DAVIS & HARMAN LLP

ATTORNEYS AT LAW

THE WILLARD
1455 PENNSYLVANIA AVENUE, NW, SUITE 1200
WASHINGTON, DC 20004

TEL 202-347-2230
FAX 202-393-3310 WWW.DAVIS-HARMAN.COM

April 24, 2017

SUBMITTED ELECTRONICALLY

Internal Revenue Service
CC:PA:LPD:PR (Notice 2017-09)
1111 Constitution Avenue, NW
Washington, DC 20224
comments@irscounsel.treas.gov

Re: Comments on Notice 2017-09 by the Committee of Annuity Insurers

Dear Sir or Madam:

We are writing on behalf of the Committee of Annuity Insurers (the "Committee") in response to a request for comments on Notice 2017-09, 2017-4 I.R.B. 542 (the "Notice").[1] The Notice provides guidance on the safe harbor from reporting penalties for certain *de minimis* errors under sections 6721(c)(3) and 6722(c)(3) (the "Safe Harbor") and announces the intention of the Internal Revenue Service ("Service") and Treasury Department to issue regulations under these sections.[2] The Notice also requests comments on the guidance contained therein. As discussed in more detail below, our comments relate to the following:

(1) Payor penalty relief. The Notice provides "reasonable cause" penalty relief for payors who timely correct *de minimis* errors after a payee elects out of the Safe Harbor. This relief should be extended to all payors that correct *de minimis* errors in a timely manner, even if the payor does not implement the Notice's requirements regarding payee notifications and elections.

(2) Payee notice requirements. The Notice states that payors are expected to notify payees about the Safe Harbor and the ability to elect out. Guidance should clarify that payors are required to provide these notices only once, but may choose to provide them more frequently.

[1] The Committee is a coalition of life insurance companies formed in 1981 to participate in the development of federal policy with respect to annuities. The Committee's 29 member companies represent more than 80% of the annuity business in the United States. A list of the Committee's member companies is attached.

[2] All section references are to the Internal Revenue Code of 1986, as amended, or the regulations thereunder.

(3) Payee elections. The Notice prescribes timing rules for correcting *de minimis* errors if a payee elects out of the Safe Harbor. Guidance should clarify certain aspects of those timing rules and extend the deadline for corrections.

(4) Revocations of payee elections. The Notice states that a payee can elect out of the Safe Harbor in writing, electronically, or by phone, but a subsequent revocation of that election must occur *via* "written notice." Guidance should provide that a revocation of a previous election can be made using the same methods permitted for making the election.

The Committee greatly appreciates the Service providing the Notice and the opportunity to comment on the guidance therein. Our comments are discussed more fully below.

(1) The "reasonable cause" relief from penalties for payors who timely correct *de minimis* errors after a payee elects out of the Safe Harbor should be extended to all payors that correct *de minimis* errors.

The Safe Harbor provides that an information return or payee statement will be treated as correct even though it includes an incorrect dollar amount, as long as the error does not exceed $100 ($25 for amounts reported as withheld).[3] The statute further provides, however, that this treatment will not apply if the payee elects out of the Safe Harbor at the time and in the manner the Secretary prescribes.[4] The Notice prescribes the rules for payees to make such an election, and it appears that the Notice contemplates the Safe Harbor being unavailable to a payor unless the payor facilitates and tracks payee elections as the Notice prescribes.[5]

The Notice also provides special relief from reporting penalties for payors in cases where payees elect out of the Safe Harbor. Specifically, the Notice states that if a payee makes a valid election out of the Safe Harbor, and the payor files corrected information returns and provides corrected payee statements within 30 days of that election (hereinafter, a "Timely Correction"), the error will be treated as due to reasonable cause and not willful neglect, so that the section 6721 and 6722 penalties will not apply. This additional relief is appropriate and very much appreciated, especially since it does not appear to be based on the Safe Harbor statute itself.

In that regard, the Safe Harbor provisions of sections 6721(c)(3) and 6722(c)(3) provide that if the requirements therein are met, an information return or payee statement that includes a *de minimis* error is treated as including correct information. This means the Safe Harbor statute

[3] Sections 6721(c)(3)(A) and 6722(c)(3)(A).

[4] Sections 6721(c)(3)(B) and 6722(c)(3)(B).

