# Internal Revenue Service
# Office of Federal, State and Local Governments

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# FSLG Newsletter – January 2010

This is the semiannual newsletter of the office of Federal, State and Local Governments (FSLG) of the Internal Revenue Service. Our mission is to ensure compliance by Federal, state, and local governmental entities with Federal employment and other tax laws through review as well as educational programs.

For more information, visit our web site at www.irs.gov/govt. For account-related assistance, contact Customer Account Services at 1-877-829-5500. To identify a local FSLG Specialist, see the directory at the end of this newsletter.

*The explanations and examples in this publication reflect the interpretation by the IRS of tax laws, regulations, and court decisions. The articles are intended for general guidance only, and are not intended to provide a specific legal determination with respect to a particular set of circumstances. You may contact the IRS for additional information. You may also want to consult a tax advisor to address your situation.*


Federal, State and Local Governments

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# CHANGES IN 2010 FOR FORM 944 FILERS

*BY WANDA VALENTINE, FSLG SENIOR ANALYST*

Form 944, *Employer's ANNUAL Federal Tax Return*, was designed to reduce burden on small employers by allowing them to file one employment tax return to report their employment tax liability for an entire taxable year, instead of four quarterly tax returns (Form 941, *Employer's QUARTERLY Federal Tax Return*). The IRS has recently released Revenue Procedure 2009-51, creating greater flexibility for these employers beginning in 2010.

## Form 944 Eligibility Requirements

Employers who have an estimated employment tax liability of $1,000 or less for the entire calendar year are generally eligible to file Form 944. However, employers required to file Form 943, Employer's Annual Federal Tax Return for Agricultural Employees, or employers required to file Schedule H (Form 1040), Household Employment Taxes are not eligible to file Form 944. In prior years employers who met the requirements to file Form 944 were notified by mail that filing that form was mandatory. However, beginning with tax year 2010, no employer will be required to file Form 944 and new procedures will be in place.

## New Notification and Opt-In Procedures in 2010

Beginning in 2010, eligible employers who qualify can elect to file Form 944 or continue to file Form 941. Eligible employers who wish to file Form 944 must make the request by calling the IRS on or before April 1st of the current tax year (April 1, 2010 for returns for tax year 2010). The IRS will respond with formal notification of the new Form 944 filing requirement. Employers can also make the request to file Form 944 in writing; written correspondence must be postmarked on or before March 15th of the current tax year (March 15, 2010 for returns for tax year 2010). But see New Employers, below.

## New Opt-Out Procedures for Current 944 Filers

Under the prior rules for tax years 2006 through 2009, employers who qualified to file Form 944 could only opt out (*i.e.*, request to file Forms 941 instead) if they estimated that their employment tax liability would exceed the $1,000 threshold or if they wanted to e-file quarterly Forms 941 instead. Beginning in tax year 2010, employers will be able to opt out of filing Form 944 for any reason if they follow the procedures set out in Revenue Procedure 2009-51.

Beginning January 1, 2010, employers who had been required to file Form 944 who want to file Forms 941 instead must notify the IRS they are electing to file quarterly Forms 941 and opting out of filing Form 944. To request to file Forms 941 instead of Form 944 for 2010, employers must call the IRS on or before April 1st of the current tax year (*e.g.,* April 1, 2010 for returns for tax year 2010) or send a written request postmarked on or before March 15th of the current tax year. But see New Employers, below.

**New Employers**

New employers that recently received an employer identification number (or had an employer identification number but were not previously required to file Forms 941 or Form 944) may call to request to opt in or out of filing Form 944 for the current tax year. These employers must call the IRS on or before the first day of the month that their first required Form 941 for the current tax year is due to establish a Form 944 filing requirement. For example, if their first return is due July 30th, they must call on or before July 1st (*e.g.*, for returns for tax year 2010, call made on or before April 1, 2010, July 1, 2010, October 1, 2010, or January 1, 2011). Employers who want make a written request to opt in or out of filing Form 944 for the current tax year must have their written correspondence postmarked on or before the 15th day of the month before their first required Form 941 for the current tax year is due (*e.g.*, for returns for tax year 2010, correspondence postmarked on or before March 15, 2010, June 15, 2010, September 15, 2010, or December 15, 2010).

**Contact Phone Numbers and Mailing Addresses**

Employers can call the IRS to request to opt in or out of filing Form 944 by using the following phone numbers:

(a) Employers in the United States, including Puerto Rico and the U.S. Virgin Islands, can call 1-800-829-4933. TTY/TDD users can call 1-800-829-4059.

