

Withdrawal of Previous Proposed Rulemaking, Notice of Proposed Rulemaking, and Notice of Public Hearing

Information Reporting Requirements for Certain Payments Made on Behalf of Another Person, Payments to Joint Payees, and Payments of Gross Proceeds From Sales Involving Investment Advisers

REG-246249-96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of previous notice of proposed rulemaking; notice of proposed rulemaking; and notice of public hearing.

SUMMARY: This document withdraws a previous notice of proposed rulemaking (LR-62-84 [1984-2 C.B. 900]) published May 29, 1984 (49 F.R. 22343). This document contains proposed regulations under section 6041 that clarify who is the payee for information reporting purposes if a check or other instrument is made payable to joint payees, provide information reporting requirements for escrow agents and other persons making payments on behalf of another person, and clarify that the amount to be reported paid is the gross amount of the payment. This document also contains proposed regulations under section 6045 that remove investment advisers from the list of exempt recipients. In addition, this document provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 17, 2001. Requests to speak (with outlines of oral comments) at a public hearing scheduled for February 7, 2001, at 10 a.m. must be submitted by January 24, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG-246249-96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered Monday through Friday between the hours of 8

a.m. and 5 p.m. to: CC:M&SP:RU (REG-246249-96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the IRS Internet site at http://www.irs.gov/tax_regs/regslst.html. The public hearing will be held in the IRS Auditorium, Seventh Floor, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Nancy L. Rose, (202) 622-4910; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy R. Traynor, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S:O, Washington, DC 20224. Comments on the collection of information should be received by December 19, 2000. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper operation of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection

techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in these proposed regulations is in §§1.6041-1(e) and 1.6045-1(c)(3). This information is required to determine if taxpayers have properly reported amounts received as income. The collection of information is mandatory. The likely respondents are businesses and other for-profit institutions.

The estimate of the reporting burden in proposed §1.6041-1 is reflected in the burden of Form 1099-MISC, *Miscellaneous Income*, which is currently 14 minutes per form. The estimate of the reporting burden in proposed §1.6045-1 is reflected in the burden of Form 1099-B, *Proceeds of Broker and Barter Exchange Transactions*, which is currently 15 minutes per form.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

Books or records relating to the collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background and Explanation of Provisions

1. Proposed Regulations Under Section 6041

Section 6041 provides that all persons engaged in a trade or business that make certain payments in the course of that trade or business to another person of \$600 or more in a taxable year must report the amount of the payments and the name and address of the recipient.

Section 3406(a) provides that a payor must withhold tax from reportable payments under certain circumstances, for example, if the payee has failed to furnish

a valid taxpayer identification number to the payor in the manner required. "Reportable payments" include payments that are required to be reported under sections 6041 and 6045. Section 3406(b)(3)(A) and (C). The party that is responsible for reporting the payments under sections 6041 and 6045 is also responsible for any backup withholding required under section 3406.

These proposed regulations address certain issues identified by the Commissioner's Information Reporting Program Advisory Committee (IRPAC) and take into account comments and information provided by IRPAC members representing the banking, real estate, insurance, and securities industries.

a. Payments to Joint Payees

The proposed regulations clarify the definition of fixed and determinable income in §1.6041-1(c) when a payment is made payable to joint payees. This issue was discussed in papers presented at IRPAC meetings in May 1994 and May 1995. The regulations provide that a payment made jointly to two or more payees may be fixed and determinable income to one payee even though the payment is not fixed and determinable income to another payee. For example, when a payment in consideration for services is made payable to joint payees, one of whom is the service provider, an information return must be made showing the service provider as the payee if the payment is fixed and determinable income to the service provider, even if the payment is not fixed and determinable income to the other payee. See, e.g., Situation 2 of Rev. Rul. 70-608 (1970-2 C.B. 286).

b. Identification of Payor

A payment reportable under section 6041 may be made by a person on behalf of another person that is the actual source of the funds. Under certain circumstances this so-called middleman, and not the person that provided the funds, is the payor obligated to report the payment under section 6041. See, e.g., Rev. Rul. 93-70 (1993-2 C.B. 294).

Consistent with Rev. Rul. 93-70, the proposed regulations add a new paragraph (e)(1) to §1.6041-1 that provides that a

person that makes a payment on behalf of another person and performs a management or oversight function in connection with, or has a significant economic interest in, the payment must report under section 6041. A management or oversight function is an activity that is more than merely administrative or ministerial. For example, a person that merely writes checks at the direction of others in connection with a transaction, sometimes referred to as a paying agent, is performing only an administrative or ministerial function and is not a payor. In contrast, a person that exercises discretion or supervision in connection with a payment is performing a management or oversight function and is a payor. A significant economic interest in a payment is an economic interest that would be compromised if the payment were not made. For example a bank has a significant economic interest in a payment to a contractor when damage occurs to property securing a mortgage held by the bank. With this standard, which was also discussed in the IRPAC papers of May 1994 and May 1995, the proposed regulations attempt to replace disparate revenue rulings with a consistent and easily administrable rule that can be applied to a variety of factual situations involving middlemen.

