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INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

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2009 IRPAC Public Report Letter from the Chair

Information reporting is a key component in IRS compliance programs that are designed to detect and pursue noncompliant taxpayers who underreport income, overstate deductions or fail to file tax returns. IRS seeks to verify compliance by comparing information returns to tax returns to see if taxpayers have filed returns and reported all their income. Information reporting also serves to further several key initiatives in the administration of federal income taxes, such as reducing burdens associated with tax return preparation.

Congress recognized information reporting as a critical function when it recommended that the IRS consider “the creation of an advisory group of representatives from the payer community and practitioners interested in the information reporting program to discuss improvements to the system.” The Information Reporting Program Advisory Committee (IRPAC) was formed in 1991 as a result of this recommendation, which is contained in the final conference report for the Omnibus Budget Reconciliation Act of 1989.

IRPAC is now completing its 19th year of advising the IRS on information reporting matters. Over the years, IRPAC has sought to form a partnership between the IRS and the private sector with the intent of improving the information reporting program in a manner that is equitable to all stakeholders. IRPAC believes this is consistent with the vision that Congress had over 20 years ago, and that vision is still relevant today.

There has been a confluence of events and key initiatives in 2009 that have inspired a wave of new information reporting requirements that not been seen since the inception of the modern information reporting program which began almost 30 years

ago. Efforts to reduce the tax gap (the difference between what taxpayers should have paid and what they actually paid), modernize systems, reduce taxpayer burden, and curtail offshore tax evasion are among the key initiatives of the day. Enhanced or additional information reporting is seen as a solution in each instance.

Among the notable events that occurred during the recent term of IRPAC were the enactment of a new information reporting regime for reporting a taxpayer's basis and holding period of securities sold (e.g., IRC § 6045(g), et seq.), and the release of the "General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals" (the Green Book). IRPAC formed two subcommittees to advise on matters relevant to information reporting with respect to these developments. Extensive comments and recommendations are contained herein. In addition, IRPAC members met several times with key representatives from the IRS who are responsible for the implementation and development of rules in these areas.

IRPAC consists of 31 members,[1] 23 of whom focus on matters related to information reporting.[2] These members formed four subgroups which are called: Emerging Compliance Issues, Burden Reduction, Modernization, and Ad Hoc. Reports from each group are contained herein, and cover a variety of issues. Among the items addressed in the subgroup's reports are:

- Reporting of payments made in settlement of payment card and third party network transactions (IRC § 6050W)
- The ability to include a logo on a payee statement
- New page on IRS.gov related to employer tax compliance for payments

[1] See IRPAC 2009 Member Biographies: http://www.irs.gov/taxpros/article/0,,id=177432,00.html.
[2] The other eight members address matters related to the Tax Gap, and their report is appended herein.

made to non-resident aliens

- Proposed regulations under IRC § 3402(t) related to withholding on certain payments made by government entities
- Form 5498 reporting for successor beneficiaries
- Taxpayer Identification Number (TIN) masking – The practice of masking a recipient's TIN on their information returns to reduce the likelihood of identity theft
- Section 530 Relief
- "B" Notices – The impact of discontinuing Form SSA-7028
- Proposed enhancements to the IRS E-Services and E-Channel programs
- Improving Form 1098 reporting (Mortgage Interest)
- Information reporting associated with Build America Bonds and Widely Held Fixed Investment Trusts (WHFITs)
- Recommendations for administering backup withholding with respect to the Barter Industry
- Suggested improvements for Form 5500 reporting
- Reporting an employee's personal use of a cell phone

The breadth of subject matter contained in these reports is impressive. I would like to thank the members of the Committee for the generous contributions they made in terms of time and effort. It has been a pleasure serving as your Chair in 2009. Your enthusiasm, willingness, and expertise have made IRPAC 2009 successful and thoroughly enjoyable.

IRPAC operates under the direction of the Office of the National Public Liaison (NPL). The administrative support that NPL provides is essential to IRPAC. On behalf of IRPAC, I would like to extend our thanks to the members of NPL who have provided outstanding support during 2009 and welcomed us to their offices in Washington DC for our committee meetings. We would like to recognize Candice Cromling (Director of NPL), Caryl Grant (IRPAC Program Manager), and Mark Kirbabas (Branch Chief and Designated Federal Officer) for their support over the years. We would also like to recognize and thank our liaisons from NPL – Anjali Garg, Velancia Matthews, Jerry Ruelle, and Michael Singleton for their support.

Information reporting is growing in terms of importance and complexity. There is much more work to be done. IRPAC is well-positioned to make significant contributions to our nation's information reporting program. Best wishes to IRPAC 2010.

Respectfully submitted,

/s/ *Jon Lakritz*

Jon Lakritz

2009 IRPAC Chair

Executive Summary of Issues

Legislative Proposals Subgroup

Administration's Proposals – Tax Information Reporting and Withholding

On May 11, 2009, Treasury released its "General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals" (the Green Book). A number of the proposals in the Green Book relate to tax information reporting and withholding requirements. On June 25, 2009, IRPAC issued a letter to Commissioner Shulman discussing the implications for the IRS, as well as payers, withholding agents and taxpayers, of these provisions of the Green Book and making a number of preliminary recommendations regarding the implementation of the proposals if they are enacted.

Cost Basis Subgroup

Notice 2009-17 – Reporting of Customer's Basis in Securities Transactions

In late 2008, legislation passed mandating cost basis reporting. Early in 2009, the IRS issued Notice 2009-17[3] seeking public opinion on 36 questions and subsequently engaged in dialogue with stakeholders. IRPAC and IRS held numerous working meetings and conference calls to discuss the questions in the Notice. IRPAC's complete written responses were published as letters dated March 2[4] and June 23,[5] 2009.

Emerging Compliance Issues Subgroup

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[3] See Notice 2009-17: Information Reporting of Customer's Basis in Securities Transactions: http://www.irs.gov/irb/2009-08_IRB/ar14.html.

[4] See IRPAC Response Letter and Responses to Questions regarding Notice 2009-17: Information Reporting of Customer's Basis in Securities Transactions (March, 2009): http://www.irs.gov/pub/irs-utl/irpac_basis_letter_march_2_2009.pdf and http://www.irs.gov/pub/irs-utl/irpac_basis_letter_response_to_irs_questions_march_2_2009.pdf.

[5] See IRPAC Response Letter to Notice 2009-17: Information Reporting of Customer's Basis in Securities Transactions (June, 2009): http://www.irs.gov/pub/irs-utl/june_addional_responses_irpac_basis_letter_june_25.pdf.

Widely Held Fixed Investment Trusts (WHFITs)

For calendar years 2007 and 2008 the IRS informed trustees and middlemen of widely held fixed investment trusts that the Service would not impose penalties as a result of failure to comply with WHFIT reporting rules which were effective beginning January 1, 2007. IRPAC recommends that the IRS provide additional penalty relief and allow a continued deferral of WHFIT statement reporting.

Build America Bonds

The American Recovery & Reinvestment Act of 2009 (ARRA) authorizes state and local governments to issue taxable Build America Bonds to finance capital expenditures, choosing either to receive a direct federal subsidy payment for a portion of borrowing costs equal to 35 percent of the total coupon interest paid to investors or to pass through tax credits to investors. These new instruments, particularly those that pass through tax credits, pose challenges to the information reporting community. Financial institutions have difficulties in distinguishing taxable state and local government bonds from the more common tax-exempt issues. Tax reporting for bonds that pass through credits require special reporting steps and are even harder to distinguish. IRPAC has asked IRS to post key identifying information on its website for payers to locate Build America Bonds that require the special reporting.

IRC §6050W

IRC §6050W was added to the Internal Revenue Code July 30, 2008, by section 3091 of the Housing Assistance Tax Act of 2008. On February 20, 2009, IRS issued Notice 2009-19[6] in which the Service asked for input on this subject, specifically with

[6] See Notice 2009-19: Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions: http://www.irs.gov/irb/2009-10_IRB/ar09.html.

regard to ten questions they posed. IRPAC responded with its comments in a letter dated March 17, 2009.[7]

Comments on Internal Revenue Manual on Form 1042 Examinations

When the IRS revises Internal Revenue Manual (IRM) Section 4.10.21 (Form 1042 Examinations) IRPAC suggests the IRS consider the suggested revisions discussed with the U.S. Withholding Agent Team in August 2008.

Use of Logos on Substitute Information Returns and Payee and Wage Statements.

The general prohibition against including slogans, advertising and logos on substitute information returns, payee statements and employee wage statements reporting amounts paid during the 2010 calendar year set forth in Revenue Procedure 2008-36 and Revenue Procedure 2008-33 should be postponed and IRS should issue guidance permitting limited exceptions to the general prohibition effective in future years.

Missing or Incorrect Taxpayer Identification Numbers on Forms 1099-MISC

The IRS requested to meet with IRPAC to discuss its concern that a relatively large number of Forms 1099-MISC are filed by payers with missing or incorrect payee taxpayer identification numbers (TINs). To address this issue, IRPAC recommended that the IRS consider providing additional guidance targeted to reach advisors who assist or provide advice to payees on how to provide accurate legal name/TIN information to payers. IRPAC also suggested the IRS provide more advice to small

[7] See IRPAC Response Letter to Notice 2009-19: Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions (March, 2009): http://www.irs.gov/pub/irs-utl/irpac_6050w_comments_march_17_2009.pdf.

business payers (and their software providers) regarding the collection of TINs from payees and the Form 1099-MISC filing requirements.

Claim for Refund of Over-Withholding by Foreign Persons Investing Through a Qualified Intermediary

A qualified intermediary (QI) reports U.S. source income paid to direct foreign account holders on a pooled basis, and generally does not separately issue Forms 1042-S to the direct foreign account holders whose payments are included in the pooled reporting. A foreign account holder who needs to file a U.S. income tax return to claim a refund for amounts over-withheld by their QI does not have a Form 1042-S issued in their name to substantiate the amounts withheld. IRPAC requested that the IRS provide some guidance regarding how such an account holder can substantiate the amount of tax withheld by providing alternative documentation in lieu of a Form 1042-S issued in their name.

Burden Reduction Subgroup

Supplemental W-4 Instructions for Non-resident Aliens

IRPAC recommends that IRS create online Form W-4 instructions for on-resident aliens, in the form of a notice, which can be provided separately to individuals to enable them to complete the Form W-4 more accurately. IRPAC drafted a sample Notice for IRS consideration which was submitted to the Large and Mid-Size Business (LMSB) operating division, for technical review and further discussion as required within the Service.

Form SSA-7028, Notice to Third Party of Social Security Number Assignment

IRPAC recommends that IRS allow payers to accept from the payee any official SSA document with the name/TIN on file with SSA or investigate whether any current

IRS systems can provide individual payees a document that is sufficient to stop backup withholding. Or IRPAC recommends that IRS encourage SSA to restore issuance of Form SSA-7028 until a viable disclosure form is developed. If the first recommendations are not possible then IRS should consider a temporary suspension of the Form SSA-7028 requirement and allow payers to follow the first notice rules upon receipt of a subsequent notice until a permanent solution is in place.

Support Misclassified Employee Relief under Section 530 of the Revenue Act of 1978 (Section 530 Relief)

IRPAC recommends additional training and outreach relative to Section 530 Relief.

E-Services – Expansion of Services

IRPAC recommends that IRS expand access to e-Service incentive products to include business entities and their affiliated companies who e-file on their own behalf (e.g., consolidated 1120) and entities who file information returns on their own without a "Reporting Agent" relationship. IRPAC also asked IRS to investigate the feasibility of being able to submit a Power of Attorney (POA) electronically with the filing of the tax return.

Form 1098, Mortgage Interest Statement

Small Business Self-Employed (SBSE) division requested IRPAC feedback on a proposal to require financial institutions to report deductable mortgage on Form 1098. As an alternative, IRPAC recommends that the Service modifies the instructions for Form 1098 and/or Reg. 1.6050H-2 to require the Recipient/Lender to report the address of the mortgaged property, the principal amount of the loan, and the amount of real

estate taxes paid during the year. These changes should only be required for new loans and sufficient time should be provided for implementation.

Form 8886, Reportable Transaction Disclosure Statement

IRPAC recommend that the Commissioner change the reporting requirements for partners, shareholders and beneficiaries of pass-through entities that appropriately file Form 8886 at the entity level. IRPAC recommends IRS clarify that the reporting requirements under section 6011 will terminate for the corporate participants in the Lease-in/Lease-out (LILO) and Sale-in/Sale-out (LILO/SILO) Settlement Initiative after the year of actual or deemed termination of the tax shelter related transactions. IRS should consider adding a provision to all closing agreements or settlements related to reportable transactions that specifies the reporting obligation, if any, for that transaction in subsequent years.

Comments on a Moratorium on Enforcement and on Methods for Determining Personal Call Usage on Employer-Provided Cell Phones – Notice 2009-46

In light of the pending legislation to remove cell phones from the definition of listed property, IRPAC recommends the temporary suspension of enforcement of the listed property rules as they impact cell phone use as well as the related employee income inclusion for personal cell phone use.

Ad Hoc Subgroup

Form 3402t

IRPAC recommends that the IRS provide additional guidance to government entities that must comply with the withholding provisions of IRC §3402(t) and that the IRS considers higher withholding thresholds.

Simplifying Employer Tax compliance for Non-resident Aliens

IRPAC recommends that IRS place on irs.gov under the International Taxpayer page, links based on visa type to allow employers as well as non-residents to manage and understand withholding and reporting requirements.

Barter Exchange Education, Back-up Withholding and "B" Notice Requirements

IRPAC recommends follow-up for the results of two studies, 1) for the abatements granted to barter exchanges for non-matching TIN civil penalties and 2) for instances where non-matching TIN penalties have been assessed without appropriate notice being sent. IRPAC recommends continued openness to accept "as needed" revisions to Topic 420 – Bartering Income and Bartering Tax center IRS.gov website sections.

