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DEPARTMENT OF THE TREASURY

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Internal Revenue Service

26 CFR Part 1

TD 9270

RIN 1545-AW72

Reporting of Gross Proceeds Payments to Attorneys

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations

SUMMARY: This document contains final regulations relating to the reporting of payments of gross proceeds to attorneys. The regulations reflect changes to the law made by the Taxpayer Relief Act of 1997 (1997 Act). The final regulations will affect attorneys who receive payments of gross proceeds on behalf of their clients and will affect certain payors (for example, defendants in lawsuits and their insurance companies and agents) that, in the course of their trades or businesses, make payments to these attorneys.

DATES: Effective Dates: These regulations are effective July 13, 2006.

Applicability Dates: For dates of applicability, see §1.6045-5(h).

FOR FURTHER INFORMATION CONTACT: Nancy Rose (202) 622-4940  
(not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Paperwork Reduction Act**

The collection of information 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 1545-1644.

Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, D.C. 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, D.C. 20224. Comments on the collection of information should be received by September 11, 2006. Comments are specifically requested concerning:

Whether the collection of information is necessary for the proper performance 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 collection of information;

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

How the burden of complying with the 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 services to provide information.

The collections of information in the final regulations are in §§1.6041-3(p) and 1.6045-5(a). Section 1021(a) of the 1997 Act added section 6045(f) to the Internal Revenue Code (Code) and requires the IRS to implement information reporting of certain payments made to attorneys. Section 1021(b) of the 1997 Act provides that the exception to information reporting in the regulations under section 6041 for payments to corporations does not apply to payments to attorneys and requires the IRS to implement information reporting for payments to attorneys. This information will be used to verify compliance with sections 6045(f) and 6041 and to determine that the amount of these payments has been reported

correctly. The collections of information are mandatory. The likely respondents (payors) are businesses and other for profit institutions.

Payors provide the information by completing Form 1099-MISC, "Miscellaneous Income," for each attorney who has received one or more payments aggregating \$600 or more from the payor during the calendar year. The burden for this requirement is reflected in the burden estimate for Form 1099-MISC. The estimated burden of information collection for the 2005 Form 1099-MISC is 16 minutes per return.

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

Books or records relating to a 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 return information are confidential, as required by 26 U.S.C. 6103.

### **Background**

This document contains amendments to the 26 CFR Part 1 under sections 6041 and 6045 of the Code. These amendments to the Income Tax Regulations revise existing §§1.6041-1 and

1.6041-3 and add new §1.6045-5. This document finalizes proposed regulations relating to information reporting under section 6045(f) of the Code for gross proceeds paid to attorneys. The proposed regulations were contained in a notice of proposed rulemaking (REG-126024-01) published in the **Federal Register** on May 17, 2002 (67 FR 35064).

Section 6045(f) was added to the Code by the 1997 Act (Public Law 105-34, section 1021 (111 Stat. 788)). Section 6045(f) generally requires information reporting for payments of gross proceeds made in the course of a trade or business to attorneys in connection with legal services (whether or not the services are performed for the payor). No information reporting is required under section 6045(f) for the portion of any payment that is required to be reported under section 6041(a) (relating to payments made in the course of a trade or business) (or that would be required to be reported under section 6041 but for the \$600 limitation) or under section 6051 (relating to receipts for employees). The 1997 Act also provides that the general exception in §1.6041-3(p)(1) for reporting payments made to corporations does not apply to payments of attorneys' fees. Public Law 105-34, section 1021(b).

Proposed regulations under sections 6041 and 6045(f) were first published in the **Federal Register** on May 21, 1999 (64 FR 27730) (the 1999 proposed regulations). The IRS received written comments on the 1999 proposed regulations, and held a public hearing on September 22, 1999. After considering those comments and the testimony at the public hearing, the IRS and the Treasury Department decided to amend and repropose regulations under sections 6041 and 6045(f). Those proposed regulations (the repropose regulations) were published in the **Federal Register** on May 17, 2002 (67 FR 35064), and incorporated the guidance in the 1999 proposed regulations with some modifications. A number of written comments were received in connection with the repropose regulations. After considering those comments, the IRS is adopting the repropose regulations with revisions, as discussed below.

