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## Insurance Company Information Reporting and Withholding Update

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## I. Form 1099, Backup Withholding, and Penalties

### A. IRS Issues New Rules for Withholding and Filing Requirements for Nonresident Aliens

The IRS recently issued two notices affecting filing requirements and withholding for nonresident alien employees. Notice 2005-76 establishes a new system for determining the amount of tax to be withheld by employers under I.R.C. § 3402 from wages paid to nonresident alien employees. Notice 2005-77 stated the IRS's intention to create an exception from filing requirements for nonresident aliens who are required to file returns on Form 1099NR solely due to the fact that they earn wages in connection to a U.S. trade or business.

Notice 2005-76 created new rules to provide that withholding for nonresident aliens more closely approximate the income tax liability of that employee. Under the current rules, nonresident alien employees were having too much tax withheld. The new rules require an employer beginning in January 1, 2006, to calculate the withholding for nonresident aliens (except for students and business apprentices from India) by applying the Publication 15, Circular E, Employer's Tax Guide, tables to the sum of wages paid for the payroll period and an additional amount specified in Notice 2005-76. This additional amount will not be included in gross wages and will not affect the employee's income. This amount is only utilized in determining the proper withholding amount. For wages paid before January 1, 1997, employers will not be held liable for underpayments of income tax withholding and related interest and penalties resulting from failing to apply the new withholding procedure if they have made a good effort to implement the new requirements in the notice as soon as possible.

The Notice also established new rules for nonresident aliens to use in completing Form W-4. A nonresident alien should: (a) not claim an exemption from withholding; (b) request withholding as if single, regardless of actual marital status; (c) claim only one allowance (except for residents of Canada, Mexico or South Korea); and (d) write "nonresident alien" or "NRA" above the dotted line on line 6 of Form W-4.

Notice 2005-77 eliminates the Form 1040NR filing requirement for nonresident aliens who earn less than the amount of one personal exemption. This new exception treats nonresident aliens the same as U.S. citizens who earn less than the exemption amount. This rule will apply beginning on or after January 1, 2006.

B. Deadline for Submissions to Voluntary Compliance Program For Withholding Taxes on Foreign Payments Extended

In Rev. Proc. 2005-71, the IRS extended the deadline until March 31, 2006, for the voluntary compliance program for withholding agents who make payments to foreign persons. This three-month extension was granted by the IRS because there was a significant interest among withholding agents who wanted to participate, but would not have been able to complete the process by the original deadline of December 31, 2005. Taxpayers may still request extensions, but extensions will only be granted through June 30, 2006.

The voluntary compliance program allows withholding agents to disclose deficiencies and reporting errors through a letter to the IRS. The withholding agent must develop procedures to ensure future compliance and if the withholding agent's procedures are acceptable, the IRS will provide an acknowledgment letter notifying the agent that it is in substantial compliance with its obligations. Information provided to the IRS through this program for prior years will not be used against the withholding agent to initiate examinations.

## II. Employee Business Expenses

A. IRS Releases Revised Per Diem Rates Publication

The IRS has posted online the revised Publication 1542, Per Diem Rates (For Travel Within the Continental United States). This publication provides the maximum per diem rates for fiscal year 2006 that an employer can use without treating a portion of the per diem allowance as wages for tax purposes. Publication 1542 is available on the IRS website, at <http://www.irs.gov/pub/irs-pdf/p1542.pdf>. This publication will only be available on the IRS website and will not be available for print copy orders.

## III. Reporting Guidelines and Forms

A. Publication 1141 Released With Correction to Rev. Proc. 2005-65

The IRS released Publication 1141, General Rules and Specifications for Substitute Forms W-2 and W-3. The publication is available on the IRS website, at <http://www.irs.gov/pub/irs-pdf/p1141.pdf>. It was originally published as Rev. Proc. 2005-65; however, that revenue procedure contained a typographic error. Rev. Proc. 2005-65 stated that in Section 2.06 of Part A that "Form W-3PR is 7.0 inches wide...", but the correct specification included in the revised publication is that "Form W-3PR is 7.3 inches wide..."

B. IRS May Grant Relief From Section 409A Reporting Requirements

Members of Congress have made it clear that they want to know exact figures when it comes to deferred compensation. In response, proposed regulations for I.R.C. §409A (REG-158080-04) were issued on September 29. These proposed regulations require reporting on Forms 1099 or W-2 all of deferred compensation amounts, even if they are not included in income. The payroll community have discussed the tremendous burden that this regulation imposes on them and therefore they have made numerous requests to the IRS for some kind of relief. The IRS is said to still be looking at the issue; however, due to the reporting deadlines, it may offer relief soon. The IRS notes, however, that no decision has been made yet.

IV. Other Matters

A. IRS Touts Alternative Procedures for Dispute Resolution

The IRS suggests that taxpayers should consider one of three nontraditional approaches to dispute resolution when weighing their options. These alternative procedures are far less costly and are much quicker than the traditional routes.

Fast track settlement is one option which reduces the time needed to settle a case to approximately 90 days. Not every taxpayer is eligible to use the fast track settlement option however. Currently, it is only available for Large and Mid-Size Business Division taxpayers, but beginning in 2006, it also will be available for small businesses. The IRS plans to publicize this service by initially introducing it in large urban areas.

Following an appeals case where no settlement was reached, a taxpayer now has two nontraditional options: post appeals mediation or post appeals arbitration. In either situation, the IRS or the taxpayer can supply the mediator or arbitrator. These may be attractive options for taxpayers seeking private settlements or a quick and less costly resolution. Both of the post appeals procedures take about six months to complete.

B. FinCen Issues New Rules for Insurance Companies in Accordance with the Bank Secrecy Act

The Financial Crimes Enforcement Network (FinCen), a Treasury Department agency, has issued new regulations establishing minimum standards for insurance companies relating to anti-money laundering programs.

Insurance companies fall within the Bank Secrecy Act's definition of a financial institution. The USA PATRIOT Act amended the Bank Secrecy Act to require the development of anti-money laundering programs for all financial institutions. FinCen's new regulations require that an insurance company develop a written anti-money laundering program which then must be approved by senior management. A copy of this program must also be provided to FinCen. Although agents and brokers are placed under no direct obligation under the new rules, they must be integrated into and trained under the insurance company's anti-money laundering program. Insurance companies must also designate a compliance officer to ensure that the program is implemented as necessary. The final requirement imposed by the new regulations is that the program must be audited by an independent party, either a third party or an officer of the insurance company who is not the compliance officer, in order to determine whether the program adequately meets the minimum standards set forth in the rules.

FinCen also amended regulations which require insurance companies to report suspicious transactions to the Treasury Department. The new regulations apply to the insurance companies and not their insurance agents or brokers. Insurance companies will now be required to file a form when cash of \$5,000 or more is provided in the purchase of an insurance policy. The \$5,000 reporting threshold applies whether one or multiple policies are being purchased. This reporting rule takes effect on May 2, 2006.

*IRS Circular 230 Disclosure:*

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