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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

February 27, 2009

Legislation

1. ***Making Work Pay Credit Requires Employers to Use New Withholding Tables by April 1, 2009***

The \$787.2 billion American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, was signed into law by the President on February 17, 2009. The law includes a *Making Work Pay Tax Credit* of as much as \$400 for individual workers and \$800 for couples. The benefit phases out for individuals making over \$75,000 a year and for couples earning over \$150,000.

The IRS has already posted new withholding tables to help employers implement the required withholding adjustments at <http://www.irs.gov/pub/irs-pdf/n1036.pdf>. Employers are asked to start using the new tables as soon as possible but not later than April 1, 2009. See IR-2009-13 (Feb. 21, 2009). The new withholding tables, along with related instructions, will be incorporated in new Publication 15-T, which will be mailed to more than 9 million employers in mid-March.

On January 15, 2009, the Center on Budget and Policy Priorities, a Washington, DC-based research organization, issued a report claiming that a two-month suspension of the payroll tax would cost \$120 billion and would benefit high income taxpayers who would likely save the tax cut. The report, *Payroll Tax Holiday a Poor Stimulus Idea "Making Work Pay" Credit a Better-Targeted Alternative*, can be found online at <http://www.cbpp.org/1-15-09tax.htm>.

2. **Stimulus Act Delays Application of Section 3402(t) Withholding Tax on Government Contractors for One Year**

American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, section 1511, amended section 3402(t), relating to withholding tax on government contractors, by delaying its effective date for one year. Section 3402(t) now applies to payments made *after December 31, 2011*. Prior to amendment, section 3402(t), added by the *Tax Increase Prevention and Reconciliation Act of 2005* (Pub. L. No. 109-222), required all government entities, with certain exceptions, to withhold 3 percent of all payments for property or services made *after December 31, 2010*.

Employer Issues

1. Value of Personal Use Vehicles: IRS Guidance Sets 2008 FMV Limits for Cents-per-Mile Method

The IRS has issued Rev. Proc. 2009-12, 2009-3 I.R.B. 32, setting the maximum fair market values for employer-provided autos, truck and vans, for purposes of valuing an employee's personal use of an employer-provided vehicle under the cents-per-mile method. Under section 280F(d)(7), the mileage allowance rate can only be used if an auto's fair market value does not exceed \$12,800, before adjustment for inflation measured by the Consumer Price Index. As adjusted for 2009, the maximum fair market value for employer-provided vehicles first made available to employees for personal use in 2009 for which the vehicle-cents-per-mile valuation rule may be applicable is \$15,000 for a passenger automobile and \$15,200 for a truck or van. The maximum value of employer-provided vehicles first made available to employees for personal use in calendar year 2009 for which the fleet-average valuation rule provided under Treas. Reg. § 1.61-21(d) of the regulations may be applicable is \$19,900 for a passenger automobile and \$19,900 for a truck or van.

2. IRS Ramping Up Employment Tax Enforcement Efforts

On January 9, 2009, at the American Bar Association Section of Taxation meeting in New Orleans, Assistant Attorney General Nathan Hochman, head of the Tax Division of the Department of Justice ("DOJ"), spoke regarding employment tax enforcement efforts. Hochman stated that the "IRS and its enforcement arm at the DOJ will be aggressively pursuing outstanding employment tax liabilities." In addition, Hochman explained that because of the budget deficit and growing tax gap "the IRS is going to have to ramp up its efforts . . . [and] those efforts, which used to almost always be civil, have now switched to the criminal realm."

3. Employers Should Record Section 409A Compliance Failures and Corrections

On January 14, 2009, William C. Schmidt, senior counsel (executive compensation) in the IRS Tax-Exempt and Governmental Entities Division, stated that employers should maintain records of section 409A operational failures and the steps that they take to improve procedures. Schmidt explained that the government expects to be informed of such procedures at the beginning of an audit. In Notice 2008-113, 2008-51 I.R.B. 1305, the IRS provided relief from the full application of income inclusion and 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). The notice provides that each taxpayer relying on the relief provided must make reasonable efforts to provide notice of the reliance to the examining agent upon the commencement of an examination of the taxpayer's federal tax return.

