

## Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payments of \$600 or more.

### T.D. 9010

## DEPARTMENT OF THE TREASURY

### Internal Revenue Service 26 CFR Parts 1, 5f, 31, and 602

## 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 Advisors

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations

SUMMARY: This document contains regulations under section 6041 that provide information reporting requirements for escrow agents and other persons making payments on behalf of another person, clarify who is the payee for information reporting purposes if a check or other instrument is made payable to joint payees, and clarify the amount to be reported. This document also contains regulations under section 6045 that incorporate the provisions of temporary regulations, which are removed, and that remove investment advisors from the list of exempt recipients.

DATES: *Effective date:* These regulations are effective January 1, 2003.

*Applicability date:* For dates of applicability of these regulations, see §§ 1.6041-1(j), 1.6045-1(c)(3)(C)(xii), 1.6049-4(a)(2), and 31.3406(a)-2(d).

FOR FURTHER INFORMATION CONTACT: Nancy L. Rose at (202) 622-4910 (not a toll-free number).

### SUPPLEMENTARY INFORMATION:

#### Paperwork Reduction Act

The collection of information requirement contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1705. Responses to this collection of information are mandatory.

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.

The estimate of the reporting burden in § 1.6041-1 is reflected in the burden of Form 1099-MISC. The estimate of the reporting burden in § 1.6045-1 is reflected in the burden of Form 1099-B.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

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

This document contains amendments to the Income Tax Regulations (26 CFR parts 1 and 5f) and Employment Tax Regulations (26 CFR part 31). These regulations finalize proposed regulations relating to

payments to joint payees, payments made on behalf of another person, and payments of gross proceeds from sales involving investment advisors. A notice of proposed rulemaking (REG-246249-96, 2000-2 C.B. 439 [65 FR 61292]) was published in the **Federal Register** on October 17, 2000. A public hearing was held on February 7, 2001, at which two commentators presented oral comments. The IRS also received other written comments responding to the notice of proposed rulemaking. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

## Explanation of Provisions and Summary of Comments

### 1. Payments Made on Behalf of Another Person

Comments were received requesting further clarification as to the meaning of the terms *management or oversight functions* and *significant economic interest* in § 1.6041-1(e)(1) of the proposed regulations. In response to these comments, the final regulations add language that was included in the preamble to the proposed regulations, explaining that a person who merely writes checks at another's direction is not exercising management or oversight with respect to the payment and that a person has a significant economic interest in a payment when such interest would be compromised if the payment were not made.

One commentator stated that an agent cannot perform management or oversight functions in connection with payments it receives and remits to its principal, and, therefore, an agent for a payee could never be required to report a payment to the payee under this standard. The commentator recommended that § 1.6041-1(e)(1) of the proposed regulations be revised to apply only to payments made by agents to third parties.

The determination of whether a person performs management or oversight functions with respect to a payment made on behalf of another, or has a significant economic interest in connection with such payment, is a factual one. Whether an agent has a reporting obligation under these standards must, therefore, be determined in each instance based on the par-

ticular facts and circumstances. The standards set forth in the proposed regulations are intended to apply to all persons making payments on behalf of another, whether they are making such payments on behalf of the payor or payee in a transaction. In keeping with the need for uniformity and consistency in this regard, the regulations also amend § 31.3406(a)-2 to eliminate the current distinction between payor agents and payee agents with respect to the obligation to backup withhold on payments. Therefore, while in some cases an agent for a payee may not be required to report a payment to its principal, the final regulation does not adopt the commentator's suggestion to eliminate the potential applicability of the regulation to all such payments.

With respect to one type of payee agent, however, the final regulation does contain an exception to the rules set forth in paragraph (e)(1). The final regulation adds paragraph (e)(3) exempting from information reporting payments made by an employee to his employer, in recognition of the principle that the employee received such payment from a third party and remitted it to his employer in the course of his employment. *Example 11* is added to illustrate this exception.

Comments were also received with respect to special reporting exceptions. One commentator asked that the current rule with respect to financial institutions be retained. The proposed regulations removed § 1.6041-3(n), which provided that banks making payments on an infrequent and isolated basis would not be subject to the reporting requirements. Banks will therefore now be subject to the same standards as other persons in determining whether they have an obligation to report payments. If a bank exercises management or oversight functions over a payment, or has a significant economic interest in the payment, it will have a reporting obligation regardless of how frequently it makes such payments. Although this is a change that imposes a new reporting burden on financial institutions, the burden is no different than the one that applies to other persons, and the final regulations therefore do not adopt this suggestion.

