

SCRIBNER, HALL & THOMPSON, LLP

SUITE 1050

1875 EYE STREET, N. W.

WASHINGTON, D. C. 20006-5409

(202) 331-8585

FAX (202) 331-2032

Writer's Direct Dial: (202) 434-9163

Writer's Email Address:

kkosko@scribnerhall.com

THOMAS C. THOMPSON, JR.
MARK H. KOVEY
STEPHEN P. DICKE
PETER H. WINSLOW
SUSAN J. HOTINE
BIRUTA P. KELLY
GREGORY K. OYLER
LORI J. BROWN
SAMUEL A. MITCHELL
JOSEPH A. SERGI
STEPHANNI M. HEMMI

FRED C. SCRIBNER, JR. (1908-1994)
LEONARD W. HALL (1900-1979)

Insurance Company Information Reporting and Withholding Update

July 2005

I.	Form 1099, Backup Withholding, and Penalties	1
II.	Employer Issues and Employee Benefits	1
III.	Insurance Agents	2
IV.	Reporting Guidelines and Forms	3

I. Form 1099, Backup Withholding, and Penalties

A. Comments Sought on Form 1099-C

The IRS is seeking comments on Form 1099-C, Cancellation of Debt. Comments are sought regarding the utility of collecting the information, the burden imposed on the taxpayer and ways to improve the system by reducing taxpayer's burden in addition to improving the systems of collecting information through technology. Comments are due by September 19 and should be sent to Glenn Kirkland, IRS, Room 6516, 1111 Constitution Avenue, NW, Washington, DC 20224.

II. Employer Issues and Employee Benefits

A. IRS Withdraws Proposed Rules Regarding Taxation of Stock Options

The IRS announced on July 1, 2005 that it withdrew the notice of proposed rulemaking relating to the application of the Federal Insurance Contributions Act (FICA), Federal Unemployment Tax Act (FUTA) to incentive stock options and options granted under employee stock purchase plans.

In explaining the rationale for withdrawing the proposed rules, the IRS noted that the proposed regulations were inconsistent with the statutory amendments made by the American Jobs Creation Act of 2004. Section 241 of the Jobs Act revised IRC §§ 3121(a) and 3306(b), so that a transfer of a share of stock to any individual pursuant to an exercise of an incentive stock option or under an employee stock purchase plan would be excluded from the application of FICA and FUTA. The Jobs Act provisions apply to stock acquired pursuant to statutory stock options exercised after October 22, 2004; thus, for stocks acquired pursuant to statutory stock options exercised prior to that date, Notice 2002-47 should control.

B. IRS Proposes Regulations on the Use of Electronic Technologies for Employee Benefit Information

On July 13, 2005, the IRS and Treasury proposed new regulations, REG-138362-04, on the use of electronic technologies used to provide employee benefit notices and to transmit employee benefit elections and consents. These proposed regulations will not take effect until after they are adopted as final regulations.

The IRS noted that the proposed regulations would coordinate existing rules with the electronic media provisions of the Electronic Signatures in Global and National Commerce Act (E-SIGN). The IRS asserts that the standards in the proposed regulations serve as "a safe harbor when an electronic medium is used for any communication that is not required to be in writing or in written form." Electronic media may be used for almost all notices, elections and consents. The regulations include a detailed list of all eligible communications.

The Treasury Department issued a press release the day the proposed regulations were announced which clarified that a plan would be able to use electronic media under either the E-SIGN consumer consent rules or under an alternative similar to the existing rules for electronically submitting retirement plan information.

Comments on the proposed regulations are due by October 12, 2005, and there will be a public hearing on November 2, 2005. Requests to speak at the hearing are due by October 12, 2005.

III. Insurance Agents

A. Insurance Agent Held Liable for Commissions Earned After Leaving Company

In a summary opinion, the Tax Court held in Marlo O. Garza et ux. v. Commissioner, 2005 WL 1693681 (July 21, 2005), that commissions earned by a former insurance agent would be taxable as income under I.R.C. § 61(a). The court further held that Garza also would be liable for self-employment taxes on that income in addition to an accuracy-related penalty for a substantial understatement of tax.

B. IRS Responds to Inquiry Regarding the Treatment of Retirement Income Received from Insurance Company

In INFO 2005-0082, the IRS responded to an inquiry regarding the treatment of retirement income received from an insurance company. The inquiry focused on whether the income should be treated as ordinary income rather than capital gain. The IRS outlined general differences between ordinary income and capital gain as well as restated the definition of a capital asset as provided by I.R.C. § 1221. The IRS noted that it could not comment on the particular situation which prompted the inquiry since specific details of that situation were unknown.

IV. Reporting Guidelines and Forms

A. New Revenue Procedure Permits Facsimile Signatures on Certain Information Returns

Rev. Proc. 2005-39 allows corporate officers or authorized agents to sign certain information returns by facsimile. A facsimile signature is one that is made by use of a rubber stamp, mechanical device or computer software. This revenue procedure allows for facsimile signatures to be used on the following forms:

- (1) any form in the Form 94X series, which includes, but is not limited to, Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return; Form 941, Employer's Quarterly Federal Tax Return; Form 943, Employer's Annual Federal Tax Return for Agricultural Employees; and Form 945, Annual Return of Withheld Federal Income Tax;
 - (2) Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons;
 - (3) Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips;
 - (4) Form CT-1, Employer's Annual Railroad Retirement Tax Return;
- or
- (5) any variant of these forms, such as, Form 941c, Supporting Statement to Correct Information; or Form 941-SS, Employer's Quarterly Federal Tax Return.

