

ITG News
Keeping First Nations Informed

Publication 4267 –D
Catalog Number 37831N Great Plains Edition January 2007

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Message from the Director

We recently released our FY 2007 Work Plan which details the goals and objectives of the office of Indian Tribal Governments for the current year. In keeping with our mission to raise the level of voluntary compliance, the Plan presents a balance of compliance checks, outreach, education, and examination activity.

It is important to understand that each of these activities serves a specific purpose. For example, Compliance Checks represent an opportunity to determine any areas where a tribal entity may be experiencing difficulties and affords them the opportunity to effect remedies at minimal risk. Outreach and Education are designed to afford tribal entities the opportunity to receive specialized training or information on current areas of concern so that they are better positioned to be fully compliant with relevant areas of federal tax law and/or the Bank Secrecy Act.

Examinations are the final part of our balanced approach to compliance. Although Tribes have many unique tax issues, the Internal Revenue Service has responsibility and authority to administer the federal tax laws for all types of entities, including governments. This includes the examination of books and records which affords the opportunity for an in-depth assessment of compliance. If a tribal entity has adhered to the requirements of the law, then an examination will likely not result in a tax change. If an error is discovered, then the ITG Specialist will propose a change in the entity's tax liability. The Specialist

may also make recommendations for changes in future practices to avoid further problems in subsequent tax periods.

While we attempt to limit our examinations to areas that we believe have likelihood for error, the mere fact that we conduct an examination does not mean that an error is present. In fact, approximately one in every six examinations we conduct does not result in a tax or filing change.

We know that an examination is often worrisome, but I hope you understand the importance it has in ensuring compliance and helping to identify errors before they grow into major problems. Information on the examination process is available on our web site at www.irs.gov/tribes.

Christie Jacobs

What is a Nontaxable General Welfare Payment?

One of the most common issues we encounter is the question of taxability of support programs offered by tribes to their members. This issue has become increasingly common as tribes have developed economic enterprises that provide them with funds necessary to create these programs. Common examples are housing assistance, scholarships, medical care, transportation, and nutrition. As these programs are developed, it is important to determine the potential tax consequence to the recipients. Unfortunately, there is a general lack of understanding of what constitutes a nontaxable general welfare payment.

As a starting point, it is important to realize that there is no statutory exemption of welfare payments from federal taxation. The Internal Revenue Service, with tacit approval from Congress and the courts, has administratively created a concept known as the General Welfare Doctrine. This doctrine has been used to exempt from federal income taxation any payments made to, or for the benefit of, individuals that are based on "need." This can be financial need, health need, economic need, educational need, etc.; but the program must define the need and the criteria employed to determine the eligibility of recipients.

It is insufficient to simply designate a program as being "need-based," or to fund it from the percentage of net gaming revenue designated for general welfare under an approved Revenue Allocation Plan and assume that will make it nontaxable. The Internal Revenue Service is the sole governmental agency that can rule on the federal tax consequence of support programs.

In creating these programs, there are several factors that should be employed to properly determine the potential federal tax impact on recipients:

- What is the “need” that will be met by the program?
- Is the “need” one that routinely would be considered by various levels of government to be a necessary item that the public would support for funding from a public source?
- Does the program have clear qualifying criteria as well as screening and evaluative mechanisms to ensure that recipients meet the criteria?
- Is there an existing ruling from the Internal Revenue Service that addresses the federal tax consequence of an essentially similar program?
- Has the responsible tribal governing body officially enacted the program?

Numerous Private Letter Rulings that address various governmental programs are available for review on our web site under the Published Guidance page at www.irs.gov/tribes. If so desired, a Tribe can request its own Private Letter Ruling on its particular program.

Remember, the General Welfare Doctrine is an administrative creation of the Internal Revenue Service. In order for a support program to qualify for exemption from federal taxation, a Tribe needs to ensure it has fully addressed the issue of “need.” Use of the term “general welfare” or the fact that the program is funded by the “general welfare” component of a Revenue Allocation Plan is insufficient to make the payments nontaxable.

Questions concerning the tax consequence of an existing or planned program or the method to secure a Private Letter Ruling should be directed to your ITG Specialist.

Am I Required to File Form 8027?

Form 8027, Employer’s Annual Information Return of Tip Income and Allocated Tips, is an annual information return required to be filed by “large food and beverage establishments.” A “large food and beverage establishment” is defined at IRC Section 6053 as any trade or business, (A) which provides food or beverages, (B) where tipping is customary, and (C) where there are more than 10 employees who work more than 80 hours on a typical business day.