Another commentator asked that we eliminate the reporting requirements for real estate agents, found in § 1.6041-3(d),

as they conflict with the proposed regulations under § 1.6041-1. The proposed regulations made conforming amendments to § 1.6041-3(d), but retained the existing provision that rent paid by real estate agents is reportable, by cross-reference to the provisions of § 1.6041-1 (a). We believe it is appropriate to require such agents to report under these regulations; therefore, we decline to adopt this comment. The final regulations do, however, change the term *real estate agents* to *rental agents* to more accurately describe the type of person who would be collecting rent from a tenant and remitting it to a landlord.

One commentator asked that the regulations clarify that insurance companies do not have a "significant economic interest" in payments they make to third parties pursuant to contracts with policyholders. Because this is a factual determination which should be made on a case by case basis, this suggestion was not adopted in the final regulations.

Several commentators expressed concern that more than one person might report the same payment pursuant to these rules. One commentator stated that a service-recipient might be obligated to report the payment made on his behalf, while the person making the payment might also report it. Another commentator described a situation where funds were transferred through several parties involved in a construction project before reaching the ultimate payee and each of the parties might meet the management or oversight/significant economic interest standard for reporting the payments.

Several of the examples illustrate the correct reporting of a payment by the parties to a transaction. In the event that several parties might be viewed as meeting the tests for reporting under § 1.6041-1(e) of the regulations, the final regulations set forth the rule that the party closest in the chain to the payee must report the payment, unless the parties agree, in writing, that one of the other parties meeting the test for reporting will report the payment. *Example 12* has been added to § 1.6041-1(e) of the regulations to illustrate this rule. This provision is not intended to preclude the optional method to report under § 1.6041-1(e)(4) of the regulations.

A commentator suggested that in *Ex-*

ample 3, dealing with an agent who performs real estate closings, we clarify that the term *settlement agent* can include a number of different persons who perform real estate closings, such as title companies or title insurance underwriters. Since these examples are meant to be illustrative only, and since any person making a payment on behalf of another person is subject to these regulations, it is not necessary to list all possible individuals who may be performing the functions described in this example. Therefore, the final regulations do not adopt this suggestion.

### 2. Amount to be Reported

One commentator objected to the rule in § 1.6041-1(f) of the proposed regulations that the amount to be reported is the gross amount, before fees and other expenses are deducted. The commentator pointed out the conflicting case law with respect to the issue of whether attorneys fees are income to the client. The final regulations provide that in cases in which the gross amount is income, the gross amount should be reported regardless of any expenses, commissions or other obligations, including backup withholding, that were deducted from the amount before the check was issued. To assist taxpayers in determining whether the gross amount or some lesser amount is includible in a particular payee's income, the Commissioner may provide guidance in the Internal Revenue Bulletin with examples. Example 1 in § 1.6041-1(f) has been modified to illustrate this rule.

In response to a comment, we have added a cross-reference to section 6045(f) of the Internal Revenue Code and the regulations thereunder in the examples in § 1.6041-1(f).

### 3. Obsolescence of Revenue Rulings

One commentator asked that we include a statement in the regulations or commentary that the regulations render obsolete any revenue rulings that are factually encompassed by the proposed rules and that all other revenue rulings pertaining to third party payments would remain in effect unless specifically deemed obsolete.

The preamble to the proposed regulations stated that "Rulings that are factually encompassed by the proposed regulations will be obsolete." A list of revenue rulings to become obsolete was included. The notice of proposed rulemaking also requested comments that identified other factually relevant rulings. No such comments were received. As the proposed regulations made clear that revenue rulings factually encompassed by the proposed regulations would be obsolete and enumerated those rulings, there is no need to include this commentator's suggestion.

Another commentator recommended that Rev. Rul. 69-595, 1969-2 C.B. 242, and Rev. Rul. 70-608, 1970-2 C.B. 286, both of which were listed in the notice of proposed rulemaking as obsolete by the proposed regulations, be obsolete only to the extent they are inconsistent with the proposed regulations. The two revenue rulings cited contain guidance relating to the definition of medical service payments, which the commentator felt should be retained.

Rev. Rul. 70-608 is listed in the notice of proposed rulemaking as obsolete only with respect to Situations 1, 2, and 5. Therefore, Situation 4 of the revenue ruling, which includes a description of medical service payments, was not obsolete. Rev. Rul. 69-595 will likewise not be obsolete with respect to the definition of medical service payments.

