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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

December 31, 2008

Legislation

1. 2009 RMDs Waived by Worker, Retiree and Employer Recovery Act

The “Worker, Retiree and Employer Recovery Act” (Pub. L. No. 110-458), which was signed into law on December 23, waives the required minimum distribution (RMD) requirement for retirement plans and IRAs for calendar year 2009. Additional provisions will ease funding requirements for employer-sponsored pension plans and provide temporary funding relief for multi-employer plans that have been negatively impacted by the economic downturn.

2. Bill Proposes Two-Month Payroll Tax Holiday

H.R. 7309, a bill co-sponsored by Rep. Louis Gohmert (R-TX), was introduced December 9, 2008, to suspend employment and income taxes for the first two months of 2009, and for other purposes. It is estimated that the bill would cost more than \$333 billion. Under the bill, the remaining \$350 billion in bailout funds under the Troubled Assets Relief Program would be applied to pay for the payroll tax holiday.

3. Survey Finds Little Support for W-2 Reporting of Health Care Costs

Responding to a proposal to require disclosure of employee health-care cost information on Forms W-2, Worldatwork (which represents 30,000 human resources professionals worldwide) submitted comments to the Senate Finance Committee on November 17, 2008, suggesting that an alternative report would provide more effective disclosure than Form W-2. The comments were based on survey results, in which a majority of respondents (62 percent) favored disclosure on a “total rewards statement,” compared to eight percent preferring Form W-2. The proposal, released October 7, 2008, was drafted by Finance Committee Chairman Max Baucus (D-MT), ranking minority member Chuck Grassley (R-IA), and Sens. Ron Wyden (D-OR), Michael B. Enzi (R-WY), and E. Benjamin Nelson (D-NE). The senators, including leaders of the Senate Finance Committee, said making workers aware of the cost of their health insurance could lead to more efficient choices of health coverage, thus reducing health care spending.

Employer Issues

1. 2009 Reimbursement Rate for Business Mileage Set

In Rev. Proc. 2008-72 (2008-50 I.R.B. XX) and IR-2008-131 (Nov. 24, 2008), the IRS announced that the optional standard mileage rate will be 55 cents per mile for business miles driven, effective January 1, 2009. The rate reflects an increase of 4.5 cents from the 2007 rate described in Rev. Proc. 2007-70 (2007-50 I.R.B. 1162). The revenue procedure also set the standard mileage rates for deducting the costs of operating an automobile for charitable, medical or moving purposes. The rate for medical or moving purposes will be 24 cents per mile, an increase of 5 cents per mile. The rate for charitable use during 2009 will remain 14 cents per mile, a statutory rate not adjusted for inflation. *See* Rev. Proc. 2008-72 for additional information and limitations on the use of the standard mileage rates.

2. Proposed Regulations under Section 409A Address Calculation of Amounts Includible in Income

Treasury and the IRS have issued comprehensive proposed regulations (REG-148326-05, 73 Fed. Reg. 74380 (Dec. 8, 2008)) that address the calculation of amounts includible in income under section 409A(a), and related issues, including the calculation of the additional taxes applicable to such income. A summary of general provisions of the proposed regulations follows.

Effect of a Failure to Comply with Section 409A(a) on Amounts Deferred in Subsequent Years

- Under the proposed regulations, each tax year generally is analyzed independently to determine if there is a plan failure. Thus, the adverse tax consequences that result from a failure to comply with section 409A(a) would apply only with respect to amounts deferred in the year in which such noncompliance occurs and to all previous taxable years, to the extent such amounts are not subject to a substantial risk of forfeiture and have not previously been included in income. If in a later year the plan is in compliance with section 409A(a) both in form and operation, the prior failure would not have continuing or permanent effect.
- Under the general rule in the proposed regulations, if all of a taxpayer's deferred amounts under a plan are nonvested and the taxpayer makes an impermissible deferral election or accelerates the time of payment with respect to some or all of the nonvested deferred amount, the nonvested deferred amount generally would not be includible in income under section 409A(a) in the year of the impermissible change in time and form of payment (although if there were vested amounts deferred under the plan, such amounts would be includible in income under section 409A(a)). In the subsequent taxable year in which the deferred amount becomes vested, the plan might comply with section 409A(a), so that no income inclusion would be required under the general rule and no additional taxes would be due for that year as a result of the late deferral election or acceleration of payment.

Calculation of the Amount Deferred under a Plan for the Taxable Year in which the Plan Fails to Meet the Requirements of Section 409A(a) and for all Preceding Taxable Years

- The first step is to determine the total amount deferred under the plan for the service provider's taxable year and all preceding taxable years. Generally, the amount deferred under a plan for a taxable year and all preceding taxable years would be referred to as the total amount deferred for a taxable year and would be determined as of the last day of the taxable year.
- The second step is to calculate the portion of the total amount deferred for the taxable year, if any, that is either subject to a substantial risk of forfeiture (nonvested) or has been included in income in a previous taxable year. For a deferred amount to be treated as previously included in income, the proposed regulations would require that the service provider actually and properly has included the amount in income in accordance with a provision of the Internal Revenue Code. This would include amounts reflected on an original or amended return filed before expiration of the applicable statute of limitations on assessment and amounts included in income as part of an audit or closing agreement process. In addition, a deferred amount would be treated as an amount previously included in income only until the amount is paid.
- The last step is to subtract the amount determined in step two from the amount determined in step one. The excess of the amount determined in step one over the amount determined in step two is the amount includible in income and subject to additional income taxes for the year as a result of the plan's failure to comply with section 409A(a).

