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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

July 31, 2009

Legislation

House Health Care Proposal (H.R. 3200) Would Impose Payroll Tax on Non-exempt Employers

Under the health care proposal recently introduced in the House, employers would be required to provide health insurance for their employees or pay an 8 percent payroll tax. The tax would be phased in for businesses with an annual payroll between $250,000 and $400,000, and businesses with an annual payroll of less than $250,000 would be exempt from the tax.

Employer Issues

1. IRS Defines Two New Groups under Work Opportunity Tax Credit

The IRS issued Notice 2009-28, 2009-24 I.R.B.1082, defining two new targeted groups for purposes of the Work Opportunity Tax Credit (WOTC) under I.R.C. § 51. Effective February 17, 2009, employers who hire individuals who are considered "unemployed veterans" or "disconnected youth" may be eligible for the WOTC. Under section 51(d)(14), an unemployed veteran is any veteran who was discharged or released from active duty in the Armed Forces at any time during the 5-year period ending on the hiring date, and who was in receipt of unemployment compensation for not less than four weeks during the one-year period ending on that same date. Under the same section, an individual is considered a disconnected youth if the individual is between the ages of 16 and 25 on the hiring date; has not regularly attended any secondary, technical, or post-secondary school during the 6 month period preceding the hiring date; has not been regularly employed during that six month period; and is not readily employable.

2. IRS Information Letter on Tax Treatment of Per Diem Payments

The IRS responded in letter form to a taxpayer asking whether per diem payments may be treated as non-taxable reimbursements. The IRS explains that, in general, an employee will be taxed, and an employer must withhold payroll taxes, on amounts that are reimbursed to an employee for business expenses. However, under Treas. Reg. § 1.62-2(c)(3) and (5), amounts paid under an accountable plan

are excluded from the employee's gross income, and are exempt from withholding and employment taxes. A reimbursement or expense allowance arrangement is considered an accountable plan if (i) the plan reimburses employees for deductible business expenses incurred while performing services for the employer, (ii) the amounts are substantiated, and (iii) the employee is required to return any excess to the employer within a reasonable time.

The IRS information letter further explains that employers may reimburse employee business expenses by providing a per diem payment in lieu of reimbursing the employee for actual lodging, meal and incidental expenses incurred by the employee for travel away from home. If employee business expenses are reimbursed on a per diem basis as described in Rev. Proc. 2008-59, 2008-41 I.R.B. 857 (Sep. 25, 2008), these expenses are deemed to be substantiated for purposes of Treas. Reg. § 1.62-2 to the extent the per diem payment is equal to the lesser of the per diem allowance for that day or the amount computed at the federal per diem rate. *See* INFO 2009-0119 (Mar. 23, 2009).

3. Tennessee Raises Taxable Wage Base for Unemployment Insurance

The Tennessee legislature passed H.B. 2324 to increase the Tennessee taxable wage base for unemployment insurance from $7,000 to $9,000 effective retroactively to January 1, 2009. The new wage base will remain in effect until the balance of the state unemployment trust fund grows to exceed $900 million. The same legislation increases certain employers' premium rates by an additional 0.6 percent and extends unemployment benefits for Tennessee claimants who have exhausted their state unemployment benefits.

Reporting Guidelines and Forms

1. IRPAC Comments on Information Reporting and Withholding Issues in Treasury's "Green Book" Released on May 11, 2009

In a June 25, 2009 letter to the Commissioner of Internal Revenue, John Lakritz, Chairperson of the Information Reporting Program Advisory Committee (IRPAC), addressed concerns related to information reporting and withholding proposals contained in the U.S. Treasury Department's *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals*, released May 11, 2009 (Green Book). Information and reporting proposals contained in the Green Book include increased withholding obligations for payments of fixed and determinable annual or periodic income and gross proceeds made to foreign intermediaries that are not qualified intermediaries (QIs); increased reporting obligations for QIs and the QIs'commonly controlled foreign financial institutions; expanded reporting obligations for payments made by government agencies, individuals who rent out their homes, and payments made to corporations; and new TIN requirements and voluntary withholding provisions for independent contractors.

With respect to the Green Book proposals, IRPAC identified the following issues and made the following recommendations:

- The Green Book proposals would result in excess withholding for non-U.S. persons. IRPAC recommends that the IRS should issue clear guidance regarding refund policies and procedures for non-U.S. persons, including simplification of the ITIN process, so that non-U.S. persons are able to obtain a prompt refund of excess amounts withheld.