#### **Summary of Comments**

Generally, the section 6045(f) information reporting requirement is intended to be broad, and few exceptions are warranted. See H. Conf. Rep. 105-220, at 546 (1997). As suggested by commentators, the final regulations adopt certain exceptions to the information reporting requirement, described below.

Section 6045-5(c) of the repropoed regulations contains an exception to the information reporting requirement relating to payments made to an attorney who conducts settlements for sales or exchanges of real estate. Commentators suggested an expansion of this exception to include payments made in connection with a refinance of a mortgage and certain other loan closings. After consideration of the comments, and the nature of these transactions, these final regulations expand the exception to include payments made to attorneys in connection with the financing of real estate. The exception now covers, for example, payments made to attorneys in connection with refinancings and mortgages, not limited to purchase-money mortgages.

Many commentators on the 1999 proposed regulations requested exceptions to the section 6045(f) information reporting requirements for payments to trustees and other fiduciaries such as administrators of estates and settlement funds. Those commentators suggested that the definition of legal services should be narrowed to except payments to those individuals, as the payments to attorneys acting as fiduciaries have no correlation to their income. The preamble to the repropoed regulations stated that this issue was considered, but reiterated that a broad definition of legal

services is appropriate and consistent with the language and purpose of section 6045(f). (67 FR 35064) Although the repropose regulations made an exception for payments to attorneys acting as real estate settlement agents, the repropose regulations did not except payments to trustees and administrators. The preamble noted that in many situations, payments are or could be made to an estate or fund, rather than to an attorney acting as a trustee or administrator. If an estate or fund were the payee, information reporting under section 6045(f) would not be required.

With respect to payments to bankruptcy trustees in particular, Example 10 of the repropose regulations describes a situation in which a bankrupt's employer withholds amounts from the bankrupt's earnings pursuant to a wage garnishment order, and forwards that amount to the bankruptcy trustee. Commentators argued that a bankruptcy trustee who receives such payments is not practicing law, and is not receiving these amounts in connection with legal services. They pointed out that many bankruptcy trustees are not attorneys. Commentators also discussed the unique position of a bankruptcy trustee, which would make the bankruptcy trustee reluctant to disclose his or her taxpayer identifying number (TIN). They also described numerous administrative burdens



bankruptcy trustees would face in connection with the receipt of a large number of information returns.

Further, numerous commentators stated that it is not always possible to avoid information reporting; in many bankruptcy situations, particularly in a Chapter 13 bankruptcy, a payor must write the check to the bankruptcy trustee and not to the bankrupt's estate. After considering the comments with respect to payments to bankruptcy trustees, and considering the unique position of attorneys acting in their capacity as bankruptcy trustees, it was determined that an exception for payments to bankruptcy trustees was appropriate. Therefore, the final regulations include an exception in §1.6045-5(c)(7) for payments to attorneys acting in the capacity of bankruptcy trustees, and remove the example contained in the repropoed regulations relating to payments to bankruptcy trustees.

Another commentator recommended that payments of life insurance made to an attorney on behalf of a client not be considered received in connection with legal services and therefore be excepted from the information reporting requirement. The IRS and the Treasury Department continue to believe that a broad definition of legal services is appropriate, and the final regulations do not adopt this

suggestion. As in the fiduciary situation, information reporting under section 6045(f) would not be required if the attorney is not the named payee.

Commentators requested additional clarification of the interplay between the information reporting rules in existing §1.6041-1(e) and (f) and the repropoed regulations under section 6045(f). In response, many of the examples in the final regulations include more cross-references to other information reporting rules, and some examples illustrate the correct reporting under sections other than section 6045(f).