(b) Employers in Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, and international callers can call 215-516-2000.

Employers can write the IRS using one of the two following mailing addresses:

Department of Treasury
Internal Revenue Service
Ogden, Utah 84201-0038

or

Department of Treasury
Internal Revenue Service
Cincinnati, Ohio 45999-0038.

**More information**

Refer to Revenue Procedure 2009-51 for more information on new procedures. You can also find more information on Form 944 and Instructions for Form 944 at www.irs.gov.

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## SPECIAL ASSESSMENTS AND REAL ESTATE TAXES

*BY STEWART ROULEAU, FSLG SENIOR ANALYST*

Real estate taxes are the main source of revenue for most local governments. The annual statements to property owners, indicating the amount of real estate taxes paid, therefore, contain crucial information for the governments and residents alike. Often these statements include listings of other charges, fees, or assessments. Treasurers, comptrollers, and tax assessors for local government should understand the differences between deductible and nondeductible items and issue statements that clearly distinguish between them.

Under IRC section 164, property taxes are deductible from gross income on the federal tax return. To constitute a property tax, a charge must be:

- Based on the value of the property,
- Made uniformly on property throughout the community, and
- Used for general community purposes (i.e., public schools)

Deductible property taxes do not include local or special assessments. Special assessments include charges imposed by government that tend to increase the value of the property, or are dedicated to the improvement of that property. These include assessments for streets, sidewalks, water mains, sewer lines, public parking facilities, and similar improvements. If a special assessment has been made in such a manner as to constitute a tax, and not a fee, and therefore would be deductible except that it has been assessed against local benefits of a kind that tend to increase the value of the property assessed, the amount of the assessment allocable to interest, maintenance and repair charges may still be deductible if the taxpayer can properly show the allocation of the assessment between the deductible and nondeductible portions. There must be a clear delineation or allocation of the items with proper reference to interest and maintenance and repair items. If the taxpayer received no itemized statement with a clear allocation to interest and maintenance and repair items, the taxpayer has no basis for claiming a deduction. If the allocation cannot be made, no part of the assessment is deductible. Governmental entities should ensure that property tax statements issued to report real estate information amounts for special assessments and user fees are reported correctly to help reduce reporting errors by property owners on their individual returns.

**Example:** The proceeds of a city bond are used to pay for sewers and sidewalks, in a new subdivision. Each year the city assesses a front foot benefit charge against the property benefited by these improvements in order to pay the principal and interest on the bond. This amount is billed to the homeowner on his real estate bill. The bill clearly shows the portion of the tax that is allocated to the interest on the bonds. In order to deduct the amounts allocable to the interest as real estate taxes, the taxpayer must prove the allocation of the assessment between interest and nondeductible purposes. The amounts to pay principal are not deductible as real estate taxes because they are special assessments that benefit the property against which they are assessed.

Amounts that represent service charges or user fees, that reflect a fixed charge for a specific service and are not based on the value of the property, are not real estate taxes and should be identified separately on the tax statement to distinguish them from deductible real estate taxes.

**Example:** A county imposes a user fee of $100 solid waste disposal, which is billed with the annual tax on assessed value of $2500. Regardless of whether the amounts are stated separately, the $100 is not deductible as real estate taxes on Form 1040.

Fees and local benefit assessments reported on property tax statements that are not clearly identified can create problems for taxpayers who overstate their deductions, and represent a potential revenue loss to governments at all levels. FSLG encourages governmental units to make statements as accurate as possible, clearly identifying all amounts included.

## FOREIGN INCOME EXCLUSION FOR INDIVIDUALS PROVIDING PERSONAL SERVICES TO A FEDERAL AGENCY

*BY KEVIN MACKESEY, FSLG SPECIALIST (FEDERAL GROUP)*

It is important for agencies of the United States to properly establish whether a U.S. citizen or a resident alien of the United States who is providing personal services overseas is a common-law employee. Incorrect classification can result in improper claims by the individual for the foreign earned income exclusion, the foreign housing exclusion, and the foreign housing deduction.

Under IRC section 911(a)(1), a qualified individual may elect to exclude from gross income a certain amount of foreign earned income, subject to certain limitations. Under section 911(b)(1)(B), foreign earned income does not include amounts paid by the United States or its agencies to its employees or agencies. Under section 911(a)(2), a qualified individual may elect to exclude from gross income the housing cost amount, subject to certain limitations. Under section 911(c)(4), a qualified individual may deduct the housing cost amount to the extent the housing cost amount is not attributable to employer provided amounts, subject to certain limitations.

