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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

November 26, 2008

Legislation

Baucus Releases Alternative Health Care Proposal

Mr. Max Baucus (D-Mont.), Senate Finance Committee Chairman, issued a white paper detailing his own health care proposal that generally dovetails with President-elect Obama's health care plan. The proposal would require all Americans to buy health insurance under a system supported by tax incentives. The paper can be viewed online at <http://finance.senate.gov/healthreform2009/finalwhitepaper.pdf>.

Forms 1099, Backup and Foreign Payee Withholding, and Penalties

IRS Continues to Target QIs to Assure Section 1441 and 1442 Withholding Compliance

Carl Cooper, senior attorney of the Office of Assistant Chief Counsel (International) in the IRS's Large and Mid-Size Business Division (LMSB), has commented that the IRS plans to issue guidance in the near future as part of its continuing effort to ensure compliance by qualified intermediaries (QI's) with withholding requirements under sections 1441 and 1442. The comments were made at a Tax Executives Institute meeting on October 28, 2008. The planned guidance will enhance documentation requirements for QIs, expand on changes proposed in Announcement 2008-98, (2008-44 I.R.B. XX (Oct. 14, 2008)), and propose sanctions for QIs that engage in abusive practices. In Announcement 2008-98, the IRS announced proposed changes 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; *see also* "IRS Announces Proposed Amendments to QI Agreement and Audit Guidance, and Requests Comments," Insurance Company Information Reporting and Withholding Update, October 31, 2008 (p. 1).

Some guidance may be released as soon as the end of this month. At the same TEI meeting, Kathy Robbins, director of field operations for the financial services industry of LMSB, indicated that there will be increased focus on information reporting requirements. Thomas Chillemi, IRS QI program manager, stated that the IRS has instructed revenue agents to take a closer look at Forms W-8 and verify Form W-8 data with information in the administrative file on that account, and to make a statistical sampling if it is a large institution with a large number of accounts.

Employer Issues

1. IRS Concludes Interest-Free Adjustment under Section 6205 Should Not Be Denied Solely Because of Application of Section 6662 Accuracy-Related Penalty

In CCA 200846022 (Oct. 6, 2008), the IRS concluded that an interest-free adjustment under section 6205 should not be denied solely because the accuracy-related penalty under section 6662(b)(1) is imposed. However, the IRS determined that the facts and circumstances warranting application of the accuracy-related penalty may indicate that the underpayment was not the result of an error or that the taxpayer knowingly underreported its liability, therefore precluding availability of an interest-free adjustment under section 6205.

Section 6205 and the regulations thereunder permit an employer who has made an undercollection or underpayment of Federal Insurance Contributions Act (“FICA”) tax, Railroad Retirement Tax Act (“RRTA”) tax (both the employer and employee shares), or federal income tax withholding, and who ascertains the error after filing the return reporting such tax, to make an adjustment without owing interest on the underpayment. (Section 6205 does not apply to the Federal Unemployment Tax Act (“FUTA”) tax.) An error is “ascertained” when the employer has sufficient knowledge of the error to be able to correct it. The determination of the CCA is based on the IRS’s determination that there is no statutory or regulatory provision linking the meaning of an “error” for purposes of section 6205 with the standard for imposing the accuracy-related penalty under section 6662(b)(1).

2. Seventh Circuit Concludes Mandatory Contributions to Section 403(b) Annuities under Salary Reduction Plan Are FICA Wages

In *University of Chicago v. United States*, 102 AFTR 2d 2008-5487, the Seventh Circuit affirmed the district court’s decision that the University of Chicago (“University”) was liable for Federal Insurance Contributions Act (“FICA”) taxes relating to contributions to mandatory retirement plans to purchase employee annuities under section 403(b) pursuant to salary reduction agreements, in addition to failure-to-deposit and failure-to-pay penalties. For FICA tax purposes, under section 3121(a)(5)(D), “wages” includes all remuneration for employment, except payments “made to, or on behalf of, an employee or his beneficiary . . . under or to an annuity contract described in section 403(b),” but the exception does not extend to those payments for the purchase of such contracts which are made by reason of salary reduction agreements. The University argued that Congress intended the “salary reduction agreement” language of section 3121(a)(5)(D) to include a voluntary salary reduction agreement in the FICA wage base (i.e., only if the agreement reflected an employee’s voluntary choice to reduce his salary and make the payments to purchase the annuity).