Federally Declared Disaster Casualty Losses

IRPAC recommends that the IRS publish more written guidance on valuations and other federally declared disaster casualty loss issues.

Electronic Furnishing of Form 1098-T, Tuition Statement

IRPAC recommends that Form 1098-T would be most effectively and securely delivered electronically based on students' negative consent.

IRPAC recommends that the IRS publish more written guidance on what amounts to include on Form 1040 from the Form 1098-T. Another recommendation is to include a sentence on line 2 under the Instructions to Students that indicates this amount may not be the correct amount to report on Form 8863, Education Credits (Hope and Lifetime Learning Credits) or Form 8917, Tuition and Fees Deduction.

Modernization Subgroup

TIN Masking on Payee 1099s

IRS should issue guidance immediately permitting payers to issue payee statements showing only the last four digits of a payee's TIN.

Form 5500

IRPAC recommends that the Service use the e-Channel program (rather than Filing Information Returns Electronically (FIRE)) to process the new Form 8955-SSA. Provide an optional, simple paper and electronic registration statement for retirement plan sponsors who are not required to file a Form 5500 or Form 5500-EZ. Expand the Employee Plans Compliance Resolution System (EPCRS) to accept voluntary correction of late Form 5500-EZ filings.

E-Channel

IRS should provide necessary funding to implement information reporting using the Electronic Tax Administration (ETA) e-Channel program.

E-Services

IRPAC recommends that IRS enhance their e-Services product to support the information reporting industry.

Forms 3921/3922

IRPAC has made comments on the draft Forms 3921 and 3922 in order to more fully comply with IRC §6039 and proposed Treasury Regulations section 1.6039-1.

Form 945-X and Instructions

IRPAC members have concerns about the length of the instructions and the lack of definitions for certain key terms.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

Legislative

Subgroup Report

DOUG BORISKY
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Administration's Proposals – Tax Information Reporting and Withholding

Recommendations

On May 11, 2009, Treasury released its "General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals" (the Green Book). A number of the proposals in the Green Book relate to tax information reporting and withholding requirements. On June 25, 2009, IRPAC issued a letter (the "Green Book letter") to Commissioner Shulman discussing the implications for the IRS, as well as payers, withholding agents and taxpayers, of these provisions of the Green Book. The Green Book letter[8] makes a number of preliminary recommendations regarding the implementation of the proposals if they are enacted; a more definitive look was deferred until actual legislative language becomes available. The Discussion section below briefly summarizes some of the principal recommendations of the letter.

Discussion

A. General Implementation Issues

If adopted in the form proposed, the Administration's tax proposals will require significant guidance from the IRS and the devotion of significant IRS resources in order to permit the proposals to be implemented in a timely and effective manner. The Green Book letter details a number of areas in which such guidance will be required. Since affected parties will not be able to take steps to implement the required procedures until such guidance is issued, the IRS will need to act quickly, in particular if the effective date provisions of the Administration's proposals are not changed.

[8] See IRPAC Green Book letter (June, 2009): http://www.irs.gov/pub/irs-utl/irpac_green_book_june_25_2009.pdf.

IRPAC hopes that any legislation enacted contains either a later effective date than the proposals currently contain, or a provision that certain of the proposals will only become effective after the publication by the IRS of implementing guidance. If the proposals are adopted without a significant change in the effective date, IRPAC recommends that the IRS consider relaxing the application of penalties that may otherwise be applicable during some specified transitional period.

B. Refunds

Some of the Green Book's withholding proposals effectively eliminate relief at source in respect of U.S. withholding taxes in certain cases and contemplate that beneficial owners will be able to obtain refunds of amounts withheld in excess of their substantive tax liability. The IRS will need to issue clear guidance regarding the types of documentation that will be acceptable for purposes of establishing

1. That tax was withheld, and
2. That the tax is attributable to a particular person, so that non-U.S. persons can establish their right to refunds.

In addition, the IRS will need to develop a procedure that allows refunds to be processed quickly and efficiently and to set up one or more operations centers to process refund requests.

C. Exceptions to Withholding and Reporting Obligations

IRS will have to issue prompt guidance regarding the exceptions to the new withholding and reporting requirements that are suggested in the Green Book, and to interpret the exceptions broadly in order to facilitate their implementation in a manner

that is not disruptive to withholding agents' and intermediaries' operations and, more generally, standard capital markets transactions.

D. Qualified Intermediary Program

Adoption of the Green Book's proposals will require the devotion of significant resources to administering the Qualified Intermediary (QI) program and the issuance of guidance on a number of issues, including the following:

1. IRS will need to devote resources to the processing of a potentially substantial number of applications for QI status, in particular from intermediaries located in jurisdictions whose "know your customer" rules have not previously been approved by the IRS.
2. IRPAC is also concerned that the Green Book proposals may sweep non-financial industry intermediary transactions into the QI rules. Because the current QI system extends only to intermediaries that conduct financial services businesses, eliminating the current non-QI process prior to the development of a workable QI system for non-financial industries could pose significant hardship on many industries.
3. Implementation of the proposals should take into account the terms of existing QI agreements in implementing the modifications to the QI program, including, in particular, the ability to "opt out" with respect to certain requirements imposed on QIs and making the proposals effective only upon the next renewal of a QI's agreement with the IRS, rather than amending outstanding agreements.

4. Treasury and IRS should consider implementing, on a case-by-case basis only, the proposed regulatory authority to require that a financial institution may be a QI only if all commonly controlled financial institutions also are QIs.
5. IRS should expedite guidance regarding the implementation of the gross proceeds withholding proposal, in particular with regard to identifying the jurisdictions that are not subject to the proposal because they have "satisfactory exchange of information programs."

E. Disclosure of Beneficial Owners of Foreign Entities

IRS should issue guidance on a number of issues raised by the Green Book's proposal to require that withholding agents obtain documentation of a foreign entity's beneficial owners as a prerequisite to granting withholding tax relief in respect of fixed determinable, annual periodical income. In particular, guidance will be needed to clarify what a withholding agent is required to do with the beneficial owner information once it has been obtained. The proposal as written lends itself to at least two interpretations, both of which present significant practical implementation challenges. For the reasons detailed in the Green Book letter, IRPAC believes that applying the proposal in a manner that would revise the substantive rules for claiming withholding tax relief raises substantial legal and practical issues that would prevent successful implementation. However, IRPAC believes that the proposal potentially could be implemented as a disclosure requirement that does not affect a foreign entity's substantive entitlement to withholding tax relief, if carefully drafted and limited in application.

The Green Book letter also summarizes a number of specific issues on which guidance will be needed in order for the proposal to be implemented effectively.

F. Reporting by Government Entities

The IRS should develop guidance on the interrelationship of the Green Book's proposal to require reporting with respect to certain payments made by federal, state, and local governments with similar rules under IRC §3402(t), 6041, and 6050W in order to minimize overlap and duplication and to provide clarity to persons required to file information returns under those provisions.

G. Reporting of Payments to Corporations

The Green Book letter suggests that rescinding the current information reporting exemption for corporate payees would be burdensome for payers and questions whether the information would provide sufficient utility to the IRS to justify this burden. The Green Book letter also provides comments regarding guidance that will be needed to implement the requirement effectively if it is enacted.

Follow-up

On August 18, 2009, IRPAC met with IRS and Treasury representatives to discuss the issues presented in the letter; since that date, IRPAC and Treasury have continued to discuss these issues.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

Cost Basis

Subgroup Report

DOUGLAS BORISKY
LISA M. CHAVEZ
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Notice 2009-17, Reporting of Customer's Basis in Securities Transactions

Recommendations

IRPAC provided significant comments and recommendations to the IRS in response to Notice 2009-17 and to more direct questions that have arisen as terms of the new reporting regime are fleshed out. These recommendations are explained in great detail in IRPAC letters dated March 2[9] and June 23, 2009.[10] Highlighted below are IRPAC's responses to the more significant issues raised by the questions in the Notice:

A. The IRS should consider issuing guidance on the new cost basis reporting regime in stages. Certain points of critical information are needed immediately; whereas other information may not be needed until later. The IRS should seek public comment to gain a sense of the optimal order in which guidance should be issued. IRPAC believes the following matters should be addressed first:

1. Clarify who is a middleman to which the rules attach.
2. Develop a draft Form 1099-B, Proceeds From Broker and Barter Exchange Transactions, and related instructions, and define the data that must be included on Basis Transfer Statements required under new IRC §6045A.
3. Clarify how to determine reportable S Corporations (S Corps).
4. Establish a course of action for resolving conflicts in classification (e.g., debt versus equity) of covered securities and exempted securities.

[9] See IRPAC Response Letter and Responses to Questions regarding Notice 2009-17: Information Reporting of Customer's Basis in Securities Transactions (March, 2009): http://www.irs.gov/pub/irs-utl/irpac_basis_letter_march_2_2009.pdf and http://www.irs.gov/pub/irs-utl/irpac_basis_letter_response_to_irs_questions_march_2_2009.pdf.

[10] See IRPAC Response Letter to Notice 2009-17: Information Reporting of Customer's Basis in Securities Transactions (June, 2009): http://www.irs.gov/pub/irs-utl/june_addional_responses_irpac_basis_letter_june_25.pdf.

5. Outline curative actions on the part of the beneficial owner (burden of proof) where a transferring financial institution refuses to, or cannot pass the information or passes unreliable information.
6. Develop acceptable processes for forensic basis development, as well as allowable uses of data from other sources apart from an upstream financial institution that may have unreliable information.
7. Recognize and reconcile any conflicts with existing Form 1099-B regulations.
8. Release reporting requirements early for mutual funds and options in order for industry to have sufficient time (3-4 years) to develop new systems/change existing systems to comply. See IRPAC letter for suggested points on equity options.[11]
9. Develop a glossary of terms and underlying principles, and consider adding it to the regulations to avoid reader confusion. Glossaries are in both the existing backup withholding regulations and the 1441 regulations.
10. Ensure that the February 15 payee statement due date and its application to all consolidated forms is made a permanent part of the regulations.

B. Although financial institutions, in general, should be well positioned to be the main repositories for basis information, they are unable to observe and track all of the events and taxpayer-level elections that could affect the basis of securities. IRPAC is concerned that customers may be given the flexibility to make or change elections in a manner that does not take into account what is workable for financial institutions. Since it is impractical to require that financial institutions be responsible for tracking all possible events and taxpayer-level elections that affect basis, financial institutions

[11] Ibid.

should be treated as passive repositories of basis information, rather than guarantors as to its accuracy.

C. IRS should not strive for perfect reconciliation between the information reported on Forms 1099-B that have cost basis information and the information on the taxpayers' tax returns. This would place an extreme burden on financial institutions, taxpayers, and the IRS.

D. IRS should request comments on defining the content of newly designed information returns and Basis Transfer Statements. As financial institutions will be required to modify their information systems and business practices, one of the most important points of information needed in order to proceed with their projects is a definition of the data that they must capture, store, report, and transmit. Delays in programming for the required data will consequently push back the timeline to become compliant. For example, financial institutions need to know if the following data will need to be reported on 1099s and Basis Transfer Statements:

1. Whether a security is covered,
2. The taxpayer's accounting method (FIFO, average cost, specific ID, etc.),
3. The source of the basis (from transferee financial institution, from taxpayer, etc.),
4. The acquisition date of the security, and
5. Any special taxpayer methodology or elections in place for the basis calculation or other unique information that should be conveyed to an acquiring financial institution regarding basis information.

E. IRPAC notes that recent “visual form” projects, like those in place for new Form 941X, Adjusted Employer's Quarterly Federal Tax Return or Claim for Refund, that

partnered with the industry to develop the required schemas, should be considered as a model for the development of a newly designed Form 1099-B and Basis Transfer Statements. IRS should also seek input from organizations such as the Securities Industry and Financial Markets Association (SIFMA), the Investment Company Institute (ICI) and the Depository Trust & Clearing Corporation (DTCC).

F. Information Reporting to Subchapter S Corporations: Under current law, there is no Form 1099-B reporting to corporations, including S Corps. New IRC §6045(g)(5) requires financial institutions, after December 31, 2011, to treat S Corps in the same manner as partnerships, thus subjecting S Corps to Form 1099-B reporting. The following issues should be addressed soon in order to provide sufficient lead time for implementation:

1. Will IRS modify Form W-9, Request for Taxpayer Identification Number and Certificate, to require S Corps to identify themselves? IRPAC recommends simple modifications to Form W-9 to identify these entities, while at the same time recognizing that since the reporting falls under IRC §6045, the taxpayer identification number (TIN) certification is required to be made under penalties of perjury.
2. The IRS should describe how the S Corp reporting effective date would operate. New §6045(g)(4) provides that an S Corp (other than a financial institution) is reportable on Form 1099-B for any sale of a covered security acquired after December 31, 2011. Will S Corp reporting apply only to accounts opened after December 31, 2011, or will it apply to all accounts regardless of when opened? If it applies to all accounts, financial institutions will most likely need to solicit

information from their existing account population to determine whether their corporate accounts are S Corps. The number of S Corps holding investment accounts is most likely small; it is difficult to justify the major expense of a mass mailing to all of a financial institution's existing exempt recipient accounts in order to uncover a small number of S Corps.

3. IRS should consider the programming changes financial institutions will need to implement to effect reporting on Forms 1099-B of only the covered assets sold and related basis information. Many financial institutions do not have the capability to screen reporting for only one form of reporting on Form 1099.
4. IRS should consider how IRC §3406 backup withholding provisions will be applied to S Corps.

