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NEW IRS REPORTING REQUIREMENTS

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NEW IRS REPORTING REQUIREMENTS

In 1997 Congress adopted an amendment to the Internal Revenue Code which requires that sureties, their attorneys and consultants must provide a report to the Internal Revenue Service any time when an attorney's name is included on the settlement check. This amendment is effective beginning on January 1, 1998, and therefore all settlement checks which include an attorney's name from this year forward will require that the surety, or any other business writing such a check, obtain the Tax ID Number of the attorney whose name is on the check, and report the total amount of the payment to the Internal Revenue Service.

THE NEW REPORTING LAW

The specific code section mandating these requirements is Internal Revenue Code § 6045(f). The subsection reads as follows:

(f) Return required in the case of payments to attorneys.

(1) In general. Any person engaged in a trade or business and making a payment (in the course of such trade or business) to which this subsection applies shall file a return under subsection (a) and a statement under subsection (b) with respect to such payment.

(2) Application of subsection.

(A) In general. This subsection shall apply to any payment to an attorney in connection with legal services (whether or not such services are performed for the payor).

(B) Exception. This subsection shall not apply to the portion of any payment which is required to be reported under section 6041(a) (or would be so required but for the dollar limitation contained therein) or section 6051.

The practical effect of this amendment is that a Form 1099-MISC must be provided by the surety every time a claimant's attorney's name is included in a check. The entire amount of the payment must be reported, and the payor may not report a lesser amount because it receives information as to the exact amount of attorney's fees. A copy of the report must also be sent to the attorney.

LEGISLATIVE HISTORY, AND REASONS FOR THE CHANGE

Before this amendment the Code required that attorney's fees be reported when they were paid by a business. IRC § 6041(a) Tres. Reg. § 1.6041-1(d)(2). Under this requirement, when any business paid for attorney's fees, they were, and still are, required to report the payment of those fees on a form 1099. However, if a gross payment was made by a business to a party and that party's attorney, and it was not known what portion of the payment was attorney's fees, there was no reporting requirement.

The legislative history indicates that Congress believed that this new reporting requirement would be a simple requirement which would make the world a better place. Specifically, the legislative history indicates that Congress thought that this would have a positive impact on compliance with tax laws. Apparently Congress felt that lawyers are the only profession where a gross payment was made, a portion of which may become income to them, and a portion of which may belong to the client.

COMPLIANCE WITH THE STATUTE

In order to comply with this statute, any business making a payment which includes an attorney's name on it must report that payment on a information return with the IRS (i.e. file a Form 1099-MISC), and must also furnish a written statement to the recipient of the payment.

Several points need to be made with regard to this reporting requirement. First, the provision applies to payments made to attorney's whether or not the attorney is the exclusive payee. In short anytime a payment is jointly made to a claimant and an attorney, a 1099 must be filed. Second, payments made to law firms are payments to attorneys and subject to the reporting requirement. Third, attorneys are required to supply their Tax Identification Numbers. Failure to do so could result in the attorney being subject to penalties.

It is quite common for insurance companies to write checks payable to both a claimant and to the claimant's attorney. Indeed, in many instances having joint payees identified on checks has become so common as to become ingrained. However, as of January 1, 1998, if the attorney's name is on the check, then the full amount of that payment needs to be reported on a Form 1099.

As a practical matter the only way to avoid having to file such a form is to leave the attorney's name off of the check.