The Seventh Circuit concluded that Congress intended section 3121(a)(5)(D) to include “salary reduction agreements,” whether voluntary or mandatory, in the FICA wage base. The court determined that the plain language of the statute demonstrates that the provision distinguishes between a salary supplement, i.e., “any payment made to, or on behalf of, an employee or his beneficiary . . . under or to an annuity contract described in section 403(b),” and a salary reduction, i.e., “a payment for the purchase of such contract which is made by reason of a salary reduction agreement.” The court also concluded that the University was liable for failure-to-deposit and failure-to-pay penalties under sections 6656 and 6651(a)(3), respectively. The court determined that the University failed to show that the failures were due to reasonable cause and not due to willful neglect because the court determined that the University’s interpretation was unsupported and unreasonable.

Reporting Guidelines and Forms

1. Final Regulations Issued on Information Reporting Rules for Employer-Owned Life Insurance Contracts

The Treasury Department and the IRS have removed temporary regulations (T.D. 9364) and issued final regulations (T.D. 9431) that require taxpayers to fulfill reporting requirements under section 6039I, relating to employer-owned life insurance contracts, by filing Form 8925, Report of Employer-Owned Life Insurance Contracts. Section 6039I generally requires applicable policyholders to file a return each year showing its total number of employees, the number of employees insured with employer-owned life insurance contracts, and the total amount of insurance in force at the end of the year under these contracts, as well as other related information. Section 6039I was enacted with section 101(j) as part of the Pension Protection Act of 2006. Section 101(j) generally requires businesses to treat proceeds from company-owned life insurance contracts as income, excluding as a death benefit only the amount of premiums and other amounts it paid for the contracts, except where certain requirements are satisfied. The temporary regulations, issued late last year, merely delegated authority to the IRS to prescribe the details of the information reporting requirements for employer-owned life insurance contracts under section 6039I. In connection with the temporary regulations, the IRS issued Form 8925, Report of Employer-Owned Life Insurance Contracts, to which the final regulations now refer.

Employers holding life insurance contracts should use Form 8925 to report the number of employees covered by employer-owned life insurance contracts issued after August 17, 2006, and the total amount of employer-owned life insurance in force on those employees at the end of the tax year. Policyholders also must indicate whether a valid consent has been received from each covered employee, and the number of covered employees for which a valid consent has not been received for purposes of Form 8925. An insurance contract is an employer-owned life insurance contract if it (i) is owned by a person who is engaged in a trade or business that employs the insured and is the direct or indirect beneficiary of the contract, and (ii) covers the life of the owner’s employee(s) on the date the life insurance contract is issued. Special rules apply in the context of master contracts. Form 8925 should be attached to the policyholder’s income tax return for each tax year ending after November 13, 2007, during which the policyholder has employer-owned life insurance contract(s) in force.

2. Treasury and IRS Issue Final and Temporary Regulations Relating to Information Reporting for Discharges of Indebtedness under Section 6050P

The Treasury and the IRS have released final and temporary regulations relating to information reporting for discharges of indebtedness (T.D. 9430) under section 6050P. Section 6050P, originally enacted by the Omnibus Budget Reconciliation Act of 1993 (Pub. L. No. 103-66), requires certain entities to file information returns with the IRS, and to furnish information statements to debtors, reporting discharges of indebtedness of \$600 or more. The new regulations reduce the information reporting burden on certain entities and protect debtors from receiving information returns that prematurely report cancellation of indebtedness income from such entities.