G. The IRS should request comments regarding the impact that proposed regulations (REG-143686-07 issued January 21, 2009) have on the ability of financial institutions to develop and implement cost basis reporting systems. IRPAC is concerned that the complex method of calculating basis under these proposed and other existing regulations could impede the ability of financial institutions to modify their information systems and business practices in a timely manner. These regulations describe a system of stock basis recovery and stock basis allocation that is currently not used at any financial institution, and was not contemplated during the extensive deliberations on cost basis reporting that industry has had with Congressional and Treasury tax staff over the past several years. See further comments in IRPAC's letter to IRS.[12]

[12] See IRPAC Response Letter and Responses to Questions regarding Notice 2009-17: Information Reporting of Customer's Basis in Securities Transactions (March, 2009): http://www.irs.gov/pub/irs-utl/irpac_basis_letter_march_2_2009.pdf and http://www.irs.gov/pub/irs-utl/irpac_basis_letter_response_to_irs_questions_march_2_2009.pdf.

H. The IRS should request comments on a financial institution's responsibility to file corrected basis information returns and Basis Transfer Statements due to information it receives after it files its Forms 1099. For example, if a publicly traded corporation releases new information about its merger or one of its distributions three or four years after the event occurred, should a financial institution be responsible for filing amended information returns and furnishing amended Basis Transfer Statements to reflect the new information? When should a broker's responsibility terminate for purposes of filing corrected information returns? Financial institutions have traditionally had to contend with post year-end adjustments to events that they report on Form 1099-DIV, Dividends and Distributions. However, when new information becomes available several years after the initial Form 1099 filing, amending information returns causes a significant disruption to taxpayers and financial institutions. For further explanations of these concerns and detailed recommendations on how to handle them, see IRPAC's March 2[13] and June 23, 2009[14] letters.

I. Conflicts on the meaning of "account" within the different industries affected by the new rules will make uniform application of the new reporting regime difficult. The definition of "account" can vary from one industry to another. Most brokers and banks are prepared to handle wash sale rules for all identical securities held in the same account and the generally understood definition of single account may not pose concern in this application. However, to impose a restriction that would force separate accounts for securities that are subject to tax lot accounting from those mutual funds where averaging is being used would pose hardship. An imposition of a rule that would

[13] Ibid.
[14] See IRPAC Response Letter to Notice 2009-17: Information Reporting of Customer's Basis in Securities Transactions (June, 2009): http://www.irs.gov/pub/irs-utl/june_addional_responses_irpac_basis_letter_june_25.pdf.

disallow the investments in the same account from having multiple tax basis calculation methods could cause harm to the capital market structure surrounding the accounts and have the unintended consequences of reducing investment. IRPAC suggests that consideration be given to reading this restriction regarding multiple methods of calculation in the same "account" as meant to apply to the same position (same Committee on Uniform Security Identification Procedure number) rather than all securities in the same account. IRS should restrict multiple ways of calculating basis to the same position in the same account, similar to the application of the wash sale rules to identical securities held in the same account.

J. The IRS should exercise additional discretion when imposing penalties for failure to comply with the new basis reporting rules, especially during the early years of the new regime. Basis reporting represents a major shift in responsibility for retrieving, maintaining, and processing large amounts of data. IRS should consider the following:

1. Complex systems development will take several years and in some cases actually affect the underlying trade processing systems;
2. The recent economic downturn has affected the financial community particularly hard so that funds available for systems development and training are minimal to none;
3. Developmental issues are complex, even on matters as simple as who owns needed data, and it will take time to work through the processes;
4. Financial service providers are traditionally not tax return preparers.

Discussion

IRPAC truly appreciates the opportunity to dialogue with the IRS and to provide comments on the development of a new cost basis reporting regime. IRPAC commends IRS efforts to seek comments from the public through Notice 2009-17. Cost basis reporting presents many complex challenges and will require close cooperation between the IRS and private industry.

This new venture will require a substantial learning curve, even for those with sophisticated cost basis systems already in place. Staff must be trained to perform cost basis work. Reporting tax basis information requires a new business culture that involves taking ownership of what traditionally has been the client's purview.

IRPAC’s comments reflect input from a variety of sources, including tax preparers, securities brokers, mutual fund companies, transfer agents, and tax advisors. IRPAC respectfully looks forward to continued engagement with the IRS in the coming years to discuss guidance and solutions toward practical and effective cost basis reporting.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

Emerging Compliance Issues

Subgroup Report

DOUGLAS BORISKY
LISA M. CHAVEZ
MARIA D. MURPHY
PAULA D. PORPILIA
SUSAN P. SEGAR
RICHARD S. HOLLINGSWORTH, SUBGROUP CHAIR

A. IRC §6050W, Information Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions

Recommendations

In response to the IRS list of questions in Notice 2009-19, Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions, IRPAC made the following recommendation:[15]

1. IRS should create a new form to minimize confusion with other, overlapping reporting provisions.
2. IRS should generally adopt the existing practices for most other information returns in areas of, e.g., substitute forms, use of the Filing Information Returns Electronically (FIRE) system, etc., and to add IRC §6050W to the group of reporting provisions listed in Treas. Reg. 31.3406(d)-1(d), which specifies the method for providing a non-certified Taxpayer Identification Number (TIN).
3. IRS should undertake an education campaign for the Payment Settlement Entity/Electronic Payment Facilitator (PSE/EPF) communities.
4. IRS should allow electronic payee statements with modifications to the consent rules in recognition of the electronic nature of the business.
5. For electronic payments to merchants doing business within the United States, the term PSE should include all entities that otherwise meet the definition without regard to their country of residence. In addition, the basic rules regarding middlemen set forth in Treas. Reg. 1. 6041-1(e) should be applied here when defining who qualifies as an EPF.

[15] See IRPAC Response Letter to Notice 2009-19: Reporting of Payments Made in Settlement of Payment Card and Third Party Network Transactions (March, 2009): http://www.irs.gov/pub/irs-utl/irpac_6050w_comments_march_17_2009.pdf.

6. Any merchant with a U.S. address on record with the PSE/EPF should be considered a participating payee, and any merchant with only a non-U.S. address on file with the PSE/EPF should qualify for the foreign address exception without additional documentation, absent actual knowledge of a U.S. presence on the part of the PSE/EPF.
7. IRS should define “United States” as not including U.S. territories.
8. IRS should use the existing regulatory definition of payment card.
9. The regulations should not include health care or accounts payable networks in the definition of third party payment networks.
10. IRS should provide that the amount to be reported is the amount paid or credited to the merchant.
11. IRS should provide in the regulations that any transaction reported under IRC §6050W will be exempt from reporting and withholding under all other Code sections, since reporting under IRC §6050W will ensure the broadest coverage without any duplication, thereby both providing IRS with the most expansive pool of information without confusing taxpayers with multiple reports of some transactions.
12. IRS should clarify the interrelationship between the health care exemption under IRC §6041 and the broader rules under IRC §6050W.
13. The same cash/calendar rules used under other reporting sections should apply for IRC §6050W purposes, and, if IRS desires to have line item correlation, the specific tax returns should be revised to provide for a line that reflects the amount reported under this section.

14. IRS should apply the same record retention and TIN matching rules as are applicable elsewhere in the Code.

Discussion

All of the recommendations are designed to provide IRS with the information called for under the statute without over-burdening the payer communities. IRS benefits by receiving the best information available without distortions caused by duplicate reporting; it also avoids unnecessary audits caused by duplication. Taxpayers benefit since they avoid receiving confusing duplicative reports that may lead to tax return errors, and they avoid having to deal with IRS inquiries resulting from such duplication and errors. The payment card community benefits by minimizing the burdens it must shoulder while still providing the required information. Existing rules are used as much as possible thereby avoiding unnecessary attempts to "reinvent the wheel."

IRPAC met with Counsel on these IRC §6050W issues in April 2009. In addition, IRPAC responded to an e-mail inquiry from Counsel in May 2009. At this writing, IRPAC is awaiting release of proposed regulations.

B. Use of Logos on Substitute Information Returns and Payee and Wage Statements

Recommendations

IRPAC recommended that the IRS postpone the general prohibition against logos including slogans, advertising and logos on substitute information returns, payee statements and employee wage statements reporting amounts paid during the 2010 calendar year set forth in Revenue Procedure 2008-36 and Revenue Procedure 2008-33. IRPAC further recommended that the use of certain logos should not be prohibited

and that the IRS should issue guidance regarding limited exceptions to the general prohibition to be made effective in future years. In addition, Volunteer Income Tax Assistance (VITA) volunteers should be trained to recognize various types of substitute tax information returns that are commonly used.

Discussion

IRPAC met with Chief Counsel in January, March, and April to discuss concerns with the general prohibition against the use of slogans, advertising and logos on information returns, payee statements and employee wage statements set forth in Revenue Procedure 2008-36 and Revenue Procedure 2008-33. Counsel provided background regarding the following concerns related to the use of slogans, advertising and logos in this context:

1. Counsel was aware of situations where advertising flyers were included in envelopes with wage statements.
2. VITA volunteers had reported that taxpayers were confused by payee statements containing logos and slogans, and often disposed of such statements believing them to be advertisements.

Following further discussion, IRPAC agreed that advertising is not appropriate on information returns, payee statements and employee wage statements, but expressed concern that a complete ban on the use of logos and slogans in this context would only increase taxpayer confusion for the following reasons:

1. Logos are a key identifier for the taxpayer and are often part of the legal name of the issuer.
2. Financial account holders are accustomed to seeing the logo of their financial

3. Employees are also accustomed to seeing the logo of their employer or their employer's payroll processor on their checks, check stubs and Forms W-2, and may dismiss forms lacking such a logo as fraudulent.

In addition, distinctions were drawn between advertising and logos and a lengthy discussion took place regarding the difficulty of distinguishing between logos and slogans. IRPAC also referred to its 1996 memorandum on the use of logos and provided comments on the issue from industry leaders.

Counsel and Tax Forms and Publications shared with IRPAC members proposed language regarding advertising and logos, which will be included in the next revision of Publication 1141, General Rules and Specifications for Substitute Forms W-2 and W-3 and Publication 1179, General Rules and Specifications For Substitute Forms 1096, 1098, 1099, 5498, W-2G and 1042-S. Counsel and Tax Forms and Publications met with IRPAC members regarding the proposed language and requested their comments. Counsel and Tax Forms and Publications agreed to postpone the general prohibition against including slogans, advertising and logos on substitute information returns, payee statements and employee wage statements reporting amounts paid during the 2010 calendar year set forth in Revenue Procedure 2008-36 and Revenue Procedure 2008-33.

C. Claim for Refund of Over-Withholding by Foreign Persons Investing Through a Qualified Intermediary

Recommendations

IRPAC recommends that guidance be published, whether via an IRS notice or through the forms and instructions, that will allow a foreign direct account holder of a Qualified Intermediary (QI) to substantiate the amount of tax withheld by the QI and reported on a pooled basis by providing alternative documentation in lieu of a Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, issued in their name.

In the alternative, IRPAC suggests that the IRS create an informational form that may be provided by a QI to foreign direct account holders who desire to file a claim for refund with the IRS. One suggestion is for the IRS to create an informational form that contains the gross amount of the payment and the amount of the taxes withheld. The informational form would allow the foreign direct account holder to substantiate the amount of the withholding and the QI would not be required to amend their Form 1042, Annual Withholding Tax Return for U.S. Source Income of Foreign Persons.

Discussion

An undocumented foreign account holder investing through a QI is subject to withholding at rate of 30 percent. Despite failing to provide the QI with documentation to prevent non-resident alien (NRA) withholding, the foreign account holder's U.S. source income may be subject to a lower rate of U.S. tax pursuant to an income tax treaty or a provision of the Internal Revenue Code.

While a foreign account holder *may* request their QI to provide a refund for amounts over-withheld through the collective refund procedure (Section 9.03 of the QI Agreement) or the reimbursement/set-off procedures (Sections 9.01(A) and (B) of the QI Agreement), the QI is not obligated to comply with the refund request. If the QI does

not apply the referenced refund procedures, the only option available to a foreign account holder who desires to obtain the amounts over-withheld is to file a claim for refund with the IRS.

To obtain a withholding tax refund or credit from the IRS, taxpayers must be able to substantiate that the withholding occurred. The only documentation the IRS Service Center will accept to prove the amount of the withholding is a Form 1042-S issued in the name of foreign account holder. The IRS does not accept any documentation (e.g., bank deposit statement, etc.) other than Forms 1042-S from taxpayers to substantiate the amount of the NRA withholding and have been denying taxpayers' (i.e., the foreign account holders') requests for refunds.

Under the QI Agreement, a QI is permitted to report payments made to its direct foreign account holders on a pooled basis rather than reporting payments to each direct account holder specifically. Generally, most QIs file Forms 1042-S on a pooled basis (i.e., a single Form 1042-S for each type of income per rate of withholding (Box 2, Gross Income and Box 5, Tax Rate, respectively)). Additionally, Section 8.01 of the QI Agreement provides that the QI is *not* required to file separate Forms 1042-S for direct foreign account holders who are subject to pooled reporting, even if requested by their account holder. Many QIs have chosen not to provide separate Forms 1042-S (even upon request) to direct account holders whose payments were included on a pooled Form 1042-S because of the requirement to make corresponding amendments to the Form 1042.

In January 2009, IRPAC met with the IRS to discuss this issue. The IRS representatives indicated they appreciated the suggestion and were willing to create a

mechanism that will allow foreign account holders investing through a QI to substantiate the amount of NRA withholding for purposes of claiming a refund from the IRS. The IRS representatives were unclear of the mechanism that would be best to address this situation.

D. Comments on Internal Revenue Manual on Form 1042 Examinations

Recommendations

When the IRS revises Internal Revenue Manual (IRM) 4.10.21 (Form 1042 Examinations) IRPAC suggests the IRS consider the suggested revisions discussed with the U.S. Withholding Agent Team in August 2008.

Discussion

In August 2008, IRS published a revised version of the section of the IRM relating to U.S. Withholding Agent Examinations. Below is a summary of IRPAC's observations on the IRM, which were discussed with the IRS. A complete outline of IRPAC's observations is included in Appendix A.