- The Green Book proposals would result in an increase in applications for QI status. IRPAC recommends that the IRS should devote sufficient resources to ensure that applications for QI status are reviewed and processed quickly.

- The Green Book proposals may sweep non-financial industry intermediary transactions into the QI rules. IRPAC recommends that the IRS should clarify whether the QI rules apply to non-financial intermediary transactions. If the QI rules apply to the non-financial sector, the IRS should postpone implementing the Green Book proposal until it has issued guidance on the expansion of the QI program into this sector.

- The Green Book proposals may result in a substantial burden on financial institutions by requiring that all commonly controlled financial institutions also be QIs. IRPAC recommends that the IRS should consider exempting some financial institutions from this provision on a case-by-case basis when the benefits of mandating QI status are outweighed by the burdens imposed.

- The Green Book proposals apparently would prevent a QI from opting out of the requirement to report all income for U.S. customers. IRPAC recommends that because this provision may be a significant disincentive for financial institutions to become or remain as QIs, the IRS should defer enactment of this provision until its impact on international markets can be determined.

- The Green Book proposals would impose withholding obligations for gross proceeds paid to non-QIs on behalf of non-U.S. persons where there is no "satisfactory information exchange program" in place. IRPAC recommends that the IRS should issue guidance recognizing that all tax treaties meet the "satisfactory information exchange program" criteria absent a specific IRS determination to the contrary.

- The Green Book proposal would require that withholding agents obtain documentation of a foreign entity's beneficial owners as a prerequisite to granting withholding tax relief, but does not explain what the withholding agent should do with this information. IRPAC recommends that the IRS should clarify the withholding agent's responsibilities. If the IRS proposes that the withholding agent is obligated to use this information to assess an entity's entitlement to withholding relief, it is IRPAC's position that this provision is not administrable.

- The Green Book proposal would accelerate and expand reporting of transactions by government agencies, already mandated by I.R.C. § 3402(f) effective January 1, 2012. IRPAC recommends that the IRS should develop guidance on the interrelationship between section 3402(f), section 6041, and reporting of payment card transactions under section 6050W.

- The Green Book proposal would extend reporting requirements for rental expenses to individuals who rent out their homes, when previously only those who were engaged in a trade or business were required to report these payments. IRPAC recommends that the IRS should implement an immediate campaign to educate taxpayers about this reporting requirement.

- The Green Book proposal would extend reporting requirements for payments made to a corporation which previously have been exempt from reporting. IRPAC recommends that the IRS should immediately finalize Qualified Payment Card Agents regulations to eliminate duplication between sections 6041 and 6050W. Clarification is also necessary as to how this provision relates to check-the-box procedures, disregarded entities, and sub-chapter S corporations.

- The Green Book proposal would require contractors to provide TINs to payors, would require payors to perform TIN matching, and would permit the payee to require the payor to withhold from payments at one of four specified rates. IRPAC recommends that the IRS should clarify whether this proposal applies to existing merchant relationships, and should provide guidance how voluntary withholding would be implemented in the context of electronic payments.

2. IRS Releases Public Comments on Revised FBAR Form and Instructions

In Announcement 2009-51, 2009-25 I.R.B. 1105, the IRS invited comments regarding the revised Foreign Bank Account Reporting (FBAR) Form and instructions (revision October, 2008). Recently, the IRS released a number of the comments that it has received. Recommendations included:

- The IRS should issue guidance regarding the reporting obligations of holders of financial instruments issued in typical capital market transactions. *See* Letter dated June 26, 2009 (2009 TNT 121-18).

- The IRS should explain what information should be obtained from a hedge fund containing foreign investments to satisfy FBAR reporting requirements. *See* Letter dated June 23, 2009 (2009 TNT 125-32).

- The IRS should consider exempting U.S. persons living abroad and working for non-U.S. companies, and single member LLCs with foreign ownership, from FBAR filing requirements. *See* Letter dated June 25, 2009 (2009 TNT 125-33).

- The IRS should consider exempting officers and employees of domestic subsidiaries of foreign publicly traded corporations from FBAR filing requirements when a responsible officer of the foreign parent has advised that a current report concerning the foreign account has been filed. *See* Letter dated June 24, 2009 (2009 TNT 125-35).