[5] For example, the Notice does not contemplate payees notifying the Service about their elections out of the Safe Harbor, and instead relies on payors maintaining records of such payee elections. Seemingly, this means that if a payor were to assert the Safe Harbor as a defense to proposed penalties, the payor would need to produce records showing which payees elected out of the Safe Harbor (and, thus, which payees did not elect out) in order for the Service to confirm that the Safe Harbor is available. If the Notice was not intended to condition the Safe Harbor's availability on a payor facilitating and tracking payee elections out, we would welcome clarification on this point.

deems the error to have never occurred in the first place, thereby negating the possibility that penalties could apply and obviating the need for the payor to satisfy an exception to penalties, such as the reasonable cause exception in section 6724(a). In contrast, the relief that the Notice provides for Timely Corrections is explicitly premised on the reasonable cause exception in section 6724(a). That exception is relevant only when an error occurs that otherwise would trigger a penalty liability. Thus, the Notice appears to reflect a determination by the Service that in cases where a penalty liability arises because the payor has made an error and a payee's election has rendered the statutory Safe Harbor unavailable, the error triggering that liability should nonetheless be waived as reasonable if the error (1) was inadvertent, (2) related solely to a dollar amount within the Safe Harbor's limits, and (3) was corrected by the payor within the timeframe the Notice prescribes.

The Committee strongly urges that this same relief be extended to similar situations involving timely corrections of inadvertent *de minimis* errors even though the payor does not implement the Notice's requirements regarding payee notifications and elections. In that regard, a number of the Committee's member companies have indicated that they may choose not to take the steps regarding payee notifications and elections that the Notice prescribes because those steps are too difficult and / or costly.[6] In particular, the following aspects of the Notice present this problem:

(a) The Notice requires that payees be allowed to elect out of the Safe Harbor with respect to either the current year (a "One-Time Election") or with respect to the current year plus all subsequent years (a "Standing Election"), with a default to a Standing Election if the payee does not specify which type.

(b) The Notice requires that payees be allowed to elect out of the Safe Harbor with respect to one or more specific types of payee statements (a "Specific Election") or with respect to all types of payee statements (a "General Election"), with a default to a General Election if the payee does not specify particular types.

(c) The Notice requires payors to retain records of any election, or revocation of an election, for as long as that information may be relevant to the administration of any internal revenue law.

To administer these rules, payors will need to implement a variety of new procedures and recordkeeping systems. These generally would include the following:

- New procedures and systems that allow all payees to elect out of the Safe Harbor and track, on a payee-by-payee basis:
    - Which payees have made a One-Time Election,

[6] It would be perfectly appropriate for a payor to consider the costs of taking the steps required for the Safe Harbor when deciding whether or not to take those steps. The Safe Harbor provides relief *from* reporting requirements and penalties, rather than *imposing* a reporting requirement. *Compare* Treas. Reg. section 301.6721-1(f)(3) (regarding the inappropriate consideration of costs when deciding whether or not to *comply* with a reporting requirement).

  - Which payees have made a Standing Election,
  - Which payees are deemed to have made a Standing Election because they did not specify whether their election was a One-Time Election or a Standing Election,
  - Which payees have made a Specific Election,
  - Which payees have made a General Election,
  - Which payees are deemed to have made a General Election because they did not specify whether their election was a Specific Election or a General Election, and
  - Various combinations of the foregoing elections, such as a payee who makes a One-Time, Specific Election with respect to Form 1099 and a Standing, Specific Election with respect to Form 1098.

- New procedures to track changes to these elections, as the Notice allows payees to revoke prior elections and make new elections at any time.
- New procedures to comply with various notice requirements under the guidance.
- New recordkeeping systems and procedures to keep long-term records of all these elections, combinations of elections, changes to elections, revocations of elections, and records of notices provided to payees.

These new procedures and requirements would require significant changes to the systems payors use to comply with their reporting obligations. All of this would be required for the sole purpose of identifying the payees for which the payor must make Timely Corrections in order to qualify for the additional "reasonable cause" penalty relief the Notice provides for certain *de minimis* errors that are not already eligible for reasonable cause relief under section 6724(a).

We certainly understand the need for the Service to publish rules regarding the payee elections that the Safe Harbor statute describes. In practice, however, many of the Committee's member companies (and, we believe, other large volume payors) will choose not to implement the requirements in the Notice regarding payee notifications and elections out of the Safe Harbor. Instead, they will simply continue their current practices of correcting all reporting errors they discover, even if the errors are *de minimis* and otherwise could be eligible for the Safe Harbor if the payor had taken the steps the Notice describes regarding payee notifications and elections.

