

**MEMO# 12882**

November 24, 2000

## **IRS ISSUES PROPOSED REGULATIONS AFFECTING INFORMATION REPORTING UNDER SECTIONS 6045 AND 6041**

[12882] November 24, 2000 TO: BROKER/DEALER ADVISORY COMMITTEE No. 26-00 TAX COMMITTEE No. 49-00 TRANSFER AGENT ADVISORY COMMITTEE No. 61-00 UNIT INVESTMENT TRUST COMMITTEE No. 28-00 RE: IRS ISSUES PROPOSED REGULATIONS AFFECTING INFORMATION REPORTING UNDER SECTIONS 6045 AND 6041 The Internal Revenue Service ("IRS") has released the attached proposed regulations which would (1) remove "a person registered under the Investment Advisers Act of 1940 who regularly acts as a broker" (an "investment adviser") from the list of exempt recipients under section 6045 and (2) clarify the rules for reporting transactions under section 6041, including those involving a "middleman." The regulations would apply prospectively to payments and sales made on or after the beginning of the first calendar year following the issuance of the regulations in final form. Proposed Changes under Section 6045 Under section 6045, a broker must file an information return on IRS Form 1099-B reporting the amount of gross proceeds from a transaction effected for an identified customer. A mutual fund, for example, generally is treated as "broker" for this purpose and is required to report gross proceeds from share redemptions to investors on Form 1099-B. However, no reporting obligation arises where a sale is effected for a customer that is an "exempt recipient." Exempt recipients currently include US or foreign corporations, tax exempt organizations, domestic and foreign governments (and instrumentalities), dealers in securities or commodities, futures commission merchants, real estate investment trusts, common trust funds, mutual funds and other entities registered under the Investment Company Act of 1940, investment advisers, and financial institutions. The proposed regulations would remove investment advisers from the list of "exempt recipients" under 6045. The stated rationale for the proposed change is to eliminate the reporting requirement for investment advisers in so-called "cash on delivery" transactions where the investment adviser initiates a sale transaction on behalf of its client with a broker or financial institution, but does not have first-hand knowledge when the sale has been completed or handle the proceeds from the sale. It appears that this proposed change might have certain unintended consequences. No tax reporting is generally required when payments of gross proceeds are made to an omnibus account in the name of an investment adviser because the investment adviser is an exempt recipient. Where an investment adviser does not otherwise qualify as an "exempt recipient" under section 6045, the proposed regulations would require payors to issue Forms 1099-B to the adviser. Proposed Changes under Section 6041 Under section 6041, all persons engaged in a trade or business that make certain payments to another person of \$600 or more in a taxable year must report the amount of the payments and the name and address of the recipient on IRS Form 1099-MISC. The proposed regulations make

three clarifying changes to the rules for reporting transactions under section 6041. First, where a payment is made jointly to two or more payees, the proposed regulations clarify that the payment may be reportable income to one payee, even though the payment is not “fixed and determinable” income to another payee. Second, the proposed regulations clarify that the amount to be reported as paid under section 6041 is the gross amount of a payment before fees, commissions, expenses, or other amounts owed by the payee to another person have been deducted. Third, the proposed regulations require a “middleman” to report a payment made on behalf of another if the middleman performs management or oversight functions in connection with the payment or has a significant economic interest in the payment. The proposed regulations provide that a management or oversight function is an activity that is “more than mere[ly] administrative or ministerial.” For example, the proposed regulations would treat a paying agent that writes checks at the direction of others in connection with a transaction as performing a merely administrative or ministerial function.<sup>1</sup> The preamble to the proposed regulations explains that a “significant economic interest” in a payment is an “economic interest that would be compromised if the payment were not made.” For example, a bank would have a significant economic interest in a payment to a contractor to repair damage to property securing a mortgage held by the bank. ACTION REQUESTED: If there are comments that the Institute should submit to the IRS on the proposed regulations, please provide them to the undersigned no later than December 20, 2000 by e-mail (dflores@ici.org) or by facsimile (202 326-5841). In particular, please consider whether the proposed removal of investment advisers from the listing of exempt recipients under section 6045 could have any unintended consequences for US mutual funds and their shareholders. Deanna J. Flores Associate Counsel Attachment (in .pdf format) 1 However, payors would retain the ability to designate a paying agent to file information returns and backup withhold under Revenue Procedure 84-33.