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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

October 31, 2008

Legislation

Proposed Form W-2 Reporting of Costs of Employee Health Coverage

A legislative proposal has recently been released that would require employers to report the cost of health insurance coverage for an employee on the employee's Form W-2, *Wage and Tax Statement*. The proposal, which would not affect the exclusion for such benefits, was drafted by a bipartisan group, including the leader of the Senate Finance Committee. The proponents said making workers aware of the cost of their health insurance could lead to more efficient choices of health coverage.

Forms 1099, Backup and Foreign Payee Withholding, and Penalties

IRS Announces Proposed Amendments to QI Agreement and Audit Guidance, and Requests Comments

In Announcement 2008-98, 2008-44 I.R.B. XX (Oct. 14, 2008), the IRS has announced that it is intending to make changes to the section 1441 withholding rules applicable to qualified intermediaries (QIs) and solicits public comments. Specifically, the proposed amendments are to the Qualified Intermediary Agreement, Appendix, Rev. Proc. 2000-12, 2000-1 C.B. 387 (QI Agreement), and to the Guidance for External Auditors of Qualified Intermediaries, Appendix, Rev. Proc. 2002-55, 2002-2 C.B. 435 (QI Audit Guidance). *See* IR-2008-116. These amendments are intended to ensure that QIs are taking the steps necessary to comply fully with their obligations under the QI Agreement, and are proposed to be effective for calendar years beginning after December 31, 2009.

Background

The IRS established the QI program in 2001 to encourage foreign financial intermediaries to comply better with U.S. withholding requirements under sections 1441 and 1442 without discouraging foreign investors that may not want U.S. tax authorities to know their identities. Under the program, foreign banks that agree to follow certain procedures may assume the responsibilities of a U.S. withholding agent without disclosing to U.S. authorities the identities of their non-U.S. account holders. A QI is any foreign intermediary (or foreign branch of a U.S. intermediary) that has entered into a QI withholding agreement with the IRS. Rev. Proc. 2002-55 contains audit guidance for an external auditor

engaged by a QI to verify the QI's compliance with the withholding agreement entered into with the IRS pursuant to Rev. Proc. 2000-12, 2000-4 I.R.B. 387 and Treas. Reg. §1.1441-1(e)(5). Under its QI Agreement, the QI generally must report annually certain aggregate information concerning the beneficial owners of U.S. source payments and make any necessary tax payments to the IRS. In lieu of an IRS audit, the QI may engage an external auditor to conduct an audit to determine whether it is complying with the withholding and reporting obligations covered by the QI agreement.

Proposed Amendments

The IRS intends to amend the QI Agreement and the QI Audit Guidance as follows:

- Notice of Material Failure of Internal Controls. The QI Agreement will be amended to provide that a QI must notify the IRS whenever the QI becomes aware of a material failure of internal controls relating to its performance under the QI Agreement, any employee allegations of such failures, or any investigation by regulatory authorities of such failures. Although any such failure may represent a significant change in circumstances that would give the IRS the right to terminate the QI Agreement, the IRS does not contemplate automatically terminating a QI Agreement by reason of such notice. Instead, the IRS expects prompt notification to enable the IRS and the QI to work together to remedy such failures so that consideration of termination will not be necessary.
- Phase 1 Fact Finding for Evaluation of Risk. The QI Audit Guidance will be amended to add an audit procedure testing certain accounts for characteristics that suggest that a U.S. person has authority over the account. This information would enable the IRS in phase 2 of the audit process to evaluate the risk of any failure of controls and if necessary to request that the external auditor perform additional audit procedures. The QI Audit Guidance also will be amended to add additional procedures for fact gathering by the external auditor relating to the IRS's evaluation of the risk of a material failure of internal controls. These procedures will include, for instance, identifying the persons charged with oversight of performance under the QI Agreement and the authority given them to prevent, deter, detect and correct such failures on the part of other operational personnel. The external auditor will be required to report any facts or circumstances observed in the course of its audit that reasonably relate to the evaluation by the IRS of the risk of a material failure of internal controls.
- Audit Oversight and Review by U.S. Auditor. The QI Audit Guidance will be amended to require the external auditor to associate a U.S. auditor with the audit and to require the U.S. auditor to accept joint responsibility for performance of the procedures under the audit guidance. The aim in joining a U.S. auditor is to assure appropriate application of U.S. withholding rules and to enhance accuracy and accountability in the audit process.