4. Seventh Circuit Affirms Independent Contractor Status

In *Estate of Suskovich v. Anthem Health Plans of Virginia, Inc.*, 553 F.3d 559 (7th Cir. 2009), the Seventh Circuit Court of Appeals affirmed the district court's grant of summary judgment in favor of Anthem, concluding that the decedent was an independent contractor rather than an employee of Anthem. The estate sought money damages from Anthem for compensation and other benefits the decedent was

allegedly denied, for services the decedent performed as a computer programmer and analyst for Anthem. The estate argued that the district court improperly found the employment contracts to be determinative of the decedent's employment status. The estate also argued that the district court improperly determined that the decedent was an independent contractor based on the "control test."

On appeal, the court determined that the district court properly found the contractual definition of the relationship to be only a "primary" factor in the analysis, and, in fact, examined whether the traditional control test provided sufficient indicia of an employment relationship. Although the estate's multiple claims were based on common law, the Fair Labor Standards Act ("FLSA"), and the Employee Retirement Income Security Act, each of which used slightly different versions of the control test, the Seventh Circuit followed the district court and applied the ten-factor control test from the Restatement (Second) of Agency. In doing so, the court noted that the estate waived any argument that the broader FLSA standard ought to apply to this case because it invoked the Restatement test in its arguments and briefs. Ultimately, applying the control test, the Seventh Circuit concluded that the decedent was an independent contractor, and that overwhelming evidence suggested that the decedent considered himself an independent contractor, filed his tax returns as an independent contractor, and was compensated like an independent contractor.

5. Third Circuit Allows Tax Gross-Up for Back Pay Award under ADA

In *Eshelman v. Agere Systems, Inc.*, No. 05-4895, 2009 WL 223858 (3d Cir. Jan. 30, 2009), the Third Circuit upheld a jury verdict for disability bias under the Americans with Disabilities Act (ADA), and, in a case of first impression, ruled that the additional tax gross-up in connection with the award of back-pay was necessary and appropriate. Under the verdict, Eshelman received \$30,000 in compensatory damages, \$170,000 in back pay, and \$6,893 for purposes of a tax gross-up. The court explained that the tax gross-up was appropriate because the "chief remedial purpose of the ADA" is to provide successful plaintiffs with "make whole" relief. Eshelman's position was based on the argument that a tax gross-up is necessary in the case of back pay where the award could lift the employee to a higher tax bracket, resulting in a greater tax burden than if the employee had received the pay "in normal course."

Reporting Guidelines and Forms

1. IRS Announces TIN Matching Program Available to Return Preparers under Section 6050W

In Announcement 2009-6, 2009-9 I.R.B. ___, the IRS stated that persons required to make returns under section 6050W, relating to information reporting on payment card and third party payment transactions, may utilize the IRS TIN Matching Program. Under procedures established by Rev. Proc. 2003-9, 2003-1 C.B. 516, the TIN Matching Program permits payors to verify the payee TINs required to be reported on information returns and payee statements. Prior to filing an information return, a program participant may check the TIN furnished by the payee against the name/TIN combination contained in the IRS database maintained for the program. After submission, the IRS informs the payor whether or not the name/TIN combination furnished by the payee matches a name/TIN combination in the data base.

Section 6050W was enacted as part of the Housing Assistance Tax Act of 2008, Pub. L. No. 110-289, signed into law on July 30, 2008. 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.

2. IRS Advice: Payments Excludable from Gross Income under Section 104(a)(2) Are Not Reportable under Section 6041, and Not Subject to Backup Withholding

In CCA 200906051 (October 27, 2008), the IRS concluded that amounts excludable from income under section 104(a)(2) are not reportable under section 6041, and are not subject to backup withholding under section 3406. Generally, under section 104(a)(2), gross income does not include the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness. To qualify for this exclusion, the taxpayer must demonstrate: (1) the underlying cause of action giving rise to the recovery is based upon tort or tort type rights; and (2) the damages were received on account of personal physical injuries or physical sickness. See e.g., *Commissioner v. Schleier*, 515 U.S. 323, 337 (1995). In the advice, the Service explained that payments that are not income are not reportable under section 6041, nor subject to backup withholding under section 3406.

