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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

May 23, 2008

LEGISLATION

1. IRS Commissioner Supports Increased Information Reporting

At the American Bar Association (ABA) Section of Taxation Meeting on May 9, 2008, IRS Commissioner Douglas Shulman said he is “philosophically” supportive of more information reporting. Shulman noted that the Administration and Congress have been discussing legislation to require banks to report payments to merchants for credit and debit card transactions, as well as legislation relating to the reporting of cost basis on sales of securities. While he recognized that implementing these proposals would be a significant undertaking for everyone involved, Shulman stated that he would welcome the day that a taxpayer needing to report capital gains would get that information on a year-end form, in a consistent format, rather than doing it himself and worrying whether the data that he uses is correct.

Cost basis reporting was also addressed on the previous day of the ABA meeting by Melissa Mueller, tax counsel to House Ways and Means Committee Democrats. Mueller explained that it is “highly likely” that cost basis reporting provisions will be enacted this year.

2. Congress Continues to Consider Taxation of ETNs

Congress and Treasury have not yet settled on the proper taxation of exchange-traded notes (“ETNs”). ETNs are generally prepaid forward contracts whose value is determined by reference to the performance of other assets or investment strategies and whose maturity date is usually 30 years. ETNs are usually marketed to small investors with an emphasis on their ability to convert their investment return to capital gain and to defer recognition until the contract is sold or matures in 30 years. From a tax perspective, ETNs raise issues of whether the holder should accrue interest-like income and whether the holders should be treated as constructively owning the underlying assets. Congress is currently considering a bill that would provide for accrual. The Neal Bill (H.R. 4912, introduced by Richard E. Neal, D-Mass, and referred to the House Committee on Ways and Means) would require holders to accrue interest equal to the short-term applicable federal rate (AFR) but issuers will not be entitled to a corresponding deduction.

3. IRS Taxpayer Advocate Recommends Bill to Shift Employment Tax Responsibility for Home Care Workers

At the American Bar Association Section of Taxation Meeting on May 9, 2008, IRS National Taxpayer Advocate Nina Olson said that her office has recommended legislation that would treat home care workers as the statutory employee of the entity that controls the employment tax account. The legislation is aimed at avoiding egregious consequences for elderly and disabled persons who are under the care of workers appointed by the state. Although under current law the elderly person may be a common-law employer, his condition may make it impossible to fulfil an employer's tax obligations. If the payroll service provider fails properly to remit tax payments in connection with home care workers, ultimate liability resides with the common-law employer. The provisions are included in H.R. 5719, which recently passed the House and has been referred to the Senate Committee on Finance.

Other Matters

1. California Proposes 7 percent State Withholding to Piggyback on Federal Backup Withholding

The state of California has proposed a 7 percent withholding "piggyback" on current Federal income tax backup withholding amounts. The proposal (A.B. 1848) would require payors that are performing backup withholding for Federal income tax purposes to withhold an additional 7 percent for California state income tax purposes, and submit such amounts to the state of California. It is rumored that the proposal is likely to be enacted.

2. Legal Challenges to DHS Rule Delay 2007 Form W-2 "No-Match" Letters

The Social Security Administration has delayed letters for the 2007 tax year to inform employers of unresolved name-SSN mismatches on Form W-2 submissions. The delay, perhaps permanent, has been caused by legal challenges relating to a Department of Homeland Security (DHS) insert to be included in the letters. The insert, under a DHS rule, would require that employers resolve the mismatches or face sanctions from the DHS.

Ask The Expert

Has the IRS been making good on promises to step up enforcement on worker misclassification issues?

Yes. It appears that the IRS has been targeting its enforcement efforts at worker misclassification, as promised. As recently as May 14, 2008, at a workshop during the American Payroll Association's 26th Annual Congress, John Tuzynski, chief of Employment Tax Operations in the IRS Small Business Self-Employed Division, stated that 30-percent of IRS audits this year will be based on worker classification issues. The emphasis on worker classification presumably is tied to the large revenue estimates that have been associated with worker misclassification. Last November, we reported

on a special IRS initiative focusing on worker misclassification in an effort to narrow the tax gap. *See* “IRS Continues to Focus on Worker Misclassification in Effort to Narrow Tax Gap,” Insurance Company Information Reporting and Withholding Update, November 30, 2007 (p. 5).

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