In that regard, the Committee's member companies (and presumably other large volume payors) typically have procedures already in place to correct reporting errors, including *de minimis* errors, that they discover or are brought to their attention within a few years. Of course, there are expenses associated with making such corrections, and the Safe Harbor could eliminate the need to make some of those corrections and reduce the payor's penalty exposure, thereby resulting in some savings. But even if a payor took all the steps the Notice requires regarding payee notifications and elections on which the Notice appears to condition the Safe Harbor's

availability, the Safe Harbor would still remain entirely contingent on payees *not* electing out, and if they do elect out the payor would still need to generate corrected returns and payee statements.

In other words, under the Safe Harbor and Notice, payors would still need to correct some *de minimis* errors and all non-*de minimis* errors, so they would still need to maintain their current systems and continue to incur expenses in doing so.[7] In addition, the costs to implement significant procedural and systems changes in order to facilitate the potential (and contingent) availability of the Safe Harbor as interpreted in the Notice and in the forthcoming regulations could outweigh the potential reduction in reporting expenses and penalty exposure the Safe Harbor would provide. In these circumstances, a payor could reasonably conclude that it is more feasible to simply continue correcting all reporting errors, including *de minimis* errors, without regard to the payee notification and election procedures on which the Notice appears to condition the Safe Harbor's availability.

A payor should not be penalized merely because it chooses to correct all *de minimis* errors rather than choosing not to take the steps the Notice prescribes for payee notifications and elections that would allow the payor to forego making such corrections under the Safe Harbor. Consider the following comparable situations:

> Situation A: Payor A takes all the steps needed for the Safe Harbor and then inadvertently makes an error that meets the Safe Harbor's definition of *de minimis* on an information return and payee statement filed in 2017. The payee contacts the payor on December 31, 2017, to elect out of the Safe Harbor and request a corrected return and payee statement. The payor complies with the request by January 30, 2018. As a result, the payor automatically receives "reasonable cause" relief under the Notice.
>
> Situation B: Payor B does not implement the types of procedures the Notice would require for payee notifications and elections out of the Safe Harbor. The payor inadvertently makes the same *de minimis* error that Payor A made, and the payee contacts Payor B on December 31, 2017, to request a corrected return and payee statement. The payor complies with the request by January 30, 2018. However, because Payor B did not implement the Notice's requirements regarding payee notifications and elections, it appears that the automatic "reasonable cause" relief in the Notice would not apply to Payor B, even though Payor B made the same error and correction as Payor A.

We do not think the disparate treatment the Notice appears to provide for these two situations is warranted. In both cases, the payor made an error that (1) was inadvertent, (2) satisfied the dollar amount limitations in the Safe Harbor statute, and (3) was corrected by the payor within 30 days of the payee notifying the payor of the error. As indicated above, the Notice appears to reflect a determination by the Service that under these facts such an error should be waived as reasonable under section 6724(a), even though the Safe Harbor as interpreted in the Notice would not seem to apply by its terms.

---

[7] *See* 2017 Instructions for Forms 1099-R and 5498, at 8 ("If you filed a Form 1099-R with the IRS and later discover that there is an error on it, you must correct it as soon as possible.").

If the Safe Harbor does not apply by its terms and the reasonable cause relief is still available, it is because the error was reasonable in the first place. As a result, it should not matter whether the Safe Harbor is unavailable because a payee elected out or because the payor did not take all the steps required in the Notice, as long as the payor takes the steps that are necessary to make a correction within a reasonable time. In that regard, the Notice states that it does not prohibit a payor from filing corrected information returns and furnishing corrected payee statements even if the payee does not elect out of the Safe Harbor.

For these reasons, the Committee asks the Service to extend the reasonable cause relief in the Notice to all similar situations where a payor corrects a *de minimis* error within a reasonable time, even if the payor has not otherwise taken the steps regarding payee notifications and elections on which the Notice appears to condition the Safe Harbor's availability. Specifically, guidance should provide that, in addition to the relief already provided in the Notice, "reasonable cause" relief under section 6724(a) will apply in any situation where:

(a) A payor files an information return or provides a payee statement that is potentially subject to penalties under section 6721 or 6722,

(b) The payor inadvertently includes an incorrect dollar amount on the information return or payee statement,

(c) The dollar amount of the error is within the limits described in the Safe Harbor, and

(d) The payor files a corrected information return and provides a corrected payee statement within a reasonable time following the end of the calendar year in which the error occurred.