3. IRS Issues Guidance Relating to Worker Classification of Federal Agency Contractors

In AM2009-002 (January 27, 2009), the Service considered the circumstances under which a personal service contractor ("PSC") working for a federal agency should be classified as an independent contractor or an employee for federal employment tax purposes. The Service explained its view that the Code governs a worker's status for tax purposes where the statute authorizing the PSC is silent or vague as to how the worker should be classified and where there is no other federal statute specific to the PSCs in question that directs how the workers are to be classified for federal employment tax purposes. Thus, the Service reasoned, the authorizing statute and related legislative history must be analyzed to determine whether they address the workers' tax treatment or otherwise specify how workers hired under the authorized personal service contracts are to be classified for federal tax purposes. However, where the authorizing statute or another federal statute does not specify the tax treatment of the worker, the Code applies, and classification of the worker will be determined by application of the common law test to the specific facts and circumstances.

Other Matters

1. IRS Commissioner Says Withholding Is Now Tier One Issue

At the 21st Annual Institute on Current Issues in International Taxation sponsored by George Washington University on December 8, IRS Commissioner Douglas Shulman stated that withholding taxes had been added to the Tier I issue list. (The IRS defines Tier I issues as those of "high strategic

importance.”) Shulman said that the IRS compliance program will work to ensure individuals, business, and corporate taxpayers understand and meet their withholding obligations, and to address “transactions that we see that are trying to circumvent withholding taxes or claiming improper tax treaty withholding taxes.” Shulman also noted that “withholding taxes is one of the key corporate tax areas on which IRS is focusing its international efforts.”

2. GAO Reports Urge Action on Information Reporting, Tax Gap

In its January 2009 report, “Tax Gap – IRS Could Do More to Promote Compliance by Third Parties with Miscellaneous Information Reporting Requirements,” the Government Accountability Office (“GAO”) recommended that Congress should consider requiring payors to report payments to corporations on Form 1099-MISC. The GAO also made eight recommendations to the IRS, including researching the extent of and reasons for payor noncompliance; identifying common reporting errors; and providing more guidance about Form 1099-MISC requirements. The IRS agreed with a number of the GAO’s conclusions. The report is available online at <http://www.gao.gov/new.items/d09238.pdf>.

In another January report, “High-Risk Series – An Update,” the GAO (pages 81-822) called on the IRS to build on the tax gap strategy that it previously developed with the Department of the Treasury. (The GAO prepares periodic High-Risk Series reports on federal program areas which are “high-risk” in the sense that they present vulnerability to waste, fraud, abuse, and mismanagement, or need broad-based transformation to address major economy, efficiency, or effectiveness challenges.) The report stated that the IRS needs to determine whether additional information reporting, such as the recently passed basis reporting for securities transactions, is possible and whether other steps could be taken to maximize information reporting. In addition, the report called on the IRS to determine whether and how the increase in electronic filing of tax returns can be leveraged to ensure that all information on tax returns can be used to improve service and enforcement. The report is available online at <http://www.gao.gov/new.items/d09271.pdf>.

Ask the Expert

Are the new “X” forms available on the IRS website to correct employment tax return errors?

Yes, the forms are now available. As we reported in the December issue, 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. Originally, it was reported that the new “X” forms, would be available for downloading starting in January. Although Form 941-X was posted in January, the other forms have been made available only in the last few days.

IRS website links to the forms and instructions are as follows:

Form 941-X	http://www.irs.gov/pub/irs-pdf/f941x.pdf
Form 941-X Instructions	http://www.irs.gov/pub/irs-pdf/i941x.pdf
Form 944-X	http://www.irs.gov/pub/irs-pdf/f944x.pdf
Form 944-X Instructions	http://www.irs.gov/pub/irs-pdf/i944x.pdf
Form 945-X	http://www.irs.gov/pub/irs-pdf/f945x.pdf
Form 945-X Instructions	http://www.irs.gov/pub/irs-pdf/i945x.pdf

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