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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

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Legislation

Newly Enacted Housing and Economic Recovery Act of 2008 Requires Information Reporting on Payment Card and Third Party Payment Transactions

The Housing and Economic Recovery Act of 2008 (the "Housing Act of 2008"), Pub. L. No. 110-289, was signed into law by the President on July 30, 2008. The Housing Act of 2008 includes a new section 6050W, relating to information reporting on payment card and third party payment transactions. As reported in last month's issue, the provision was previously proposed as part of the Alternative Minimum Tax Relief bill of 2008 (H.R. 6275).

Under section 6050W, a bank that enrolls a business to accept credit cards and contracts with the business to make payment on credit card transactions will be required to report to the IRS the business's gross credit card transactions for each calendar year. The bank also will be required to provide a copy of the information report to the business. Similar provisions will apply to an organization that provides a network enabling buyers who have established accounts with the organization to transfer funds to sellers who have a contractual obligation to accept payment through the network.

The provision also imposes reporting requirements on intermediaries who receive payments from a payment settlement entity and distribute such payments to one or more participating payees. Thus, for example, in the case of a corporation that receives payment from a bank for credit card sales effectuated at the corporation's independently-owned franchise stores, the bank will be required to report the gross amount of reportable payment transactions settled through the corporation (notwithstanding the fact that the corporation does not accept payment cards and would not otherwise be treated as a participating payee). In turn, the corporation, as an intermediary, will be required to report the gross amount of reportable payment transactions allocable to each franchise store. However, the bank will have no reporting obligation with respect to payments made by the corporation to its franchise stores. See Joint Committee on Taxation, Technical Explanation of Division C of H.R. 3221, the "Housing Assistance Tax Act of 2008" as Scheduled for Consideration by the House of Representatives on July 23, 2008.

The transactions subject to information reporting generally will be subject to backup withholding requirements. In addition, present law penalties relating to the failure to file correct information returns will apply to information reporting required under the provision.

The provision generally is effective for returns for calendar years beginning after December 31, 2010. The amendments to the backup withholding requirements apply to amounts paid after December 31, 2011. However, solely for purposes of carrying out any TIN matching program established under section 3406(I): (i) the amendments are treated as taking effect on the date of the enactment, and (ii) each person responsible for setting the standards and mechanisms for transactions between the merchant acquiring entities and the persons who agree to accept such cards as payment are treated in the same manner as a payment settlement entity. Presumably, this will allow reporters to contact the IRS prior to the effective date of the provision to determine whether a name/TIN combination matches a name/TIN combination maintained in the IRS data base.

The Secretary is also granted authority under the provision to issue guidance to implement the reporting requirement, including rules to prevent the reporting of the same transaction more than once.

Forms 1099, Backup and Foreign Payee Withholding, and Penalties

1. IRS Allows Section 3509 Reduced Rates for Certain Employment Taxes Upon Employer Reclassification Following IRS Determination

In CCA 200825043 (May 13, 2008), the IRS concluded that employers may use section 3509 rates to calculate their liability for income tax withholding and the employee's share of FICA tax where the employer (a) has become aware of a misclassification after receiving a determination letter from the Service regarding a worker's classification as an employee, (b) meets the requirements of section 3509, and (c) seeks to correct a failure to withhold employment taxes for a prior year. The IRS based its conclusion on legislative history which refers to reclassification of workers, but does not discuss whether the reclassification is triggered by a Service enforcement action in an examination or may be initiated by the employer due to the receipt of a determination letter. Moreover, allowing employers to determine employment tax liability using section 3509 rates following an SS-8 determination to correct underpayments will encourage compliance with the SS-8 determination. The IRS also concluded that the employer is eligible to make a section 6205 interest-free adjustment to pay its employee FICA tax and federal income tax withholding liability for prior years, as determined under section 3509, when the employer is reclassifying a worker following receipt of a determination letter from the Service regarding the worker's classification as an employee.