With regard to the correction period proposed in item (d) immediately above, allowing a specified number of days following the end of a calendar year to correct a *de minimis* error would be consistent with the approach already reflected in the Notice. In that regard, the Notice contemplates a payee having until the end of each calendar year to elect out of the Safe Harbor for that year. In such cases, the Notice provides "reasonable cause" relief if the payor corrects the error by January 30 of the following year. Because the relief we are requesting would not be conditioned on a payee electing out of the Safe Harbor and instead would be available without regard to any payee election, the period for making a timely correction (and thus qualifying for the penalty relief we are proposing) would need to be defined without regard to the date on which a payee makes an election. Starting this correction period at year-end would be consistent with the Notice's approach to providing relief where payees actually elect out of the Safe Harbor within the timeframe the Notice allows.[8]

[8] A similar clarification will be needed to address situations where a payee makes a Standing Election out of the Safe Harbor. We also propose that the correction period be extended from 30 days to 90 days. These points are discussed under heading (3), *infra*.

(2) Guidance should clarify the timing and frequency of the notification requirements applicable to payors.

The Notice states that regulations are expected to require payors to notify payees about the Safe Harbor and the ability to elect out (the "General Notification"). The Notice also states that payees are limited to the payor's prescribed methods for electing out, but only if the payor gives advance notice of those methods (the "Election Notification"). As a result, payors who intend to rely on the Safe Harbor and who want to prescribe particular election methods for payees will need to provide the General Notification and the Election Notification.[9] Guidance is needed to clarify the timing and frequency of these notification requirements. The Committee requests that such guidance provide as follows:

- A payor can provide the General Notification and the Election Notification in a single document or as part of (or along with) another document, such as a Form 1099-R.

- A payor needs to provide the General Notification only once, but can choose to provide it more frequently. For example, a life insurance company that issues a commercial annuity could provide the General Notification:

  - When the contract is issued without having to provide it again;

  - When the first payee statement (such as a copy of Form 1099-R) is provided with respect to the contract, without having to provide the notification again; or

  - When each payee statement with respect to the contract is provided.

- The same timing and frequency requirements described above for the General Notification should apply to the Election Notification, except the payor would need to provide an updated Election Notification if it changes its prescribed methods for electing out of the Safe Harbor.

(3) Guidance should clarify certain aspects of the timing rules for Timely Corrections of *de minimis* errors and extend the deadline for such corrections.

As indicated above, the Notice states that if a payor corrects a *de minimis* reporting error within 30 days of a payee electing out of the Safe Harbor (the "Correction Period"), the payor will not be subjected to reporting penalties. As a result, the payor needs to know when the Correction Period commences in order to qualify for the penalty relief. Further guidance is needed on this question for cases involving written elections, Standing Elections, and the absence of an election. In addition, 30 days may be insufficient to facilitate corrections, so guidance should extend the Correction Period to 90 days. These points are discussed below.

[9] We assume that payors who do not intend to rely on the Safe Harbor would not be subject to these notice requirements. Guidance also may need to clarify this point.

(a) Commencement of the Correction Period

The Notice discusses the Correction Period in terms of a corrected return or payee statement being filed or provided "within 30 days of the date of the election." It may not be clear when the "date of the election" occurs in cases where the election is made in writing or in cases involving a Standing Election or where no election is made, so guidance should address these questions. Specifically, guidance should clarify the following:

- Written Elections. In cases where an election is made in writing, the start of the Correction Period should be the date the payor actually receives the written election. If a payee mails a written election to the payor, the payor may not receive it for some time, whether due to the normal pace of mail or a delivery delay. This would adversely affect the payor's ability to make a Timely Correction and qualify for the penalty relief the Notice provides, at no fault of the payor. Payors should have the benefit of the full Correction Period in all cases.

- Standing Elections and No Election. As indicated above, the Notice allows a payee to make (or deems a payee to make) a Standing Election, under which the election out of the Safe Harbor applies to the current year and all succeeding years until revoked. As an initial matter, it is not entirely clear from the Notice whether the penalty relief for Timely Corrections is available for corrections that a payor makes in years after a Standing Election is first made. For example, if a payee makes a Standing Election in 2017, and the payor makes a *de minimis* error in 2018 but corrects that error, does the penalty relief in the Notice apply? Guidance should clarify that it does.