Some commentators asked that the IRS develop a new form for reporting settlement payments made to plaintiffs and their attorneys that would show the names and TINs of both plaintiff and attorney, the amounts paid to each, and backup withholding if applicable. The commentators proposed new Form 1099-SET, "Settlement Proceeds," to satisfy the reporting obligations set forth under both sections 6045 and 6041 with respect to these payments. The IRS already has several different forms in the Form 1099 series that allow for reporting of a variety of types of payments, including payments under section 6045(f). Adding another form to the Form 1099 series limited to only one type of payment would not increase efficiency for the IRS or taxpayers. Moreover, payors could not use the

proposed Form 1099-SET in connection with settlement payments that constitute wages reportable on Form W-2, "Wage and Tax Statement." For these reasons, the final regulations do not adopt this suggestion.

A number of commentators correctly pointed out that under the repropoed regulations, information reporting for amounts paid to attorneys may be required even though the payors also must report these amounts to the attorneys' clients pursuant to section 6041. Commentators stated that duplicate reporting would be a problem under automated systems for generating information returns. In many cases, their systems are designed to generate only one Form 1099 for a payment. Nevertheless, Congress mandated reporting by a payor under both section 6045(f) (to an attorney) and 6041 (to the attorney's client) with respect to the same payment. Section 6045(f)(2)(B) provides an exception for payments required to be reported under section 6041. The IRS and the Treasury Department interpret the exception in section 6045(f)(2)(B) as applying only where the section 6045(f) payment otherwise would be required to be reported under section 6041 with respect to the same payee (i.e., the attorney), and not where section 6041 imposes a separate reporting requirement with respect to another payee (i.e., the client). See §1.6045-

5(c)(4). In cases in which the payment is made to the attorney for the benefit of the client, section 6041 requires reporting with respect to the client, and section 6045(f) requires reporting with respect to the attorney. Each of these statutory reporting requirements serves an independent purpose - reporting the amount paid for the benefit of the client who has to include that amount in income, and reporting a gross proceeds payment to the attorney. Section 1.6041-1(a)(1) was revised to clarify that there is a requirement to report to both the attorney and client in that situation.

Other commentators discussed the requirement to backup withhold on payments to an attorney if the attorney does not provide an accurate TIN to the payor. The commentators suggested that there are both practical and ethical problems with respect to backup withholding on payments to attorneys. They noted that the amounts paid to the attorney generally belong to the attorney's client and that there may be difficulty in determining how to claim the withholding on the client's income tax return. The IRS and the Treasury Department believe that payments to attorneys for legal services are reportable payments under section 3406(b)(3)(C), and are thus subject to backup withholding. The legislative history to section 6045(f) makes clear that Congress intended

such payments to be subject to backup withholding. H. Conf. Rep. 105-220, at 546 (1997). As the commentators point out, backup withholding on a payment to an attorney that constitutes the income of the attorney's client raises some practical concerns, but it is nonetheless required by the statute. Backup withholding can be avoided as long as the attorney provides an accurate TIN to the payor. Furthermore, there are procedures in place affording an opportunity to correct an inaccurate TIN before backup withholding is required. See §31.3406(d)-5; Rev. Proc. 93-37 (1993-2 C.B. 477).

A comment was received with respect to the exception in §1.6045-5(c)(5) of the repropoed regulations for payments to certain non-residents that are not engaged in a trade or business within the United States and that do not perform any labor or personal services within the United States. The commentator stated that, as drafted, the exception is too narrow and will result in unnecessary information reporting. The commentator suggested that the exception should be based solely on whether the payment to the non-resident alien individual, foreign partnership, or foreign corporation is in connection with legal services performed outside the United States. The commentator suggested that a payor be entitled to

rely for purposes of making this determination on a signed statement by the attorney or law firm to the effect that the services for which payment is made were performed outside the United States, provided that the payor does not know that the statement is inaccurate. The commentator noted that payments of gross proceeds to non-resident alien attorneys may be reportable under this section although attorneys' fees paid to such attorneys would not be reportable under section 6041.

The gross proceeds reporting requirement under section 6045(f) is intended to be broad and has a different purpose than information reporting under section 6041 for payments for services. Congress expressed its intent with respect to section 6045(f) "that the IRS will administer this provision so that it will not apply to foreign attorneys who can clearly demonstrate that they are not subject to U.S. tax." Joint Committee on Taxation Staff, General Explanation of Tax Legislation Enacted in 1997, 105<sup>th</sup> Cong., 1<sup>st</sup> Sess. 215 (1997).