Comments Requested

The IRS requests comments, which should be submitted on or before February 28, 2009.

Reporting Guidelines And Forms

1. IRS Updates Rates for Valuing Noncommercial Flights

The IRS issued Rev. Rul. 2008-48 (2008-38 I.R.B. 604) providing Standard Industry Fare Level (SIFL) mileage rates and terminal charges for purposes of determining the value of noncommercial flights on employer-provided aircraft under Treas. Reg § 1.61-21(g). The rates apply for the second half of 2008.

2. Disregarded Entities Not Disregarded for Employment and Excise Tax Purposes

Regulations promulgated last year include a provision, effective for wages paid on or after January 1, 2009, that a disregarded entity is treated as “a separate entity” for purposes of employment taxes and related reporting requirements and that “the separate entity” is treated as a corporation for these purposes. Treas. Reg. § 1.1361-4, Treas. Reg. § 301.7701-2(c)(2)(iv) (T.D. 9356). The regulations also provide that disregarded entities are treated as separate entities for purposes of certain excise taxes reported on Form 720, “Quarterly Federal Excise Tax Return;” Form 730, “Monthly Tax Return for Wagers;” Form 2290, “Heavy Highway Vehicle Use Tax Return;” and Form 11-C, “Occupation Tax and Registration Return for Wagering;” excise tax refunds or payments claimed on Form 8849, “Claim for Refund of Excise Taxes;” and excise tax registrations on Form 637, “Application for Registration (For Certain Excise Tax Activities).” The excise tax provisions of the regulations applied to liabilities imposed and actions required or permitted in periods beginning on or after January 1, 2008.

3. IRS Updates Rules on Business Travel Expense Substantiation

The IRS has issued Rev. Proc. 2008-59, 2008-41 I.R.B., which updates rules for determining the amount of an employee’s business travel expenses for lodging, meals, and incidental expenses that is deemed substantiated under Treas. Reg. § 1.274-5, when the employer provides a per diem allowance. The procedure also provides an optional method for employees and self-employed individuals who are not reimbursed to compute the deductible costs paid or incurred for business meals and incidental expenses while traveling away from home. The procedure updates the list of high-cost localities and increases the per-diem rate for those locations from \$237 to \$256 per day (\$198 for lodging and \$58 for meal and incidental expenses). The per diem rate for other localities (i.e., not within the high-cost category) was increased from \$152 to \$158 per day (\$113 for lodging and \$45 for meal and incidental expenses). The procedure, which supercedes Rev. Proc. 2007-63, 2007-42 I.R.B.809, is generally effective for allowances or expenses that are paid on or after October 1, 2008, for travel away from home on or after that date, subject to certain transition rules.

Ask The Expert

Does a payor need to take action in connection with a B-Notice if the individual is no longer performing services for the payor?

Yes. Under section 3406(a)(1)(B), (d)(2)(B), (e)(2), and (h)(8) and Treas. Reg. § 31.3406(d)-5(c), (d), (e), and (f), if the IRS or a broker notifies a payor that a payee's name/TIN combination is incorrect, the payor generally must:

- Identify accounts of the payee that contain the same incorrect name/TIN combination;
- Send to the payee a copy of the notice sent by the IRS or the broker (or an acceptable substitute notice) to the payor; and
- Impose backup withholding on all reportable payments made to the account starting after the close of the 30th business day after the payor receives that notice, and on or before the close of the 30th calendar day after the payor receives certification from the payee ending of the correct name and TIN.

Accordingly, even if no additional payments will be made to a payee that could be subject to backup withholding, the payor still must send the payee a copy of the notice the payor received from the IRS or broker. See also Rev. Proc. 93-37, 1993-2 C.B. 477.

IRS Circular 230 Disclosure:

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**For comments or questions, or if you would like to receive the Information Reporting and Withholding Update via electronic mail, please contact Lynlee Baker at (202) 434-9172 or lbaker@scribnerhall.com
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