Ten or more employees mean the total employees at all of the employer’s establishments who provide services in connection with the provision of food and beverages--not just the directly tipped employees. Therefore, the hostess, wine stewards, cooks, kitchen help, etc. would be considered together with the directly tipped employees (waiters, beverage servers, etc.) in determining whether or not you are required to file Form 8027.

A separate Form 8027 is required for each food and beverage establishment

operated by the employer. In addition, one Form 8027 is required for each venue in the same building where the customers occupy a separate area for the activity and where the gross receipts for the activity are recorded separately for that food and beverage activity. For instance, a casino that has a beverage service, a buffet, and two restaurants, generally would be required to file four (4) Forms 8027.

The Form 8027 requires an allocation to tipped employees when the establishment has reported tips of less than 8% of gross receipts. The instructions for Form 8027 give detailed information on how to make the allocation. If you are in a tip agreement with the IRS and your reported tips are less than 8%, the allocation is reported only on the W-2s of those employees who are not participating (not reporting tips at or above the agreed tip rate) in the tip agreement.

Form 8027 is due the last day of February (by March 31st if filing electronically) for the preceding calendar year. Form 8809, Application for Extension of Time to File Information Returns, can be used to file for extension but must be filed before the due date for filing Form 8027. See the instructions for Form 8027 and Form 8809 for where to file.

If you are an establishment participating in a Gaming Industry Tip Compliance Agreement (GITCA) with the IRS, you do not have to file Form 8027 as long as you maintain the data in a comparable format and provide the data to the ITG Tip Coordinator by the Form 8027 due date. A suggested format for this purpose is available through your ITG Specialist or the ITG Tip Coordinator. Participants in a Tip Rate Determination Agreement (TRDA) must file the Form 8027 with the IRS, Cincinnati, Ohio 45999 and send a courtesy copy to the ITG Tip Coordinator, at IRS—attn: Julia Reese, 12600 West Colfax Avenue - Suite C-300, Lakewood, Colorado 80215, by the due date.

Employee Tip Income Program Questions

ITG has a full-time Tip Coordinator to assist you with any questions about tip reporting agreements. If you are interested in securing a Tip Agreement, have questions concerning your existing agreement, or have received a notice about tip reporting responsibilities that is unclear, please contact Julia Reese at (303) 231-5250, extension 236.

IRS Provides Guidance on Per Diem Expense Reimbursements Paid By Employers

The Internal Revenue Service has issued guidance emphasizing the need for employers to track the amount of expense reimbursement allowances paid to

employees on a per diem basis. Revenue Ruling 2006-56 tells employers that if they routinely pay per diem allowances in excess of the federal per diem rates, but do not track the allowances and do not require the employees either to actually substantiate all the expenses or pay back the excess amounts and do not include the excess amounts in the employee's income and wages, then the entire amount of the expense allowances is subject to income tax and employment tax.

Generally, amounts employers pay employees to reimburse them for substantiated business expenses are not subject to income tax or employment tax. For reimbursements of expenses for meals and other incidentals associated with business travel, employees get this exclusion for reimbursements for each day of travel up to the federal per diem rates without having to actually substantiate the amounts of the expenses. However, if an employer pays expense allowances that exceed the federal per diem rates, the excess amounts are subject to income tax and employment tax if they are not repaid to the employer unless the employee actually substantiates all of the expenses covered by the per diem allowance.

The revenue ruling illustrates when a per diem allowance arrangement that fails to track the excess amounts and does not include the unsubstantiated, unrepaid excess amounts in the employee's income and wages constitutes a pattern of abuse of the rules for tax-free expense reimbursements. The finding that the arrangement is abusive causes all allowances paid under the arrangement to be subject to income tax and employment tax, not just the excess amounts. While the revenue ruling uses a scenario in the trucking industry because of the industry's widespread use of per diem allowances, the analysis in the revenue ruling applies to any employer in any industry that uses per diem allowances to reimburse employee expenses.

Revenue Ruling 2006-56 is effective immediately. However, the IRS recognizes that employers may need some time to adjust their systems so they can track excess allowances and account for them correctly. As a result, the IRS has instructed agents not to apply the results under the revenue ruling for taxable periods ending on or before December 31, 2006 in the absence of intentional noncompliance.

Update on Customer Satisfaction Survey

As we prepare for issuance of this edition of ITG News, we are just finalizing our analysis of the feedback from the recent survey. We will be posting a summary report on the web site at www.irs.gov/tribes in the near future and will also post a listing of specific actions we will undertake to address any concerns that surfaced. Our thanks to everyone who

participated in this important annual undertaking.