The revenue procedure requires that the person responsible for filing the form retain a letter acknowledging the use of a facsimile signature. This letter should be signed under penalties of perjury by the corporate officer or authorized agent responsible for signing the form. The letter should state that the facsimile signature on the return is the signature adopted by the signing agent for filing the return and the signature was affixed to the form by the filing agent at his or her direction. The letter should be retained for four years and does not need to be sent to the IRS unless it is specifically requested.

B. Treasury Seeks Review of IRS Forms

The Treasury Department has requested that the Office of Management and Budget review certain Internal Revenue Service forms and regulations. Those items slated for review are: Form 1099-DIV, Dividends and Distributions; Form 5309, Application for Determination of Employee Stock Ownership Plan; Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities, and associated Schedule M, Transaction Between Foreign Disregarded Entity of a Foreign Tax Owner and the Filer on Other Related Entities; Form 8891, U.S. Information Return for Beneficiaries of Certain Canadian Registered Retirement Plans; Form SS-4, Application for Employer Identification Number, in addition to the version used in Puerto Rico, Form SS-4PR; T.D. 8940, REG-107069-97, final rules on purchase price allocations in deemed and actual asset acquisitions; T.D. 9040, REG-107184-00, final regulations facilitating electronic tax administration; and T.D. 9088, REG-106359-02, final regulations regarding the application of I.R.C. § 482 to compensatory stock options.

Comments are due by August 3, 2005, and should be send to Alexander T. Hunt, OMB, Room 10235, New Executive Office Building, Washington, DC 20503, and Treasury Department Clearance Officer, Treasury Department, Room 11000, 1750 Pennsylvania Avenue, NW, Washington, DC 20220.

C. IRS Updates Requirements for Electronically and Magnetically Filing Forms W-4

The IRS has revised Publication 1245, Filing Form W-4 Employee's Withholding Allowance Certificate, Electronically or Magnetically, in Rev. Proc. 2005-42. The revenue procedure explains in great detail the requirements for submitting Forms W-4 electronically or magnetically.

The revenue procedure reiterates the temporary regulations issued in April 2005 that employers are no longer required to routinely submit Forms W-4 to the Service; however, these forms are still subject to review. Rev. Proc. 2005-42 also notes that Part B of Publication 1245, Electronic Filing Specifications, has been completely revised.

The Filing Information Returns Electronically (FIRE) system is now on the internet at <http://fire.irs.gov>, and the system is no longer a dial-up connection. The revenue procedure warns taxpayers that the FIRE system will be down from December 23, 2005 through January 3, 2006 in order for the IRS to update its system to reflect current year changes.

Another change instituted in the revenue procedure is that the IRS will no longer accept 8mm, 4mm or Quarter-Inch Cartridges for processing information returns. Additionally, 3½-inch diskettes will no longer be accepted in tax year 2006.

Taxpayers who wish to file Forms W-4 electronically or magnetically must first submit a Form 4419, Application for Filing Information Returns Electronically/Magnetically. The taxpayer must then wait for authorization from the IRS before submitting electronic or magnetic files. Authorization should be granted or denied within 30 days of receipt of the request.

D. GAO Recommends Mandatory Electronic Filing for Forms 5500

The Government Accountability Office made recommendations aimed at improving the timeliness and content of Form 5500, Annual Return/ Report of Employee Benefit Plan. The GAO noted that the current Form 5500 lacks critical information that would better assist the primary users of these reports: the Department of Labor, the IRS and the Pension Benefit Guaranty Corporation. The GAO expressed that timeliness was another problem related to the Form 5500. The GAO felt that certain information, such as a plan's funding status, could be reported earlier than the current filing deadline. Mandatory electronic filing also would close the sometimes significant delay in processing and releasing the Form 5500 information. The IRS generally agreed with the GAO recommendations.

E. Procedural Questions Were Focus of IRS Hearing on Form W-4 Regulations

A public hearing was held on July 26, 2005, addressing the proposed rules, which seek to relieve some of the administrative burdens imposed on employers relating to withholding of employee taxes. While the general reaction to the new rules has been favorable, some have expressed fears that tax fraud may increase. There are also concerns relating to certain procedural issues.

The new regulations, which became effective April 14, 2005, relieve employers from the obligation of submitting copies of certain potentially questionable Forms W-4, Employee's Withholding Allowance Certificate. The new regulations also provide the IRS with the authority to notify an employer of a maximum number of withholding exemptions that a particular employee may claim; these notifications are known as "lock-in" letters.

Prior to the new regulations, employers were required to send the IRS any Form W-4, which claimed more than 10 allowances or claimed complete exemption from withholding if \$200 or more in weekly wages was expected to be earned.

Comments at the hearing ranged from challenges faced by payroll departments to the procedural applications of "lock-in" letters. There were questions and requests for additional guidance regarding the application of these regulations with the recently issued supplemental wage withholding regulations. Overall the speakers noted that employers viewed the new regulations favorably, because it seems that they will reduce administrative burden. However, one speaker at the hearing cautiously warned that the new rules may lead to a higher degree of tax fraud since employer scrutiny of Forms W-4 will decrease.

Circular 230 Disclosure:

The material in this newsletter should not be construed as legal opinions of Scribner Hall & Thompson, LLP. Per Circular 230 requirements, you are advised that any discussion of Federal tax issues in this newsletter is not intended or written to be used, and cannot be used by you, to avoid penalties imposed under the Internal Revenue Code or to promote, market or recommend to another party any transaction or matter addressed herein.