Federal Acquisition Regulation (FAR) section 2.101 states that a “personal services contract” means a contract that, by its express terms or as administered, makes the contractor personnel appear to be, in effect, Government employees. In determining whether a services contract is personal or nonpersonal, FAR section 37.104(c)(2) provides that, “each contract arrangement must be judged in the light of its own facts and circumstances, the key question always being: Will the Government exercise relatively continuous supervision and control over the contractor personnel performing the contract.”

A person is an employee if the relationship between that person and the person for whom he or she performs services is the common-law relationship between employer and employee. This relationship exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished but also as to how the result is accomplished. An employee is subject to the will and the control of the employer concerning not only what is to be done but how it is to be done (Treas. Reg 31.3401(c)-1(a) and (b); 31.3121(d)-1(c); 31.3306(i)-1(a) and (b)). All the facts and circumstances of each case are considered, and no single factor is dispositive. For more information on determining whether a worker is an employee, see Publication 15-A.

While there are substantial similarities between the criteria used to determine whether a worker is providing personal services rather than non-personal services under federal government contract law, and the common-law factors used by the IRS to determine whether a worker is an employee or an independent contractor, the factors are not identical. The FAR is silent as to whether or not workers under personal services contracts with an agency are employees for federal tax purposes. A federal agency must consider the IRS common-law tests in determining whether a personal services contractor is an employee or an independent contractor.

After considering the common law tests, if the federal agency determines the worker is an employee, it must treat the worker for federal tax purposes as an employee and the individual’s pay from the U.S. government does not qualify for exclusion or deduction.

If you have questions about whether the person providing personal services is an employee or an independent contractor, see Publication 15-A, Employer's Supplemental Tax Guide.

# SOCIAL SECURITY AND MEDICARE TAXES AND SECTION 218 RETROACTIVE PAYMENTS

*BY WANDA VALENTINE, FSLG SENIOR ANALYST*

State and local governments that have established Section 218 agreements with the Social Security Administration (SSA) can agree to modify these agreements to establish coverage for past years. These modifications can be effective retroactively, going back as much as five years. In most cases, this will require a government entity to make retroactive payments to the IRS for back employment taxes.

In the past, government entities paid these employment taxes using the Form 941c, which is now obsolete. A new process has been developed to facilitate these back payments and prevent erroneous refunds. In cases where the section 218 modification agreement covers only years for which the statute of limitations on assessment remains open, a government entity should use Form 941-X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, to amend the quarterly employment tax returns and pay the back employment taxes. If the modification covers years where the IRS statute is barred or closed, the government entity will need to initiate a closing agreement with IRS for those barred statute years.

Under section 218(c)(4) of the Social Security Act, an entity covered by a section 218 Agreement and the Social Security Administration can agree to modify the section 218 Agreement. Section 218(e) specifies that coverage may cover a retroactive period of not more than five calendar years. If the government entity executes this agreement, the entity is expected to pay the additional social security and/or Medicare taxes associated with the retroactive coverage.

## IRS Statutes of Limitations

Under section 6501(a) and 6501(b)(2) of the Internal Revenue Code, the statute of limitations for assessment of social security and Medicare taxes is three years from the date the returns are deemed filed. When returns are timely filed, the statute runs from April 15th of the year following the calendar year for which the employment tax returns are due and filed. For example, in tax year 2006, a 4th quarter Form 941 return that is timely filed by the due date of January 31, 2007, has a statute that runs until April 15th, 2010.

If a government entity seeks to implement a retroactive modification to a section 218 agreement covering a five-year period, the earliest two years will generally be barred from assessment. To allow payments on the full five-year retroactive period (including the barred statute years), the government entity will be allowed to enter into a closing agreement with IRS under which it waives the statute of limitations for assessment and agrees to pay the full amount of tax due at the time the closing agreement is executed.

The office of Federal, State and Local Governments will coordinate the closing agreement process for these types of payments and can be contacted in writing at the following address:

IRS
SE:T:GE:FSL
Att: FSLG Closing Agreement Coordinator
1111 Constitution Ave.
Washington, D.C. 20224

More information about Section 218 Agreements may be found in IRS Publication 963, Federal-State Reference Guide.

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