Foreign persons not engaged in trade or business within the United States are subject to U.S. tax on amounts of certain types of income received from sources within the United States (e.g., under section 871(a)). Foreign persons engaged in trade or business within the United States are subject to U.S. tax on taxable income effectively connected with the conduct

of such trade or business within the United States (e.g., under section 871(b)). Thus, a foreign person can demonstrate clearly that it is not subject to U.S. tax only if it clearly demonstrates both that the income in question would not be subject to U.S. tax if the foreign person were not engaged in trade or business in the United States and that the income in question is not effectively connected with the conduct of a trade or business within the United States. The commentator's proposed approach would not produce a clear demonstration that both conditions are satisfied and so would be inconsistent with the intent expressed by Congress. Therefore, the final regulations do not adopt the commentator's suggestion.

In addition to written comments, a number of telephone calls were received with questions and comments regarding the repropoed regulations. Many of the callers raised questions as to whether an attorney is the payee of a check where the check is made out to the attorney's client, but "in care of" the attorney, or to the attorney's client trust account, or other scenarios. Since these questions were raised by a number of callers, the final regulations address them. Generally, an attorney is the payee on a check written to the attorney's client trust fund, but not on a check which the attorney may not negotiate. (§1.6045-5(d)(4)).

The repropoed regulations indicated in §1.6045-5(h) that the regulations would become effective with payments made during the first calendar year that begins at least two months after the publication of the regulations as final regulations.

Consequently, the final regulations will apply to payments made in or after 2007. This delayed effective date affords time to implement any changes required in automated information processing systems.

Section 6724(a) states that no penalty relative to information reporting shall be imposed with respect to a failure that is due to reasonable cause and not to willful neglect. Section 301.6724-1(a) provides in part that a penalty is waived for reasonable cause if the filer establishes that there are significant mitigating factors with respect to the failure, or that the failure arose from events beyond the filer's control, and that the filer acted in a responsible manner. Under §301.6724-1(b)(1), significant mitigating factors include the fact that prior to the failure the filer was never required to file the particular type of return with respect to which the failure occurred. Under §301.6724-1(d)(1)(i), acting in a responsible manner means that the filer exercised reasonable care, which is that standard of care that a reasonably prudent person would use



under the circumstances in the course of its business in determining its filing obligations. Pursuant to these provisions, a penalty waiver may apply, for example, if an information report would have been required under the reproposed regulations, but not under the final regulations.

### **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.

It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. This certification is based on the facts that: (1) the time required to prepare and file a 2005 Form 1099-MISC, "Miscellaneous Income," is minimal (currently estimated at 16 minutes per form); and (2) it is not anticipated that, as a result of these regulations, many small entities will have to prepare and file more than a few forms per year.

Pursuant to section 7805(f) of the Code, the Notice of Proposed Rulemaking preceding this regulation was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

**Drafting Information**

The principal author of these regulations is Nancy L. Rose of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division.

**List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

**Amendments to the Regulations**

Accordingly, 26 CFR part 1 is amended as follows:

PART 1--INCOME TAXES

Par. 1. The authority citation for part 1 continues to read, in part, as follows:

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

Par. 2. Section 1.6041-1(a)(1) is amended as follows:

1. In paragraph (a)(1)(ii), the first sentence is removed and two sentences are added in its place.

2. Paragraph (a)(1)(iii) is added.

The revision and addition read as follows:

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

(a) \* \* \*

(1) \* \* \*

(ii) Information returns required under other provisions of the Internal Revenue Code. The payments described in paragraphs (a)(1)(i)(A) and (B) of this section shall not include any payments of amounts with respect to which an information return is required by, or may be required under authority of, section 6042(a)(relating to dividends), section 6043(a)(2)(relating to distributions in liquidation), section 6044(a)(relating to patronage dividends), section 6045(relating to brokers' transactions with customers and certain other transactions), sections 6049(a)(1) and (2) (relating to interest), section 6050N(a) (relating to royalties), or section 6050P(a) or (b)(relating to cancellation of indebtedness). For information returns required under section 6045(f) (relating to payments to attorneys), see special rules in §§1.6041-1(a)(1)(iii) and 1.6045-5(c)(4). \* \* \*

