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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

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LEGISLATION

President Signs The Mortgage Forgiveness Debt Relief Act of 2007

On December 19, 2007, the President signed into law the Mortgage Forgiveness Debt Relief Act of 2007, Pub. L. No. 110-356. In addition to providing exclusion from income for discharge of certain residential indebtedness, the act increases, from \$50 to \$85 per partner, the penalty for failure to file partnership returns under section 6698 (effective for returns required to be filed after Dec. 20, 2007), and imposes a similar penalty for failure to file S corporation returns under new section 6699.

FORMS 1099, BACKUP AND FOREIGN PAYEE WITHHOLDING, AND PENALTIES

1. IRS Phone Forum Outlines New Form 1099 Requirements, Including for Widely Held Fixed Investment Trusts

In a recent phone forum, the IRS outlined new reporting requirements for Form 1099-A, Form 1099-B, Form 1099-C and Form 1099-MISC. The new requirements for 2007, under recently promulgated Treas. Reg. § 1.671-5(d) (T.D. 9308), include special reporting rules for widely held fixed investment trusts (WHFITs) that vary from the general reporting rules for trusts.

Beginning January 1, 2007, trustees and middlemen are required to report on Forms 1099 all items of gross income and proceeds attributable to a trust interest holder of a WHFIT. Previously, WHFITs were required to file Form 1041, but Form 1041 for 2006 instructed WHFITs to check the final return box on that form. Generally, for calendar year 2007, trustees and middlemen must report on Form 1099-B the amount of non pro-rata partial principal payments (as defined in Treas. Reg. § 1.671-5(b)(13)), trust sales proceeds (as defined in Treas. Reg. § 1.671-5(b)(21)), redemption asset proceeds (as defined in Treas. Reg. § 1.671-5(b)(14)), redemption proceeds (as defined in Treas. Reg. § 1.671-5(b)(15)), sales asset proceeds (as defined in Treas. Reg. § 1.671-5(b)(17)), the sales proceeds (as defined in Treas. Reg. § 1.671-5(b)(18)) that are attributable to a trust interest holder. To determine the amount of each item of proceeds to be reported on Form 1099-B, see generally Treas. Reg. § 1.671-5. If the trustee provides WHFIT information using the safe harbor rules in Treas. Reg. § 1.671-5(f)(1) or (g)(1), the trustee or middleman must determine the amounts reported on Forms 1099 under Treas. Reg. § 1.671-5(f)(2) or (g)(2), as appropriate.

2. IRS Issues Final Regulations Defining Section 403(b) Salary Reduction Agreement for FICA Purposes

The IRS has issued final regulations (T.D. 9367) that adopt prior temporary and proposed rules (T.D. 9159, REG-155608-02) in defining the term “salary reduction agreement” (SRA) for purposes of section 3121(a)(5)(D). The regulations are effective November 15, 2007, and applicable to contributions to all section 403(b) plans made on or after that date. Section 3121(a)(5)(D) provides that payments made by employers to purchase section 403(b) contracts are not includable as wages unless made in accordance with a “salary reduction agreement.” However, the term is defined broadly and includes payments that are excludable from gross income under section 403(b). In the preamble, the Treasury and IRS explained that the broader scope of the FICA rule is consistent with the general policy underlying FICA.

Under the regulations, for purposes of section 3121(a)(5)(D), the term “salary reduction agreement” means:

a plan or arrangement (whether evidenced by a written instrument or otherwise) whereby payment will be made by an employer, on behalf of an employee or his or her beneficiary, under or to an annuity contract described in section 403(b) –

- If the employee elects to reduce his or her compensation pursuant to a cash or deferred arrangement as defined at Treas. Reg. § 1.401(k)-1(a)(2) of this chapter;
- If the employee elects to reduce his or her compensation pursuant to a one-time irrevocable election made at or before the time of initial eligibility to participate in such plan or arrangement (or pursuant to a similar arrangement involving a one-time irrevocable election); or
- If the employee agrees as a condition of employment (whether such condition is set by statute, contract, or otherwise) to make a contribution that reduces his or her compensation.

REPORTING GUIDELINES AND FORMS

1. IRS Continues to Consider Changes to Proposed Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding* and Form 1042-S, *Foreign Person’s U.S. Source Income Subject to Withholding*

The IRS has pulled the proposed versions of Form W-8BEN, *Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding* and 1042-S, *Foreign Person’s U.S. Source Income Subject to Withholding* from the IRS website. At a recent financial services industry conference, Carl Cooper, senior counsel with the IRS Office of Associate Chief Counsel (International), explained that the IRS may have been too aggressive with its “end of 2007” effective date. The IRS said it will review the comments received on the proposed Forms and at some point propose new draft Forms.

