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INSURANCE COMPANY INFORMATION REPORTING AND WITHHOLDING UPDATE

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Legislation

Legislation Introduced to Clarify Independent Contractor Rules

On July 30, 2009, legislation was introduced in the House (H.R. 3408), which, if passed, would clarify the rules that govern classification of workers as employees or independent contractors. Businesses are required to contribute to and withhold payroll taxes from workers who are classified as employees, but not workers who are classified as independent contractors. According to Rep. Jim McDermott (D-Wash.), the purpose of the bill is to “level the playing field,” by ensuring that all businesses classify workers appropriately.

Employer Issues

1. IRS Fields Flurry of Responses on Substantiation of Employer-Provided Cellphones

In Notice 2009-46, 2009-23 I.R.B. 1068, the IRS solicited comments regarding its proposals to simplify the substantiation requirements for business use of employer-provided cell phones. Currently, employers are entitled to a deduction under section 162(a) for the cost of providing cell phones to employees so long as the employee uses the cell phone for business purposes only. To the extent the employee also uses the cell phone for personal use, the employee is taxed on the value of that use as a fringe benefit. Most of those who submitted comments in response to Notice 2009-46 agreed that current substantiation requirements are onerous and outdated and asked that cell phones be removed from listed property under section 280F altogether. Other recommendations included:

- Allowing a minimal personal use allowance of phone minutes that would not be taxed. (2009 TNT 154-18).

- Classifying the use of mobile phone service as a de minimus fringe benefit under section 132(a)(4) similar to personal use of landline phones, office printers, fax machines and internet use. (2009 TNT 140-15).

- Requiring documentation of the business reason for issuing cell phones to employees in conjunction with a written policy clarifying the appropriate use of employer-provided cell phones. (2009 TNT 140-15).

- Deeming the entire amount of an employee's use of an employer-provided cell phone as business use if the employee can document that the employee maintains and uses a non-employer-provided cell phone for personal purposes during work hours. (2009 TNT 154-18).

2. Expense Reimbursement Arrangement Is Accountable Plan

In PLR 200930029 (Jul. 24, 2009), the IRS concluded that an expense reimbursement plan that reimbursed employees for the cost of supplies, tools, equipment and training was an accountable plan. Payments made by an employer under an accountable expense reimbursement plan are deductible by the employer and the payments are not considered taxable income to the employee. In order to qualify as an accountable plan, the plan must satisfy certain requirements, including the business connection test of section 1.62-2(d), the substantiation requirements of section 1.62-2(e)(1) and the return-of-excess requirement of section 1.62-2(f).

3. IRS Revises Guidance to Workers Reclassified as Employees

The IRS recently revised Notice 989, *Commonly Asked Questions When IRS Determines Your Work Status is "Employee"* (Rev. July 2009). The revised notice provides expanded guidance to workers who are reclassified from independent contractors to employees, regarding the steps that may be necessary to comply with federal tax laws. In many cases, workers reclassified as employees will be required to file amended returns. Further, business-related deductions previously claimed on Schedule C, will need to be moved to Schedule A, where the deduction will receive less favorable tax treatment. Notice 989 (Rev. 7-2009), is available on the IRS website at http://www.irs.gov/pub/irs-pdf/n989.pdf.

4. House Health Care Proposal Might Have Affect on Worker Classification

Under the House health care proposal (H.R. 3200), *America's Affordable Health Choices Act of 2009*, employers who fail to provide health insurance benefits for employees might be subject to a tax equal to 8 percent of the noncovered employees' wages. A recent article discusses concerns that the tax might encourage employers to consider reclassifying their workers as independent contractors in order to avoid payment of the tax. *See* Olson, "Tax of 8 Percent on Wages in House Bill Could Affect Worker Classification," BNA Daily Tax Report (Aug. 3, 2009). Practitioners quoted in the article suggest that although widespread reclassification of workers is not anticipated, imposition of the 8 percent tax would likely become a factor to consider when an employer decides whether to treat its workers as employees or as independent contractors.

5. IRS E-mail Advisories on Employment Tax Matters

The IRS recently published a trio of chief counsel e-mail advisories addressing employment tax matters. In CCA 200929010 (June 19, 2009), the IRS concluded that a state law determination of a worker's classification is not determinative of the worker's classification for federal tax purposes. In CCA 200929014 (June 22, 2009), the IRS advised that an employee of an international organization is exempt from income and employment taxes. And in CCA 200929015 (June 24, 2009), the IRS discussed liability for employment tax in the context of back pay.

6. Tax Court Decides Outside Salesman Is Not a Statutory Employee

In *Rosemann v. Commissioner*, T.C. Memo. 2009-185, the Tax Court examined whether an outside salesman was a statutory employee under section 3121(d)(3) or a common law employee. A worker who qualifies as a statutory employee may avoid the Schedule A limitation for employee business expenses by reflecting business income and expenses on Schedule C. In essence, a statutory employee is treated as an employee for social security and Medicare tax purposes, and as self-employed for income tax purposes. The types of workers who generally qualify as statutory employees include agent or commission drivers, traveling salespersons, life insurance salespersons and home workers. A worker qualifies as a statutory employee only if the worker is not a common law employee. The court found that the level of control over the employment relationship, the ability of the employer to terminate the at-will relationship and the provision of employee benefits were sufficient to establish that the relationship was that of a common law employee, rather than a statutory employee in this case.