Background

As originally enacted, section 6050P applied solely to “applicable financial entities,” which was then defined to include only financial institutions, credit unions, and Federal executive agencies. In 1996, final regulations under section 6050P required applicable financial entities, as then defined, to report cancellation of debt upon the occurrence of one of several “identifiable events” as provided in Treas. Reg. § 1.6050P-1(b)(2)(i)(A) through (H). (T.D. 8654). One of these identifiable events was the expiration of a “non-payment testing period” pursuant to Treas. Reg. § 1.6050P-1(b)(2)(i)(H). The 1996 regulations created a rebuttable presumption (the “36-month rule”) under Treas. Reg. § 1.6050P-1(b)(2)(iv) that this period expired if a creditor had not received a payment for 36 months.

In 1996, the scope of section 6050P was expanded to cover any government agency in the executive, judicial, or legislative branch as well as any applicable financial entity, and in 1999, the definition of “applicable financial entity” under section 6050P was expanded to include any organization “a significant trade or business of which is the lending of money.” *See* The Debt Collection Improvement Act of 1996, Pub. L. No. 104-134 (110 Stat. 1321, 368-369 (1996)), and The Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170 (113 Stat. 1860, 1931 (1999)). In 2004, the Treasury and IRS published final regulations to reflect the changes to section 6050P but continued application of the 36-month rule. (T.D. 9160). Based on concerns that the application of the 36-month rule might trigger premature information reporting of cancellation of indebtedness income, the new regulations limit the application of the 36-month rule to the entities for which it was originally intended.

Other Matters

1. IRS Rules Employer Payments for Self-Insurance Medical and Dental Services Are Deductible in Year Services Provided

In TAM 200846021 (Nov. 14, 2008), the IRS concluded that if an accrual method employer provides medical and dental services to employees under self-insured medical and dental plans, and the employer pays the service providers more than 2½ months after the end of the taxable year in which services are provided, the employer may deduct the payments in its taxable year during which the

medical and dental services are provided to employees. The IRS based its conclusion on the fact that the plan did not involve a welfare benefit fund under section 419(e), and that the plan terms provided that benefits are eligible for reimbursement if the employee was a participant on the date that medical or dental services were provided.

Under a discriminatory plan excess reimbursements for highly compensated employees do not qualify for exclusion, but are taxable to the employee. In such a situation, the IRS reasoned, citing Treas. Reg. § 1.105-11(h), the income is in the year the services are provided if the plan provides that such reimbursements relate to such year. Further, the IRS determined that its conclusions would remain the same if the payments were treated as deferred compensation under section 404, because such payments would be included in the employee's income of the employee under section 404(a)(5) and thus would be deductible to the employer in the same taxable year.

2. SSA Announces 2009 Contribution and Benefit Base

In Notice 2008-103 2008-46 I.R.B. 1156, the Social Security Administration announced that the contribution and benefit base for remuneration paid in 2009, and self-employment income earned in taxable years beginning in 2009 is \$106,800.

Ask The Expert

We understand that the annual IRS Information Reporting Program Advisory Committee (IRPAC) meeting was last month. What are the most recent IRPAC developments?

Yes, the IRPAC annual public meeting was held on October 29, 2008, and IRPAC recommended that the IRS –

- Mask the Taxpayer Information Number (TIN) on information reporting forms;
- Improve instructions for disaster reporting of postponed annual tax year contributions to IRAs;
- Improve the reporting return (Form 990) for tax-exempt organizations; and
- Provide guidance for a taxpayer receiving Schedule K-1 and Form 1099 or Form 1042-S0 for the same partnership income.

In addition, the IRPAC Office of Professional Responsibility Subgroup recommended that the IRS Office of Professional Responsibility (“OPR”) consider providing guidance in the form of hypotheticals that address different types of conduct potentially subject to Circular 230 sanctions. The OPR has developed a penalty grid to indicate the range of sanctions to be applied to particular non-filing and non-paying conduct by Circular 230 practitioners, and provided a copy to the subgroup for comment. Michael Chesman, then Director of the OPR (he has since left the government) has indicated his belief that the grid will go a long way towards increasing transparency of the office and of the sanction process. Nevertheless, the IRPAC Subgroup recommended that OPR consider scrapping the grid in favor of the hypotheticals.

See IR-2008-124 (Oct. 29, 2008). The 2008 Information Reporting Program Advisory Committee Report is available online at <http://www.irs.gov/taxpros/article/0,,id=187812,00.html>.

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