- The IRS should consider revising the FBAR form and instructions as follows: (i) adding a signature line for joint filers, (ii) using an average exchange rate to account for the fluctuation of currency throughout the year, (iii) adding an additional category for taxpayers who own a foreign corporation (which is not required to file the FBAR) that has a foreign account, (iv) allowing the maximum value of the account as of the end of the quarter to be used instead of the maximum daily value, and (v) permitting the form to be filed electronically. *See* Letter dated June 26, 2009 (2009 TNT 122-76).

- The IRS should issue guidance to clarify that certain investments in offshore hedge funds, private equity funds, and venture capital funds are not considered "financial accounts" for purposes of FBAR filing requirements. In addition, an exception from FBAR filing requirements should be provided for officers, directors or employees of a section 501(c)(3) tax exempt organization. *See* Letter dated June 25, 2009 (2009 TNT 121-17).

- The IRS should clarify that a private investment fund organized outside the United States as a foreign partnership or foreign corporation will not be treated as a "financial account" with respect to FBAR filing requirements. *See* Letter dated June 19, 2009 (2009 TNT 119-23).

- The IRS should revise Part V of the form to permit consolidation of reporting for partnership tiers in the same manner as currently permitted for other groups of consolidated companies. *See* Letter dated June 24, 2009 (2009 TNT 125-34).

The IRS will continue through August 31, 2009 to accept comments from the public regarding the October 2008 revised form and instructions.

3. IRS Guidance on Form 1099 Reporting to Volunteer Drivers

In an information letter, the IRS responded to a question presented by a constituent of Congressman David Obey (D-WI), who asked whether Form 1099-MISC must be provided to volunteer drivers for a charity. The IRS explained that under I.R.C. § 6041, generally any person who, in the course of business, makes a payment of fixed or determinable income to another person of $600 or more in any taxable year must file an information return on Form 1099-MISC with the IRS. However, as explained by the IRS, if the charity simply reimburses the volunteer driver for actual expenses, or if the charity is unaware that its reimbursement exceeds actual expenses, there is no payment of fixed or determinable income that triggers the information reporting requirements. The volunteer driver, however, will be required to treat as income any reimbursement that exceeds the volunteer's actual expenses for gas and oil, or 14 cents per mile for mileage, incurred on behalf of the charity. Depreciation, maintenance and insurance are not allowable expenses to the volunteer. *See* INFO 2009-0118 (Jan. 12, 2009).

4. IRS Advises Employer on Dealing with Employee Claiming that Earnings Are Not Subject to Income Tax

The IRS has issued an information letter responding to an employer asking how to appropriately meet its withholding obligations for an employee who asserted that his earnings were not subject to

income tax. The IRS explained that I.R.C. § 3402 requires the withholding of federal income tax in accordance with prescribed tables or procedures for every payment of wages, unless otherwise excepted by the Code. When the employee commences work, the employer is required to obtain a signed withholding exemption certificate (Form W-4) from the employee certifying the employee's marital status and number of withholding exemptions. The IRS advised that, where an employee fails to provide a valid From W-4, the employer is required to withhold income tax as if the employee is a single person with no withholding exemptions. *See* INFO 2009-0121 (May 19, 2009).

5. IRS Addresses Withholding of Self-Employment Tax from Termination Payments under Section 1402(k)

The IRS responded to a constituent's question presented by Senator Herb Kohl (D-WI), asking whether payments received by a retired insurance agent from his former insurance company are subject to self-employment tax. In response to several lawsuits in a number of jurisdictions, I.R.C. § 1402(k) was added to the Code. Section 1402(k) exempts certain termination payments received by former insurance salesmen from self-employment tax if specified requirements are met. In general, the exemption applies if the taxpayer receives the amount after termination of his agreement to perform services, the taxpayer performs no services after termination, the taxpayer enters into a covenant not to compete, and the amount received by the taxpayer depends primarily on policies sold by the taxpayer and not on length of service or overall earnings of the taxpayer. As explained by the IRS, termination payments received by the constituent were not excluded from self-employment tax because the amount of the payment received by the retired agent was based, at least in part, upon the number of years of service. *See* INFO 2009-0110 (May 28, 2009).