(iii) Information returns required under section 6045(f) on or after January 1, 2007. For payments made on or after January 1, 2007, to which section 6045(f)(relating to

payments to attorneys) applies, the following rules apply. Notwithstanding the provisions of paragraph (a)(1)(ii) of this section, payments to an attorney that are described in paragraph (a)(1)(i) of this section but which otherwise would be reportable under section 6045(f) are reported under section 6041 and this section and not section 6045(f). This exception applies only if the payments are reportable with respect to the same payee under both sections. Thus, a person who, in the course of a trade or business, pays \$600 of taxable damages to a claimant by paying that amount to the claimant's attorney is required to file an information return under section 6041 with respect to the claimant, as well as another information return under section 6045(f) with respect to the claimant's attorney.

For provisions relating to information reporting for payments to attorneys, see §1.6045-5.

\* \* \* \* \*

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

1. Revising the first sentence in paragraph (p)(1).
2. In paragraph (p)(8), removing the language "(q)" and adding "(p)" in its place.

The revision reads as follows:

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

\* \* \* \* \*

(p) \* \* \*

(1) A corporation described in §1.6049-4(c)(1)(ii)(A), except with respect to payments made to a corporation after December 31, 1997 for attorneys' fees, and except a corporation engaged in providing medical and health care services or engaged in the billing and collecting of payments in respect to the providing of medical and health care services. \* \* \*

\* \* \* \* \*

Par. 4. Section 1.6045-5 is added to read as follows:

§1.6045-5 Information reporting on payments to attorneys.

(a) Requirement of reporting--(1) In general. Except as provided in paragraph (c) of this section, every payor engaged in a trade or business who, in the course of that trade or business, makes payments aggregating \$600 or more during a calendar year to an attorney in connection with legal services (whether or not the services are performed for the payor) must file an information return for such payments. The information return must be filed on the form and in the manner required by the Commissioner. For the time and place for filing the form, see §1.6041-6. For definitions of the terms under this

section, see paragraph (d) of this section. The requirements of this paragraph (a)(1) apply whether or not--

(i) A portion of a payment is kept by the attorney as compensation for legal services rendered; or

(ii) Other information returns are required with respect to some or all of a payment under other provisions of the Internal Revenue Code and the regulations thereunder.

(2) Information required. The information return required under paragraph (a)(1) of this section must include the following information:

(i) The name, address, and taxpayer identifying number (TIN) (as defined in section 7701(a)) of the payor;

(ii) The name, address, and TIN of the payee attorney;

(iii) The amount of the payment or payments (as defined in paragraph (d)(5) of this section); and

(iv) Any other information required by the Commissioner in forms, instructions or publications.

(3) Requirement to furnish statement. A person required to file an information return under paragraph (a)(1) of this section must furnish to the attorney a written statement of the information required to be shown on the return. This requirement may be met by furnishing a copy of the return to the attorney. The written statement must be furnished to the

attorney on or before January 31 of the year following the calendar year in which the payment was made.

(b) Special rules--(1) Joint or multiple payees--(i) Check delivered to one payee attorney. If more than one attorney is listed as a payee on a check, an information return must be filed under paragraph (a)(1) of this section with respect to the payee attorney to whom the check is delivered.

(ii) Check delivered to payee nonattorney. If an attorney is listed as a payee on a check but the check is delivered to a nonattorney who is a payee on the check, an information return must be filed under paragraph (a)(1) of this section with respect to the payee attorney listed on the check. If more than one attorney is listed as a payee on a check but the check is delivered to a nonattorney who is a payee on the check, the information return must be filed with respect to the first-listed payee attorney on the check.

(iii) Check delivered to nonpayee. If two or more attorneys are listed as payees on a check, but the check is delivered to a person who is not a payee on the check, an information return must be filed under paragraph (a)(1) of this section with respect to the first-listed payee attorney on the check.

