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## Insurance Company Information Reporting and Withholding Update

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## I. Legislation

### A. JCT Report Lists Revenue-Raising Proposals

On January 27, 2005, the Joint Committee on Taxation released a report, which outlined a list of potential revenue-raising proposals. The list includes proposals affecting employment taxes, as well as health, pension, and employee benefits.

One proposal would provide for consistent FICA tax treatment of salary reduction contributions to 1) employer-sponsored retirement plans, which contributions are included in wages for FICA tax purposes, and 2) other plans that are not employer-sponsored, which contributions are not included in wages for FICA tax purposes.

Another proposal would conform the definition of “qualified medical expenses” for purposes of the tax treatment of reimbursements under employer-sponsored accident and health plans, HSAs, and MSAs, so that such medical expenses could be claimed as itemized deductions.

## II. Life Insurance, Annuities, and Qualified Plans

### A. Automatic Rollovers from Qualified Retirement Plans

On December 28, 2004, the IRS issued Notice 2005-5, which provides guidance relating to automatic rollover rules under I.R.C. § 401(a)(31)(B), as added by the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Under these rules, mandatory distributions of more than \$1,000 from a qualified retirement plan must be paid in a direct rollover to an individual retirement plan (i.e., an individual retirement account or an individual retirement annuity), unless the distributee affirmatively elects to have the amount rolled over to an eligible retirement account or to receive the distribution directly. The plan administrator must notify the distributee in writing that the distribution may be paid in a direct rollover to an individual retirement plan.

Notice 2005-5 is presented in a question-and-answer format and provides guidance relating to the application of the automatic rollover rules to enable plan sponsors to timely comply with the new rules.

The automatic rollover rules are effective March 28, 2005, the effective date of related final regulations published by the Department of Labor. 29 CFR § 2550.404a-2. The regulations issued by the Department of Labor provide the safe harbor provisions under which a plan administrator’s designation of a recipient institution for the automatic rollover, and the

initial investment choice for the rolled over funds, would be deemed to satisfy the fiduciary responsibility provisions under ERISA.

Notice 2005-5 (automatic rollovers) may be viewed at: [www.irs.gov/irb/2005-03\\_IRB/ar10.html](http://www.irs.gov/irb/2005-03_IRB/ar10.html).

B. Final Regulations Issued on I.R.C § 401(k) Plans

On December 28, 2004, Treasury and the IRS issued final regulations governing cash or deferred arrangements under I.R.C. § 401(k) plans, and employer matching and employee contributions under I.R.C. § 401(m). T.D. 9196. The comprehensive final regulations reflect the significant statutory changes that have occurred since the regulations were last updated in 1994.

The final regulations are effective for plan years beginning on or after January 1, 2006. However, employers may use the new rules for any plan year that ends after December 29, 2004, provided that the plan applies all the rules of the final regulations, to the extent applicable, for that plan year and all subsequent plan years. Taxpayers are cautioned that a decision to apply the final regulations in the middle of a plan year could only be successfully implemented if the plan has been operated in accordance with the final regulations for that year. For plan years beginning before the effective date of the final regulations, the plan must apply the rules of the prior regulations (as they appeared in the April 1, 2004, edition of 26 CFR part 1), the statutory provisions of I.R.C. § 401(k) and (m), and applicable IRS notices.

### III. Employer Issues and Employee Benefits

A. Employee Plans Taxpayer Assistance

In a recent issue of Employee Plans News, the IRS provided contact information to assist taxpayers with employee plan questions. For retirement plans technical and procedural questions, taxpayers may call (877) 829-5500. For questions relating to retirement income, IRAs, ROTH IRAs, medical savings accounts and section 125 cafeteria plans, taxpayers may call (800) 829-1040. Taxpayers also may access employee plan information at: [www.irs.gov/ep](http://www.irs.gov/ep).

B. Form 5500

The Department of Labor's Employee Benefits Security Administration has launched a dedicated website to announce relief from Form 5500, Annual Return/Report of Employee Benefit Plan, filing deadlines for filers in a FEMA-declared disaster area. The website is at: [www.efast.dol.gov/disaster\\_relief.html](http://www.efast.dol.gov/disaster_relief.html).

C. Redesigned Form 941

The IRS has redesigned Form 941, Employer's Quarterly Federal Tax Return, for use in the first quarter of 2005 (ending March 31, 2005). The Winter 2004 issue of the SSA/IRS Reporter contains information about using the redesigned form and may be viewed at: [www.irs.gov/businesses/small/article/0,,id=98868,00.html](http://www.irs.gov/businesses/small/article/0,,id=98868,00.html).

