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Insurance Company Information Reporting and Withholding Update

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I. Legislation

A. \$146 Billion Tax Cut Package Approved by Congress

Congress approved H.R. 1308, a \$146 billion tax cut package, which extends many popular tax reductions and reliefs. The provisions were scheduled to expire on December 31, 2004. Congress settled on business extenders amounting to \$13 billion in savings for the business community. The extensions will last through 2005. One extension to note is the extension of the combined employment tax reporting demonstration project, a pilot program designed to test combined federal and state tax reporting. For purposes of this program, the test state is authorized to treat tax information provided to it by the IRS as though the information had been collected by the test state itself.

II. Employer Issues and Employee Benefits

A. Compliance Problems with Deferred Compensation Plans

Cheryl E. Press, a senior attorney in the Office of Division Counsel/Associate Chief Counsel, Tax Exempt/Government Entities, spoke at an American Law Institute - American Bar Association conference in Washington, D.C. At the conference, Press highlighted some of the compliance problems which are frequently found in audits of I.R.C. § 457 deferred compensation plans. Press said that for eligible plans the most common errors came from a lack of coordination of limits, as well as lenient or non-existent procedures for determining when employees can claim a hardship. Problems with covenants not to compete were common for the ineligible plans. Press pointed out that the burden of showing that a covenant not to compete is a good covenant is on the employer. Additionally, problems with the rolling risk of forfeiture often in conjunction with a covenant not to compete were found. According to Press, agents look for a business purpose and for an arm's-length transaction, not just a tax motivation.

B. Holiday Gift Coupon Is Not Tax-free Fringe Benefit

In TAM 200437030, the IRS determined that an employer-provided \$35 holiday gift coupon redeemable at grocery stores was not a tax-free fringe benefit under I.R.C. § 132(a)(4), but instead was a cash equivalent even though the coupon was subject to some restrictions. The employer was a tax-exempt organization, who historically gave a ham, turkey or gift basket as an annual holiday gift. The employer started providing a \$35 gift coupon because some employees for religious and dietary reasons requested an alternative to the holiday ham or turkey. The coupon included some restrictions in that, it could only be used at certain food stores, the coupon could only be used once and any unused portion was forfeit, and it could not be used for the purchase of alcohol, tobacco, or pharmacy goods.

Under I.R.C. § 132(a)(4), gross income does not include any fringe benefit that qualifies as a de minimis fringe benefit. I.R.C. § 132(e)(1) defines a de minimis fringe benefit as any property or service the value of which, after taking into account the frequency with which similar benefits are provided, is so small as to make accounting for it unreasonable or administratively impracticable. Additionally, Treas. Reg. § 1.132-6(c) provides, except for a few special rules found under Treas. Reg. § 1.132-6(d), that cash equivalent fringe benefits including gift certificates and charge or credit cards, are generally not excludable under I.R.C. § 132(a) even if the same property or service if given directly to the employee would qualify as a de minimis fringe benefit. Accordingly, the IRS concluded that the employer-provided gift coupon did not qualify as a de minimis fringe benefit, and was therefore not a tax-free gift.

III. Employee Business Expenses

A. Terminal Charges and SIFL Rates for Noncommercial Flights

In Rev. Rul. 2004-70, the IRS published the Standard Industry Fare Level (SIFL) rates and terminal charges applicable under Treas. Reg. § 1.61-21(g) for the valuation of noncommercial flights on employer-provided aircraft. The rates are in effect for July 1, 2004, through December 31, 2004. The terminal charge will be \$35.21, and the SIFL cents-per-mile rates are \$.1926 per mile up to 500 miles, \$.1469 per mile from 501-1500 miles, and \$.1421 per mile over 1500 miles.

B. FY-2005 Per Diem Rates Available on GSA Website

The GSA (General Services Administration) has posted on its website the per diem rates that will be effective October 1, 2004 through September 30, 2005. The standard rate for all cities within the continental U.S. (CONUS) will be \$91, including \$60 for lodging and \$31 for meals and incidental expenses. Additionally, the GSA has added over 20 new destinations. Per diem rates may be figured by locality, or by using a “high-low” system under which there is one uniform per diem rate for all “high-cost” areas, and another for all other areas within the CONUS. The “high-low” rates for FY 2005 should be released by the IRS before the end of October. The rates can be accessed through the GSA website at www.gsa.gov/perdiem.

IV. Reporting Guidelines and Forms

A. IRS Posts Ten Most Common Errors in Completing Forms 1042-S

The IRS has posted on its website the ten most common errors found during the processing of Forms 1042-S, “Foreign Person’s U.S. Source Income Subject to Withholding.” As announced on the

IRS website, the posting of the ten common errors is part of the ongoing effort by the IRS to “develop enhanced computer data consistency and validity controls to ensure the integrity, accuracy and completeness of Forms 1042-S submitted by Withholding Agents.”

The most frequent problems occur with the non-entry or incorrect entry of codes and names in boxes that require such information. The number one processing error is an incorrect income code entered in Box 1, which requires an entry. Also important to note is that the number three processing error is the inconsistent calculation of U.S. federal tax withheld which is reported in Box 7. An amount inconsistent with a “valid tax rate” may result in an error notice. The posting includes a list of income codes, exemption codes, and recipient codes, as well as a link to other pertinent publications and forms. The post may be found at the www.irs.gov site by going to the businesses section, then under small, international, and finally news and articles.

V. Other Matters

A. Proposed Regulations to Treat Timely Mailing as Timely Filing

The IRS has proposed regulations that would amend Treas. Reg. § 301.7502-1 to provide that, other than direct proof of actual delivery, a registered or certified mail receipt is the only prima facie evidence of delivery of documents that have a filing deadline prescribed by the internal revenue laws. In the preamble to the proposed regulations (REG-138176-02), the IRS acknowledged that there is conflict among the courts as to whether the provisions in I.R.C. § 7502 provide the exclusive means to establish prima facie evidence of delivery of a document to the IRS or the United States Tax Court. Accordingly, the proposed regulations amend Treas. Reg. § 301.7502-1(e)(1) to clarify that other than direct proof of actual delivery, the only other means of establishing prima facie evidence of delivery of federal tax documents is to prove the use of registered or certified mail by way of a registered or certified mail receipt.