Section 1.6041-1(e)(2) of the proposed regulations provides an exception to the general rule of §1.6041-1(e)(1) by referencing the procedures in Rev. Proc. 84-33 (1984-1 C.B. 502) for an optional method for payors to designate a paying agent to file information returns and backup withhold.

The proposed regulations include examples, derived primarily from revenue rulings and private letter rulings, which are intended to be all-inclusive. Rulings that are factually encompassed by the proposed regulations will be obsolete. Comments are requested identifying other factually relevant rulings or suggesting appropriate additional examples.

The proposed regulations make two changes to §1.6041-3 (to be effective January 1, 2001). They revise §1.6041-3(d) to conform the cross-reference to §1.6041-1 to the language effective January 1, 2001, and to clarify the current rule that real estate agents who manage rental property and make payments of rent to

landlords are payors and continue to be subject to the general requirements of §1.6041-1. The proposed regulations also remove §1.6041-3(n), which provides an exception to the information reporting requirements of section 6041 for amounts that a bank or similar institution collects on behalf of, and pays over or credits to the account of, the actual owner of the funds, but only if it does not collect the items on a regular and continuing basis. Rev. Rul. 77-53 (1977-1 C.B. 368) further restricted this limitation to banks that collect items on a regular and continuing basis and also assume a management function or perform more than the mere collection and payment or crediting of funds to a customer's account. This holding is consistent with the "management and oversight" standard of the proposed regulations. Accordingly, *Example 11* of the proposed regulations preserves the holding of Rev. Rul. 77-53. Section 1.6041-3(n) is removed to avoid confusion and redundancy. However, its removal will change current requirements by imposing a reporting requirement on a bank that collects and pays or credits funds on behalf of a customer on an infrequent or isolated basis if it performs a management or oversight function in connection with the payment, a transaction that is currently within the §1.6041-3(n) exception.

The proposed regulations also remove paragraphs (b) and (c) of §31.3406(a)-2. These paragraphs provide a standard for information reporting by a so-called middleman that is inconsistent with the standard in the proposed regulations. As amended, §31.3406(a)-2 reiterates the general rule of section 3406(h) (also stated in §35a.9999-3, Q & A 1) that the definition of payor for information reporting purposes determines who is the payor for backup withholding purposes as well.

c. Amount to be Reported When Fees, Expenses or Commissions are Deducted From a Payment

The proposed regulations add a new paragraph (f) to §1.6041-1 that clarifies that the amount to be reported as paid to a payee is the gross amount of the payment or payments before fees, commissions, expenses, or other amounts owed by the payee to another person have been de-

ducted. See, e.g., Rev. Rul. 67-197 (1967-1 C.B. 319); Rev. Rul. 54-571 (1954-2 C.B. 235). The rule, which applies whether the payment is made jointly or separately to the payee and another person, is also cross-referenced in *Example 6* and *Example 8* of §1.6041-1(e)(3).

The rule of §1.6041-1(f) is illustrated by two examples involving payment of taxable damages by a defendant to a plaintiff. These examples, read with *Example 8* of §1.6041-1(e)(3), are, in part, inconsistent with *Example 2* of the proposed regulations at §1.6045-5(f), published on May 21, 1999 (64 FR 27730). *Example 2* states that a defendant that pays a settlement to a plaintiff and knows the amount of the plaintiff's attorney fees included in the payment is required to report the payment of the attorney fees under section 6041 and not the gross proceeds under section 6045(f). However, under §1.6041-1(e) of these regulations, the defendant is not exercising management or oversight in connection with, and therefore is not required to make an information return under section 6041 for, the payment to the attorney. The plaintiff, not the defendant, is required to report the payment of attorney fees to plaintiff's attorney under section 6041 (assuming that the payment is made in the course of the plaintiff's trade or business and that the other requirements of section 6041 apply). Accordingly, *Example 2* in the final regulations under section 6045(f) will be revised to provide that the defendant is not required to make an information return under section 6041 but is required to make an information return under section 6045(f), even if the defendant knows the amount of plaintiff's attorney fees.

d. Revenue Rulings to Become Obsolete

As discussed above, the proposed regulations apply to the factual situations addressed in the following revenue rulings, which will become obsolete:

Rev. Rul. 93-70 (1993-2 C.B. 294)
Rev. Rul. 85-50 (1985-1 C.B. 345)
Rev. Rul. 77-53 (1977-1 C.B. 368)
Rev. Rul. 73-232 (1973-1 C.B. 541)
Rev. Rul. 70-608, Situations 1, 2, and 5 (1970-2 C.B. 286)
Rev. Rul. 69-595 (1969-2 C.B. 242)
Rev. Rul. 67-197 (1967-1 C.B. 319)
Rev. Rul. 65-129 (1965-1 C.B. 519)
Rev. Rul. 64-36 (1964-1 C.B. 446)

Rev. Rul. 59-328 (1959-2 C.B. 379)
Rev. Rul. 55-606 (1955-2 C.B. 489)
Rev. Rul. 54-571 (1954-2 C.B. 235)

2. Proposed Regulations Under Section 6045

Section 6045 provides that a broker must file an information return showing the name and address of the broker's customer and other details, such as the amount of the gross proceeds of the transaction, as the Secretary may require. Section 6045(c) defines a broker as a dealer, a barter exchange, or any other person who, for a consideration, regularly acts as a middleman with respect to property or services.

Section 1.6045-1(a)(2) provides that a customer is the person who makes a sale effected by a broker, if the broker acts as (i) an agent for the customer in the sale, (ii) a principal in the sale, or (iii) the party in the sale responsible for paying or crediting the proceeds to the customer. Under §1.6045-1(h), a broker must treat the person whose name appears on the broker's books and records as the principal.

Section 5f.6045-1(c)(3), also published as proposed regulations (49 F.R. 22343), provides that no return of information is required with respect to a sale effected for a customer that is an exempt recipient. Among the categories of exempt recipients is a person registered under the Investment Advisers Act of 1940 who regularly acts as a broker (an investment adviser).

Section 5f.6045-1(c)(3)(iii) provides that, in a cash on delivery or similar transaction, only the broker that receives the gross proceeds against delivery of the securities sold is required to report a sale, unless the broker's customer is another broker (a second-party broker) that is an exempt recipient. In that case, only the second-party broker is required to report.

One effect of these provisions is to shift the reporting requirement in a cash on delivery transaction from the broker that receives the gross proceeds against delivery of the securities to an investment adviser. For example, in §5f.6045-1(c)(4) *Example (4)*, an investment adviser instructs a broker/dealer to sell securities owned by the investment adviser's customer and to pay the proceeds of the sale to a custodian bank. The custodian bank is instructed to

deliver the securities to the broker/dealer against delivery of the proceeds of the sale. The investment adviser, and not the broker/dealer or the custodian bank, is required to report the payment of the proceeds of the sale to the investment adviser's customer, because (1) the broker/dealer paid the gross proceeds of the sale to the custodian bank against delivery of the securities sold, and (2) the custodian bank's customer was the investment adviser, an exempt recipient.

Commentators on the proposed regulations objected to the imposition of the reporting obligation under section 6045(a) on investment advisers because (1) investment advisers generally do not have first-hand knowledge that a sale has been completed, and (2) investment advisers generally do not handle the proceeds of a sale and, consequently, cannot comply with the backup withholding requirements of section 3406. Investment adviser reporting issues were also the subject of IRPAC papers presented at meetings in November 1995 and October 1997.

These proposed regulations withdraw the 1984 proposed regulations. In general, they propose to incorporate the provisions of §5f.6045-1 into §1.6045-1(c)(3) and (4). The proposed regulations also remove investment advisers from the list of exempt recipients and revise current §5f.6045-1(c)(4) *Examples 4* and *5* to clarify that, under the revised rules, an investment adviser that initiates a sale on behalf of a customer is required to make a return of information only if the sale relates to an investment account in the investment adviser's name (i.e., the identity of the customer is not disclosed to the account custodian).

Proposed Effective Date

The provisions of these regulations under sections 6041 and 3406 are proposed to be applicable for payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations. The provisions of these regulations under section 6045 are proposed to be applicable for sales effected on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. An initial regulatory flexibility analysis has been prepared for the collection of information in this notice of proposed rulemaking under 5 U.S.C. section 603. The analysis is set forth in this preamble under the heading "Initial Regulatory Flexibility Analysis." Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Initial Regulatory Flexibility Analysis

The collection of information proposed in §1.6041-1(e) is needed to clarify the requirements for filing an information return under section 6041 when a person makes a payment on behalf of another person or to joint payees. The objectives of the proposed regulations are to provide uniform, practicable, and administrable rules under section 6041 for persons making payments on behalf of another person or to joint payees. The types of small entities to which the proposed regulations may apply are small businesses. An estimate of the number of small entities affected is not feasible because of the large variety of entities and transactions to which the proposed regulations may apply. However, in 1997 a total of 73,273,621 Forms 1099-MISC were filed with the IRS. The number of 1997 Forms 1099-MISC that related to transactions that involved payments made on behalf of another person or to joint payees cannot be determined. The current estimated reporting burden relating to Form 1099-MISC is 14 minutes per form. No special professional skills are necessary for preparation of the reports or records. There are no known Federal rules that duplicate, overlap, or conflict with these proposed regulations. The regulations proposed are considered to have the least economic impact on

small entities of all alternatives considered.