(2) Attorney required to report payments made to other attorneys. If an information return is required to be filed with respect to a payee attorney under paragraph (b)(1) of this section, the attorney with respect to whom the information return is required to be filed (tier-one attorney) must file an information return under this section for any payment that the tier-one attorney makes to other payee attorneys with respect to that check, regardless of whether the tier-one attorney is a payor under paragraph (d)(3) of this section.

(c) Exceptions. Notwithstanding paragraphs (a) and (b) of this section, a return of information is not required under section 6045(f) with respect to the following payments:

(1) Payments of wages or other compensation paid to an attorney by the attorney's employer.

(2) Payments of compensation or profits paid or distributed to its partners by a partnership engaged in providing legal services.

(3) Payments of dividends or corporate earnings and profits paid to its shareholders by a corporation engaged in providing legal services.

(4) Payments made by a person to the extent that the person is required to report with respect to the same payee



the payments or portions thereof under section 6041(a) and §1.6041-1(a) (or would be required to so report the payments or portions thereof but for the dollar amount limitation contained in section 6041(a) and §1.6041-1(a)).

(5) Payments made to a nonresident alien individual, foreign partnership, or foreign corporation that is not engaged in trade or business within the United States, and does not perform any labor or personal services in the United States, in the taxable year to which the payment relates. For how a payor determines whether a payment is subject to this exception, see §1.6041-4(a)(1).

(6) Payments made to an attorney in the attorney's capacity as the person responsible for closing a transaction within the meaning of §1.6045-4(e)(3) for the sale or exchange or financing of any present or future ownership interest in real estate described in §1.6045-4(b)(2)(i) through (iv).

(7) Payments made to an attorney in the attorney's capacity as a trustee in bankruptcy under Title 11, United States Code.

(d) Definitions. The following definitions apply for purposes of this section:

(1) Attorney means a person engaged in the practice of law, whether as a sole proprietorship, partnership, corporation, or joint venture.

(2) Legal services means all services related to, or in support of, the practice of law performed by, or under the supervision of, an attorney.

(3) Payor means a person who makes a payment if that person is an obligor on the payment, or the obligor's insurer or guarantor. For example, a payor includes--

(i) A person who pays a settlement amount to an attorney of a client who has asserted a tort, contract, violation of law, or workers' compensation claim against that person; and

(ii) The person's insurer if the insurer pays the settlement amount to the attorney.

(4) Payments to an attorney include payments by check or other method such as cash, wire or electronic transfer.

Payment by check to an attorney means a check on which the attorney is named as a sole, joint, or alternative payee. The attorney is the payee on a check written to the attorney's client trust fund. However, the attorney is not a payee when the attorney's name is included on the payee line as "in care of," such as a check written to "client c/o attorney," or if the attorney's name is included on the check in any other

manner that does not give the attorney the right to negotiate the check.

(5) Amount of the payment means the amount tendered (e.g., the amount of a check) plus the amount required to be withheld from the payment under section 3406(a)(1), because a condition for withholding exists with respect to the attorney for whom an information return is required to be filed under paragraph (a)(1) of this section.

(e) Attorney to furnish TIN. A payor that is required to file an information return under this section must solicit a TIN from the attorney at or before the time the payor makes a payment to the attorney. The attorney must furnish the correct TIN to the payor, but is not required to certify the TIN. A payment for which a return of information is required under this section is subject to backup withholding under section 3406 and the regulations thereunder.

(f) Examples. The following examples illustrate the provisions of this section. The examples assume that P is not a payor with respect to A, the attorney, under section 6041. See section 6041 and the regulations thereunder for rules regarding whether P is required under section 6041 to file information returns with respect to C. The examples are as follows:

Example 1. One check--joint payees--taxable to claimant.

Employee C, who sues employer P for back wages, is represented by attorney A. P settles the suit for \$300,000. The \$300,000 represents taxable wages to C under existing legal principles. P writes a settlement check payable jointly to C and A in the amount of \$200,000, net of income and FICA tax withholding with respect to C. P delivers the check to A. A retains \$100,000 of the payment as compensation for legal services and disburses the remaining \$100,000 to C. P must file an information return with respect to A for \$200,000 under paragraph (a)(1) of this section. P also must file an information return with respect to C under sections 6041 and 6051, in the amount of \$300,000. See §§1.6041-1(f) and 1.6041-2.