D. Coverage and Reimbursement by Employer-Provided Medical Reimbursement Plan Excludable from Employee's Gross Income

On December 24, 2004, the IRS released PLR 200452013, which addressed the federal income tax treatment of an employer-provided medical reimbursement plan. Under the plan, the employer establishes and contributes to individual member accounts, which are held in trust for the payment of, or reimbursement for, medical expenses incurred after retirement or other termination of employment. There is no salary reduction, employee election, or right to receive cash or any other taxable or nontaxable benefit under the plan. Members, their spouses, and dependents are eligible for reimbursement or payment of substantiated medical expenses to the extent that such expenses are not reimbursed by any other plan, up to the balance of the individual member account. Upon the death of a member, the member's spouse and dependents are entitled to medical expense reimbursement or payment until any remaining account balance is exhausted. If the deceased member has no spouse or dependents, any remaining account balance is allocated among the accounts of other members.

The IRS held that the employer-provided medical reimbursement plan satisfies the requirements set forth in Rev. Rul. 2002-41 and Notice 2002-45 pertaining to employer-sponsored health reimbursement arrangements. Accordingly, the IRS concluded that the employer contributions to and coverage under the plan are excludable from the member's gross income pursuant to I.R.C. § 106. The payments of and reimbursement for medical expenses are excludable from the member's gross income pursuant to I.R.C. § 105(b).

E. Final Regulations Issued on HIPAA Rules for Group Health Plans and Group Health Insurance Issuers

On December 29, 2004, the IRS issued final regulations governing portability requirements for group health plans and group health insurance issuers. T.D. 9166. The final regulations implement the statutory changes to the Internal Revenue Code, ERISA, and the Public Health Services Act, pursuant to the enactment of the Health Insurance Portability and Accountability Act of 1996 (HIPAA). The final regulations retain much of the framework of the interim rules issued in April 1997, improve the portability of health coverage, and minimize burdens on group health plans and group health insurance issuers.

The final regulations are effective February 28, 2005, and apply to plan years beginning on or after July 1, 2005. Thus, each plan or issuer must comply with the April 1997 interim rules until the final regulations become applicable to that plan or issuer.

F. General Information Pertaining to Qualified Parking Plans

On December 31, 2004, the IRS released INFO 2005-0201, which provided a general information response to an information request regarding certain qualified parking plans. The IRS stated that the request described the type of plan addressed in Rev. Rul. 2004-98, in which an employer reduced employees' wages in return for employer-provided parking. Under that arrangement, the value of the parking was excludable from the employees' gross incomes under I.R.C. § 132(a)(5). However, the employer reimbursed the employees for some of the parking cost and excluded the reimbursements from the employees' gross incomes. The employees did not actually incur reimbursable parking expenses. Thus, Rev. Rul. 2004-98 held that I.R.C. § 132(a)(5) was inapplicable to the reimbursed amounts and that the purported reimbursements were includible in the employees' gross incomes, and were wages subject to employment taxes.

G. Proposed Regulations Issued on Withholding Rates for Supplemental Wages

On January 5, 2005, the IRS issued proposed regulations, which would amend the rules for flat rate withholding on supplemental wages to reflect statutory changes over the past 10 years. Prop. Treas. Reg. § 31.3402(g)-1(a)(1) defines supplemental wages as wages that are not regular wages. Regular wages are defined as amounts paid at a regular hourly, daily, or similar periodic rate, or at a predetermined fixed determinable amount.

The proposed regulations also reflect that under the American Jobs Creation Act of 2004 (Jobs Act), the optional flat rate for withholding on supplemental wages, paid after December 31, 2004, is the applicable rate of tax under I.R.C. § 1(i)(2), currently 25 percent. However, supplemental wages in excess of \$1 million paid during a calendar year are subject to mandatory withholding at the maximum rate of tax, currently 35 percent.

Comments and requests for a public hearing may be submitted to the IRS, by April 5, 2005, via mail, hand-delivery, or electronically.

H. Dependent Group Life Insurance Program

On January 14, 2005, the IRS released TAM 200502040, which addressed the taxability of amounts resulting from a dependent group life insurance program offered to employees.

Under the dependent group life insurance program, the employee paid the entire premium on an after-tax basis. The IRS concluded that the dependent group life insurance program was term insurance, subject to the fringe benefit rules and the Table 1 uniform rates under Treas. Reg. § 1.79-3(d)(2). To the extent that the uniform rates exceed the premiums paid such that the amount cannot be considered a de minimis fringe benefit, the excess is includible in the employee's gross income. Such excess will also be treated as wages subject to FICA tax, but will not be treated as wages for purposes of the FUTA tax.