If certain requirements are satisfied, section 3509 reduces an employer's liability for federal income tax withholding and the employee portion of the FICA taxes where the employer failed to deduct and withhold those taxes because it treated the employee as a nonemployee. Section 3509(a). To qualify for the reduced rates under section 3509, the employer must have: (i) treated the worker as a nonemployee for purposes of both income tax withholding and FICA tax; (ii) treated the worker as a nonemployee for purposes of information reporting; and (iii) not intentionally disregarded the deduction and withholding requirements. Section 3509(c).

If section 3509 rates apply to determine the employer's tax liability for the employee's share of FICA tax and income tax withholding, the employer nonetheless remains liable for the full amount of the employer's share of FICA tax. Furthermore, any payment of federal income tax by the employee will not

abate the employer's liability under section 3509 for income tax required to be withheld; similarly, the employee's payments of self-employment tax do not offset the employer's liability under section 3509 for the employee's share of FICA tax.

2. No Assessment of Employment Taxes until IRS Satisfies Procedural Requirements of Section 7436

In CCA 200822026 (May 30, 2008), the IRS concluded that where a revenue officer failed to meet the requirements of section 7436, which provides Tax Court jurisdiction to review certain employment tax determinations, an assessment of employment taxes based on the section 6020(b) return prepared by the revenue officer is improper. However, once the procedural defects are corrected and the requirements of section 7436 are met, employment taxes may thereafter be assessed, under Notice 2002-5, 2002-1 C.B. 320.

Under section 6020(b), if any person fails to make a required return or makes, willfully or otherwise, a false or fraudulent return, the Secretary is authorized to make a return from the Secretary's own knowledge and from such information as can be obtained through testimony or otherwise. Section 6020(b)(2) provides that any return made and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes. Section 7436 gives the Tax Court jurisdiction to determine certain "worker classification issues" (i.e., the proper amount of the additions to tax, additional amounts, and penalties that relate to the employment tax imposed by subtitle C with respect to determinations of worker classification, and whether the taxpayer is entitled to relief under §530 of the Revenue Act of 1978) if there is an actual controversy involving a determination by the Secretary (as part of an examination) that one or more individuals performing services for the taxpayer are employees. However, certain procedures, as described in Notice 2002-5, must be followed prior to an assessment of employment taxes to meet the requirements of section 7436.

3. IRS Targets Reporting Failures with John Doe Summons Against UBS

In a John Doe Summons on July 1, 2008, the U.S. District Court for the Southern District of Florida authorized the IRS to request information from UBS AG, a Switzerland-based bank, to identify certain U.S. taxpayers. The IRS investigation includes inquires into the identities of U.S. taxpayers who failed to file Forms W-9 and for whom UBS failed to file Forms 1099.

Reporting Guidelines and Forms

1. With Gas Prices Higher, IRS Increases Automobile Mileage Rates

In Announcement 2008-63, the IRS increased the optional standard mileage rate to 58.5 cents per mile for business miles, effective July 1, 2008. The rate reflects an increase of 8 cents from the old rate prescribed in Rev. Proc. 2007-70, 2007-50 I.R.B. 1162, effective January 1, 2008. The standard automobile mileage rate for medical or moving deduction purposes is now 27 cents per mile, which also reflects an increase of 8 cent per mile. The rate for charitable use during 2008 remains 14 cents per 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.

Bills have been recently introduced in both the House (H.R. 6283) and the Senate (S. 3032) to increase the standard mileage rates for business, medical and moving purposes to 70 cents per mile, and for charitable purposes to 40 cents per mile.

2. IRS Issues Rev. Proc. 2008-32 Updating Form 941 and Schedule B Substitute Specifications

The IRS has released Rev. Proc. 2008-32, 2008-28 I.R.B. 82 (superceding Rev. Proc. 2007-42, 2007-27 I.R.B. 15), which provides the general rules and specifications for paper and computer-generated substitutes for the January 2008 revision of Form 941, Employer's Quarterly Federal Tax Return, and Schedule B (Form 941), Report of Tax Liability for Semiweekly Schedule Depositors. This revenue procedure will be reproduced as IRS Publication 4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941).

