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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

September 30, 2008

Legislation

Genetic Information Nondiscrimination Act Affects Employers and Health Plan Sponsors

The Genetic Information Nondiscrimination Act of 2008 (Pub. L. No. 110-233) (the “Genetic Nondiscrimination Act of 2008”) could have important practical consequences for employers and employee benefits plan sponsors, according to Russell Weinheimer, senior counsel of the IRS, Tax Exempt and Governmental Entities Division, at the September 4, 2008 conference sponsored by the American Law Institute-American Bar Association.

The Genetic Nondiscrimination Act of 2008 amends the Employee Retirement Income Security Act of 1974 (ERISA), the Public Health Service Act (PHSA), and the Internal Revenue Code to prohibit a group health plan from adjusting premium or contribution amounts for a group on the basis of genetic information. The act also provides that a group health plan may not request or require an individual or a family member of such individual to undergo a genetic test. In addition the act prohibits a group health plan from requesting, requiring, or purchasing genetic information: (1) for underwriting purposes; or (2) with respect to any individual prior to such individual’s enrollment in connection with such enrollment (although obtaining such information incidentally is not a violation). The Internal Revenue Code changes made by § 103 of Pub. L. No. 110-233 are effective with respect to group plans for plan years beginning after May 21, 2009. The Act instructs the Secretary of the Treasury to issue final regulations or other guidance not later than 12 months after the date of the enactment Act to carry out the amendments. Temporary regulations implementing Genetic Nondiscrimination Act of 2008 have been added to the IRS 2008-2009 Priority Guidance Plan.

Reporting Guidelines And Forms

1. New Law Provides “Wages” Include Differential Employer Payments to Employees Called to Active Duty

Under the Heroes Earnings Assistance and Relief Tax Act of 2008 (Pub. L. No. 100-245) (the “Tax Relief Act of 2008”), differential pay will be considered wages for tax purposes as of January 1, 2009. “Differential pay” is a term commonly used to refer to amounts paid to an employee called to active duty with the United States uniformed services by employers who voluntarily agree to maintain the

level of compensation that the service member would otherwise have received from the employer during the service member's period of active duty. Currently, such amounts are not treated as wages for purposes of the federal income tax withholding rules. Under Rev. Rul. 69-136, 1969-1 C.B. 252, the service member is treated as terminating the employment relationship with the employer that pays the differential pay upon being called for active duty.

The Tax Relief Act of 2008 amended the definition of wages for purposes of the federal income tax withholding rules applicable to an employer's payment of wages. The provision includes as wages the employer's payment of any differential wage payment to the employee. Differential wage payment is defined as any payment which: (1) is made by an employer to an individual with respect to any period during which the individual is performing service in the uniformed services while on active duty for a period of more than 30 days; and (2) represents all or a portion of the wages that the individual would have received from the employer if the individual were performing services for the employer.

In addition, the provision amends the term "compensation" to include differential wage payments (as defined for purposes of wage withholding) for purposes of the limitation on contributions to an IRA. The provision also provides rules relating to differential wage payments (as defined for purposes of wage withholding) for purposes of a retirement plan that is subject to section 414(u), relating to special rules that permit defined benefit plans and individual account plans to satisfy the requirements of the Uniformed Services Employment and Reemployment Rights Act of 1994.

Recently, members of the Employment Taxes Committee, at the ABA Section of Taxation meeting on September 12, 2008 in San Francisco, were told that guidance relating to the new differential pay provision has been added to the IRS Guidance Plan.

2. New FICA Withholding For Domestically Controlled Foreign Employers of Certain U.S. Persons under Government Contracts

Under the Heroes Earnings Assistance and Relief Tax Act of 2008 (Pub. L. No. 110-245) (the "Tax Relief Act of 2008"), new section 3121(z) extends FICA tax withholding to foreign employers of U.S. persons if any employee of the foreign person is performing services in connection with a contract between the U.S. Government and any member of any domestically controlled group of entities which includes such foreign person. Under the Tax Relief Act of 2008, such foreign person shall be treated for FICA purposes as an American employer with respect to such services performed by such employee.