I. IRS Posts Guide to Fringe Benefits

On January 27, 2005, the IRS posted a Taxable Fringe Benefit Guide on its website. The guide provides basic information pertaining to taxability, withholding, and reporting requirements for fringe benefits.

IV. Employee Business Expenses

A. IRS Releases Publication 1542

The IRS has released Publication 1542 (Rev. January 2005), Per Diem Rates (for Travel Within the Continental United States). The maximum Federal per diem rates, effective October 1, 2004, are listed in Table 4 of the publication.

V. Reporting Guidelines and Forms

A. IRS Seeks Comments on New Information Reporting Rules for Taxable Mergers and Acquisitions

On December 30, 2004, the IRS published Notice 2005-7, which seeks comments on the information reporting requirements under I.R.C. § 6043A, as added by the American Jobs Creation Act of 2004. I.R.C. § 6043A supplements the information reporting provisions under I.R.C. §§ 6043(c) and 6045, and requires information reporting by an acquiring corporation in any taxable acquisition, as prescribed by Treasury regulations.

The IRS seeks comments regarding issues such as the coordination of information reporting requirements under I.R.C. § 6043A with the requirements of the temporary and proposed regulations under I.R.C. §§ 6043(c) and 6045, rules for nominee reporting, adoption and amount of dollar thresholds, form design, and filing deadlines. Comments may be submitted to the IRS, by March 1, 2005, via mail, hand-delivery, or electronically.

Taxpayers required to report pursuant to Temp. Treas. Reg. §§ 1.6043-4T and 1.6045-3T must continue to report pursuant to those regulations.

B. Electronic Filing Requirements for Large Corporations and Exempt Organizations

On January 11, 2005, the IRS released IR-2005-8, which stated that temporary regulations had been issued requiring certain large corporations and tax-exempt organizations to electronically file their income tax or annual information returns beginning in 2006. T.D. 9175.

For tax year 2005, corporations with total assets of \$50 million or more must electronically file their 2005 Forms 1120 and 1120S, and tax-exempt organizations with total assets of \$100 million or more must electronically file their 2005 Form 990.

For tax year 2006, corporations and tax-exempt organizations with \$10 million or more in total assets must electronically file their 2006 returns. Private foundations and charitable trusts, regardless of total asset size, must electronically file their Form 990-PF.

Specialized forms, such as Form 1120L, are not capable of being electronically filed and are not subject to the electronic filing requirements.

The effective date of the temporary regulations is February 12, 2005.

C. New Code on 2005 Form W-2 for I.R.C. § 409A Income Deferrals

On January 18, 2005, the IRS published Announcement 2005-5, which advises employers of a new code (i.e., "Code Z-Income under section 409A on a nonqualified deferred compensation plan) for use on 2005 Form W-2, Box 12. The new code will be used to identify income from participation in a nonqualified deferred compensation plan that fails to meet the requirements of I.R.C. § 409A. The new code will also be used on Form 1099-MISC for nonemployees.

## VI. Other Matters

A. Termination Payments Were Ordinary Income to Retiring State Farm Agent

On December 15, 2004, the U.S. District Court for the Southern District of Alabama granted summary judgment for the government in Jones v. United States, S.D. Ala., No. 03-

0453-CB-C. Jones was a State Farm agent and operated his own office pursuant to a State Farm Agent's Agreement (Agreement). The Agreement provided for termination payments if prescribed conditions were satisfied. Jones satisfied the conditions and received termination payments from State Farm. Jones contended that the termination payments were for the sale of intangible assets (goodwill and going concern value), and therefore were capital assets entitled to capital gains treatment. The court concluded that Jones "did not sell any intangible assets because those assets (and the assets to which they attached) were owned by State Farm."

B. Award of Contingent Attorneys' Fees Includible in Plaintiff's Gross Income

On January 24, 2005, the U.S. Supreme Court decided Commissioner v. Banks, U.S. No. 03-892, and Commissioner v. Banaitis, U.S. No. 03-907. In a unanimous opinion, the Court resolved a split among the courts of appeals and held that "when a litigant's recovery constitutes income, the litigant's income includes the portion of the recovery paid to the attorney as a contingent fee."

*This Update is provided solely for informational purposes and is not intended to furnish legal advice with respect to a reader's particular factual circumstances. For additional information on any of the topics in this Update, please contact Stephanni Hemmi at Scribner, Hall & Thompson, LLP.*