3. IRS Updates Guidance for Form W-2 and Form W-3 Substitutes

The IRS has issued guidance regarding the preparation and use of substitute forms for Form W-2, Wage and Tax Statement, and Form W-3, Transmittal of Wage and Tax Statements, for wages paid during the 2008 calendar year. *See* Rev. Proc. 2008-33, 2008-28 I.R.B. 93 (superceding Rev. Proc. 2007-43, 2007-27 I.R.B. 26). The revenue procedure will be reproduced as the next revision of IRS Publication 1141, *General Rules and Specifications for Substitute Forms W-2 and W-3*.

4. IRS Bars Logos on Statements to Employee

The IRS also announced that, with the exception of the IRS's e-file logo, slogans, advertising, and other logos will not be allowed on Forms W-3, Copy A of Forms W-2, or any employee statements reporting wages paid during the 2010 calendar year, and thereafter. *See* Rev. Proc. 2008-33, 2008-28 I.R.B. 93. The IRS e-file logo on the IRS official employee copies may be included, but it is not required, on any of the substitute form copies. If you have comments about the prohibition against including slogans, advertising, and other logos on information returns and employee statements, send them to: Internal Revenue Service, Attn: Substitute Forms Program, SE:W:CAR:MP:T:T:SP, IR 6526, 1111 Constitution Ave., NW, Washington, DC 20224.

5. IRS Issues Guidance Illustrating Changes to Supplemental Wage Payment Reporting

In Rev. Rul. 2008-29, 2008-24 I.R.B. 1149 (obsoleting Rev. Rul. 67-131, 1967-1 C.B. 291, and Rev. Rul. 66-294, 1966-2 C.B. 459), the IRS provided nine examples that illustrate the application of section 3402 in determining the amount of income tax required to be withheld with respect to certain supplemental wages an employer pays to an employee. The guidance reflects changes made by the American Jobs Creation Act of 2004, and final regulations issued under sections 3401 and 3402, generally effective for wages paid on or after January 1, 2007.

The ruling illustrates application of the supplemental wage payment rules under the following circumstances: (1) commissions paid at fixed intervals with no regular wages paid to the employee; (2) commissions paid at fixed intervals in addition to regular wages paid at different intervals; (3) draws paid

in connection with commissions; (4) commissions paid to the employee only when the accumulated commission credit of the employee reaches a specific numerical threshold; (5) a signing bonus paid prior to the commencement of employment; (6) severance pay paid after the termination of employment; (7) lump sum payments of accumulated annual leave; (8) annual payments of vacation and sick leave; and (9) sick pay paid at a different rate than regular pay.

6. IRS Issues Proposed Regulations under Section 6039 on Statutory Stock Options

The IRS has issued proposed regulations (REG-103146-08) under section 6039 that reflect changes made by the Tax Relief and Health Care Act of 2006 (the "Health Care Act"). These proposed regulations affect corporations that issue statutory stock options and provide guidance to assist corporations in complying with the return and information statement requirements under section 6039.

Section 6039 requires corporations to file an information return with the IRS and furnish a written statement to each employee, in a manner prescribed by the Secretary in regulations, regarding: (i) the corporation's transfer of stock pursuant to the employee's exercise of an incentive stock option described in section 422(b); and (ii) the transfer of stock by the employee where the stock was acquired pursuant to the exercise of an option described in section 423(c). The proposed regulations address the time and manner for filing a return with the IRS, as well as the information to be contained in the return and furnished to employees.

Section 6039, as amended by the Health Care Act, applies to stock transfers occurring on or after January 1, 2007. However, the obligation to file section 6039 information returns for 2007 stock transfers was waived by the IRS in Notice 2008-8, 2008-3 I.R.B. 276 (December 19, 2007).