7. IRS Revises Definition of "Disconnected Youth" for Work Opportunity Tax Credit

In Notice 2009-28, 2009-24 I.R.B. 1082, the IRS provided guidance for employers seeking to qualify for the Work Opportunity Tax Credit for employees who are "unemployed veterans" or "disconnected youth," two new groups authorized under the *American Recovery and Reinvestment Tax Act of 2009.* (Pub. L. No. 111-5). In Notice 2009-69, 2009-35 I.R.B. ___, published August 12, 2009, the IRS clarified that workers who otherwise satisfy the definition of "disconnected youth" under 51(d)(14)(B)(ii)(IV), will qualify for the credit as "not readily employable by reason of lacking a sufficient number of basic skills" if the worker was employed only occasionally since high school graduation or receipt of a GED.

Reporting Guidelines and Forms

1. IRS Extends Deadline for FBAR Reporting for Certain Filers and Invites Comments

Any person who has a financial interest in or signature authority over foreign financial accounts with an aggregate value in excess of $10,000 per calendar year is required to file a Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR), unless otherwise exempt from the filing requirement. As reported in the June 2009 issue of this newsletter, the IRS extended the FBAR filing deadline to September 23, 2009, for taxpayers who recently learned of their FBAR filing requirement,

paid tax on all 2008 taxable income and lack sufficient information to complete and file the FBAR report timely. *See* IRS website http://www.irs.gov/newsroom/article/0,,id=210174,00.html. *See also* Announcement 2009-51, 2009-25 I.R.B. 1105 for extension related to definition of "United States person." In Notice 2009-62, 2009-35 I.R.B. __, published August 7, 2009, the IRS further extended the FBAR filing deadline for one year to June 30, 2010, for persons who during the calendar year 2008 had (I) signature or other authority but no financial interest in a foreign financial account; or (ii) a financial interest in, or signature authority over, a foreign financial account in which the assets are held in a commingled fund.

According to reports, the IRS advised practitioners in a June conference call that it now interprets foreign hedge funds, foreign mutual funds, and foreign private equity funds to be "foreign commingled funds" for purposes of the FBAR filing requirements.

In this same notice, the IRS requested comments regarding the following:

- When should a person with signature authority over, but no financial interest in, a foreign financial account be relieved of filing an FBAR for the account?

- In what circumstances should the exception from FBAR filing for officers and employees of banks and certain publicly-traded domestic corporations be expanded to apply to all officers and employees who have only signature authority, and no financial interest in, an employer's foreign financial account?

- How might the bank and publicly-traded exception apply to officers and employees with only signature authority over accounts owned by clients of their employer?

- When should an interest in a foreign entity be subject to FBAR reporting? Should principles of sections 1297 and 1298(b) be applied to determine when an interest in a foreign entity is subject to FBAR reporting? Are the passive asset and passive income thresholds of 50 percent and 75 percent appropriate?

Comments and suggestions are due by October 6, 2009.

2. IRS Releases More Comments on FBAR Filing Requirements

The IRS recently published additional comments from several sources regarding the revised FBAR filing requirements. Currently, the instructions to Form TD F 90-22.1 (Report of Foreign Bank and Financial Accounts) provide an exception from FBAR filing requirements for officers and employees of banks that are examined by Federal bank supervisory agencies for safety and soundness. One group recommended that the IRS clarify whether this exception applies to officers and employees of U.S. branches of foreign banks. This same group also recommended that a similar exception be granted to officers and employees of broker-dealers registered with the Securities and Exchange Commission. Exceptions from FBAR reporting would be justified, according to these comments, because the extensive regulatory supervision already in place is equivalent to that of banks (2009 TNT 140-16). A state investment board recommended that the IRS clarify whether state pension plans and their employees are

required to file the FBAR with respect to foreign bank and financial accounts of the state plan (2009 TNT 154-20). Finally, a non-profit organization, representing the rights and interests of Americans living abroad, expressed concerns about the ability of U.S. citizens to maintain bank accounts overseas because of the increased administrative burdens imposed on foreign banks serving U.S. citizens. This commenter recommended that the IRS repeal the proposed QI regulations, revert to prior FBAR regulations, increase the minimum amount for filing, eliminate confiscatory penalties, and exempt from reporting those who only have signatory authority over an account but no personal financial interest (2009 TNT 139-14).