The collection of information in proposed §1.6045-1(c)(3) will not have a significant economic impact on a substantial number of small entities. The proposed regulations will relieve investment advisers of the requirement to make information returns under section 6045(a), and few, if any, financial custodians that may be affected by the regulations are small entities.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely (in the manner described in the ADDRESSES caption) to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 7, 2001, beginning at 10 a.m. in the IRS Auditorium, Seventh Floor, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of the preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by January 24, 2001. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda

will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Donna M. Crisalli, Office of the Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (LR-62-84) amending 26 CFR part 1 that was published in the **Federal Register** on May 29, 1984 (49 F.R. 22343) is withdrawn. In addition, 26 CFR parts 1, 5f, and 31 are proposed to be amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.6041-1 also issued under 26 U.S.C. 6041(a). * * *

Par. 2. Section 1.6041-1 is amended by:

1. Removing the language "paragraph (g)" in the second sentence of paragraph (b)(1) and adding the language "paragraph (i)" in its place.
2. Adding two sentences after the fourth sentence of paragraph (c).
3. Redesignating paragraphs (e) through (g) as paragraphs (g) through (i).
4. Adding new paragraphs (e) and (f), and (j).

The additions and revisions read as follows:

§1.6041-1 Return of information as to payments of \$600 or more.

* * * * *

(c) * * * A payment made jointly to two or more payees may be fixed and determinable income to one payee even though the payment is not fixed and determinable income to another payee. For example, property insurance proceeds paid jointly to the owner of damaged property and to a contractor that repairs the prop-

erty may be fixed and determinable income to the contractor but not fixed and determinable income to the owner. * * *

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(e) *Payment made on behalf of another person*—(1) *In general.* A person that makes a payment in the course of its trade or business on behalf of another person is the payor that must make a return of information under this section with respect to that payment if the payment is described in paragraph (a) of this section and, under all the facts and circumstances, that person—

(i) Performs management or oversight functions (i.e., performs more than mere administrative or ministerial functions) in connection with the payment; or

(ii) Has a significant economic interest in the payment.

(2) *Optional method to report.* A person that makes a payment on behalf of another person but is not required to make an information return under paragraph (e)(1) of this section may elect to do so pursuant to the procedures established in Rev. Proc. 84–33 (1984–1 C.B. 502) (optional method for a paying agent to report and deposit amounts withheld for payors under the statutory provisions of backup withholding) (see §601.601(d)(2) of this chapter).

(3) *Examples.* The provisions of this paragraph (e) are illustrated by the following examples:

Example 1. Bank B provides financing to C, a real estate developer, for a construction project. B puts the funds in an escrow account and makes disbursements from the account for labor, materials, services, and other expenses related to the construction project. In connection with the payments, B performs the following functions on behalf of C: approves payments to the general contractor or subcontractors; ensures that loan proceeds are properly applied and that all approved bills are properly paid to avoid mechanics or materialmen’s liens; conducts site inspections to determine whether work has been completed (but does not check the quality of the work); evaluates and assesses the cost of the project, including costs of changes; and communicates resulting concerns to C or to the general contractor so that modifications can be made or additional funding obtained. B is performing management or oversight functions in connection with the payment and is subject to the information reporting requirements of section 6041 with respect to payments from the escrow fund.

Example 2. Mortgage company D holds a mortgage on business property owned by E. When the property is damaged by a storm E’s insurance company issues a check payable to both D and E in settlement of E’s claim. Pursuant to the contract between D and E, D holds the insurance proceeds in an

escrow account and makes disbursements according to E’s instructions to contractors and subcontractors performing repairs on the property. D is not performing management or oversight functions, but D has a significant economic interest in the payments because the purpose of the arrangement is to ensure that property on which D holds a mortgage is repaired or replaced. D is subject to the information reporting requirements of section 6041 with respect to the payments to contractors.

Example 3. Settlement agent F provides real estate closing services to real estate brokers and agents. F deposits money received from the buyer or lender in an escrow account and makes payments from the account to real estate agents or brokers, appraisers, land surveyors, building inspectors, or similar service providers according to the provisions of the real estate contract and written instructions from the lender. F may also make disbursements pursuant to verbal instructions of the seller or purchaser at closing. F is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041. For the rules relating to F’s obligation to report the gross proceeds of the sale, see section 6045(e) and §1.6045–4.

Example 4. Assume the same facts as in *Example 3*, except that the seller instructs F to hire a contractor to perform repairs on the property. F selects the contractor, negotiates the cost, monitors the progress of the project, and inspects the work to ensure it complies with the contract. With respect to the payments to the contractor, F is performing management or oversight functions and is subject to the information reporting requirements of section 6041.

