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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's SSN & EIN:

TY:

Conference of right held:

ISSUE:

Whether payments Taxpayer made to independent contractors that were reportable payments under section 6041 of the Internal Revenue Code (Code) were subject to backup withholding under section 3406 of the Code.

CONCLUSION:

The payments Taxpayer/payor made to the independent contractors/payees were reportable payments under section 6041 of the Code. As a result of Taxpayer's failure to obtain the taxpayer identification numbers (TINs) of the independent contractors/payees at the time of such payments, the payments are subject to the backup withholding under section 3406 of the Code.

FACTS:

Taxpayer owns and operates a used car dealership. During the years in question, Taxpayer made payments of commissions and service fees to various independent contractors for personal services provided for his business. Specifically, Taxpayer paid commissions to auto wholesalers for locating and transporting

cars to his dealership for purchase. Taxpayer also paid auto repair shops, auto body shops, and auto detail services for work performed on his dealership's cars. These independent contractors were paid by checks drawn on Taxpayer's dealership account during the calendar years 1995 and 1996. Taxpayer deducted these payments as business expenses on Schedule C of his 1995 and 1996 Form 1040, Individual Income Return.

All of Taxpayer's payments to the independent contractors that are in question exceed \$600 for the relevant calendar year. At the time Taxpayer made payments to the independent contractors, no TINs were obtained, and Taxpayer did not file the required Forms 1099 for purposes of compliance with the information reporting provisions of section 6041 of the Code.

During an audit of Taxpayer's 1995 and 1996 individual tax returns in 1998, the Service determined that Taxpayer's payments to various independent contractors were subject to (1) the information reporting requirements of section 6041 of the Code, and (2) the backup withholding requirements of section 3406. Upon learning of the information reporting requirements, Taxpayer obtained the TINs of the independent contractors and issued the required Forms 1099.

LAW and ANALYSIS:

Section 3406(a)(1)(A) of the Code provides that, in the case of a reportable payment, if the payee fails to furnish his TIN in the manner required, then the payor must deduct and withhold 31 percent of the payment.

Under section 3406(b)(3) of the Code, the term "reportable payment" is defined to include any payment of a kind, and to a payee, required to be shown on a return required under sections 6041 and 6041A of the Code. Under sections 6041 and 6041A, payments of \$600 or more made during a calendar year to a contractor by a service-recipient engaged in a trade or business are reportable payments.

Section 6041(a) of the Code and section 1.6041-1(a)(1) of the Income Tax Regulations require all persons engaged in a trade or business who make payments in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensation, remunerations, emoluments, or other fixed or determinable gains, profits, and income of \$600 or more in any taxable year, to file an information return with the Service setting forth the amount of such gains, profits and income, and the name and address of the recipients of such payments.

Section 31.3406(e)-1(b)(1)(i) of the regulations describes when backup withholding is required. Section 31.3406(e)-1(b)(1)(i) provides that a payor is required to withhold under section 3406(a)(1)(A) of the Code at a rate of 31 percent on any reportable payment (as defined in section 3406(b)) at the time the payor pays the reportable payment (as described in section 31.3406(a)-4 of the regulations) to the payee if the payor has not received the payee's TIN in the manner required in section 31.3406(d)-1.

Sections 31.3406(a)-4(a)(1) and 31.3406(b)(3)-1(b)(3) of the regulations describe the point in time for the payor to withhold 31 percent of the payee's reportable payment as required under the backup withholding tax provisions. Section 31.3406(a)-4(a)(1) provides that the payor must withhold at the time it makes the payment to the payee or to the payee's account that is subject to withholding. Amounts are considered paid when they are credited to the account of, made available to, the payee. Section 31.3406(b)(3)-1(b)(3) provides that a payment is a reportable payment if the aggregate amount of the current payment and all previous payments to the payee during the calendar year equal \$600 or more. The amount subject to withholding is the entire amount of the payment that causes the total amount paid to the payee to equal \$600 or more and the amount of any subsequent payments made to the payee during the calendar year.

Section 31.3406(d)-1(d) of the regulations describes the required manner for payees of commissions and nonemployee compensation to furnish their TINs to payors. Section 31.3406(d)-1(d) provides that the payee must furnish the payee's TIN to the payor either orally or in writing.

Based on the above, Taxpayer's payments to the independent contractors were payments made in the course of Taxpayer's used car sales business. Such payments were made to persons who were not employed by Taxpayer, but provided services for the benefit of Taxpayer's used car dealership for compensation. All of the payments in question are for \$600 or more. All of the payments in question were made within the specific calendar years of 1995 and 1996. Accordingly, Taxpayer's payments to the independent contractors were reportable payments as described in sections 6041 and 3406 of the Code.

Taxpayer obtained the independent contractors' TINs and issued the required Forms 1099 to the Service and the independent contractors after the commencement of an audit of his 1995 and 1996 individual tax returns in January of 1998. The provisions of section 3406 of the Code and the applicable regulations require that 31 percent of any reportable payments be withheld by the payor if the payor has not received the payee's TIN either orally or in writing. Taxpayer neither received the TINs from

the independent contractors nor deducted the required backup withholding from the payments received by the independent contractors during calendar years 1995 and 1996.

The provisions of sections 31.3406(a)-4(a)(1) and 31.3406(b)(3)-1(b)(3) of the regulations specify the time a payor is required to withhold. Taxpayer's obligation to backup withhold commenced with the entire amount of the payment that caused the total amount paid to an independent contractors to equal \$600 or more for the calendar year.

We conclude, therefore, that the payments Taxpayer/payor made to the independent contractors/payees were reportable payments under section 6041 of the Code. As a result of Taxpayer's failure to obtain the TINs of the independent contractors/payees at the time of such payments, the payments are subject to backup withholding under section 3406 of the Code.

A copy of this technical advice memorandum is to be given to the taxpayer. Section 6110(j)(3) provides that it may not be used or cited as precedent.