3. IRS Notice Offers 2008 Guidance for Reporting and Withholding under Section 409A and Suspends Deferral Reporting

Notice 2008-115 (2008-52 I.R.B. 1367) provides guidance for employers and payers on reporting and wage withholding requirements under section 409A. Generally, these requirements reflect an extension of the guidance provided in Notice 2006-100 (2006-51 I.R.B. 1109) and Notice 2007-89 (2007-46 I.R.B. 998), applicable to calendar years 2005, 2006, and 2007. Notice 2008-115 is effective for calendar year 2008 and will remain in effect for subsequent calendar years until further guidance is issued. However, the Treasury Department and the IRS do not expect to issue further guidance until the recently proposed regulations under section 409A (REG-148326-05, discussed above), addressing calculation of amounts includible in income, are made final. It is expected that with respect to annual deferral reporting (Form W-2, box 12, code Y and Form 1099-MISC, box 15a), the future guidance will not be made effective until the calendar year after the regulations are finalized.

For calendar year 2008, Notice 2008-115 permanently waives requirements for deferral reporting by employers and payers under section 6041 and section 6051. Thus, an employer is not required to report to an employee the total amount of deferrals for the year under a nonqualified plan in box 12 of Form W-2 using code Y, and a payer is not required to report to a nonemployee worker the total amount of deferrals for the year under a nonqualified plan in box 15a of Form 1099-MISC. However, an employer still is required to report amounts includible in gross income under section 409A, and in wages under section 3401(a), in box 1 of Form W-2 as wages paid to the employee during the year. An employer must also report such amounts in box 12 of Form W-2 using code Z. In addition, a payer must

report amounts includible in gross income under section 409A and not treated as wages under section 3401(a) as nonemployee compensation in box 7 of Form 1099-MISC. A payer must also report such amounts in box 15b of Form 1099-MISC.

Guidance for service providers is also provided in the new notice. Service providers must report as income and pay taxes due on amounts includible in gross income under section 409A for 2008. *See* Notice 2008-115, section IV. If the service provider fails to report and pay taxes due as provided in the notice for 2008, the IRS may assert additional income taxes, penalties and interest.

Background

In connection with the enactment of section 409A, the American Jobs Creation Act of 2004 (2004 Jobs Act) requires annual reporting of all compensation deferred under the plan for the year regardless of whether such compensation is includible in gross income pursuant to section 409A(a)(1)(A). As a result, reporting and withholding obligations consist of two parts: inclusion reporting, when there is a section 409A violation, and deferral reporting. With respect to deferral reporting, the 2004 Jobs Act added sections 6041(g)(1) and 6051(a)(13) to require that all deferrals for the year under a Nonqualified Plan be separately reported on a Form 1099, or Form W-2. However, neither section 6041(g)(1) nor section 6051(a)(13) requires the reporting of deferrals for benefit of a person under a nonqualified plan if a Form 1099-MISC or a Form W-2 otherwise is not required to be filed for the person. With respect to inclusion reporting, section 3401(a) was amended by the 2004 Jobs Act to provide that the term “wages” includes any amount includible in the gross income of an employee under section 409A. For purposes of reporting nonemployee compensation, section 6041 was also amended to require that amounts includible in gross income under section 409A that are not treated as wages must be reported as gross income. *See* section 6041(g)(2).

Notice 2005-1

The Treasury and IRS first provided reporting and withholding guidance with respect to section 409A in Notice 2005-1 issued on December 20, 2004. Notice 2005-1 imposes the following reporting and withholding requirements:

- An employer must report to an employee the total amount of deferrals for the year under a Nonqualified Plan in box 12 of Form W-2 using code Y. *See* Q&A-29.
- An employer must report amounts includible in gross income under section 409A and in wages under section 3401(a) in box 1 of Form W-2 as wages paid to the employee during the year. An employer must also report such amounts in box 12 of Form W-2 using code Z. *See* Q&A-33.
- A payer must report to a nonemployee the total amount of deferrals for the year under a Nonqualified Plan in box 15a of Form 1099-MISC. *See* Q&A-30.
- A payer must report amounts includible in gross income under section 409A and not treated as wages under section 3401(a) as nonemployee compensation in box 7 of Form

1099-MISC. A payer must also report such amounts in box 15b of Form 1099-MISC. See Q&A-35.

Notice 2006-100

Notice 2006-100, modifying Notice 2005-1, permanently waives employers' and payers' deferral reporting requirements under section 6041 and section 6051 for calendar years 2005 and 2006. See also Notice 2005-94, 2005-2 C.B. 1208.

Notice 2007-89

Notice 2007-89, modifying Notice 2005-1, 2005-2 I.R.B. 274, generally reflected an extension to 2007 of the guidance provided in Notice 2006-100, applicable to 2005 and 2006 tax years.