Example 5. Real estate agent G manages certain rental property on behalf of property owner H. In addition to collecting the rent G arranges for various services that are needed to maintain the property (e.g., painting, repairs, lawn mowing, etc.), determines that the services have been satisfactorily performed, and pays the service providers. G is performing management or oversight functions and is subject to the information reporting requirements of section 6041 with respect to the payments to the service providers. With respect to the payments of rent to H, see §1.6041–3(d).

Example 6. Literary agent J receives a payment from publisher L of fees earned by J’s client, author K. J deposits the payment into a bank account in J’s name and pays K the net amount after subtracting J’s commission. From time to time and as directed by K, J also makes payments to attorneys, managers, and other third parties from these funds for services rendered to K. J does not order or direct the provision of services by the third parties to K, and J exercises no discretion in making the payments to them. J is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041 in connection with the payments to K or to the third parties. For the rules relating to L’s obligation to report the payment of the fees to K, see paragraphs (a)(1)(i) and (f) of this section. For the rules relating to K’s obligation to report the payment of the commission to J and the payments to the third parties for services, see paragraphs (a)(1)(i) and (d)(2) of this section.

Example 7. Attorney P deposits into a client trust fund a settlement payment from R, the defendant in a breach of contract action for lost profits in which P represented plaintiff Q. P makes payments from the client trust fund to service providers such as expert witnesses and private investigators for expenses incurred in the litigation. P decides whom to hire, negotiates the amount of payment, and determines that the services have been satisfactorily performed. In the event of a dispute with a service provider, P withholds payment until the dispute is settled. With respect to payments to the service providers P is performing management or oversight functions and is subject to the information reporting requirements of section 6041.

Example 8. Assume the same facts as in *Example 7*, except that after paying the service providers and deducting his legal fee, P pays Q the remaining funds that P had received from the settlement with R. With respect to the payment to Q, P is not performing management or oversight functions and does not have a significant economic interest in the payment, and is not subject to the information reporting requirements of section 6041. For the rules relating to R’s obligation to report the payment of the settlement proceeds to P, see section 6045(f) and §1.6045–5. For the rules relating to R’s obligation to report the payment of the settlement proceeds to Q, see paragraphs (a)(1)(i) and (f) of this section. For the rules relating to Q’s obligation to report the payment of attorney fees to P, see paragraphs (a)(1)(i) and (d)(2) of this section.

Example 9. Medical insurer S operates as the administrator of a health care program under a contract with a state. S makes payments of government funds to health care providers who provide care to eligible patients. S receives and reviews claims submitted by patients or health care providers, determines if the claims meet all the requirements of the program (e.g., that the care is authorized and that the patients are eligible beneficiaries), and determines the amount of payment. S is performing management or oversight functions and is subject to the information reporting requirements of section 6041 with respect to the payments.

Example 10. Race track employee T holds deposits made by horse owner U in a special escrow account in U’s name. U enters into a contract with jockey V to ride U’s horse in a race at the track. As directed by U, T pays V the fee for riding U’s horse from U’s escrow account. T is not performing management or oversight functions and does not have a significant economic interest in the payment, and is not subject to the information reporting requirements of section 6041. For the rules relating to U’s obligation to report the payment of the fee to V, see paragraph (a)(1)(i) of this section.

Example 11. Bank W collects payments from mortgagors and remits the amounts to the mortgagees or credits their accounts. W performs no other task with respect to the mortgage payments and has no other interest in the accounts. Although W collects payments on a regular and continuing basis, W is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041 with respect to the payments.

(f) *Amount to be reported when fees, expenses or commissions are deducted*—

(1) *In general.* The amount to be reported as paid to a payee is the gross amount of the payment or payments before fees, commissions, expenses, or other amounts owed by the payee to another person have been deducted, whether the payment is made jointly or separately to the payee and the other person.

(2) *Examples.* The provisions of this paragraph (f) are illustrated by the following examples:

Example 1. Attorney P represents client Q in a breach of contract action for lost profits against defendant R. R settles the case for \$100,000 damages and \$40,000 for attorney fees. R issues a check payable to P and Q in the amount of \$140,000. R is required to make an information return reporting a payment to Q in the amount of \$140,000.

Example 2. Assume the same facts as in *Example 1*, except that R issues a check to Q for \$100,000 and a separate check to P for \$40,000. R is required to make an information return reporting a payment to Q in the amount of \$140,000.

* * * * *

(j) *Effective date.* The provisions of paragraphs (b), (c), (e), and (f) apply to payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations.

§1.6041-3 [Amended]

Par. 3. Section 1.6041-3, as in effect on January 1, 2001, is amended as follows:

1. In paragraph (d), removing the language “(but the agent is subject to the requirements of paragraph (a)(1)(ii) and (2)(ii) of §1.6041-1)” and adding the language “(but the agent is required to report payments of rent to the landlord in accordance with §1.6041-1(a)(1)(i)(B) and (2))” in its place.