Reporting Abuses/Schemes

We continue to work with tribes and tribal officials to address financial abuses and schemes being promoted in Indian country. Working together can help ensure the integrity of tribal finances and eliminate the threats posed by individuals with schemes that appear “too good to be true” and often are. If you are aware of financial impropriety or of a promoter advocating a scheme that appears highly suspect, contact:

ITG Abuse Detection and Prevention Team at (716) 686-4860

or

via e-mail at tege.itg.schemes@irs.gov.

How to Avoid an Averaged Failure to Deposit (FTD) Penalty

The best way to avoid an averaged FTD penalty is to provide a complete and valid record of Federal tax liability (ROFT) with the return. The ROFT is a record of the dates and dollar amounts of payments or wages that were paid and is used to verify the timeliness of deposits. Form 941 semi-weekly schedule depositors report their ROFT information on Schedule B (Form 941), Employer’s Record of Federal Tax Liability. Form 945 semi-weekly schedule depositors report their ROFT information on Form 945A, Annual Record of Federal Tax Liability. Whereas monthly schedule depositors report their monthly ROFT information on the ROFT section of the return.

The ROFT is not accepted for processing if a negative liability amount is entered or if the total of the liability amounts entered on the ROFT does not equal the total amount of tax reported on the return. When the ROFT information is deemed invalid, it is excluded from the return processing and a CP 207 notice is issued with a blank ROFT that must be completed and returned. If the corrected ROFT is not returned on or before the date requested, an averaged FTD penalty is computed by averaging the total tax amount reported on the return and distributing those amounts equally throughout the tax period. Your deposits will be considered late when applied to the averaged ROFT amounts because the averaged ROFT amounts and dates figured will differ from your actual tax liability amounts and incurred dates for which you made your deposits. The penalty rate used to calculate the penalty increases according to the number of days the tax liability remains unpaid. The averaged liability amounts not properly or timely deposited will be charged at the penalty rates shown below:

-2 percent for deposits made 1 to 5 days late.

-5 percent for deposits made 6 to 15 days late.

- 10 percent for deposits made 16 or more days late but within 10 days of the date of the first notice we sent you asking for the balance of tax due.
- 10 percent for deposits made at unauthorized financial institutions.
- 10 percent for amounts subject to electronic deposit requirements but not deposited using EFTPS.
- 15 percent for amounts still unpaid more than 10 days after the date of the first notice we sent you asking for the balance of tax due.

Remember to follow the steps below when completing the tax liability schedule:

- Report each tax liability (not your deposits) on the tax liability schedule.
- Verify that the total amount reported on your tax liability schedule equals your total tax liability shown on your return.
- Do not show negative amounts on the tax liability schedule. If a prior period tax adjustment results in a decrease in your tax liability, reduce your liability for the same day you discovered the error and by the amount of the tax decrease resulting from the error, but not below zero. Apply any remaining decrease to subsequent liabilities on the schedule.

Pub 4268—Employment Tax Guide for Tribes

Our on-line Employment Tax Guide was updated in October 2006. You can download this comprehensive guide from a link on our landing page at www.irs.gov/tribes.

Self-Assess Your Federal Tax Compliance Risks

Tribal entities can now self-assess their federal tax compliance and work with ITG to address any problems they uncover. Entities electing to participate receive a fillable template from ITG, and are provided with the name of a local ITG Specialist who will serve as their resource during the process.

Information on the program, as well as an on-line request form, is available through the “Enhancing Federal Tax Compliance” link on the right-hand side of the ITG web site landing page at www.irs.gov/tribes, or you can make an inquiry about the program via email to tege.itg.tefac@irs.gov

Year End Reconciliation Process

Did you know, as the Social Security Administration (SSA) processes employer wage reports, it maintains a record of total Social Security and Medicare wages and tips processed for each employer? Did you know these totals are then compared with the totals for Internal Revenue Service (IRS) employment tax records filed by the employer with IRS on Form 941 returns? Guess what... employers whose reports to IRS and SSA do not balance are contacted for an

explanation of the discrepancy and asked for additional wage evidence. Another fact that should not come as a surprise to you...failure to resolve these discrepancies may result in IRS assessment of penalties for filing incorrect reports.