Example 2. One check--joint payees--excludable to claimant. C, who sues corporation P for damages on account of personal physical injuries, is represented by attorney A. P settles the suit for a \$300,000 damage payment that is excludable from C's gross income under section 104(a)(2). P writes a \$300,000 settlement check payable jointly to C and A and delivers the check to A. A retains \$120,000 of the payment as compensation for legal services and remits the remaining \$180,000 to C. P must file an information return with respect to A for \$300,000 under paragraph (a)(1) of this section. P does not file an information return with respect to tax-free damages paid to C.

Example 3. Separate checks--taxable to claimant. C, an individual plaintiff in a suit for lost profits against corporation P, is represented by attorney A. P settles the suit for \$300,000, all of which will be includible in C's gross income. A requests P to write two checks, one payable to A in the amount of \$100,000 as compensation for legal services and the other payable to C in the amount of \$200,000. P writes the checks in accordance with A's instructions and delivers both checks to A. P must file an information return with respect to A for \$100,000 under paragraph (a)(1) of this section. Pursuant to §1.6041-1(a) and (f), P must file an information return with respect to C for the \$300,000.

Example 4. Check made payable to claimant, but delivered to nonpayee attorney. Corporation P, is a defendant in a suit for damages in which C, the plaintiff, has been represented by

attorney A throughout the proceeding. P settles the suit for \$300,000. Pursuant to a request by A, P writes the \$300,000 settlement check payable solely to C and delivers it to A at A's office. P is not required to file an information return under paragraph (a)(1) of this section with respect to A, because there is no payment to an attorney within the meaning of paragraph (d)(4) of this section.

Example 5. Multiple attorneys listed as payees.

Corporation P, a defendant, settles a lost profits suit brought by C, for \$300,000 by issuing a check naming C's attorneys, Y, A, and Z, as payees in that order. Y, A, and Z do not belong to the same law firm. P delivers the payment to A's office. A deposits the check proceeds into a trust account and makes payments by separate checks to Y of \$30,000 and to Z of \$15,000, as compensation for legal services, pursuant to authorization from C to pay these amounts. A also makes a payment by check of \$155,000 to C. A retains \$100,000 as compensation for legal services. P must file an information return for \$300,000 with respect to A under paragraphs (a)(1) and (b)(1)(i) of this section. A, in turn, must file information returns with respect to Y of \$30,000 and to Z of \$15,000 under paragraphs (a)(1) and (b)(2) of this section because A is not required to file information returns under section 6041 with respect to A's payments to Y and Z because A's role in making the payments to Y and Z is merely ministerial. See §1.6041-1(e)(1), (e)(2) and (e)(5) Example 7 for information reporting requirements with respect to A's payments to Y and Z. As described in Example 3, P must also file an information return with respect to C, pursuant to §1.6041-1(a) and (f).

Example 6. Amount of the payment--attorney does not provide TIN. (i) Corporation P, a defendant, settles a suit brought by C for \$300,000 of damages. P will pay the damages by a joint check to C and his attorney, A. A failed to furnish P with A's TIN. P is required to deduct and withhold 28 percent tax from the \$300,000 under section 3406(a)(1)(A) and paragraph (e) of this section. P writes the check to C and A as joint payees, in the amount of \$216,000. P also must file an information return with respect to A under paragraph (a)(1) of this section in the amount of \$300,000, as prescribed in paragraph (d)(5) of this section. If the damages are reportable under section 6041 because they are not excludable from gross income under existing legal principles,

and are not subject to any exception under section 6041, P must also file an information return with respect to C pursuant to §1.6041-1(a) and (f) in the amount of \$300,000.