2. Removing paragraph (n) and redesignating paragraphs (o) through (q) as paragraphs (n) through (p).

Par. 4. Section 1.6045-1, as in effect on January 1, 2001, is amended as follows:

1. Revising paragraph (a) introductory text.

2. Revising paragraphs (c)(3) and (c)(4).

3. Removing the language “5f.6045-1(c)(3)(ii) of this chapter” and adding the language “paragraph (c)(3)(iii) of this section” in its place in each place it appears in paragraph (g)(4) *Examples 1, 4, 5, 6, and 7(i).*

The revisions read as follows:

§1.6045-1 Returns of information of brokers and barter exchanges.

(a) *Definitions.* The following definitions apply for purposes of this section and §1.6045-2:

* * * * *

(c) * * *

(3) *Exceptions*—(i) *Sales effected for exempt recipients*—(A) *In general.* No return of information is required with respect to a sale effected for a customer that is an exempt recipient under paragraph (c)(3)(i)(B) of this section.

(B) *Exempt recipient defined.* The term *exempt recipient* means—

(1) A corporation as defined in section 7701(a)(3), whether domestic or foreign;

(2) An organization exempt from taxation under section 501(a) or an individual retirement plan;

(3) The United States or a State, the District of Columbia, a possession of the United States, a political subdivision of any of the foregoing, a wholly-owned agency or instrumentality of any one or more of the foregoing, or a pool or partnership composed exclusively of any of the foregoing;

(4) A foreign government, a political subdivision thereof, an international organization, or any wholly-owned agency or instrumentality of the foregoing;

(5) A foreign central bank of issue as defined in §1.895-1(b)(1) (i.e., a bank that is by law or government sanction the principal authority, other than the government itself, issuing instruments intended to circulate as currency);

(6) A dealer in securities or commodities registered as such under the laws of the United States or a State;

(7) A futures commission merchant registered as such with the Commodity Futures Trading Commission;

(8) A real estate investment trust (as defined in section 856);

(9) An entity registered at all times during the taxable year under the Investment Company Act of 1940 (15 U.S.C. 80a-1, *et seq.*);

(10) A common trust fund (as defined in section 584(a)); or

(11) A financial institution such as a bank, mutual savings bank, savings and loan association, building and loan asso-

ciation, cooperative bank, homestead association, credit union, industrial loan association or bank, or other similar organization.

(C) *Exemption certificate.* A broker may treat a person described in paragraph (c)(3)(i)(B) of this section as an exempt recipient based on a properly completed exemption certificate (as provided in §31.3406(h)-3) of this chapter or on the broker’s actual knowledge that the payee is a person described in paragraph (c)(3)(i)(B) of this section. A broker may require an exempt recipient to file a properly completed exemption certificate and may treat an exempt recipient that fails to do so as a recipient that is not exempt.

(ii) *Excepted sales.* No return of information is required with respect to a sale effected by a broker for a customer if the sale is an excepted sale. For this purpose, a sale is an excepted sale if it is so designated by the Internal Revenue Service in a revenue ruling or revenue procedure (see §601.601(d)(2) of this chapter).

(iii) *Multiple brokers.* If a broker is instructed to initiate a sale by a person that is an exempt recipient described in paragraph (c)(3)(i)(B)(6), (7), or (11) of this section, no return of information is required with respect to the sale by that broker. In a redemption of stock or retirement of securities, only the broker responsible for paying the holder redeemed or retired, or crediting the gross proceeds on the sale to that holder’s account, is required to report the sale.

(iv) *Cash on delivery transactions.* In the case of a sale of securities through a cash on delivery account, a delivery versus payment account, or other similar account or transaction, only the broker that receives the gross proceeds from the sale against delivery of the securities sold is required to report the sale. If, however, the broker’s customer is another broker (second-party broker) that is an exempt recipient, then only the second-party broker is required to report the sale.

(v) *Fiduciaries and partnerships.* No return of information is required with respect to a sale effected by a custodian or trustee in its capacity as such or a redemption of a partnership interest by a partnership provided the sale is otherwise reported by the custodian or trustee on a properly filed Form 1041, or the redemp-

tion is otherwise reported by the partnership on a properly filed Form 1065, and all Schedule K-1 reporting requirements are satisfied.

(vi) *Sales at issue price.* No return of information is required with respect to a sale of an interest in a regulated investment company (within the meaning of section 851) that computes its current price per share for purposes of distributions, redemptions, and purchases so as to stabilize the price per share at a constant amount that approximates its issue price or the price at which it was originally sold to the public.