1. Withholding Tax Issues as a Tier I Issue

With withholding tax being elevated to a Tier 1 issue in December 2008, IRS examiners are required to examine withholding matters during every examination, and to coordinate the audit and their findings with the issue owner executive and issue management team.

IRPAC suggested that the IRM provide that the examination manager has discretion in each case to consider certain predetermined factors (e.g., type of business, industry, internal controls, etc.) with respect to each taxpayer, and, if appropriate, perform a spot check to determine if a full-scope withholding tax exam is required.

2. Comparison of Forms 5471 and 5472 to Forms 1042 and 1042-S

Section 4.10.21.9.6 of the IRM requires IRS examination agents to compare payments reported on Form 5471, Information Return of United States Persons with Respect to Certain Foreign Corporations, and Form 5472, Information Return of a 25% Foreign-Owned Corporation, to payments reported by the taxpayer on Forms 1042 and 1042-S.

IRPAC suggested that the IRM should include a note indicating that the amounts reported on Forms 5471 and 5472 will not match the amounts reported on Forms 1042 and 1042-S because of the difference in accounting methods. Forms 5471 and 5472 are filed on the accrual basis and Forms 1042 and 1042-S are filed on the cash disbursements basis.

3. Payments for Personal Services – Contemporaneous Documentation

Generally, personal services are sourced at the location where the services are performed. The burden of proof of non-U.S. source is on the withholding agent. IRM 4.10.21.9.4 provides the following factors that the IRS examiner should consider in determining where the personal services were performed: contemporaneous records, travel expenses, vendor contracts, and interviews with the approver of the expense or contract.

IRPAC suggested that it be noted that the list of factors set forth in IRM 4.10.21.9.4 is a nonexclusive list, and that the withholding agent can apply a reasonably prudent business person standard to determine where the services were performed. IRPAC also suggested that the IRS delete the statement related to the reliability of the foreign vendor's statement about where the services were performed.

4. Validation Process of Forms W-8

IRM 4.10.21.8.4.3 sets forth the steps an examiner should take to determine the validity of Forms W-8.

IRPAC suggested that IRM 4.10.21.8.4.3 be modified to clarify that each section is severable. For example, a Form W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding, with an invalid tax treaty claim should still be valid to document the beneficial owner's status as foreign (assuming the remainder of the form is otherwise valid).

At the conclusion of the August 2008 meeting, the U.S. Withholding Agent Team indicated they understood the need for clarifying certain items in the IRM and stated they would take IRPAC's observations under advisement.

E. Missing or Incorrect Taxpayer Identification Numbers on Forms 1099-MISC, Miscellaneous Income

Recommendations

In response to IRS concerns regarding a relatively large number of Forms 1099-MISC that are filed with incorrect or missing payee TINs, IRPAC recommended that the IRS consider:

1. Providing more guidance to sole proprietors and/or other service provider payees on how to provide accurate legal name/TIN information by telephone or in writing. The IRS could consider providing such targeted guidance in the form of FAQs on IRS.gov;

2. Establishing a program to educate practitioners and the accounting community that advises small business owners/payers regarding the collection of TINs from payees and the associated Form 1099-MISC filing requirements; and
3. Working with small business software providers to enhance their software so it will assist business owners with obtaining proper names and TINs from service provider payees.

Discussion

After Forms 1099 have been filed with the Service, IRS compares the name/TIN combinations reported by payers on six types of Forms 1099 (i.e., Forms 1099-B, DIV, INT, MISC, OID, and PATR) with those on the IRS systems. If the IRS determines a payer issued one of these types of Forms 1099 with incorrect TINs, the IRS sends a CP 2100[16] letter to the payer notifying them of the accounts with name/TIN mismatches. When sending the CP 2100, IRS also includes a list of Forms 1099 that were filed with no TIN; though not a part of the "B" Notice[17] program, this supplemental listing serves to remind payers of the need to be backup withholding on those accounts. Subsequent to the issuance of the CP 2100 letter (about 11 months later), the IRS will also generally send the payer a Proposed Penalty Notice 972CG assessing a penalty for each occurrence of a name/TIN mismatch or missing TIN (as well as other filing failures such as for late filing). This penalty may be waived if the payer can show it took the appropriate actions to meet the requirements of reasonable cause including the IRS solicitation requirements as set forth in the Treasury Regulations.

[16] See Backup Withholding Page: http://www.irs.gov/govt/fslg/article/0,,id=110339,00.html.
[17] Ibid.

IRS has determined, through data on Forms 1099-MISC, that there are approximately two million payees that have incorrect or missing TINs. IRS sent CP 2100 letters to payers regarding most of these incorrect or missing TINs, and also sent approximately fifty to sixty-five thousand proposed penalty notices. Nevertheless, the level of compliance remains much lower than the IRS believes it should be.

IRS advised that it is concerned with both timely and accurate Form 1099-MISC reporting as well as backup withholding compliance. Further, the problem seems to stem from smaller business payers that do not have back office staffs and have a small number of payees.

Focusing only on Forms 1099-MISC issued without TINs, IRS has audited a small number (approximately 100) of those payers from varying industries to ascertain why compliance with obtaining TINs has been an issue. In some cases, the IRS assessed backup withholding against the payers.

IRS, however, does not have the resources to resolve the missing TIN compliance issue solely through the audit process. IRS has considered issuing “soft notices” for the missing TIN accounts but does not believe such letters would add much value since CP 2100 letters are often disregarded by payers.

Members of the Small Business Self-Employed (SBSE) division ors IRS met with IRPAC in April 2009 to request guidance on how to otherwise address the issue. During the meeting, IRPAC noted the following:

1. The likelihood of a missing or incorrect TIN on a Form 1099-MISC is probably much greater than on other types of Forms 1099. First, the other Forms 1099, such as a Form 1099-INT or DIV, are generally issued by larger institutions to

repeat investment clients, whereas a Form 1099-MISC could be a one-time issuance by a "mom and pop" entity for the performance of services. Smaller entities are less likely to be knowledgeable about TINs and filing rules. Further, many service providers are sole proprietors doing business under a business name but filing returns with the IRS under his/her legal name and using his/her social security number (SSN) as their TIN. The individual may provide the payer with his/her SSN and the name of his/her sole proprietorship business instead of his/her legal name, unintentionally creating a name/TIN mismatch.

2. Most accounts payable systems are not designed to track backup withholding.
3. As noted above, payers are not obligated to collect certified TINs on Forms W-9, Request for Taxpayer Identification Number and Certificate, from service provider payees. However, some payers do collect the forms as part of their standard practice. Members of IRPAC have observed that the current version of the Form W-9 is troublesome for some payees to properly complete. For instance, the instructions are not clear on how a single member Limited Liability Company (LLC) should complete the form. This difficulty may result in unintentional name/TIN mismatches. IRPAC has previously provided recommendations to the IRS regarding changes to the Form W-9 and related instructions.

F. Build America Bonds

Recommendations

IRPAC recommended that the IRS facilitate the flow of information between state and municipal issuers of Build America Bonds (BABs) and nominees by publishing essential information to IRS.gov. IRPAC requested that the information include, at a

minimum, the classification of the bond, Committee of Uniform Security Identification Procedures (CUSIP) numbers, a description of the bond (including the name of the issuer and contact information of the issuer), and also specify whether the issuer would receive direct payment from the federal government as a subsidy or if the bondholder would receive a tax credit.

Discussion

IRPAC met with Chief Counsel and members of the Tax Exempt and Government Entities (TEGE) operating division via conference call in June, 2009 to discuss BABs, which were authorized in the American Recovery & Reinvestment Act of 2009 (ARRA). Of particular concern is the bond offering federal tax credits in addition to the coupon interest normally received by investors.

IRPAC stated that BABs bore resemblance to Clean Renewable Energy Bonds and Gulf Tax Credit Bonds in that they posed potential identification challenges, which were discussed in IRPAC's 2007 Public Report.[18] The BAB program allows municipal issuers to sell an unlimited amount of taxable debt in 2009 and 2010. A potential complication is the ability to strip or separate the tax credits from the interest payments. Such stripping activity would create additional securities for which reporting is required.

In IRPAC's 2007 Public Report, IRS noted that it cannot release bond information such as CUSIP numbers and issuer names without the consent of the issuer. At that time, IRS was considering asking issuers to voluntarily authorize a release of bond information when filing Form 8038, Information Return for Tax-Exempt Private Activity Bond Issues. Further, adding a disclosure release was not then discussed with Counsel and another Form 8038 specifically for tax credit bonds was under consideration.

[18] See the 2007 IRPAC Public Report: http://www.irs.gov/taxpros/article/0,,id=187672,00.html.

In June 2009, IRPAC noted that the current Form 8038 does not have a disclosure checkbox. Counsel replied that a revised Form 8038 will include lines for positive consent to publish CUSIP numbers. The form is scheduled for release in January 2010. IRPAC noted that negative consent would be preferable. Although the IRS agreed that negative consent would be more effective, they felt unable to proceed with that format and will provide for positive consent on the form. IRS noted that tracing this information is important to improve taxpayer compliance and that a bondholder unit was developed last year to simplify the process to this end.

IRPAC believes the addition of a disclosure consent checkbox to Form 8038 will improve the flow of information from issuers of BABs to nominees. Consequently, nominees will be able to provide more accurate information returns to the IRS and taxpayers. Taxpayers would receive timely and accurate information in order to prepare their income tax returns. The IRS would overall receive more accurate and complete returns.

G. Widely Held Fixed Investment Trusts

Recommendations

IRPAC recommends that IRS provide additional penalty relief and allow for continued deferral of Widely Held Fixed Investment Trusts (WHFIT) reporting to allow brokers additional time to work out the delivery side of WHFIT statements, the need to determine whether reportable information should be on Forms 1099-Composite or on the WHFIT statement and a need to educate the tax return preparer community about what to do with WHFIT statements.

Discussion

WHFIT reporting rules were published on January 24, 2006 in the Federal Register (T.D. 9241, 2006-7 I.R.B. 427 [71 FR 4002]) under §1.671-5. IRPAC and IRS have had annual discussions on WHFITs. IRPAC, in its 2006 Public Report,[19] recommended that IRS publish a complete list of issues as a directory on IRS.gov to help ensure complete reporting. This recommendation endorsed the 2002 IRPAC suggestions and was again requested during a meeting in 2007.

In 2008, IRPAC met with IRS representatives to describe the current state of progress toward compliance in WHFIT reporting. At that time, much work remained for trustees to generate the required data, which would be delivered to intermediary service providers who would calculate, organize and format data for brokers. It was apparent that only a small segment of the WHFIT universe could be reported on under the new regulations for 2008. Accordingly, IRPAC asked for continued penalty relief for 2008.

IRPAC met with IRS representatives in August 2009 to discuss the current state of the industry's capability to comply with WHFIT reporting rules. IRPAC noted that progress was being made primarily by the intermediaries who process information from the trustees and provide the results to brokers. IRPAC noted, however, that progress has been slow because the intermediaries have been working through data quality issues residing in mortgage-backed trusts.

The IRS is currently working to address issues, which were raised previously, but, as the industry has worked to implement the requirements, additional issues have been raised. Such issues include:

1. To produce a compliant WHFIT statement for investors, brokers (most of whom deal with intermediaries) need to see sample WHFIT statements that meet the

[19] See the 2006 IRPAC Public Report: http://www.irs.gov/pub/irs-utl/2006_irpac_public_meeting.pdf.

requirements set forth in the Treasury Regulations so they can work with print vendors in creating their WHFIT statements.

2. Some financial industry members are divided as to whether traditional reportable data (e.g. interest on Form 1099-INT) should be included on the WHFIT statement or continue to be separately reported.
    a. The financial services industry urges IRS to expand its communications efforts (e.g. forms instructions) with the tax preparer industry, including software vendors to minimize confusion and improve efficiency.
    b. IRPAC also urges the IRS to increase its educational outreach efforts with taxpayers who may be confused when they receive their normal Form 1099-Composite statement in February, and then supplemental WHFIT data in March. This confusion will likely cause an unnecessary increase in amended returns to be filed.
    c. Because of the complexity of WHFIT reporting, many retirees invested in mortgage backed bond trusts may find they incur higher tax preparation fees. Increased educational efforts will help these older investors understand why they may face additional charges to sort out their complex tax situation.

IRPAC believes that these issues are significant and it is prudent for IRS to consider deferring required compliance and providing additional penalty relief for WHFIT reporting for the 2009 reporting year. The delay would benefit payers by allowing them to become better prepared to deliver uniform and accurate tax forms and statements. Taxpayers would avoid potentially more expensive tax return preparation fees and

reduced number of amended returns. IRS would benefit from additional time to consider a communication/education effort toward the tax preparer industry, which would result in receiving more accurate tax returns and fewer amended returns to process in the future.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

Burden Reduction

Subgroup Report

NADINE K. HUGHES
JERRI LANGER
CONSTANCE LOGAN
RALPH V. ZERBONIA
BARBARA L. MCARTHUR , SUBGROUP CHAIR

A. Supplemental W-4, Employee's Withholding Allowance Certificate, Instructions for Non-resident Aliens

Recommendation

IRPAC recommends that IRS create online Form W-4 instructions for non-resident aliens, in the form of a Notice, which can be provided separately to individuals to enable them to complete the Form W-4 more accurately. IRPAC drafted a sample Notice for IRS consideration that was submitted to the Large and Mid-size Business (LMSB) operating division for technical review and further discussion as required within the Service.

Discussion

The standard Form W-4 and instructions are not sufficient in explaining the necessary detailed points that must be considered whenever a non-resident alien must complete the form. Although there is reference to other publications, these may not be made readily available, at the time of completing the Form W-4, causing inaccurate withholding.