7. IRS Issues Proposed Regulations on Employer Comparable Contributions to HSAs

The IRS has issued proposed regulations (REG-120476-07) providing guidance on employer comparable contributions to Health Savings Accounts (HSAs) under section 4980G, as amended by sections 302, 305 and 306 of the Tax Relief and Health Care Act of 2006. The proposed regulations also provide guidance relating to the requirement of a return to accompany payment of the excise tax under section 4980B, 4980D, 4980E, or 4980G and the time for filing that return. The regulations address the following:

- Contributions to Nonhighly Compensated Employees. (The regulations interpret new paragraph (d) of section 4980G, which provides an exception to the comparability rules that allows, but does not require, employers to make larger contributions to the HSAs of nonhighly compensated employees than the employer makes to the HSAs of highly compensated employees.)
- The maximum HSA contribution permitted for employees who become eligible individuals mid-year.
- Qualified HSA Distributions (a direct distribution of an amount from a Health Flexible Spending Arrangement (Health FSA) or a Health Reimbursement Arrangement (HRA) to an HSA).
- Requirement of return and time for filing of the excise tax under sections 4980B, 4980D, 4980E or 4980G.

The sections of these regulations that provide guidance on employer comparable contributions to HSAs under section 4980G are proposed to apply to employer contributions made on or after the first day of the first calendar year after the final regulations are published in the Federal Register. *However, taxpayers may rely on these regulations for guidance with respect to employer contributions made on or after January 1, 2007, and before the effective date of final regulations.* The sections of these regulations that provide guidance relating to the excise tax under section 4980B, 4980D, 4980E and 4980G are proposed to be effective for calendar years (or plan years, where applicable) beginning after the date the final regulations are published in the Federal Register.

Other Matters

Treasury and IRS Issue Final Regulations on Interest-Free Employment Tax Adjustments

Treasury and the IRS have issued final regulations (T.D. 9405) under section 6011 concerning the requirement to file a return, under sections 6205(a) and 6413(a) concerning the process for making adjustments of underpayments and overpayments of employment taxes, under section 6302 concerning deposit obligations, and under sections 6402 and 6414 concerning refund claims for overpayment of employment taxes. The final regulations, effective January 1, 2009, adopt the proposed regulations (REG-111583-07) with modifications.

Adjusted return replaces current return process

The final regulations change the process by which employers can make interest-free adjustments to correct underpayments or overpayments of employment tax. The final regulations eliminate the existing process that uses the current return to make adjustments and provide a new process which will use an original return or separately filed adjusted return to make adjustments. Unlike Form 941c, the new return will not be filed as an attachment to a current return and will not affect the liability reported on the current return. Accordingly, the regulations eliminate any reference to the use of supplemental returns to make adjustments, and provide that Forms 2504 and 2504-WC will be treated as adjusted returns under the same rationale and criteria that they have been treated as supplemental returns under Rev. Rul. 75-464. Thus, corrections reported on these forms following an examination will continue to be eligible for interest-free adjustment treatment.

Interest-free Adjustments for Underpayments

Under the final regulations, when a return is filed that reports less than the correct amount of employee or employer portions of FICA or RRTA tax, and the employer discovers such error after filing the return, the employer should adjust the resulting underpayment of tax by reporting the additional amount due on an adjusted return for the return period in which the wages or compensation was paid. The adjustment must be made by the due date of the correct return for the return period in which the error is ascertained, and the amount of the underpayment must be paid by the time the adjustment is made, or interest will begin to accrue from that date. An underpayment adjustment may be made only within the period of limitations for assessment. For underpayments of income tax withholding where the incorrect amount was withheld, subject to limited exceptions, an adjustment may be made only for errors ascertained during the calendar year in which the wages were paid.