Now that you know the SSA and IRS balance these reports, why not beat them to the punch. Save yourself from that dreaded letter. You should balance or reconcile your Form 941 reports to your Form W-3 for the year. This will help you identify and resolve errors in your records which could lead to the filing of erroneous reports. You should balance cumulative quarterly Forms 941 for the tax year to the Form W-2/W-3 information in your records at the end of the tax year.

Compare the amounts you reported to SSA on Form W-2 to the sum of the amounts you reported to IRS on Form 941s for the tax year. The amounts shown in the table on the left, should match on the SSA and IRS reports. If these amounts do not match, recheck records and identify necessary adjustments.

After identifying any over or under reporting of income or wages, adjust any overpayment or underpayment of taxes on the Form 941 for the erroneous quarter. For example, a 2006 reporting error discovered during February 2007 would be an adjustment on the first quarter 2007 Form 941. Form 941c is not a standalone form; it must be filed with the next quarter's Form 941.

ITEMS	W-2/W-3 Box #	941 Line #
Compensation/Wages	Box 1	Line 2
Federal Income Tax Withheld	Box 2	Line 3
Social Security Wages	Box 3	Line 6a
Social Security Tips	Box 7	Line 6c
Social Security Tax	Box 4	Line 6b+6d
Comparison Computation		divided by 2
Medicare Wages	Box 5	Line 7a
Medicare Tax	Box 6	Line 7b
Comparison Computation		divided by 2

To add your name or email address to our mailing list, please contact us via email at Carole.M.Oller@irs.gov or call Carole Oller at (605) 787-5650.

ITG Area Contacts

Great Plains Area

Illinois, Iowa, Kansas, Missouri, Montana, Nebraska, North Dakota, South Dakota, Wyoming

John Walters, Manager
Fargo, ND
701-239-5400 ext. 253
john.l.walters@irs.gov

Jeff Clairmont, Specialist
Kalispell, MT
406-752-6149 ext. 24
jeff.r.clairmont@irs.gov

Serina Halverson, Specialist
Omaha, NE
402-361-0286
serina.m.halverson@irs.gov

Jennifer Kuntz, Specialist
Fargo, ND
701-239-5400 ext. 221
jennifer.r.kuntz@irs.gov

Carole Oller, Specialist
Rapid City, SD
605-787-5650
carole.m.oller@irs.gov

Kim Wind, Specialist
Rapid City, SD
605-341-8749 ext. 237
kim.s.wind@irs.gov

Electronic Deposit-Same Day Payment Option

Publication 15, *Circular E Employers Tax Guide*, Revision 1-2007, will soon be out. On page 22, there is an update to depositing employment taxes electronically. This is not new, it is just now being added to Publication 15.

You must make electronic deposits of all depository taxes (such as employment tax, excise tax, and corporate income tax) using the Electronic Federal Tax Payment System (EFTPS) in 2007 if: Your total deposits of depository taxes in 2005 were more than \$200,000 or You were required to use EFTPS in 2006.

If you are not required to use EFTPS, you may participate voluntarily, by calling 1-800-555-4477 or visit the EFTPS website at www.eftps.gov

For deposits made by EFTPS to be on time, you must initiate the transaction at least one business day before the date that the deposit is due. The next day the deposit will be removed from your account and transferred. Because the Automated Clearing House (ACH) is a two-step process (initiate the instructions one day, the money actually moves the next), some taxpayers (e.g. \$100,000 depositors) had difficulty making timely deposits. If taxpayers missed the ACH cut-off time to initiate a timely deposit, they could use the same day settlement feature referred to as the Electronic Tax Application (ETA). Under EFTPS, all taxpayers may use ETA as a routine payment option, and as a backup payment method. Enrollment in EFTPS automatically enrolls the taxpayer to use ETA as a backup payment method. Instructions on ETA are provided in the EFTPS enrollment package.

If something happens where you missed your bank cut-off time or you met the requirements for the \$100,000 next-day deposit rule, remember you have the Same Day Payment Option. Contact your local bank to ensure they offer this option, also check with them on any fees they may impose. Paying their fee may be a whole lot cheaper than paying Federal Tax Deposit Penalties.

Casino Winnings by Canadians

There have been a lot of questions recently regarding what to do when a resident of Canada receives winnings at a casino. When a Canadian resident receives winnings they are subject to thirty percent withholding, except for winnings derived from blackjack, baccarat, craps, roulette, and big 6 wheel games.

The casino is required to issue a Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, to nonresident aliens to report payments. Any gambling winnings paid to a nonresident alien must be reported, except for the exceptions noted earlier, and taxes must be withheld. The taxes withheld should be deposited with the Internal Revenue Service based on your regular deposit schedule, either monthly or semi-weekly. The withholding rate is thirty percent.