IRPAC believes that making the essential information available in one document, rather than subsequent references to multiple publications, will help reduce the burden to a vast majority of non-resident aliens and employers in understanding and administering the withholding requirements. IRPAC drafted supplemental W-4 instructions for non-resident aliens for IRS consideration. The supplemental instructions are comprehensive except that persons requiring information on non-service related scholarships and fellowships, which require more detailed explanations, will still be referred to existing publications.

IRS will benefit from the supplemental instructions by receiving more correct withholding from the source of income rather than delayed collection of the proper federal withholding at the time the non-resident alien files their appropriate personal income tax return. In some cases, the collection of such taxes may be further delayed or impossible to collect once the non-resident alien has returned to their home country, thus adding to the continuously growing tax gap.

IRPAC has been working on the non-resident alien W-4 issue for some time. IRPAC's 2008 Public Report included this issue with a recommendation to create a new Form W-4 NR. However, after many meetings with IRS staff, it was concluded that this was not the best alternative. Therefore, IRPAC carried the issue over into the 2009 sessions.

IRS agrees that the current Form W-4 and instructions do not provide adequate guidance for non-resident alien employees. IRPAC met with representatives from IRS LMSB in April 2009. All IRS personnel were supportive of the W-4 supplemental instructions for non-resident aliens. However, the difficulties IRS would encounter to add the supplemental instructions to the current W-4 instructions was made apparent to IRPAC members. IRS stated that the non-resident alien W-4 supplement could be released as a Notice and posted on IRS.gov. This would require only minor changes to the W-4 instructions, e.g. references to the notice containing the supplemental instructions. IRPAC agreed that release of a Notice was a viable solution.

IRPAC also discussed with LMSB various methods needed to educate the public upon subsequent release of the Notice. A suggestion was made to have the Small

Business Self-Employed (SBSE) Stakeholder Liaison develop the communication regarding the Notice for employers.

IRS has completed a technical review of IRPAC's supplemental W-4 instructions. See Appendix B for the reviewed draft of the supplemental W-4 instructions for non-resident aliens. IRS is moving the supplemental instructions through the appropriate approval steps with the goal to deploy the Notice for tax year 2010. IRPAC will continue to work with IRS on the finalization of the Notice and supplemental W-4 instructions for non-resident aliens.

B. Form SSA-7028, Notice to Third Party of Social Security Number Assignment

Recommendations

Payee Provides Document to Payer:

1. Given the Social Security Administration's (SSA) concerns over proper consent-based disclosure forms, IRPAC recommends that IRS allow payers to accept directly from the payee any official SSA document that shows the name/taxpayer identification number (TIN) on file with SSA.
2. Alternatively, IRPAC recommends that IRS investigate whether any current IRS systems can be utilized to provide individual payees a document that, when provided to payers, is sufficient to stop backup withholding.

SSA Provides Document to Payer:

1. If a consent-based document is the only acceptable method, IRPAC recommends that IRS encourage SSA to restore issuance of Form SSA-7028 until a viable disclosure form is developed.

2. Alternatively, IRPAC recommends that IRS identify other official SSA documents that could be used in lieu of SSA-7028 and permit payers to stop backup withholding upon receipt of one of these alternatives.

Finally, IRPAC recommends that IRS consider a temporary suspension of the Form SSA-7028 requirement and instead allow payers to follow the first notice rules upon receipt of a second or subsequent notice until a permanent solution is in place.

Discussion

IRS Publication 1281**,** Backup Withholding for Missing and Incorrect Name/TIN(s), provides that an individual receiving a second "B" Notice[20] must go to their local SSA office to have his or her Social Security Number (SSN) validated on Form SSA-7028 in order to stop or prevent backup withholding. However, SSA will no longer issue Form SSA-7028 for this purpose. As a result, individual taxpayers who receive a second "B" Notice have no remedy available to them to stop backup withholding. This results in excessive backup withholding and financial hardship for payees that are attempting in good faith to comply with the "B" Notice rules promulgated by the IRS, and causes unnecessary friction between the payers, which must continue withholding, and the payees.

This issue was originally brought to IRS in 2008 by IRPAC's Emerging Compliance Issues Subgroup and appeared in the 2008 Annual Report titled "Procedures for complying with Second 'B' Notices appear outdated and should be coordinated with the Social Security Administration's current policies." In addition,

[20] See Backup Withholding webpage: http://www.irs.gov/govt/fslg/article/0,,id=110339,00.html.

IRPAC submitted a letter in May 2009 recommending that this issue be included on the 2009-2010 Guidance Priority List.[21]

Subsequently, IRPAC has learned that SSA will only issue Form SSA-7028 for its original purpose; as authorization from new SSN applicants to notify their employers directly of their SSN, for tax and wage reporting purposes, once the SSN is assigned. Form SSA-7028 was created to reduce SSA field office (FO) traffic by eliminating the need for the FO to re-contact the applicant to visit the FO when the SSA is assigned. Over time, SSA and IRS began using Form SSA-7028 for the verification and disclosure of SSNs for other purposes.

SSA's Office of Privacy and Disclosure (OPD) has recommended that all "inappropriate" use of the Form SSA-7028 be discontinued. Per OPD, although the SSA-7028 requires the individual's signature, it is not a proper consent document for the purpose of disclosure in accordance with SSA regulations and Program Operations Manual System. Therefore, OPD also recommended that the current Form SSA-7028 be revised to unequivocally state that the form's only use is to notify employers of SSNs upon assignment and that any wording on the form, or in its instructions, that would imply that the Form SSA-7028 could be used for consent–based disclosures be deleted.

IRPAC has emphasized to IRS the urgent need to expedite release of instructions for payers with options for handling second "B" Notices. IRS CP-2100 Notices are being mailed to payers who are instructed to inform payees that a Form SSA-7028 is required to prevent/stop backup withholding. Without a change to the current procedures there is no way for individuals to resolve second "B" Notices.

[21] See IRPAC Response Letter to the 2009-2010 Guidance Priority List (May, 2009): http://www.irs.gov/pub/irs-utl/irpac_priority_guidance.pdf.

IRPAC will continue its meetings with IRS Chief Counsel and SSA in an effort to reach a workable solution. Ideally, backup withholding could be discontinued when a payee provides the payer with any official SSA documentation. Alternatively, IRS should work with SSA on the development of a viable consent-based solution. In either case, IRPAC recommends that the IRS temporarily suspend the Form SSA-7028 requirement and allow payers to follow first "B" Notice rules until a permanent solution is found.

C. Support Misclassified Employee Relief under Section 530 of the Revenue Act of 1978

Recommendations

IRPAC recommends additional training and outreach relative to Section 530 of the Revenue Act of 1978 (Section 530 Relief). IRS internal training should include an emphasis of the following four requirements of the current IRS policy and existing law:

1. Section 530 should be considered as the first step in any case involving worker classification;
2. The agent must explore the applicability of Section 530 even if the business does not raise the issue;
3. The agent is required to provide IRS Publication 1976, Do You Qualify for Relief Under Section 530, at the beginning of the employment tax exam; and
4. The legislative history of the statute makes it clear that Congress intended that "reasonable basis" be liberally interpreted in favor of taxpayers.

Further, IRPAC encourages IRS to expand Section 530 information and training efforts outside of the examination process. For example:

1. IRS Publication 1976, can be emphasized at future IRS tax forums;

2. IRS and State participation in agency training programs provides an excellent avenue for open discussion with employers and practitioners on ways to help employers manage Section 530 issues; and
3. IRS can make employers and practitioners more aware of the issues involved in Section 530 Relief before an audit occurs through communications in employer trade journals or IRS.gov.

Discussion

Section 530 is a safe harbor provision that prevents the IRS from retroactively reclassifying "independent contractors" as employees and subjecting the principal to federal employment taxes, penalties, and interest for such misclassification. However, although agents are following the rules, application of Section 530 Relief is difficult and fact-intensive, and agents may not always be clear on how to apply it to a given set of facts. Practitioners and employers also find the Section 530 Relief process to be difficult, and are therefore concerned that the evaluation of whether the facts satisfy the Section 530 requirements may not always proceed as it should.

The need for Section 530 has not diminished over the last 30 years, as there is no less confusion or difficulty in determining a worker's status than there was in 1978. In fact, the determination has become even harder because of the IRS' inability to provide guidance on worker classification issues. Thus, compliance with Section 530 is even more important today than it has ever been.

While the worker classification issue does not seem to go away, for most businesses it has been on the "back burner" for over a decade. In 1996, IRS recognized that the relevance of the common law factors varies depending on the nature of the

business and may change over the years as the business environment changes. Therefore, after seeking input from the public, IRS revised training for its revenue agents with the issuance of Training Document 3320-102. The stated goal of the training materials was "to ensure that IRS examiners properly classify workers as independent contractors or employees in a manner that is impartial and reflective of current law." Examiners were encouraged to consider the entire relationship between a business and a service provider and to understand that as long as the rules were followed, businesses could legitimately use independent contractors. Additionally, examiners were reminded that it was Congressional intent that certain relief provisions of Section 530 be construed liberally in favor of taxpayers.

During the same time period the IRS launched the Classification Settlement Program (CSP) which provides a standard settlement agreement for instances in which the examiners determine that certain workers are misclassified (IRS Fact Sheet FS-1996-05). The settlement offer, which is still in place, is quite favorable. In most cases, if a business agrees to begin treating the workers in question as employees prospectively, a tax assessment is made for only one year (rather than for all years of the examination). Moreover, the tax rate used for this assessment, assuming the misclassification was not a matter of intentional disregard, is a rate that is much less than the usual federal income tax withholding and FICA rates (IRC §3509). The program was developed around Section 530 and the amount of relief provided under the CSP depends on the strength of the business' Section 530 argument.

This effort most likely helped IRS with its backlog of highly contentious worker classification cases. With the IRS' very public effort to increase taxpayers' confidence

that examiners were unbiased in their determinations and ease the administration of the issue, many businesses enjoyed a "quiet period" because the practical result was that agents seemed to lose interest in the issue. Likewise for businesses, there was very little motivation to make any self-corrections. The ”deal” was better if the IRS found the error and made a CSP assessment as a result of an examination.

In the IRS's efforts to close the tax gap, employee misclassification is resurrected as a key issue. The IRS is not alone in this desired pursuit of misclassified workers and in fact may be reacting to some encouragement from Congress and certainly many States. Senate appropriators voted on July 12, 2007, to urge the IRS to provide increased enforcement in industries where the misclassification of employees as independent contractors is widespread.

The IRS Chief of Employment Tax stated at an American Bar Association Section of Taxation meeting that worker classification cases would be a major focus in 2008. Since that time, the IRS has announced that it entered into memorandums of understanding with nearly 30 states to share data and collaboratively approach this and other employment tax issues (News Release IR-2007-184, IRS and States to Share Employment Tax Examination Results). Further, IRS hosted a webcast to discuss the importance of properly classifying workers, and published new Form 8919, Uncollected Social Security and Medicare Tax on Wages. This form is used by workers who believe they have been misclassified as independent contractors to calculate and report the employee share of uncollected Social Security and Medicare taxes due on their compensation.

One of the legislative recommendations made by National Taxpayer Advocate Nina Olson in her 2008 Annual Report to Congress was to replace Section 530 with a provision applicable to both employment taxes and income taxes, and require related IRS guidance to include specific industry focus. In addition, her recommendation includes directing the IRS to develop an electronic tool that employers would be entitled to use and rely on to determine worker classification; allowing both employers and employees to request classification determinations and seek recourse in the U.S. Tax Court; and directing the IRS to conduct public outreach and education campaigns to increase awareness of the rules and consequences associated with worker classification. In the report, the National Taxpayer Advocate recognized and stated, "depending on the terms of the relationship between a business and a worker... many workers should be classified as independent contractors."[22]

IRPAC supports this strategy, but notes that until a fair replacement of the current Section 530 relief is enacted, Section 530 relief is the only legislatively supported recourse an employer has where the employer has misclassified a worker. It is noted that in most cases even today, the initial misclassification is unintentional. Moreover, independent contractor classification is still the standard for many positions across many different industries, and service users in those industries are not likely to independently question this determination. The very conditions that caused the enactment of Section 530 relief still carry meaning today.

Training and Outreach

[22] See the National Taxpayer Advocate's Annual Report to Congress: http://www.irs.gov/pub/irs-utl/08_tas_exec_summ0108v2.pdf.

Since misclassification of employees is a serious matter to any employer, communication and education on the issues are very important. We note that for the present, such information and training efforts may not get to taxpayers outside of the examination process. As employers learn the elements of employee classification and application of Section 530 Relief, employment practices almost always improve. The IRS is encouraged to find ways to better inform the public of these points well before the audit stage.

IRPAC suggests that IRS Publication 1976 be emphasized in the upcoming IRS Nationwide Tax Forums and in press releases targeted to wider employer audiences, such as in local newspapers or employer trade journals, to make employers and the practitioners more aware of the issues involved in Section 530 Relief before an audit occurs.

In addition, the IRS currently holds agency training programs jointly with many states as part of SBSE outreach where Publication1976 can also be publicized. Since these forums are conducted as open two-way sessions, it will give the IRS opportunity to hear employer and practitioner thoughts on other ways to help employers manage these difficult issues in these difficult times.

In the event of legislative changes or replacements to Section 530 Relief, recognized as a real possibility, education and training should continue to include discussion of some form of relief for employers that helps to balance fairness in ways that Section 530 Relief currently offers.

In an Audit Context

It is important to note that many practitioners have shared with IRPAC that agents are generally well informed about Section 530 Relief and are doing their job regarding the relief process. Also, many told IRPAC that as practitioners, they found Section 530 Relief very hard to apply to facts themselves. The complexity of Section 530 Relief is ripe for miscommunications and misunderstandings between an agent and the audited employer.