3. Third Circuit Holds that Federal Tax Law Preempts State Law Claims in Classification Suit

In *Umland v. PLANCO Financial Services, Inc.*, No. 06-4688 (3rd Cir. 2008), the Third Circuit affirmed the district court, holding federal income tax law preempts state law claims for damages based on misclassification of a worker as an independent contractor. The plaintiff alleged that PLANCO Financial Services, Inc. ("PLANCO") misclassified her as an independent contractor for several years and that, after reclassifying her as an employee, PLANCO deducted its share of the Federal Insurance Contributions Act (FICA) taxes (owed as a result of plaintiff's status as an employee) from her paychecks. The court determined that permitting plaintiff's suit to proceed would interfere with the

IRS's administrative scheme for handling such disputes, citing IRS Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, Treas. Reg. § 31.3121(d)-1 (defining employees for purposes of FICA), and the Internal Revenue Manual, pt. 4, ch. 23, § 6 (2003) (describing the "Classification Settlement Program"). The court concluded that the plaintiff failed to state a claim upon which relief could be granted.

The court based its conclusion on the determination that FICA does not create a private right of action, and all of the breach-of-contract claims, at root, alleged FICA violations. In addition, the court determined that the claim for unjust enrichment, in connection with the employer's portion of FICA that was collected from the plaintiff, was preempted by section 7422, which required the plaintiff to seek a refund from the IRS.

4. Recent Article Addresses Independent Contractor Determinations

In a recent article, Robert W. Wood described the impact of various laws on the determination of employee/independent contractor status. See Wood, Robert W., *How Laws Impact Independent Contractor Determinations*, Tax Notes, Vol. 120, No. 7, 2008; see also Wood, Robert W., *Legal Requirements That Influence Control of Independent Contractors and Employees*, Journal of Tax Practice and Procedure, August-September 2008.

Other Matters

1. Court Refuses To Grant IRS Summary Judgement Motion Relating To Section 530 Relief

In *U.S. v. Porter*, 102 A.F.T.R. 2d 2008-5557, a federal district court in Iowa refused to grant the IRS a summary judgment that the taxpayer was not entitled to relief under section 530 of the Revenue Act of 1978, because there were genuine issues of material fact whether the requirements for such relief were satisfied. By its terms, section 530 is a relief provision available only to employers who erroneously classify their employees. Section 530 applies if (i) the taxpayer does not treat a worker as an employee for employment tax purposes during a particular period; (ii) the taxpayer files all required federal employment tax returns on a basis consistent with this treatment; and (iii) the taxpayer has a reasonable basis for not treating the worker as an employee.

2. TIGTA Says IRS Should Act To Increase Withholding Compliance

The Treasury Inspector General for Tax Administration (the "TIGTA") recently released a report titled "The Withholding Compliance Program Is Improving Taxpayer Compliance; However, Additional Enforcement Actions Are Needed." The Withholding Compliance Program analyzes wage and tax information reported on the *Wage and Tax Statement* (Form W-2) and tax return data to identify taxpayers who have not had enough taxes withheld and do not comply with filing tax-payment requirements. The goal of the Withholding Compliance Program is to ensure that taxpayers have enough income taxes withheld from their wages to meet their tax obligations. In the report, the TIGTA concludes that while the program has improved taxpayer compliance, more effort is needed to ensure that employers comply with the tax withholding requirements and to penalize taxpayers who make false

statements that result in the underwithholding of taxes. The report can be viewed at <http://www.ustreas.gov/tigta/auditreports/2008reports/200840167fr.pdf>.

Ask The Expert

What reporting and withholding issues have been receiving the most legislative and administrative attention lately?

At the National Association of Tax Reporting and Payroll Management Conference on September 9, 2008, Mark Howard, senior counsel for the IRS's Salt Lake City office, described several areas getting more attention by the IRS and Congress, including worker classification, employee leasing/professional organization issues, and discussed compensation for executives under tiered pay structures.

Howard also noted that examinations are focusing on employee tool reimbursement plans offered by third parties. He appeared to suggest that the IRS is interested in shutting down tool plan administrators. The IRS has previously indicated concern that employers are improperly using tool plans to recharacterize amounts properly treated as employee wages. For example, in CCA 200745018 (Aug. 2, 2007), amounts paid by an employer to its employee service technicians as purported reimbursements for the use of the technicians' tools under the taxpayer's "tool plan" were not excluded from wages for employment tax purposes as amounts paid under an accountable plan. As a result, the IRS concluded that amounts paid under the plan must be included in the technician's gross income, reported as wages or other compensation to the technician on Form W-2, and subject to withholding and payment of employment taxes. The IRS based its conclusion on the fact that the employers plan failed each of the three requirements of an accountable plan (both in design and operation): business connection, substantiation, and return of excess. See "Employment Tax Enforcement Issues Addressed at ABA Midyear Meeting," Insurance Company Information Reporting and Withholding Update, February 29, 2008 (p. 4).

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