The final regulations also provide guidance to accommodate certain circumstances under which an underpayment occurs and an original return has not been filed. Specifically, if an employer filed a return reporting FICA tax when a return reporting RRTA tax should have been filed, the employer can make an interest-free adjustment by filing an original return reporting the correct amount of RRTA tax and attaching an adjusted return to correct the erroneously reported FICA tax. Similar provisions are provided if an employer filed a return reporting RRTA tax when a return reporting FICA tax should have been filed. In addition, the final regulations provide the process by which an employer can make an interest-free adjustment if the employer failed to file a return for a return period solely because the employer failed to treat any individuals as employees. The employer can make an interest-free adjustment to report the tax due with respect to the reclassified workers by filing an original return and an attached adjusted return reporting the correct amount of tax, in accordance with the instructions for the adjusted return.

Interest-free Adjustments for Overpayments

The final regulations also provide procedures for making interest-free adjustments for overpayments of employment taxes. An interest-free adjustment for an overpayment, however, may not be made after a claim for refund has been filed.

If an employer ascertains an overpayment error within the applicable period of limitations on credit or refund, the employer is required to repay or reimburse its employees the amount of overcollected employee FICA tax or employee RRTA tax prior to the expiration of the applicable period of limitations on credit or refund. Unlike the proposed regulations, the final regulations do not require the employer to repay or reimburse the employee or to adjust the overpayment by the due date of the return for the return period following the return period in which the error is ascertained. Once an employer repays or reimburses an employee to the extent required, the employer may report both the employee and employer portions of FICA or RRTA tax as an overpayment on an adjusted return. In addition, the employer must certify on the adjusted return that it has repaid or reimbursed its employees to the extent required. However, the requirement to repay or reimburse does not apply to the extent that taxes were not withheld from the employee, or the employer, after reasonable efforts, cannot locate the employee; in such cases, the employer may make an adjustment for only the employer share of FICA or RRTA tax.

Under the final regulations, reporting of the overpayment constitutes an interest-free adjustment if the overpayment is reported on an adjusted return filed before the 90th day prior to expiration of the period of limitations on credit or refund. Similar rules apply for making interest-free adjustments for overpayments of income tax withholding, except that an interest-free adjustment may be made only if the employer ascertains the error and repays or reimburses its employees within the same calendar year that the wages were paid and reports the adjustment on an adjusted return.

Deposits, payments, and credits

For interest-free adjustments of underpayments, the proposed rules provide that the amount must be paid when the adjusted return is filed. If the amount is not paid when the adjusted return is filed, a penalty under section 6656 for failure to deposit may apply. The adjusted overpayment amount will be applied as a credit toward payment of the employer's liability for the calendar quarter (or calendar year

for annual returns being adjusted) in which the adjusted return is filed, unless the IRS notifies the employer that the credit will be applied to a different return period or that the employer is not entitled to the adjustment because there was no overpayment or because the requirements for making an adjustment were not satisfied.

Ask the Expert

What is the status of the legislative efforts to remove cell phones from the definition of listed property under section 280F?

The Taxpayer Assistance and Simplification bill, H.R. 5719, would remove cell phones from the definition of listed property under section 280F. However, the bill has not been enacted, and there has been no reported action since April when the bill was passed by the House.

Section 132 provides that an employee may exclude from gross income the business use of an employer-provided cell phone as a working condition fringe benefit. However, any personal usage of an employer-provided cell phone is a taxable fringe benefit. Currently, strict substantiation requirements must be satisfied for business cell phone usage to qualify for the section 132 exclusion because cell phones are listed property under section 280F. Under the proposal, the heightened substantiation requirements that apply to listed property would not apply to cellular telephones or similar telecommunications equipment.

It is possible that the issue will be addressed by the IRS without legislation. In a letter to Rep. Dennis Moore, the IRS stated that it is considering regulatory changes that will ease record-keeping requirements in connection with the exclusion of business cell phone usage from an employee's gross income under section 132. *See* INFO 2008-0012 (June 27, 2008).

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