(vii) *Obligor payments on certain obligations.* No return of information is required with respect to payments representing obligor payments on—

(A) Nontransferable obligations (including savings bonds, savings accounts, checking accounts, and NOW accounts);

(B) Obligations as to which the entire gross proceeds are reported by the broker on Form 1099 under provisions of the Internal Revenue Code other than section 6045 (including stripped coupons issued prior to July 1, 1982); or

(C) Retirement of short-term obligations (i.e., obligations with a fixed maturity date not exceeding 1 year from the date of issue) that have original issue discount, as defined in section 1273(a)(1).

(viii) *Callable obligations.* No return of information is required with respect to payments representing obligor payments on demand obligations that also are callable by the obligor and that have no premium or discount.

(ix) *Foreign currency.* No return of information is required with respect to a sale of foreign currency other than a sale pursuant to a forward contract or regulated futures contract that requires delivery of foreign currency.

(x) *Fractional share.* No return of information is required with respect to a sale of a fractional share of stock if the gross proceeds on the sale of the fractional share are less than \$20.

(xi) *Certain retirements.* No return of information is required from an issuer or its agent with respect to the retirement of book entry or registered form obligations as to which the relevant books and records indicate that no interim transfers have occurred.

(xii) *Cross reference.* For an exception for certain sales of agricultural commodi-

ties and certificates issued by the Commodity Credit Corporation after January 1, 1993, see paragraph (c)(7) of this section.

(xiii) *Effective date.* The provisions of this paragraph (c)(3) apply for sales effected on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as final regulations.

(4) *Examples.* The following examples illustrate the application of the rules in paragraph (c)(3) of this section:

Example 1. P, an individual who is not an exempt recipient, places an order with B, a person generally known in the investment community to be a federally registered broker/dealer, to sell P's stock in a publicly traded corporation. B, in turn, places an order to sell the stock with C, a second broker, which will execute the sale. B discloses to C the identity of the customer placing the order. C is not required to make a return of information with respect to the sale because C was instructed by B, an exempt recipient as defined in paragraph (c)(3)(i)(B)(6) of this section, to initiate the sale. B is required to make a return of information with respect to the sale because P is B's customer and is not an exempt recipient.

Example 2. Assume the same facts as in *Example 1* except that B has an omnibus account with C so that B does not disclose to C whether the transaction is for a customer of B or for B's own account. C is not required to make a return of information with respect to the sale because C was instructed by B, an exempt recipient as defined in paragraph (c)(3)(i)(B)(6) of this section, to initiate the sale. B is required to make a return of information with respect to the sale because P is B's customer and is not an exempt recipient.

Example 3. D, an individual who is not an exempt recipient, enters into a cash on delivery stock transaction by instructing K, a federally registered broker/dealer, to sell stock owned by D, and to deliver the proceeds to L, a custodian bank. Concurrently with the above instructions, D instructs L to deliver D's stock to K (or K's designee) against delivery of the proceeds from K. The records of both K and L with respect to this transaction show an account in the name of D. Pursuant to paragraph (h)(1) of this section, D is considered the customer of K and L. Under paragraph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because D is L's customer and is not an exempt recipient.

Example 4. Assume the same facts as in *Example 3* except that E, a federally registered investment adviser, instructs K to sell stock owned by D and to deliver the proceeds to L. Concurrently with the above instructions, E instructs L to deliver D's stock to K (or K's designee) against delivery of the proceeds from K. The records of both K and L with respect to the transaction show an account in the name of D. Pursuant to paragraph (h)(1) of this section, D is considered the customer of K and L. Under para-

graph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because D is L's customer and is not an exempt recipient.

Example 5. Assume the same facts as in *Example 4* except that the records of both K and L with respect to the transaction show an account in the name of E. Pursuant to paragraph (h)(1) of this section, E is considered the customer of K and L. Under paragraph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because E is L's customer and is not an exempt recipient. E is required to make a return of information with respect to the sale because D is E's customer and is not an exempt recipient.

Example 6. F, an individual who is not an exempt recipient, owns bonds that are held by G, a federally registered broker/dealer, in an account for F with G designated as nominee for F. Upon the retirement of the bonds, the gross proceeds are automatically credited to the account of F. G is required to make a return of information with respect to the retirement because G is the broker responsible for making payments of the gross proceeds to F. * * * * *

§1.6045-2 [Amended]

Par. 5. In §1.6045-2, paragraph (b)(2)(ii), is amended by removing the language “§5f.6045-1(c)(3)(i)(B) of the Temporary Income Tax Regulations under the Tax Equity and Fiscal Responsibility Act of 1982” and adding the language “§1.6045-1(c)(3)(i)(B)” in its place.

Par. 6. In §1.6049-4, as in effect on January 1, 2001, paragraph (a)(2) is revised to read as follows:

§1.6049-4 Return of information as to interest paid and original issue discount includible in gross income after December 31, 1982.