A statement of denial of Section 530 Relief in the IRC §7436 letter, Notice of Determination of Worker Misclassification, without explanation raises questions for some practitioners on whether their arguments for the application of Section 530 Relief have been understood by agents in complying with the requirements. IRPAC is aware that practitioners have expressed concern that although agents are following the rules, application of Section 530 Relief is difficult and fact-intensive and agents may not always be clear on how to apply it to a given set of facts. Practitioners and employers also find the Section 530 Relief process to be difficult, and are therefore concerned that the evaluation of whether the facts satisfy the Section 530 requirements may not always proceed as it should.

To avoid miscommunication, it is important for the IRS to inform employers about Section 530 Relief. IRPAC recommends that IRS Publication 1976 be provided to employers as early in an audit stage as feasible whenever the agent knows that the misclassification issue could arise. Although we understand that Publication 1976 is being provided in audits, it is not clear that it is always being provided upfront.

Agents are being trained on the technicalities of Section 530 Relief and do understand their responsibilities whether in an LMSB or SBSE audit context. IRPAC

believes that in addition, it is important for IRS leadership to emphasize that relief under Section 530 Relief is a legal right if the taxpayer satisfies the requirements and all the facts must be fully considered in applying Section 530 Relief. Such emphasis can help to ensure proper resolution of the difficult legal issue in examination.

Employee misclassification is so embroiled in interpretation and industry practice, that clear cut results are extremely rare. Section 530 Relief was enacted to assist taxpayers because of the challenges involved in determining proper worker classification. Where issues arise, employee misclassification matters should be handled with fairness and consistency.

In addition, a white paper by the National Association of Tax Reporting and Payroll Management explains the history and intent behind the application of Section 530 Relief, points out the current concerns and concludes with recommended solutions to the audit concerns.[23]

D. E-Services – Expansion of Services

Recommendations

IRPAC recommends that IRS expand access to e-Service incentive products to include business entities and their affiliated companies that e-file on their own behalf (e.g. consolidated 1120) and entities who file information returns on their own without a "Reporting Agent" relationship. Currently, a person/entity needs to meet certain requirements to have full access to e-Services products.

[23] See "Section 530: Its History and Application in Light of the Federal Definition of the Employer-Employee Relationship for Federal Tax Purposes" (February 2009) National Association of Tax Reporting and Payroll Management: http://www.irs.gov/pub/irs-utl/irpac-br_530_relief_-_appendix_natrm_paper_09032009.pdf.

IRPAC also asked IRS to investigate the feasibility of being able to submit a Power of Attorney (POA) electronically with the filing of the tax return.

Discussion

E-Services is a suite of web-based products that allow tax professionals and payers to conduct business with the IRS electronically. E-Services offer the following incentive products:

1. Disclosure Authorization (DA): allows eligible users to complete authorization forms, view and modify existing forms, and receive acknowledgement of accepted submissions immediately, all online.
2. Electronic Account Resolution (EAR): allows eligible users to expedite closure on clients' account problems by electronically sending/receiving account related inquiries.
3. Transcript Delivery System (TDS): allows eligible users to request and receive account transcripts, wage and income documents, tax return transcripts, and verification of non-filing letters.

Tax Professionals who are active participants in the IRS e-file program and e-file five or more accepted individual or business returns in a season are eligible to use all of these incentive products.

Circular 230 Practitioners who qualify as attorneys, Certified Public Accountants, or Enrolled Agents have unlimited access to all of these incentive products whether they e-file their client returns or not.

Reporting Agents, who are accepted participants in IRS e-file, are provided access to TDS and EAR incentive products. A Reporting Agent is an accounting

service, franchiser, bank, or other person who complies with Revenue Procedure 2007-38 and is authorized to sign a Form 940/941/944 for a taxpayer.

Currently, the e-Services products are designed for third party filers of tax return information. Business entities filing returns on their own behalf are excluded from using the e-Services incentive products unless they meet the Circular 230 practitioner definition. Also, IRS suggests that any taxpayer who uses a third party to transmit returns or other information to the IRS retain active addresses with the IRS and stay on top of the third party's actions since the taxpayer retains primary liability for them. The inability of the business entity to have direct access to e-Services also precludes this necessary monitoring. Many of these entities currently place phone calls to IRS contacts who then manually research issues and provide available information to the entities. IRPAC believes that the expansion of access to e-Services products will eliminate many of the phone calls and manual processes.

Expansion of e-Service incentive products was included in the list of Electronic Tax Administration (ETA) e-Services Enhancement Recommendations, that IRPAC provided at IRS request.[24]

IRS is handling a tremendous amount of its investigations by correspondence (1099 matching audits, correspondence audits, etc). In order for a representative to properly respond to this correspondence, a POA (or other taxpayer authorization) is required. If the POA is already on file with the IRS by being electronically filed with the return in question, it would reduce the burden of having to get another POA signed and returned to the representative. This would allow a more timely response to most notices

[24] See IRPAC response to ETA e-Services request (September, 2009): http://www.irs.gov/pub/irs-utl/irpac_eservices_enhancements.pdf.

since taxpayers typically send these notices to the tax return preparer for response to the IRS. If the IRS would expand the authority already granted to the tax return preparer, by checking the box on the tax return, the preparer could deal with the IRS regarding all issues for that particular return. No additional POA would be required, greatly reducing burden.

IRS' Wage and Investment (W&I) operating division presented the issue of expanded access to e-Services to the directors of Electronic Products and Services Support (EPSS) and ETA. This issue is on the ETA list of potential e-Service changes. Final decision on any changes rests with ETA. Initial discussions look favorable that this additional access will be granted. IRS W&I investigated the possibility of submitting the POA electronically with the filing of the return. IRS determined that this cannot be done at this time because of the signature requirements on the POA.

E. Form 1098, Mortgage Interest Statement

Recommendations

SBSE requested feedback from IRPAC on a proposal to require financial institutions to report the amount of deductible mortgage interest on Form 1098. However, this calculation requires information that recipient/lenders do not have. IRPAC recommends that an alternative solution is to modify the instructions for Form 1098 and/or Reg. 1.6050H-2 to require the recipient/lender to report the address of the mortgaged property, the principal amount of the loan, and the amount of real estate taxes paid during the year. These changes should only be required for new loans and sufficient time should be provided for implementation (e.g. 18 months after the effective

date). IRS should encourage the recipient/lender to provide this information on all loans if it is readily available in their processing systems.

Discussion

Form 1098 is issued by recipients/lenders to payers of mortgage interest to report the amount of interest received by the recipient/lender during the calendar year. This amount is not necessarily the tax deductible amount for home mortgage interest. The amount allowed as a deduction involves an extremely complicated calculation following significant accumulation of information. Specifically, deductible home mortgage interest is limited to the interest on up to $1 million of home acquisition indebtedness and $100,000 of home equity debt secured by the payer's principal residence and no more than one other residence. Form 1098 currently does not provide all of the information to the payer/borrower to accurately determine the allowable deduction. Recipients/lenders are currently required to provide only the amount of interest received, points paid on purchase, refund of overpaid interest, and mortgage insurance premiums. The form contains an optional box that the lender may use to report real estate taxes, mortgaged property address, insurance, or other information.

SBSE requested feedback from IRPAC on a proposal to require financial institutions to report on Form 1098 the amount of mortgage interest deductible when the amount of indebtedness exceeds $1,000,000 for home mortgages or $100,000 for home equity loans. The calculation of deductible interest is complicated and requires information that recipients/lenders do not have in their records, such as the amount of loans the payer/borrower holds with other financial institutions. Consequently, IRPAC

believes the responsibility for calculation of the amount of deductible mortgage interest must remain with the payer/borrower.

In June 2009, the Burden Reduction subgroup met with representatives of SBSE to discuss alternatives that could be implemented by the lenders and that would provide useful information to the IRS. As a result of the discussion, IRPAC designed a survey and circulated it to various financial institutions. The results of this survey indicated that all of the respondents could provide the address of the mortgaged property, the amount of real estate taxes paid by the institution, and the principal balance at the beginning or end of the year on new loans, if given at least 18 months to implement changes to their reporting systems. None of the respondents could provide information regarding the use of the funds borrowed, whether or not the loan had been refinanced, or any other information that they were not currently providing.

A recent GAO Report (GAO-09-769, Home Mortgage Interest Deduction: Despite Challenges Presented by Complex Tax Rules, IRS Could Enhance Enforcement and Guidance) recommended that Form 1098 be revised to require third party lenders to provide information on mortgage balances at the beginning and end of the current year or the average balance, the address of the secured property, an indicator of loan refinancing in the current year, and an indicator of whether the mortgage relates to an acquisition loan or a home equity loan, to assist the IRS with the detection of noncompliance in the home mortgage area. The report included a sample of a revised 1098 including this information and made suggestions for modifying the instructions, training examiners and educating the public on the mortgage interest limits.

Based on the discussions with SBSE, the lender survey, and the GAO Report, IRPAC recommends, as an alternative to SBSE's proposal, that recipients/lenders be required to provide the address of the mortgaged property, the principal balance of the loan at the end of the year, and the amount of real estate taxes paid by the institution during the year. This information would aid IRS in screening returns for audit and detecting noncompliance by identifying those taxpayers who have outstanding home loans cumulatively in excess of $1 million, taxpayers who have second or third mortgage loans on the same property (often indicative of home equity loans), and taxpayers claiming deductions for home mortgage interest on more than two residences. This information could help with detection of underreported income if, for instance, a taxpayer owns several homes, some of them may be rental property. This information would also benefit tax practitioners and taxpayers to more easily and accurately determine the deductible home mortgage interest amount thus fostering compliance.

IRC §6050H authorizes the Treasury Secretary to prescribe the form and required information to be reported regarding home mortgage interest. Treas. Reg. 1.6050H-2(a)(2)(vi) dictates the reporting of any information required by Form 1098 or its instructions, thus these recommendations are within IRS' authority to change.

F. Form 8886, Reportable Transaction Disclosure Statement

Recommendations

1. The Commissioner should exercise his discretion under IRC §6707A and 6011 to change the reporting requirements for partners, shareholders and beneficiaries of pass-through entities that appropriately file Form 8886 at the entity level.

2. IRS should clarify that the reporting requirements under §6011 will terminate for the corporate participants in the Lease-in/Lease-out (LILO) and Sale-in/Sale-out (LILO/SILO) Settlement Initiative after the year of actual or deemed termination of the tax shelter related transactions. Further, IRS should consider adding a provision to all closing agreements or settlements related to reportable transactions that specifies the reporting obligation, if any, for that transaction in subsequent years.

Discussion

IRC §6707A, enacted in 2004, imposes a severe penalty on the failure to disclose the details of reportable transactions on a properly filed IRS Form 8886 as required by §6011. For tax shelters, designated by the IRS as "listed" transactions, this is a mandatory penalty without exceptions for reasonable cause or good faith, is not required to be proportional to the tax benefits derived from the transaction, and has been criticized as "unconscionable" and "unconstitutional" by the Taxpayer Advocate. Both IRPAC in its 2008 Report, and The Taxpayer Advocate, in her 2008 Annual Report to Congress, identified this issue as burdensome.

Penalty: The total penalty for any transaction depends upon the type of transaction, the type of entity or entities involved, and the duration of the transaction.

"Listed transactions" and transactions "the same as, or substantially similar" to listed transactions carry a penalty of $100,000 for a natural person (individual) and $200,000 for any others (corporations, partnerships, or trusts), for each taxable year of the transaction. If a pass-through entity is involved in a listed transaction, all of the beneficial owners, shareholders and partners, must also report the transaction, resulting

in a “stacking effect.” Thus, if a partnership with two partners participated in a transaction substantially similar to a listed transaction for a three-year period, and the partnership and its partners failed to file the required 8886 forms, the mandatory penalty would be $1,200,000 ($200,000/year for the partnership, and $100,000 for each of the two partners, for three reporting periods). Currently, this penalty imposes strict liability regardless of the taxpayer’s knowledge or intent, cannot be challenged in court, there is no statute of limitations on assessment, and the IRS may not rescind any penalties related to listed transactions. However, in June 2009, in a letter to IRS, several prominent legislators criticized the severity of the penalties that are disproportionate to the tax benefits received, especially for small businesses inadvertently involved in listed transactions, and committed to remedial legislation to correct the inequities. In response, IRS Commissioner Shulman agreed to suspend collection enforcement action through September 30, 2009 for penalties assessed on cases where the annual tax benefit from the transaction is less than $100,000 for individuals or $200,000 for other taxpayers per year. Subsequently, Commissioner Shulman extended the suspension of collection enforcement actions through December 31, 2009 to allow the Congress time to address this issue.

Failure to report other Reportable Transactions that are not Listed Transactions carries a penalty of $10,000 for individuals and $50,000 for corporations and partnerships, for each transaction and each taxable period involved. IRS may rescind a penalty for transactions other than listed transactions if “rescinding the penalty would promote compliance with the requirements of this title and effective tax administration.” Recent regulatory guidance allows IRS to rescind the penalties for transactions that are

not listed transactions if the penalty is disproportionate to the tax benefit received and there was reasonable cause for the failure to disclose. Absent from the non-exclusive list of factors that would support rescission of the penalties, was any reference to the failure of a partner or shareholder to report a transaction that was timely and appropriately reported by the pass-through entity and included all elements related to the individual partners or shareholders.

The §6707A penalties are in addition to any other penalty, such as substantial understatement or negligence.

Listed Transactions: The term "listed transaction" means a reportable transaction, which is the same as, or substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction for purposes of §6011. Generally listed transactions are transactions considered abusive tax shelters.

Reportable Transaction: The term "reportable transaction" means any transaction of a type, which the Secretary determines as having a potential for tax avoidance or evasion. The currently applicable categories are:

1. Confidential transactions;
2. Transactions with contractual protections;
3. Section 165 losses; and
4. Transactions of interest, specifically identified in IRS pronouncements.