3. IRPAC Supplements Comments on Proposed Changes to Basis Reporting Guidance

Under the *Energy Improvement and Extension Act of 2008* (Pub. L. No. 110-343, 122 Stat. 3765), Congress imposed additional reporting obligations on brokers who are currently required to file information returns regarding the gross proceeds realized by customers from the sale of securities. Effective January 1, 2011, brokers will be required to include the customer's adjusted basis in the security that was sold, and whether any gain or loss from the sale of the security is long-term or short-term. On February 6, 2009, the IRS published Notice 2009-17, 2009-8 I.R.B. 575, seeking comments on the new basis reporting requirements. IRPAC released preliminary comments on March 2, 2009. These comments are available for review in the April 2009 issue of this newsletter. Recently, IRPAC released supplemental comments regarding the proposed changes to basis reporting, as follows:

- The IRS should make it clear that investors are responsible for reviewing statements and communications from brokers to verify that the correct tax lots are reflected in the sale transaction, and for informing brokers if a correction is necessary.
- The IRS should consider an exemption from cost basis reporting with respect to day traders who average more than 25 trades per day, or who elect to be taxed on a mark-to-market basis.
- IRPAC recommends that "identical securities," for purposes of the wash sale rules under section 1091, be defined to include only those securities that have exactly identical CUSIPs and are held in the same account.
- Form 1099-B reporting for options should apply to the gain or loss on sale or expiration of the put rather than to proceeds and basis separately or alternatively, option sales could be reported the same as actual stock sales with basis reported as the original purchase price minus commission, and gross proceeds reported as the close out amount posted to the account.
- The IRS should consider exempting Widely Held Fixed Investment Trusts and other difficult investments, such as investments in partnerships and S-corporations, from the basis reporting rules.
- The IRS should consider reading the restriction regarding multiple methods of calculation in the same account as applicable only to the same position (same CUSIP number) rather than to all securities in the same account.

4. IRS Seeks Comments on Forms 940 and 944

As part of its paperwork reduction effort, Treasury and the IRS are soliciting comments for the following: (I) Form 940 and Form 940-PR, Employer's Annual Federal Unemployment Tax Return (FUTA); (ii) Form 944 and Form 944(SP), Employer's Annual Employment Tax Return; and (iii) Form 944-X, Adjusted Employer's Annual Federal Tax Return or Claim for Refund. *See* 74 Fed. Reg. 35911; 74 Fed. Reg. 40645. Treasury and the IRS are interested in comments that address improvement in the quality and utility of the information reported and ways to minimize the burden of collecting and reporting the information by respondents. Comments are due by September 21, 2009 for Forms 940 and 940PR; and October 13, 2009 for Forms 944, 944(SP), and 944-X respectively.

5. Withholding Taxes Apply to Back Pay and Front Pay Portions of Settlement

In *Josifovich v. Commissioner*, 104 A.F.T.R.2d 2009-5807 (D.N.J. July 31, 2009), the plaintiff brought suit against her former employer under a variety of legal theories, including breach of contract, promissory estoppel and discrimination. The case was settled, and the Court ordered the employer to withhold employment taxes from the portion of the settlement proceeds that was allocated to back pay and front pay. The Court also denied plaintiff's request to "gross-up" the portion of the settlement proceeds subject to withholding. The Court distinguished the case from from *Eshelman v. Agere Sys. Inc.*, 554 F.3d 426 (3d Cir. 2009), where gross-up was allowed, on the basis that the plaintiff had voluntarily entered into a settlement agreement and the Court was unwilling to alter the terms of that agreement simply because the plaintiff was "dissatisfied with the anticipated tax consequences of her agreement."

6. IRS Advises on Tax Treatment of Judgments and Settlements

The IRS recently released a publication explaining how employment-related judgments and awards paid by the IRS to its current or former employees should be treated for tax purposes. *See* Program Manager's Technical Advice (PMTA) 2009-035. Although the PMTA addresses employment-related judgments and awards paid by the IRS, logically the guidance indicates how the IRS would treat these types of payments made by other employers and their insurers. According to the PMTA, severance pay, back pay and front pay are generally considered wages and are subject to FICA and income tax withholding. Compensatory and consequential damages that are paid on account of physical injury or physical sickness caused to the claimant are excluded from income under section 104(a)(2) and not reported on any information return. However, compensatory and consequential damages that are paid for some reason other than physical injury or physical sickness, including damages for emotional distress, are taxable income but not wages and therefore are reportable on Form 1099-MISC, but are not subject to wage withholding. Likewise, punitive damages and liquidated damages are also taxable and reportable on Form 1099-MISC but are not subject to wage withholding.

7. IRS Updates Publication 1220

On July 6, 2009, the IRS published Rev. Proc. 2009-30, 2009-27 I.R.B. 27. Rev. Proc. 2009-30 supersedes Rev. Proc. 2008-30, 2008-23 I.R.B. 1056 and contains updates for filing Forms 1098, 1099, 3921, 3922, 5498, 8935, and W-2G. The updated Revenue Procedure should be used to prepare 2009 and prior year information returns for submission to the IRS using electronic filing. Rev. Proc. 2009-30 is available on the IRS website at http://www.irs.gov/irb/2009-27_IRB/ar08.html.

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