6. Quartet of Tax Court Decisions Finds Settlement Proceeds Not Qualified for Exclusion under Section 104(a)(2)

In *Johnson v. Commissioner*, T.C. Memo. 2009-156, the Tax Court held that amounts paid in settlement of a suit brought by a taxpayer against his mortgage company over an attempted wrongful foreclosure of his residence were not excluded from income under I.R.C. § 104(a)(2). Section 104(a)(2) excludes from gross income damages received by a taxpayer on account of physical injuries or physical sickness that are received pursuant to a tort or tort-type claim. The court concluded that the payments were not excluded because the settlement was for breach of contract and not for a tort-based claim that resulted in physical pain or physical illness to the taxpayer. The Court also concluded that amounts retained from the settlement proceeds by the attorney in payment of legal fees must be included in the taxpayer's gross income.

In *Prinster v. Commissioner*, T.C. Summ. Op. 2009-99, the Tax Court held that amounts paid in settlement of a suit brought by a taxpayer claiming wrongful termination of employment were not excludable under section 104(a)(2). The taxpayer alleged that he suffered from headaches, vomiting, diarrhea, hypertension, hyperlipidemia and diabetes as a result of the actions of his former employer. The court, however, held that the symptoms experienced by the taxpayer were either physical manifestations of emotional distress, which did not constitute physical injury or physical sickness under 104(a)(2), or were not shown by the taxpayer to have resulted from his termination.

In *Hellesen v. Commissioner*, T.C. Memo. 2009-143, the Tax Court held that amounts paid in settlement of a suit brought by a taxpayer and his wife against their former employer for sexual harassment, tortious discharge and other claims were not excludable under section 104(a)(2). The taxpayer claimed to be suffering from physical symptoms caused by the employer's wrongful acts. The court found that none of the settlement proceeds received by the taxpayer were excludable under section 104(a)(2) because the settlement agreement did not allocate damages to physical injury or physical illness, nor did the taxpayer allege physical injuries in his complaint.

In *Longoria v. Commissioner*, T.C. Memo. 2009-162, the Tax Court held that amounts paid in settlement of a suit brought by a taxpayer against his former employer for workplace discrimination were not excludable under section 104(a)(2). Although the Court acknowledged that the taxpayer had suffered some physical injuries as a result of the discrimination, the court held that the payments were not on account of physical injuries or physical sickness as required by section 104(a)(2) because the settlement agreement allocated no portion of the settlement to this category of damages and the taxpayer did not mention physical injuries in his complaint.

7. IRS Releases Publication 919, *How Do I Adjust My Tax Withholding?*

The IRS recently released Publication 919, *How Do I Adjust My Tax Withholding?* This publication informs taxpayers about changes that will affect their withholding for 2009, including revisions to the definition of qualifying child, taxation of differential wage payments made to active members of the military, and increases to the alternative minimum tax exemption amount. The publication is available on the IRS web site at http://www.irs.gov/pub/irs-pdf/p919.pdf.

8. IRS Guidance on Determination of Employer Designation for Workers Treated as Independent Contractors

In email advice, the IRS addressed whether a parent company or its subsidiary should be considered the employer of workers historically treated as independent contractors. The IRS referred to section 530 of the Revenue Act of 1978 and section 3401(d)(1) of the Internal Revenue Code for guidance on employer designation. Under section 530 of the Revenue Act of 1978, employers who have historically treated workers as independent contractors and had a reasonable basis for doing so, may be relieved from employment tax obligations related to those workers if the workers are reclassified as employees. Under section 3401(d), an employer is the person for whom an individual performs services unless that person does not control payment of wages, in which case the person having control of the payment of wages is considered the employer. *See* CCA 200928039 (May 22, 2009).

Other Matters

IRS Answers on Qualification for Making Work Pay Credit

In two recently released letters, the IRS responded to constituents of Congressman Vernon Ehlers (R-MI) and Senator Susan Collins (R-ME) regarding qualification requirements for the Making Work Pay Credit. The American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, authorized a

credit for many taxpayers who will be reporting earned income in 2009 and 2010. The credit is equal to the lesser of 6.2 percent of earned income or $400 for individuals and $800 for married couples filing jointly. The credit phases out for taxpayers with adjusted gross incomes over $75,000 for single taxpayers and $150,000 for married taxpayers filing joint returns. The Act also provides for a one-time $250 payment for taxpayers receiving social security benefits; however, this one-time payment will reduce any other credit received under the Act. The IRS advised that a married couple may qualify for the credit even if one spouse is retired, as long as the couple files a joint return and the couple's adjusted gross income is under the specified amounts. *See* INFO 2009-0097 (Apr. 28, 2009); INFO 2009-0105 (May 14, 2009).

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