### Effect on Other Documents

The following revenue rulings are obsolete as of January 1, 2003:

- 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, 1970-2 C.B. 286, Situations 1, 2, and 5
- Rev. Rul. 69-595, 1969-2 C.B. 242, except with respect to the definition of medical service payments.
- 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

## Special Analyses

It has been determined that this Treasury decision 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. A final regulatory flexibility analysis under 5 U.S.C. section 604 has been prepared for the collection of information in this Treasury decision. This analysis is set forth in this preamble under the heading "Final Regulatory Flexibility Analysis." Pursuant to section 7805(f), the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Final Regulatory Flexibility Analysis

The collection of information contained 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 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 regulations may apply.

There are no known Federal rules that duplicate, overlap or conflict with these regulations. The regulations are considered to have the least economic impact on small entities of all alternatives considered.

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

## Drafting Information

The principal author of these regulations is Nancy L. Rose of Office of the Associate Chief Counsel (Procedure and Administration).

\* \* \* \* \*

## Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 5f, 31, and 602 are 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 as follows:

1. In paragraph (b)(1), the second sentence is amended by removing the language “paragraph (g)” and adding the language “paragraph (i)” in its place.

2. Paragraph (c) is amended by adding two sentences after the penultimate sentence.

3. Paragraphs (e), (f), and (g) are redesignated as paragraphs (g), (h), and (i), respectively.

4. Adding new paragraphs (e), (f), and (j).

The additions 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 property may be fixed and determinable income to the contractor but not fixed and determinable income to the owner, and should be reported to the contractor. \* \* \*

\* \* \* \* \*

(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 in connection with the payment (this would exclude, for example, a person who performs mere administrative or ministerial functions such as writing checks at another’s direction); or

(ii) Has a significant economic interest in the payment (*i.e.*, an economic interest that would be compromised if the payment were not made, such as by creation of a mechanic’s lien on property to which the payment relates, or a loss of collateral).

(2) *Determination of payor obligated to report.* If two or more persons meet the requirements for making a return of information with respect to a payment, as set forth in paragraph (e)(1) of this section, the person obligated to report the payment is the person closest in the chain to the payee, unless the parties agree in writing that one of the other parties meeting the requirements set forth in paragraph (e)(1) of this section will report the payment.

(3) *Special rule for payment by employee to employer.* Notwithstanding the provisions of paragraph (e)(1) of this section, an employee acting in the course of his employment who makes a payment to his employer on behalf of another person is not required to make a return of information with respect to that payment.

(4) *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 by the Commissioner. See, *e.g.*, 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).

(5) *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 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: 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). B is performing management or oversight functions in connection with the payments and is subject to the information reporting requirements of section 6041 with respect to payments.

*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 oral 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*. In addition, 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.* G is a rental agent who manages certain rental property on behalf of property owner H. G finds tenants, arranges leases, collects rent, responds to tenant inquiries regarding maintenance, and hires and makes payments to repairmen. G subtracts her commission and any maintenance payments from rental payments and remits the remainder to H. With respect to payments to repairmen, G is performing management or oversight functions and is subject to the information reporting requirements of section 6041. With respect to the payment of rent

to H, G is subject to the information reporting requirements of section 6041 regardless of whether she performs management or oversight functions or has a significant economic interest in the payment. See § 1.6041-3(d) for rules relating to rental agents. See § 1.6041-1(f) to determine the amount that G should report to H as rent.

*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. From time to time and as directed by K, J makes payments from these funds to attorneys, managers, and other third parties for services rendered to K. After subtracting J's commission, J pays K the net amount. 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 the third parties or to K. 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*. In addition, assume 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, 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 the regulations thereunder. 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 govern-

ment 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, 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.* X is a certified public accountant employed by Firm Y, and is not a partner. Client Z pays X directly for accounting services. X remits the amount received to Y, as required by the terms of his employment. X does not have any reporting obligation with respect to the payment to Y. For the rules relating to Z's obligation to report the payment to Y for services, see paragraphs (a)(1)(i) and (d)(2) of this section.