2. IRS Modifies Section 402(l) Exclusion Guidance to Include Premiums Paid to Self-Insured Plan

In Notice 2007-99, the IRS modified Q&A-23 of Notice 2007-7, 2007-5 I.R.B. 395, to provide that the section 402(l) exclusion may apply in the context of self-insured accident or health plans. Section 402(l), added by the Pension Protection Act of 2006, provides for an exclusion from gross income for certain distributions paid from an eligible governmental plan that are used to pay certain “qualified health insurance premiums.” The term “qualified health insurance premiums” is defined in the statute as premiums paid directly to the provider of accident or health *insurance* plan or qualified long-term care insurance contract. In anticipation of a technical correction deleting the reference to “insurance,” Q&A-23 has been amended to provide that an accident or health plan, which is defined under section 105(e), includes a self-insured plan.

3. IRS Updates Publication 1187, Specifications for Filing Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding, Electronically or Magnetically

The IRS has announced an update to Publication 1187, *Specifications For Filing Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding, Electronically or Magnetically* as previously revised in September of 2006. (See Announcement 2007-110.) The changes below are effective for Form 1042-S tax year 2007, filed in calendar year 2008.

- An explanatory note was added to the Recipient 'Q' Record which reads: If you are a nominee that is the withholding agent under Code Section 1446, enter the Publicly Traded Partnership's (PTP) name and other information in the NQI/FLW-THR fields; positions 401-666.
- In the Recipient 'Q' Record, a new field, NQI/FLW-THR State Code, was added to positions 643-644. Enter the two-alpha character state code (see table Part A, Sec. 14). If a state code or APO/FPO is not applicable then blank fill.
- Additional instructions were added to the Recipient 'Q' Record, NQI/FLW-THR Country Code, positions 647-648. The instructions read: Enter the two-character Country Code abbreviation, where the NQI/FLW-THR is located. Enter blanks if the NQI/FLW-THR has a U.S. address.
- The Field Title was changed and additional instructions were added to the Recipient 'Q' Record, NQI/FLW-THR Postal Code or ZIP Code, positions 649-657. The instructions read: Enter the alpha/numeric foreign postal code or U.S. ZIP Code for all U.S. addresses including territories, possessions and APO/FPO. Enter the code in the left most position and blank fill the remaining positions. DO NOT use hyphens or blanks between numbers or letters (e.g. if the postal code written as A6B 3C5 input as A6B3C5). Left-justify.

4. 2008 Reimbursement Rate for Business Mileage Set

In Rev. Proc. 2007-70, 2007-50 I.R.B. 1162 and IR-2007-192 (Nov. 27, 2007), the IRS announced that the optional standard mileage rate is 50.5 cents per mile for business miles driven, effective January 1, 2008. The rate reflects an increase of 2 cents from the 2006 rate described in Rev. Proc. 2006-49, 2006-47 I.R.B. 936. The revenue procedure also set the standard mileage rates for

deducting the costs of operating an automobile for charitable, medical or moving purposes. The rate for medical or moving purposes is now 19 cents per mile, reflecting an decrease of 1 cent per mile. The rate for charitable use during 2008 will remain at 14 cents a mile, a statutory rate not adjusted for inflation. See Rev. Proc. 2007-70 for additional information and limitations on the use of the standard mileage rates.

5. RIA Calculates 2008 FMV Limitations for Use of Cents-per-mile Method of Valuing Taxable Fringe Benefit of Employer-Provided Vehicle

RIA has calculated the maximum fair market values for employer-provided autos, truck and vans, for purposes of the cents-per-mile method of valuing the taxable fringe benefit of an employee's personal use of an employer-provided vehicle. The mileage allowance rate (i.e., 48.5 cents per mile for 2007, not yet announced for 2008) can only be used if the auto's fair market value does not exceed the current value (as adjusted for inflation under section 280F(d)(7)) of \$12,800 (in 1988 dollars), measured by the Consumer Price Index ("CPI") for automobiles. Based on the October CPI data, RIA has determined the maximum fair market value of \$15,000 for employer-provided passenger automobile first made available to employees for personal use in 2008. In 2007, this limit was \$15,100. For a truck or van, the 2008 limit is \$15,900. In 2007, this limit was \$16,100.

6. IRS Modifies Instructions to Reflect Notice 2007-89 Guidance

The instructions for Form W-2, Form W-3 and Form 1099-MISC have been modified to reflect Notice 2007-89, 2007-46 I.R.B. 998, relating to reporting and wage withholding requirements for 2007 under section 409A. Notice 2007-89 permanently waived for calendar year 2007 requirements for deferral reporting requirements by employers and payers under section 6041 and section 6051. Thus, an employer is not required to report to an employee the total amount of deferrals for the year under a nonqualified plan in box 12 of Form W-2 using code Y, and a payer is not required to report to a nonemployee the total amount of deferrals for the year under a nonqualified plan in box 15a of Form 1099-MISC.