(a) * * *

(2) *Payor.* For payments made on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as final regulations, a payor is a person described in paragraph (a)(2)(i) or (ii) of this section.

(i) Every person who makes a payment of the type and of the amount subject to reporting under this section (or under an applicable section under this chapter) to any other person during a calendar year.

(ii) Every person who collects on behalf of another person payments of the type and of the amount subject to reporting under this section (or under an applicable section under this chapter), or who otherwise acts as a middleman (as defined in paragraph (f)(4) of this section) with respect to such payment.

* * * * *

PART 5f—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

Par. 7. The authority citation for part 5f is amended by removing the authority citation for Sec. 5f.6045-1 to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§5f.6045-1 [Removed]

Par. 8. Section 5f.6045-1 is removed.

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 9. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 10. Section 31.3406-0 is amended by:

1. Revising the entry for §31.3406(a)-2, paragraph (b).

2. Adding an entry for §31.3406(a)-2, paragraph (d).

The revision and addition read as follows:

§31.3406-0 Outline of the backup withholding regulations.

* * * * *

§31.3406(a)-2 Definition of payors obligated to backup withhold.

* * * * *

(b) Persons treated as payors.

* * * * *

(d) Effective date.

* * * * *

Par. 11. Section 31.3406(a)-2 is revised to read as follows:

§31.3406(a)-2 Definition of payors obligated to backup withhold.

(a) *In general.* Payor means the per-

son that is required to make an information return under section 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, or 6050N, with respect to any reportable payment (as described in section 3406(b)), or that is described in paragraph (b) of this section.

(b) *Persons treated as payors.* The following persons are treated as payors for purposes of section 3406—

(1) A grantor trust established after December 31, 1995, all of which is owned by two or more grantors, and for this purpose spouses filing a joint return are considered to be one grantor;

(2) A grantor trust with ten or more grantors established on or after January 1, 1984 but before January 1, 1996;

(3) A common trust fund; and

(4) A partnership or an S corporation that makes a reportable payment.

(c) *Persons not treated as payors.* The following persons are not treated as payors for purposes of section 3406 if the person does not have a reporting obligation under the section on information reporting to which the payment relates—

(1) A trust (other than a grantor trust as described in paragraph (b)(1) or (2) of this section) that files a Form 1041 containing information required to be shown on an information return, including amounts withheld under section 3406; or

(2) A partnership making a payment of a distributive share or an S corporation making a similar distribution.

(d) *Effective date.* The provisions of this section apply to payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations.

§31.3406(a)-4 [Amended]

Par. 12. Section 31.3406(a)-4 is amended as follows:

1. In paragraph (c)(1), first sentence, removing the language “Any middleman (as defined in §31.3406(a)-2(b))” and adding the language “A middleman payor (as defined in §31.3406(a)-2(b) or in the section on information reporting to which the payment relates)” in its place.

2. In paragraph (c)(3), first sentence, removing the language “§31.3406(a)-2(b)(4)” and adding the language “§31.3406(a)-2(b)(1) or (2)” in its place.

§31.3406(b)(3)-2 [Amended]

Par. 13. In §31.3406(b)(3)-2, paragraph (b)(5) is amended by removing the language “§5f.6045-1(c)(3)(ix)” and adding the language “§1.6045-1(c)(3)(x)” in its place.

§31.3406(d)-4 [Amended]

Par. 14. In §31.3406(d)-4, paragraph (a)(1) introductory text is amended by removing the language “the payor of the instrument (as defined in §31.3406(a)-2(b)(3)),” and adding the language “a broker holding a security (including stock) for a customer in street name,” in its place.

§31.3406(h)-1 [Amended]

Par. 15. In §31.3406(h)-1, paragraph (c), second sentence, is amended by removing the language “§5f.6045-1(c)(3)(ii) and (iii)” and adding the language “§1.6045-1(c)(3)(iii) and (iv)” in its place.

§31.3406(h)-2 [Amended]

Par. 16. Section 31.3406(h)-2 is amended as follows:

1. In paragraph (c), third sentence, removing the language “with two or more grantors described in §31.3406(a)-2(b)(4), which is treated as a middleman payor” and adding the language “described in §31.3406(a)-2(b)(1) or (2), which is treated as a payor” in its place.

2. In paragraph (d), first sentence, removing the language “A middleman payor (as defined in §31.3406(a)-2(b))” and adding the language “A middleman payor (as defined in §31.3406(a)-2(b) or in the section on information reporting to which the payment relates)” in its place.

3. In paragraph (f)(6), removing the language “§31.3406(a)-2(a)” and adding the language “§31.3406(a)-2” in its place.

Robert E. Wenzel,
Deputy Commissioner
of Internal Revenue.

(Filed by the Office of the Federal Register on October 16, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2000, 65 F.R. 61292)