  Guidance also should clarify when the Correction Period starts in such situations, given that no formal election is made in the years following a Standing Election yet the payee is still deemed to have elected out of the Safe Harbor for those years. Likewise, as discussed under heading (1) above, the automatic "reasonable cause" penalty relief should be extended to payors who correct inadvertent *de minimis* errors even though the payor has not implemented the Notice's requirements regarding payee notifications and elections out of the Safe Harbor. Guidance is needed to clarify when the Correction Period commences in these situations as well.

  Such guidance should provide that in these situations, the Correction Period commences on the last day of the calendar year in which the *de minimis* error occurred. This would be consistent with the Notice, which otherwise gives payees until the end of the calendar year to elect out of the Safe Harbor for that year.

(b) Duration of the Correction Period

It will be difficult in some common circumstances for payors to process a payee's election out of the Safe Harbor and perform the corrected reporting within 30 days of the date the election is made. For instance, if a payor is informed that a payee has identified a *de minimis* error on a payee statement, the payor will need to examine the statement, review the facts and circumstances relating to the event that gave rise to the statement, confirm the existence of an

error, follow up with the payee and possibly other parties if more information is needed, and determine the correct amount to be reported before the payor can process a corrected payee statement and information return. If a payee statement includes more than one *de minimis* error as contemplated by the Safe Harbor, this process could be even more involved and time consuming. As a result, the Committee requests that the Correction Period be extended to 90 days. This longer Correction Period would provide payors with valuable additional time to satisfy their obligations to file corrected information returns and furnish corrected payee statements without imposing any significant additional burdens on the Service or taxpayers.

(4) Guidance should clarify how elections can be revoked.

The Notice states that a payee can elect out of the Safe Harbor in writing, electronically, or by phone. In contrast, when discussing a payee's ability to revoke a prior election out of the Safe Harbor, the Notice refers only to a "written notice" of revocation. This suggests, for example, that a payee could elect out of the Safe Harbor online, but would need to revoke that election my mailing a letter to the payor. There would seem to be no reason for a difference in permitted methods for elections and revocations, and the possibility that different methods may be required could confuse payees or discourage revocations to the detriment of payors that wish to rely on the Safe Harbor. As a result, guidance should provide that the revocation of a prior election can be made using any of the methods that are permitted for the election itself.

* * * * *

The Committee greatly appreciates this opportunity to comment on the Notice. If you have any questions, please do not hesitate to contact any of the undersigned at 202-347-2230 or the email addresses noted below.

Counsel to the Committee of Annuity Insurers

Mark E. Griffin
Partner, Davis & Harman LLP
megriffin@davis-harman.com

Bryan W. Keene
Partner, Davis & Harman LLP
bwkeene@davis-harman.com

Attachment

THE Committee OF Annuity Insurers
www.annuity-insurers.org

AIG Life & Retirement, Los Angeles, CA
Allianz Life Insurance Company, Minneapolis, MN
Allstate Financial, Northbrook, IL
Ameriprise Financial, Minneapolis, MN
Athene Annuity & Life Company, Des Moines, IA
AXA Equitable Life Insurance Company, New York, NY
Fidelity Investments Life Insurance Company, Boston, MA
Genworth Financial, Richmond, VA
Global Atlantic Life and Annuity Companies, Southborough, MA
Great American Life Insurance Co., Cincinnati, OH
Guardian Insurance & Annuity Co., Inc., New York, NY
Jackson National Life Insurance Company, Lansing, MI
John Hancock Life Insurance Company, Boston, MA
Lincoln Financial Group, Fort Wayne, IN
MassMutual Financial Group, Springfield, MA
Metropolitan Life Insurance Company, New York, NY
National Life Group, Dallas, TX
Nationwide Life Insurance Companies, Columbus, OH
New York Life Insurance Company, New York, NY
Northwestern Mutual Life Insurance Company, Milwaukee, WI
Ohio National Financial Services, Cincinnati, OH
Pacific Life Insurance Company, Newport Beach, CA
Protective Life Insurance Company, Birmingham, AL
Prudential Insurance Company of America, Newark, NJ
Symetra Financial, Bellevue, WA
The Transamerica companies, Cedar Rapids, IA
TIAA, New York, NY
USAA Life Insurance Company, San Antonio, TX
Voya Financial, Inc., Atlanta, GA

The Committee of Annuity Insurers was formed in 1981 to participate in the development of federal policies with respect to annuities. The member companies of the Committee represent more than 80% of the annuity business in the United States.