However, an employer still is required to report amounts includible in gross income under section 409A and in wages under section 3401(a) in box 1 of Form W-2 as wages paid to the employee during the year. An employer must also report such amounts in box 12 of Form W-2 using code Z. In addition, a payer must report amounts includible in gross income under section 409A and not treated as wages under section 3401(a) as nonemployee compensation in box 7 of Form 1099-MISC. A payer must also report such amounts in box 15b of Form 1099-MISC. (Notice 2006-100 provided guidance with respect to service providers for 2005 and 2006.) See also Notice 2007-100 for IRS transitional relief and other guidance relating to section 409A operational failures.

7. IRS Issues Transitional Relief and Correction Guidance on Certain Failures of Nonqualified Deferred Compensation Plans to Operate in Compliance with Section 409A

The IRS has issued Notice 2007-100, 2007-52 I.R.B. 1243, providing transitional relief and guidance on corrections for certain failures of nonqualified deferred compensation plans to operate in

compliance with section 409A (operational failures). In Notice 2007-100, the IRS provides relief for certain operational failures that are corrected in the same year. The Notice also provides transition relief through 2010 for operational failures up to a certain amount that are not corrected in the same taxable year by limiting the amount of income inclusion and additional taxes. In addition, the Notice describes and requests comments on a potential expanded program that would limit the income inclusion and additional taxes under section 409A for certain operation failures involving larger amounts.

The Notice includes information reporting requirements relating to these operational failures. In connection with certain unintentional operational failures corrected in the same taxable year, the following requirements are generally imposed:

- The service recipient must attach to its timely-filed (including extensions) original federal income tax return for its taxable year in which the failure occurred a statement entitled “§ 409A Relief under § II of Notice 2007-100,” setting out certain information, e.g., description of the failure and the steps taken to correct the failure (Failure Information), and
- must provide to each service provider affected by such failure a statement entitled “§ 409A Relief under § II of Notice 2007-100,” setting out similar Failure Information, by no later than the date (with extensions) on which it is required to provide an information return (Form W-2 or 1099) to such service provider for the calendar year in which such failure occurred.
- In addition, upon the commencement of an examination of the taxpayer’s federal tax return, the taxpayer must generally provide notice to the examining agent of the taxpayer’s reliance on the Notice for years covered by the examination.

In connection with transitional relief for certain operational failures involving limited amounts, the following requirements are generally imposed:

- The service recipient must attach to its timely-filed (including extensions) original federal income tax return for its taxable year in which it discovers the failure a statement entitled “§ 409A Relief under § III of Notice 2007-100” setting out similar Failure Information, and
- must provide to each such service provider a statement entitled “§ 409A Relief under § III of Notice 2007-100” including similar Failure Information not later than the date (with extensions) on which it is required to provide an information return (Form W-2 or 1099) for the calendar year in which it discovers such failure to a service provider who is affected by such failure.
- A service provider who is relying on the transitional relief with respect to a failure to comply with section 409A must attach to its timely-filed (including extensions) original federal income tax return for the year in which such failure was discovered information similar to Failure Information.
- In addition, upon the commencement of an examination of the taxpayer’s federal tax return, the taxpayer relying on this transitional relief must provide Notice to the examining agent of the taxpayer’s reliance on the Notice for years covered by the examination.

Other Matters

New IRS Projects Focus on Reducing Reporting Burdens Relating to Capital Gains and Employment Tax

The IRS Office of Taxpayer Burden Reduction has announced that it has projects underway to ease reporting burdens relating to capital gains and employment tax. In the context of capital gains, an IRS cross-functional team led by the office has been established to recommend short-term and long-term solutions to reduce burden and increase voluntary compliance relative to computing adjusted cost basis and reporting gain or loss on the sale of securities on Form 1040, Schedule D - Capital Gains and Losses. It has been estimated that capital gains tax reporting noncompliance contributes \$17 billion to the tax gap. The long-term goal of the project is to develop recommendations to establish reporting by third-parties (financial institutions) of adjusted cost basis and gain or loss on the sale of securities transactions.

A project is also underway to design new forms that will be used to correct employment tax reporting errors. Currently, the Form 941c, *Supporting Statement to Correct Information*, which is not an amended return and must never be filed as a stand-alone return, is used to correct employment taxes reported on any Form 941, *Employer's Quarterly Federal Tax Return* or Form 945, *Annual Return of Withheld Federal Income Tax*, and other similar forms. The IRS expects to implement the new forms in 2009.

Ask The Expert

Is there other tax legislation that could be enacted before the end of the year?

Yes, the Tax Technical Corrections Act of 2007 (the Act), H.R. 4839, has been passed by the House and the Senate and cleared for the White House. The Act includes technical corrections relating to recent acts as well as the Internal Revenue Service Restructuring and Reform Act of 1998. If signed into law, the provisions relating to information reporting and withholding will be described in our next issue.

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