5(d) may be included in the summary total on the Form 1099 filed with the IRS.

SECTION VI: PROCEDURES FOR FURNISHING THE WRITTEN TAX
INFORMATION STATEMENT TO BENEFICIAL OWNERS UNDER REGULATION
§ 1.671-5

(a) Electronic statements.

Section 1.671-5(k) provides that the information reporting sections in subpart B, part III, subchapter A, chapter 61, of the Code (§§ 6041 through 6050W) and the regulations thereunder are incorporated into the WHFIT rules to the extent those provisions are not inconsistent with the WHFIT reporting rules.

Effective March 9, 2002, § 401 of the Job Creation and Worker Assistance Act of 2002, an off-Code provision, removed the paper delivery impediment by authorizing all payee statements required by §§ 6041 through 6050W to be furnished electronically. Additionally, § 4.5.1 of Rev. Proc. 2008-36, 2008-33 I.R.B. 340, provides that if a person is required to furnish a written statement (Copy B or acceptable substitute) to a recipient, then the statement may be furnished electronically instead of on paper. Provided that the trustee or middleman has followed the rules and procedures outlined

in § 4.5.1 of Rev. Proc. 2008-36, a trustee or middleman may provide electronically the written tax information statement required to be furnished to a beneficial owner under § 1.671-5(e).

(b) Composite statements.

Section 4.2.1 of Rev. Proc. 2008-36 indicates that a composite recipient statement may be used for certain Forms 1099 and provides the rules for providing such a composite statement. Composite statements that meet the requirements of § 4.2.1 of Rev. Proc. 2008-36 may be used to provide the WHFIT information required to be furnished to beneficial owners under the WHFIT reporting rules, provided that the information required to be provided to the beneficial owner that is not required to be reported to the IRS on Forms 1099 also is included in an accompanying statement.

(c) Summary totals.

As noted above, it is permissible for middlemen and trustees to include income from a WHFIT in the summary totals on Forms 1099-INT, Forms 1099-DIV, and Forms 1099-MISC, when these forms are provided to the IRS. Middlemen and trustees may also include income from a WHFIT in a summary total provided to a beneficial owner, but only if the summary total is accompanied by sufficient information to enable the beneficial owner to properly report its items of income, deduction and credits from the WHFIT on its federal income tax return and such information satisfies the requirements of § 1.671-5(e) as modified by the reporting safe harbors in §§ 1.671-5(f) and (g) and for the transition year, satisfies Section III of this Notice.

However, the deadline for furnishing WHFIT information to a TIH may differ from

that for furnishing information with respect to other securities that the middleman may hold for the TIH. Where WHFIT information is included in a summary total with information regarding securities that are required to be reported at an earlier date, the inclusion of WHFIT information on the statement does not alter the earlier deadline. Additionally, if the amount of WHFIT income is determined to be different than what was reported on the earlier date, a corrected Form 1099 must be sent to the TIH.

SECTION VII: FURNISHING TAX INFORMATION PACKAGES FOR CERTAIN NMWHFITS

There are a number of royalty trusts and commodity trusts that meet the definition of a WHFIT. The IRS and the Treasury Department have been asked to clarify the application of the WHFIT rules with respect to furnishing TIHs in a royalty trust or a commodity trust with information necessary to properly report the tax consequences of their ownership interest in the trust. Under the structure of the WHFIT reporting rules, trustees are to make trust information available to middlemen. See § 1.671-5(c). The middlemen are then required to provide Forms 1099 to the IRS and to furnish written tax information statements to TIHs on whose behalf or account the middleman holds an interest in the WHFIT or acts as an intermediary. See §§ 1.671-5(d) and (e).

TIHs in royalty and commodity trusts need certain information (e.g., cost depletion schedules) in order for them to properly report the tax consequences of ownership of a trust interest. Historically, some royalty trusts have distributed annual tax packages or booklets to TIHs that included this information. In some cases, the

trustee of a royalty trust makes this information available on an Internet website.

Middlemen are concerned that the WHFIT rules now require them to publish and mail this information, which was formerly provided by the trustees of these trusts. Middlemen have inquired whether they can provide this additional information by providing a TIH with the address of an Internet website where the information can be found. Until further guidance is issued, the IRS and the Treasury Department have determined that providing the TIH of a royalty or commodity trust with the address of an Internet website where the information can be found is sufficient to meet the requirements of § 1.671-5(e) if the trustee or middleman also informs the TIH that a written tax information package will be provided if requested and the middleman or trustee does in fact furnish a written package if requested. This does not, however, relieve trustees and middlemen of any requirement to provide the IRS and TIHs with individualized calculation of the items of income that are required to be reported to the IRS on a Form 1099.

It has been suggested that the IRS and the Treasury Department clarify the application of the WHFIT reporting rules to royalty and commodity trusts. One suggested clarification is to limit the burden on middlemen to providing the IRS with appropriate Forms 1099 and providing TIHs with statements regarding the information provided on the Form 1099, and to require trustees to maintain an Internet website capable of providing investor-specific information for other items that are required to be provided to the TIH under § 1.671-5(e) but are not required to be included on the Form 1099. The IRS and the Treasury Department request comments regarding this

suggestion and also welcome any alternative suggestions on how trustees and middlemen should share the reporting burden. The IRS and the Treasury Department also request comments on whether there are other types of NMWHFITs from which TIHs need significant information to report the tax consequences of ownership of an interest in the NMWHFIT on their individual tax returns and suggestions on how this information could best be provided.

Comments should include a reference to Notice 2010-4. Send submissions to CC:PA:LPD:RU (Notice 2010-4), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8:00 a.m. and 4:00 p.m. to CC:PA:LPD:RU (Notice 2010-4) , Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224, or sent electronically via the following email address: *Comments@irscounsel.treas.gov*. Please include the notice number 2010-4 in the subject line of any electronic communication. All materials submitted will be available for public inspection and copying.

SECTION VIII: EFFECTIVE DATE

This notice is effective on December 17, 2009.

SECTION IX: DRAFTING INFORMATION

The principal author of this notice is Michala P. Irons of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Michala P. Irons at (202) 622-3050 (not a toll-free call).