4. IRS Notice Provides Transitional Relief and Correction Guidance on Certain Failures of Nonqualified Deferred Compensation Plans to Operate in Compliance with Section 409A

The IRS has issued Notice 2008-113, 2008-51 I.R.B. XX, providing relief from the full application of the income inclusion and the penalty taxes under section 409A, with respect to certain failures of a nonqualified deferred compensation plan to operate in compliance with section 409A(a) (an operational failure). Notice 2008-113 makes obsolete Notice 2007-100, 2007-52 I.R.B. 1243, for taxable years beginning on or after January 1, 2009. However, Taxpayers may rely on Notice 2008-113 for taxable years beginning before January 1, 2009.

Notice 2008-113 provides procedures under which taxpayers can obtain full relief from income inclusion and additional taxes under section 409A with respect to certain operational failures of a nonqualified deferred compensation plan to comply with section 409A(a), including:

- Methods for correcting certain operational failures during the service provider's taxable year in which the failure occurs, and (for certain service providers) also during the subsequent taxable year, to avoid income inclusion under section 409A(a).
- Relief limiting the amount includible in income under section 409A(a) for certain operational failures that involve only limited amounts.
- Relief limiting the amount includible in income under section 409A(a) for certain operational failures that involve more than limited amounts, but subject to further required actions to correct the failure.
- Special transition relief for certain operational failures occurring before January 1, 2008.

In addition, the IRS requests comments on whether procedures should be adopted for correction of a failure of a plan to comply with the plan document requirements of Treas. Reg. § 1.409A-1(c).

Reporting Guidelines and Forms

Temporary and Proposed Regulations Modify Employment Tax Return and Deposit Rules

Treasury and the IRS have issued temporary (T.D. 9440) and proposed regulations (REG-148568-04) under sections 6011 and 6302, relating to requirements for filing Federal employment tax returns and for depositing employment taxes, respectively. The new regulations reflect significant revisions from temporary (T.D. 9239) and proposed regulations (REG-148568-04) published on January 3, 2006. The regulations continue to permit most employers to file an annual Form 944 rather than a quarterly return and modify the lookback period and de minimis deposit rule for these employers. However, the regulations have been revised to incorporate commentators' suggestions to make the program voluntary. The regulations also adopt the de minimis safe harbor originally proposed in the 2006 regulations.

Generally, the regulations allow certain employers to file an annual employment tax return, Form 944, to report their social security, Medicare, and withheld Federal income taxes rather than the quarterly Form 941. For these employers, Form 944 will replace Form 941 and reduce their burden by reducing the number of returns they are required to file each year. Form 944 will not replace certain other forms, e.g., Schedule H (Form 1040), "Household Employment Taxes." However, if an employer files Form 944, the employer may choose to report wages with respect to household employees on Form 944, instead of reporting such wages on Schedule H (Form 1040).

Other Matters

IRS Announces New IRPAC Members

The IRS announced the selection of seven new members for the Information Reporting Program Advisory Committee (IRPAC):

- S. Douglas Borisky is counsel with Cleary Gottlieb Steen & Hamilton LLP in New York, N.Y.
- Elizabeth T. Dold is a principal attorney in the Groom Law Group in Washington, D.C.
- Lisa Germano is the president, general counsel and co-founder of the Actuarial Benefits & Design Company in Midlothian, Virginia.
- Joan M. Hagen is Managing Director, Financial Management Services, and University Chief Accountant for Indiana University in Bloomington, Indiana.
- Jerri LS Langer is a founding member of Cokala Tax Information Reporting Solutions in Ann Arbor, Michigan.
- Emily L. Lindsay is currently teaching financial accounting and managerial accounting at American University, Kogod School of Business, as Executive-in-Residence in Washington, D.C.
- Kathy M. Ploch is a tax manager for Zientek & Company, PC in Houston, Texas.

The appointees will join 27 returning members who are in the second or third year of a three-year term.

Ask the Expert

Are there new forms that should be used to correct employment tax return errors?

Yes. The IRS has recently announced that, starting in 2009, there will be new processes for correcting errors on employment tax returns. To correct employment tax errors discovered on or after January 1, 2009, taxpayers may now use the new corresponding "X" forms as soon as the errors are discovered. For example, use the new Form 941-X, Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund, to correct errors on a previously filed Form 941. Employers can choose to make an adjustment or claim a refund on the corresponding "X" form in connection with overpayments. However, in connection with underpayments, employers correcting an underpayment must use the corresponding "X" form. Amounts owed must be paid by the receipt of the return, and payments can be made using EFTPS, by sending a check, or by credit card. Because of the new processes, the 2009 employment tax returns are being revised to eliminate the lines for prior period adjustments.

The new "X" forms, including those shown below, will be available for downloading starting in January. Links to each form and the instructions will be added as the forms become available.

- Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, and Instructions.
- Form 944-X, Adjusted Employer's Annual Federal Tax Return or Claim for Refund, and Instructions.
- Form 945-X, Adjusted Annual Return of Withheld Federal Income Tax or Claim for Refund, and Instructions.

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