Reporting Requirements: Form 8886 must be attached to each tax return that includes a reportable transaction and for the first year of the transaction, an exact copy must be mailed directly to the IRS Office of Tax Shelter Analysis (OTSA). The transaction must be explained in detail and penalties will apply if it is not complete.

Because of the severe monetary penalties, often disproportionate to the tax benefits received or intended, many practitioners are filing “protective” Forms 8886 for transactions in the ordinary course of business, unrelated to any tax shelter scheme, but could arguably fall into one of the reportable transaction categories, such as §165 losses. Often these loss transactions and other reportable transactions occur within a partnership or S corporation and are passed through to various individuals.

The burden on taxpayers to accurately file Form 8886 and include all required disclosures, and the burden on IRS to process arguably unnecessary forms was discussed with representatives of SBSE in June 2009. SBSE confirmed that all Forms 8886 mailed directly to OTSA and most Forms 8886 filed with returns are reviewed. They also indicated that protective disclosures are processed the same as other disclosures. Further, SBSE stated that Form 8886 is an important information gathering activity to assist IRS in the detection and deterrence of tax avoidance. One reason for the requirement that each partner and shareholder disclose regardless of entity level reporting is that the individual partners or shareholders may have additional activity or varying fact patterns related to the transaction. IRPAC responded that conversely, most participants in pass-through activities not only do not extend, modify or alter the transaction but are completely unaware of the elements of any tax shelters or other transactions and would be incapable of adding any helpful information to their individually filed Forms 8886. Further, according to the instructions for partnership and S corporation returns, a pass-through entity that is required to file Form 8886 must determine if any of the partners or shareholders are required to disclose the transaction and provide those individuals with information they need to file Form 8886. Practice

pass-through entities and software providers merely attach a complete copy of Form 8886 to the K-1 distributed to affected partners or shareholders.

Another reporting issue involves the recent settlement related to LILO/SILO transactions. LILO/SILO transactions are listed tax-shelter transactions under Rev. Rul. 2002-69 and Notice 2005-13, respectively, and subject to the $100,000/$200,000 reporting penalties. In October 2008, IRS offered a settlement initiative to approximately 45 corporations and two-thirds agreed to participate. The terms of the settlement required the participants to terminate the LILO/SILO activity in 2008 and report 80% of the inception to date original issue discount income (OID) related to the LILO/SILO in 2008 and report 100% of the remaining OID in subsequent years. If the participants are required to continue reporting for each year that OID is accrued, failure to file Form 8886 in those subsequent years would result in a $200,000 annual penalty. According to the settlement, the activity will be deemed terminated in 2008 notwithstanding the recognition of the OID in subsequent years. However, absent clarification to the contrary, participants will be compelled to file a complete Form 8886 each year thus burdening the participants and the IRS unnecessarily. This dilemma was discussed with SBSE representatives on June 16, 2009 and they acknowledged the need for further guidance.

Accordingly, IRPAC makes two recommendations related to Reportable Transactions:

1. For reportable transactions involving pass-through entities, only the direct entity level participant in the transaction should be required to file Form 8886 provided it lists the names, addresses, identifying numbers, and potential tax benefits for

each partner or shareholder. If a partner is also a partnership or S Corporation, this secondary pass-through entity should also be required to file Form 8886 identifying its indirect participants and potential tax benefits. A copy of the 8886 should be a required attachment to each K-1, confirming that the reporting requirements are met. Reg. §1.6011-4 should be amended to provide that if the direct participant is a pass-through entity and appropriately discloses the transaction on Form 8886, partners and shareholders that were indirect participants in the reportable transaction are not required to separately file Form 8886, but must attach the entity generated form to their individual tax returns. Alternatively, Reg. §1.6707A-1T should be amended to reflect that a factor to consider for rescission of penalties is whether the taxpayer was an indirect participant and the direct participant was a pass-through entity that appropriately filed Form 8886.

2. IRS should clarify that the reporting requirements of section 6011 will cease after 2008 related to the LILO/SILO listed transactions for all the corporate participants in the settlement initiative regardless of any OID recognition in subsequent years. IRS should also consider adding a provision to all closing agreements or settlements related to reportable transactions that specifies the reporting obligation, if any, for that transaction in subsequent years.

G. Comments on a moratorium on enforcement and on methods for determining personal call usage on employer-provided cell phones – Notice 2009-46

Recommendations

Moratorium

In light of the pending legislation to remove cell phones from the definition of listed property, IRPAC recommends the temporary suspension of enforcement of the listed property rules as they impact cell phone use as well as the related employee income inclusion for personal cell phone use.

Notice 2009-46, Substantiating Business Use of Employer-Provided Cell Phones, Comments

Simplified Substantiation Methods

Minimal Personal Use

1. IRPAC recommends that employers should establish a policy under which an employee who is provided a cell phone by the employer will agree to maintain and use a non-employer provided cell phone for personal use.
2. IRPAC recommends that an employer's policy include a definition of appropriate use of employer provided cell phones along the same lines as policies governing use of employer provided computers and other technology.
3. If an employer provides a cell phone with "unlimited use" or "fixed flat minute" billing and the employees' job requires at least 50% business use, the IRS should assume that the entire cost of the cell phone is business use.

Safe Harbor Substantiation

1. IRPAC believes it reasonable to allow the employer to elect to use internally developed pricing schedules or actual billings in lieu of a national pricing list. IRPAC strongly recommends the IRS avoid publishing a national rate list, which can quickly become outdated then become very unfair to administer.

2. The IRS suggested safe harbor of 75% business use/ 25% personal use is a fair resolution of a difficult determination and one that many employers will elect to follow.

Statistical Sampling Method

In IRPAC's opinion, the one method that seems allowable for documenting both listed and de-listed property is under Reg. §1.274-5T(c) which allows a sampling supported by collateral evidence. There is potential in the approach under Revenue Procedure 2004-29, however, this revenue procedure does not authorize all necessary statistical sampling components, see IRPAC comment letter, for further details.[25] IRPAC also notes that cell phone use varies between employees even within the same industry and this will make establishing a sampling strategy difficult.

Other Topics of Interest

Employer's Written Policy

An employer's written policy should be made applicable to all employees and clearly written to explicitly provide that personal use of employer provided cell phones and related technology is prohibited by the employer. Members of IRPAC suggested specific policy inclusions.[26]

Methods Used by Employers to Determine Fair Market Value (FMV) of Employer Provided Cell Phones

[25] See IRPAC response to Notice 2009-46, Substantiating Business Use of Employer-Provided Cell Phones (August, 2009): http://www.irs.gov/pub/irs-utl/irpac_cell_phone_comment_letter-notice_2009-46_jl_final.pdf
[26] Ibid.

IRPAC provided examples of two methods used by some employers, small and large, to determine FMV with discussion of their limitations and benefits.[27]

Simplified Method of Determining FMV

IRPAC believes it is reasonable to allow employers to use internally developed pricing schedules or actual billings but opposes IRS publication of a yearly schedule of pricing.

Discussion

IRPAC appreciated the opportunity to provide comments on the development of new methods for determining personal call usage on employer-provided cell phones and commends the IRS' efforts to seek comments through Notice 2009-46. This notice requests comments from the public regarding several proposals to simplify the procedures under which employers substantiate an employee's business use of employer-provided cellular telephones or other similar telecommunications equipment (e.g. Blackberry, pager, iPhones, smart phones and other 3G equipment, PDAs, GPS locators).

Notice 2009-46 suggests some means of documenting business use of cell phones that would be simpler than the current requirement for detailed logs of date, time, duration, business purpose, etc. IRPAC believes that the ideal solution, as suggested by IRS Commissioner Douglas Shulman, is for Congress to pass legislation ensuring no tax consequences to employers or employees for personal use of work-related devices such as cell phones provided by employers. Looking to an impending

[27] Ibid.

legislative change, IRPAC believes the best course of action for the present is a moratorium on enforcement.

IRPAC's comment letter on Notice 2009-46, dated August 31, 2009, provides detailed discussion of the recommendations summarized above.[28]

[28] Ibid.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

Ad Hoc

Subgroup Report

JAMES DRIVER
JOAN HAGEN
KATHY PLOCH
RON WHITNEY
STEPHEN LEROUX, SUBGROUP CHAIR

A. Proposed Regulations under IRC §3402(t) – Withholding on Certain Payments Made by Government Entities

Recommendations

IRPAC recommends that the IRS provide additional guidance to government entities that must comply with the withholding provisions of IRC §3402(t) and that the IRS considers higher withholding thresholds. The costs of implementation of IRC §3402(t) in terms of systems and staffing requirements will be enormous and a government entity's constituencies might experience reduced services as governments are forced to increase spending on administrative systems to comply with the withholding requirements. Vendors that provide property and services to government entities already operating in an uncertain economic environment will experience decreased cash flows, further straining their ability to pay for labor and supplies. IRPAC recommends the IRS consider additional relief provisions in recognition of these economic factors. IRPAC also recommends that clarification be provided that IRC §3402(t) withholding does not conflict with the treatment and reporting of other types of payments. IRPAC recommends guidance on how to determine if payees listed in regulations qualify for exemption from withholding. Guidance is also required to assist government entities in collecting the information necessary to apply these payee exceptions. These recommendations will enhance payers' compliance with the regulations and help to reduce unnecessary withholding and reporting.

Discussion

IRS released Proposed Regulations under IRC §3402(t) for public comment on December 5, 2008. The Proposed Regulations provide for withholding on certain payments made by government entities or their payment administrators to persons

providing property or services. Government entities would benefit from additional guidance, clarification and relief provisions with respect to the Proposed Regulations. Government entities would benefit from clarification that IRC §3402(t) withholding does not conflict with the treatment and reporting of other types of payments. In particular, qualified plan and deemed Individual Retirement Account (IRA) distributions to participants and beneficiaries subject to withholding under IRC §3405; employer contributions to employee benefit and deferred compensation plans, including any payments by an employer to, or for the benefit of, an employee; and certain payments related to investments, including annual distributions made by colleges and universities as trustees to beneficiaries of charitable remainder trusts, and capital contributions made by endowments from colleges and universities to limited partnerships for investment purposes.

The Proposed Regulations provide that payments to certain payees are exempt from withholding:

1. Government entities subject to 3402(t)
2. Tax-exempt organizations
3. Foreign governments
4. Certain payments to nonresident aliens
5. Foreign corporations
6. Indian tribal governments
7. Certain pass-through entities

Currently, there is a lack of guidance on how to determine that payees qualify for these exemptions. Guidance is required to assist government entities in collecting the

information necessary to apply these exceptions. Absent such a mechanism to facilitate proper application of the exceptions, an unnecessary burden will be imposed on entities not subject to taxation, and the IRS will be burdened with processing additional filings and requests for refunds from these excepted entities.

The Proposed Regulations provide a transition rule for interest and penalties for failure to withhold on payments made in the first year that the regulations are effective for entities who make a good faith effort to comply with the requirements of IRC §3402(t). Government entities would benefit from clarification of the conditions necessary to meet the standard of "good faith effort to comply."

Relief Provisions

Certain provisions for relieving the compliance burden should be considered. Raising the $10,000 per payment threshold would help alleviate concerns about discouraging affected government entities from using payment cards for transactions over the threshold amount and thereby putting the payment card industry at a competitive disadvantage and increasing administrative costs of disbursement mechanisms.

The Proposed Regulations provide a threshold of $100,000,000 of annual payments for determining if a political subdivision of a state (or any instrumentality thereof) is subject to withholding under IRC §3402(t). This determination would be enhanced by a special rule allowing the averaging of multiple accounting years.

The Proposed Regulations provide that payments made under written or binding contracts in effect before issuance of final regulations are not subject to IRC §3402(t) withholding, unless such contract is materially modified. Government entities will require

time to negotiate renewal options and draft contractual amendments to reflect the impact of the withholding requirements. The date set by the regulations relating to contract renewals should take into consideration this additional time required. In addition, many government entities are subject to statutory requirements favoring the use of minority-owned and other small contractors who will be especially sensitive to the adverse cash flow impact of the withholding requirements. A multi-year phase-in approach based on the size of the contractor might mitigate the impact on small contractors.

IRS is currently considering comments submitted in response to the proposed regulations. IRPAC submitted its comments in January.[29]

B. Simplifying Employer Tax Compliance for Non-Resident Aliens

Recommendations

IRPAC's original recommendation in 2008 was a "decision tree" format on IRS.gov that provides employers with step-by step guidelines based on facts and circumstances to arrive at an employment tax withholding answer for non-resident alien scholars. Since the IRS determined that technologically the project was not feasible, the IRS Large and Mid-size Businesses (LMSB) operating division, proposed an alternative that is close to being fully developed and IRPAC supports. This alternative, which will be housed on IRS.gov under the International Taxpayer page, will provide links based on visa type to allow employers as well as non-residents to manage and understand withholding and reporting requirements.

Discussion

[29] See IRPAC Response Letter to Proposed Regulations §31.3402(t) (March, 2009): http://www.irs.gov/pub/irs-utl/irpac_letter_3402t_regs_march_5_2009.pdf

Since Tax Treaties cannot be substantively changed or altered either quickly or easily, this recommendation works with existing laws to enhance compliance in an easy to use format.

LMSB initially thought a decision tree might be possible but later discovered that IRS.gov could not handle that kind of technical maneuvering. However, LMSB has been able to come up with an effective alternative, which actually expands the information provided.

This project began as a discussion on non-resident scholars and served as a carryover item from the 2008 IRPAC recommendation. The recommendation focused on the employer being hampered by several issues. The first issue is the obvious complexity of the laws and regulations. The second issue is the constant status changes that occur with an individual. The employer is hard-pressed to apply confidently the correct tax withholding and reporting.