*Example 12.* Bank contracts with Title Company with respect to the disbursement of funds on a construction loan. Pursuant to their arrangement, the contractor sends draw requests to Title Company, which inspects the work, verifies the amount requested, and then sends the draw request to Bank with supporting documents. Bank pays Title Company the amount of the draw request, and Title Company insures Bank against any loss if it cannot obtain the necessary lien waivers. Bank has a significant economic interest in the payment as a mortgagee, and Title Company exercises management or oversight over the payment. Since Title Company is closest in the chain to the contractor, Title Company should report the payment, unless the parties agree in writing that Bank will report the payment.

(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 amount includible in the gross income of the payee (which in many cases will be 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 another person. The Commissioner may, by guidance published in the Internal Revenue Bulletin, illustrate the circum-

stances under which the gross amount or less than the gross amount may be reported.

(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. Under applicable law, the full \$140,000 is includible in Q's gross taxable income. 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. For the rules with respect to R's obligation to report the payment to P, see section 6045(f) and the regulations thereunder.

*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. For the rules with respect to R's obligation to report the payment to P, see section 6045(f) and the regulations thereunder.

\* \* \* \* \*

(j) *Effective date.* The provisions of paragraphs (b), (c), (e), and (f) apply to payments made after December 31, 2002.

Par. 3. Section 1.6041-3 is amended as follows:

1. Revising paragraph (d).
2. Removing paragraph (n) and redesignating paragraphs (o), (p) and (q) as paragraphs (n), (o) and (p), respectively.

The revisions read as follows:

*§ 1.6041-3 Payments for which no return of information is required under section 6041.*

\* \* \* \* \*

(d) Payments of rent made to rental agents (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)).

\* \* \* \* \*

Par. 4. Section 1.6045-1 is amended as follows:

1. Revising paragraph (a) introductory text.
2. Revising paragraphs (c)(3) and (c)(4).
3. In paragraph (g)(3)(iv), first and third sentences, removing the language "§ 5f.6045-1(c)(3) of this chapter" and adding "paragraph (c)(3) of this section" in its place.
4. In paragraph (g)(4) *Examples 1, 4,*

5, 6, 7(i), 8(i), and 9(i), removing the language “§ 5f.6045–1(c)(3)(ii) of this chapter” and adding “paragraph (c)(3)(iii) of this section” in its place in each place it appears.

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 association, 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, on the broker’s actual knowledge that the payee is a person described in paragraph (c)(3)(i)(B), or on the applicable indicators described in § 1.6049–4(c)(1)(ii)(A) through (M). 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 redemption 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 that can hold itself out as a money market fund under Rule 2a–7 under the Investment Company Act of 1940 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), with or without application of the *de minimis* rule.

(D) Demand obligations that also are callable by the obligor and that have no premium or discount.

(viii) *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.

(ix) *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.

(x) *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.

(xi) *Cross reference.* For an exception for certain sales of agricultural commodities and certificates issued by the Commodity Credit Corporation after January 1, 1993, see paragraph (c)(7) of this section.

(xii) *Effective date.* The provisions of this paragraph (c)(3) apply for sales effected after December 31, 2002.

(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 effect a sale of P's stock in a publicly traded corporation. B, in turn, places an order to sell the stock with C, a second broker, who 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 advisor, 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 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 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.

\* \* \* \* \*

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, 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 after December 31, 2002, 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 \* \* \*

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 in the table for § 31.3406(a)-2, paragraph (b).

2. Adding an entry to the table 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 (treating for this purpose spouses filing a joint return as 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.* A person on the following list is not treated as a payor 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 after December 31, 2002.

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 “A person that is a middleman and is a person 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 “§ 31.3406(a)–2(b)(1) or (2)” in its place.

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 “§ 1.6045–1(c)(3)(x)” in its place.

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 “a broker holding a security (including stock) for a customer in street name,” in its place.

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 “§ 1.6045–1(c)(3)(iii) and (iv)” in its place.

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 “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 “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 “§ 31.3406(a)–2” in its place.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 17. The authority citation for part 602 continues to read in part as follows:

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

Par. 18. In section 602.101, paragraph (b) is amended by adding the following OMB Control numbers in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers

\* \* \* \*

(b) \* \* \*

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.6041–1 .....	1545–1705
* * * * *	
1.6045–1 .....	1545–1705
* * * * *	

Robert E. Wenzel,  
Deputy Commissioner  
of Internal Revenue.

Pamela F. Olson,  
Acting Assistant Secretary of the Treasury  
(Tax Policy).

(Filed by the Office of the Federal Register on July 25, 2002, 8:45 a.m., and published in the Federal Register for July 26, 2002, 67 F.R. 48754)