(ii) Rather than paying by joint check to C and A, P will pay the damages by a joint check to C and F, A's law firm. F failed to furnish its TIN to P. P is required to deduct and withhold 28 percent tax from the \$300,000 under section 3406(a)(1)(A) and paragraph (e) of this section. P writes the check to C and F as joint payees, in the amount of \$216,000. P also must file an information return with respect to F under paragraph (a)(1) of this section in the amount of \$300,000, as prescribed in paragraph (d)(5) of this section. If the damages are reportable under section 6041 because they are not excludable from gross income under existing legal principles, and are not subject to any exception under section 6041, P must also file an information return with respect to C pursuant to §1.6041-1(a) and (f) in the amount of \$300,000.

Example 7. Home mortgage lending transaction. (i) Individual P agrees to purchase a house that P will use solely as a residence. P obtains a loan from lender L to finance a portion of the cost of acquiring the house. L disburses loan proceeds of \$300,000 to attorney A, who is the settlement agent, by a check naming A as the sole payee. A, in turn, writes checks from the loan proceeds and from other funds provided by P to the persons involved in the purchase of the house, including a check for \$800 to attorney B, whom P hired to provide P with legal services relating to the closing.

(ii) P, not L, is the payor of the payment to A under paragraph (d)(3) of this section. P, however, is not required to file an information return with respect to A under paragraph (a)(1) of this section because the payment was not made in the course of P's trade or business. Even if P made the payment in the course of P's trade or business, P would not be required to file an information return under section 6045(f) with respect to A because P is excepted under paragraph (c)(6) of this section.

(iii) A is not required to file an information return under paragraph (a)(1) of this section with respect to the payment to B because A is not the payor as that term is defined under paragraph (d)(3) of this section. A is not required to file an information return under paragraph (b)(2)

with respect to the payment to B because A was listed as sole payee on the check it received from P. See section 6041 and §1.6041-1(e) for whether A or L must file information returns under that section. See section 6045(e) and §1.6045-4 for whether A is required to file an information return under that section.

Example 8. Business mortgage lending transaction. The facts are the same as in Example 7 except that P buys real property that P will use in a trade or business. P, not L, is the payor of the payment to A under paragraph (d)(3) of this section. P, however, is not required to file an information return under section 6045(f) with respect to A because P is excepted under paragraph (c)(6) of this section. A is not required to file an information return under paragraphs (a) or (b)(2) of this section with respect to the payment to B. See section 6041 and §1.6041-1(e) to determine whether P or L must file an information return under that section with respect to the payment to A, and whether P or A must file a return with respect to the payment to B. See section 6045(e) for rules regarding whether A is required to file information returns under that section.

Example 9. Qualified settlement fund. Corporation P agrees to settle for \$300,000 a class action lawsuit brought by attorney A on behalf of a claimant class. Pursuant to the settlement agreement and a preliminary order of approval by a court, A establishes a bank account in the name of Q Settlement Fund, which is a qualified settlement fund (QSF) under §1.468B-1. A is also designated by the court as the administrator of the QSF. Corporation P transfers \$300,000 by wire in Year 1 to A, who deposits the funds into the Q Settlement Fund. In Year 2, the court approves an award of attorney's fees of \$105,000 for A. In Year 2, Q Settlement Fund delivers \$105,000 to A. P is required to file an information return under paragraph (a) of this section with respect to A for Year 1 for the \$300,000 payment it made to A. The Q Settlement Fund is required to file an information return under section 6041(a) and §1.468B-2(1)(2) with respect to A for Year 2 for the \$105,000 payment it made to A.

(g) Cross reference to penalties. See the following sections regarding penalties for failure to comply with the requirements of section 6045(f) and this section:

(1) Section 6721 for failure to file a correct information return.

(2) Section 6722 for failure to furnish a correct payee statement.

(3) Section 6723 for failure to comply with other information reporting requirements (including the requirement to furnish a TIN).

(4) Section 7203 for willful failure to supply information (including a TIN).



(h) Effective date. The rules in this section apply to payments made on or after January 1, 2007.

Mark E. Matthews,  
Deputy Commissioner for Services and  
Enforcement.

Approved: June 8, 2006

Eric Solomon,  
Acting Deputy Assistant Secretary of the Treasury (Tax Policy).