The casino files a Form 1042 along with 1042-S with the Internal Revenue Service in March of the year following the payment. Nonresident aliens file Form 1040 NR because they have essentially received a U.S. source of income subject to tax. The Form 1040 NR is due by the

fifteenth day of the fourth month after the tax year end, generally April 15. Only verifiable gambling losses up to the amount of winnings can be claimed.

For more guidance, Publication 3908, *Gaming Tax Law and Bank Secrecy Act Issues for Indian Tribal Governments*, is available. You may also contact your local Indian Tribal Government Specialist with any questions.

Federal Tax Calendar for First Quarter 2007

January 2007

January 4, Thursday - *Make a deposit for 12/27-12/29

January 5, Friday - *Make a deposit for 12/30-1/2

January 10, Wednesday - *Make a deposit for 1/3-1/5. Employees report December tip income to employers if \$20 or more.

January 12, Friday - *Make a deposit for 1/6-1/9

January 16, Tuesday - **Make a deposit for December if under the monthly deposit rule.

January 18, Thursday - *Make a deposit for 1/10-1/12

January 19, Friday - *Make a deposit for 1/13-1/16

January 24, Wednesday - *Make a deposit for 1/17-1/19

January 26, Friday - *Make a deposit for 1/20-1/23

January 31, Wednesday - *Make a deposit for 1/24-1/26

NOTE: Issue W-2s and 1099s to recipients by January 31st.

February 2007

February 2, Friday - *Make a deposit for 1/27-1/30

February 7, Wednesday - *Make a deposit for 1/31-2/2

February 9, Friday - *Make a deposit for 2/3-2/6

February 12, Monday – Employees report January tip income to employers if \$20 or more.

February 14, Wednesday - *Make a deposit for 2/7-2/9

February 15, Thursday - **Make a deposit for January if under the monthly deposit rule.

February 16, Friday - *Make a deposit for 2/10-2/13

February 22, Thursday - *Make a deposit for 2/14-2/16

February 23, Friday - *Make a deposit for 2/17-2/20

February 28, Wednesday - *Make a deposit for 2/21-2/23

NOTE: File W-2s with SSA and 1099s with IRS by February 28th

March 2007

March 2, Friday - *Make a deposit for 2/24-2/27

March 7, Wednesday - *Make a deposit for 2/28-3/2

March 9, Friday - *Make a deposit for 3/3-3/6

March 12, Monday – Employees report February tip income to employers if \$20 or more.

March 14, Wednesday - *Make a deposit for 3/7-3/9

March 15, Thursday - **Make a deposit for February if under the monthly deposit rule.

March 16, Friday - *Make a deposit for 3/10-3/13

March 21, Wednesday - *Make a deposit for 3/14-3/16

March 23, Friday - *Make a deposit for 3/17-3/20

March 28, Wednesday - *Make a deposit for 3/21-3/23

March 30, Friday - *Make a deposit for 3/24-3/27

NOTES: *= Make a Payroll Deposit if you are under the semi-weekly deposit rule.

**= Make a Monthly Deposit if you qualify under that rule.

NOTE: Deposits made through EFTPS must be initiated at least one day prior to the due dates listed above in order to be timely.

Return Filing Dates

January 2nd

-File Form 730 and pay the tax on applicable wagers accepted during November 2006.

January 31st

-File Form 941 for the 4th quarter of 2006 If all deposits paid on time and in full, file by February 12th.

-File Form 940 for 2006 if liable for Federal Unemployment Tax (not participating or current with state unemployment tax). If all deposits paid on time and in full, file by February 12th.

-File Form 730 and pay the tax on applicable wagers accepted during December.

-File Form 945 for 2006. If all deposits paid on time and in full, file by February 12th.

-File Form 943 for 2006 (agricultural entities). If all deposits paid on time and in full, file by February 12th.

February 28th

-File information returns for all payments reported to recipients on Forms 1099, 1098, 5498, and W-2G, using Form 1096 as a transmittal. If filing these forms electronically, file by March 31st.

-File Form W-3, along with copy A of Forms W-2 you issued for 2006. File by March 31st if filing electronically.

-File Form 730 and pay the tax on applicable wagers accepted during January.

-File Form 8027 if you are a large food and beverage establishment. File by March 31st if filing electronically.

March 31st

-File Form 730 and pay the tax on applicable wagers accepted during February.