The 2009 discussions have now broadened to include all visa holders and tax issues related to their employment. As stated above, the new format will offer links from the International Taxpayer webpage that will be determined by visa type. The information contained in these pages will allow the employer and employee to be on the same understanding level for the taxation issues. On each visa webpage there will be discussions concerning the tax residency rule, common types of incomes for the visa type, individual tax filing requirements, tax treaty information, withholding tax provisions, and the integration of immigration and tax laws. IRPAC has also requested a webpage that addresses retirement plan beneficiary issues for the non-resident alien.

The release of these pages will substantially reduce confusion over withholding issues concerning non-resident aliens. IRPAC will follow–up with LMSB in the upcoming year to gather feedback and possible enhancements to the website pages, but believes the website offers a clearer picture on non-resident alien employment tax issues.

C. Form 5498, IRA Contribution Information: Reporting for Successor Beneficiaries

Recommendations

IRPAC recommends the IRS provide guidance and/or instruction to address Form 5498 reporting with respect to a successor beneficiary of a deceased IRA beneficiary. An IRA in this situation is often termed a stretch IRA. IRPAC recommends the guidance/instructions provide that Form 5498 reporting for the year of an IRA beneficiary's death and subsequent years indicate the successor beneficiary and the original IRA owner or plan participant as well as such successor's share of any December 31 fair market value. To the extent multiple successor beneficiaries exist and have assets remaining in an account, separate Forms 5498 are recommended for each one titled as described above with their share (amount) of the December 31 fair market value. IRPAC recommends for the year of a beneficiary's death that no final Form 5498 is required in the deceased beneficiary name. However, IRPAC recommends the guidance/instructions should state that upon request, the beneficiary's date of death value must be provided to the executor or administrator of the deceased beneficiary's estate.

Discussion

Currently, no specific Form 5498 reporting guidelines/instructions are provided for a successor beneficiary of a deceased IRA beneficiary. IRA Custodians, Trustees and Issuers (C/T/Is) are reporting on these successor beneficiary (inherited) IRAs by extrapolating guidance in Revenue Procedure 89-52 and current Form 5498 instructions. Additionally, recent guidance on account titling is found in Notices 2007-7 and 2008-30 with respect to beneficiaries of deceased plan participants following rollover to inherited traditional and Roth IRAs, respectively. Thus, identical situations have and will result in different reporting results.

The 2009 Form 5498 instructions state:

> "**Inherited IRAs**. In the year an IRA participant dies, you, as an IRA trustee or issuer, generally must file a Form 5498 and furnish an annual statement for the decedent and a Form 5498 and an annual statement for each no spouse beneficiary. An IRA holder must be able to identify the source of each IRA he or she holds for purposes of figuring the taxation of a distribution from an IRA, including exclusion from current year gross income as an eligible rollover distribution under section 402(c). Thus, the decedent's name must be shown on the beneficiary's Form 5498 and annual statement. For example, you may enter "Brian Willow as beneficiary of Joan Maple" or something similar that signifies that the IRA was once owned by Joan Maple. You may abbreviate the word "beneficiary" as, for example, "bene."
>
> For a spouse beneficiary, unless the spouse makes the IRA his or her own, treat the spouse as a no spouse for reporting purposes.
>
> An IRA set up to receive a direct rollover for a non-spouse designated beneficiary is treated as an inherited IRA."

This guidance leads C/T/Is to make assumptions for the following reporting issues and provides background to current reporting inconsistencies:

1. For the year a beneficiary dies, are multiple Forms 5498 for both successor beneficiary(ies) and the deceased beneficiary required? If assumed yes, for the naming convention purposes, is the requirement for the final Form 5498 for the

deceased beneficiary met by issuing one in the beneficiary of the original decedent's (IRA owner or plan participant) name? Or, if such deceased beneficiary was a successor beneficiary, is the previous beneficiary's name/title used, or are all prior beneficiaries, including the original decedent, named? In addition, is the Form 5498 requirement for the successor beneficiary(ies) met by issuing one in the name of the successor beneficiary with the now deceased original/prior beneficiary, or with the original decedent's name, or with all prior parties?

2. Is the reporting requirement for a deceased beneficiary in question 1 not applicable and thus only applicable for the year of death reporting for the original IRA owner?
3. For the years after a beneficiary's death where assets remain in the IRA through the end of the year, is the Form 5498 reporting done in the name/title of the current successor beneficiary, preceding beneficiary(s), and original IRA owner/plan participant?
4. For the years after a beneficiary's death where assets remain in the IRA through end of year, is the Form 5498 reporting done in the name/title of the current successor beneficiary and the original IRA owner/plan participant?
5. For the years after a beneficiary's death where assets remain in the IRA through end of year, is the Form 5498 reporting done in the name/title of the current successor beneficiary, the original beneficiary of the deceased IRA owner/plan participant, and the original IRA owner/plan participant?

6. For the years after a beneficiary's death where assets remain in the IRA through end of year, is the Form 5498 reporting done in the name/title of the current beneficiary and the immediately preceding deceased beneficiary?

These inconsistencies with respect to current reporting and naming conventions for successor beneficiaries are presented in the following example:

Brian Willow as original beneficiary and Joan Maple as original IRA owner:

Brian Willow, as Bene of Joan Maple IRA

Brian dies, having named his daughter Sandra as successor beneficiary:

Sandra Willow, as Bene of Joan Maple **or**

Sandra Willow, as Bene of Brian Willow, as Bene of Joan Maple **or**

Sandra Willow, as Bene of Brian Willow

Sandra dies, having named her husband George as successor beneficiary:

George Willow, as Bene of Joan Maple **or**

George Willow, as Bene of Brian Willow, as Bene of Joan Maple **or**

George Willow, as Bene of Sandra Willow, as Bene of Joan Maple **or**

George Willow, as Bene of Sandra Willow, as Bene of Brian Willow, as Bene of Joan Maple **or**

George Willow, as Bene of Sandra Willow

Consideration was also given to the following factors in support of our recommendation:

1. A successor beneficiary of the beneficiary of the original IRA owner/plan participant will usually be taking required minimum distributions (RMDs) based on the single life expectancy of the original beneficiary and the original

beneficiary's age in the year following the death of the original owner. Thus, IRPAC considered the possibility of adding the original beneficiary to the Participant's name field. The advantage from the IRS's perspective is the record for audit purposes and the potential limitation of a successor beneficiary from using his/her own life expectancy factor for calculating and taking required minimum distributions, thus resulting in the distribution of less than the required amount and also stretching the tax deferral period. Since traditional (including Simplified Employee Pension Plans) and Savings Incentive Match Plan for Employees (SIMPLE) IRA assets are generally pre-tax, an incorrect determination of life expectancy by using a longer life expectancy (based on a younger successor beneficiary age) will delay the inclusion of IRA distributions in income and increase pretax earnings – also delaying taxation. Since Roth IRA assets are generally post-tax and qualified distributions are tax free (after a 5 year holding period), an incorrect determination of life expectancy by using a longer life expectancy (based on a younger successor beneficiary age) will increase tax free earnings and delay their receipt. However, factors working against and limiting the value of requiring the original beneficiary to the name field:

a. The five year payout rule was elected,
b. Spouse was original IRA beneficiary and the spouse died before life expectancy payments were required to begin,
c. Payments to non-spouse beneficiary were set based on plan requirements more restrictive than allowed,

d. For a traditional/SIMPLE IRA with death after the required beginning date, the life expectancy payments may be based on the longer life expectancy of the decedent, rather than an older beneficiary (followed by a much younger successor beneficiary being named).

2. The successor beneficiary IRAs already outstanding may have been transferred from the C/T/I of the original beneficiary IRA, thus information collected by current C/T/I may be insufficient for future Form 5498 reporting based on solution.
3. The cost of gathering additional beneficiary information and recording the information will be significant.

A significant issue for electronic reporting on Filing Information Returns Electronically (FIRE) is the 80-character limitation in the name/title field. This may cause difficulty if the C/T/I is required to list all previously deceased beneficiaries and original owners.

IRPAC understands the IRS is not ready to provide such guidance/instructions; however, the IRS has informed IRPAC that it will study the recommendation and background from this year's discussions and will add this issue to its current priority guidance list. IRPAC would appreciate the opportunity to provide further input prior to guidance/instructions being issued.

D. Barter Exchange Education, Back-up Withholding and "B" Notice Requirements

Recommendations

IRPAC recommends follow-up for the results of two studies:

1. For the abatements granted to barter exchanges for non-matching Taxpayer Identification Numbers (TIN) civil penalties, and
2. For instances where non-matching TIN penalties have been assessed without appropriate notice being sent.

IRPAC recommends continued openness to accept “as needed” revisions to Barter Topic 420 and IRS.gov website sections relating to barter exchange. IRPAC also recommends the IRS continue to encourage the modern trade and barter industry to place the IRS.gov barter exchange link and other pertinent IRS information on their individual websites via assistance from the International Reciprocal Trade Association.

Discussion

Barter Exchanges are defined as third-party record keepers under the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and as such are subject to Form 1099-B reporting and subsequent “B” Notice solicitations for non-matching TINS. The “B” Notice, which states the payer will back-up withhold, makes an assertion that is impossible for barter exchanges to comply with since they do not control any cash accounts for their client members. In its 2007 Public Report IRPAC made three recommendations regarding this issue:

1. That the IRS educate the barter industry through outreach programs to effectively reduce 972CG penalties.
2. The “B” Notice be amended to provide language more pertinent to the barter industry’s inability to comply with back-up withholding.
3. Exempt barter exchanges from back-up withholding requirements.

In 2008, the IRS concluded that recommendations #2 and #3 above would require legislative changes, which are outside the scope of the operating division's authority. As a result, the Ad Hoc Subgroup of IRPAC worked in conjunction with the SB/SE E-Business and Emerging Issues group on the following creative new approaches to addressing the barter back-up withholding issue:

1. A study to determine the percentage of abatements granted to barter exchanges for proposed 972CG non-matching TIN civil penalties.
2. A study examining reported instances of where non-matching TIN penalties have been assessed without 972CG Notices of Proposed Civil Penalty letters being sent.
3. Revision of the Topic 420 – Bartering Income and Bartering Tax Center IRS.gov sections to make them more pertinent:
    a. Request the modern trade and barter industry post important IRS.gov barter exchange links to their individual websites to provide better education and increased compliance.
    b. Place a link on IRS.gov directing users to the March 2009 CNN news report on the modern trade and barter industry.

Ron Whitney, Ad Hoc member and Executive Director of the International Reciprocal Trade Association, submitted revisions to the barter sections of the IRS.gov website in 2009 that were approved and implemented by the Service. Further, Mr. Whitney sent a mass email in the Spring of 2009 to all known barter exchange companies advising them to post the newly revised IRS.gov barter section links on their individual websites to improve education and compliance. Similar email communications

will take place in the future as additional website revisions are completed. Lastly, the CNN news segment link on the IRS.gov website is expected to be operational by October 2009.

E. Federally Declared Disaster Casualty Losses

Recommendations

IRPAC recommends that the IRS publish more written guidance on valuations and other federally declared disaster casualty loss issues. This could be accomplished by increasing the frequently asked questions (FAQs) on IRS.gov, writing more IRS notices, and providing examples shown in the forms, instructions, and publications. Assistance for real world examples could be solicited from the various practitioner groups around the country, as they have experience with the various issues that disasters bring. IRPAC also suggests that other examples could be drawn from IRS Revenue Agents when they audit the tax returns. IRPAC recommends utilization of Revenue Procedure 2006-32 (or something similar) for all federally declared disaster losses. This guidance would be fair to all victims of the various disasters the country has experienced recently. It would be less burdensome on the IRS, tax practitioners, and taxpayers that prepare their own returns as everyone would have other choices in arriving at fair market values.

Discussion

Our country has always had various types of natural disasters. However, it appears that after the Gulf Coast area experienced Hurricane Katrina in 2005, these disasters have increased all over the country. Congress did a phenomenal job in quickly passing the Katrina Emergency Tax Relief Act of 2005. This legislation gave

practitioners and taxpayers guidance on different ways to calculate valuations in order to prepare as accurate a return as possible under the circumstances. Since Hurricane Katrina, the Gulf Coast area has experienced other hurricanes and they have been almost as devastating. However, those affected areas did not receive the same relief and guidance Hurricane Katrina victims received. Since 2005, the country has also experienced floods and fires. In the past, Congress drafted legislation relating to the specific disaster. However, in 2008, Congress passed the National Disaster Relief Act of 2008 that provides tax relief for victims of federally declared disasters occurring after December 31, 2007 and before January 1, 2010. This legislation created uniformity in the rules and it is more efficient.

IRS has also been successful in posting timely information on IRS.gov regarding all of these new issues and disasters. Each casualty loss is unique and sometimes poses questions that are not addressed in the legislation. IRS.gov contains a section of FAQs that are helpful, but not always timely.

Suggested FAQs

Q. Is there an audit technique guide to assist in the preparation of casualty losses?

A. No. However, Publication 584, Casualty, Disaster and Theft Loss Workbook, Internal Revenue Manual 4.10.7.3 and 4.10.7.4 are tools that provide guidance.

Q. The cost of making repairs to restore property to its original condition can be used as a measure of the decrease in the Fair Market Value (FMV) of the property (Reg. 1.165-7(a)(2)(ii). However, to use the cost of repairs method to substantiate the amount of the loss, the repair expenditures must be made. Hurricane Ike occurred on September 13,

2008, so when would be the final date those repairs would have to be made in order to use the cost of repairs method?

A. To be able to use the cost of repairs method, the repairs must have been made by the due date of the tax return. If they have not, then you must file the return without the casualty loss and then amend the return after the repairs are made.

Q. Instructions tell us to write “Hurricane….” and any Revenue Procedure used in red ink at the top of the Form 1040. For those that electronically file, we cannot put a statement in red ink at the top of the return. Our software allows us to put statements at the top, but only in black ink. Because Congress wants taxpayers to electronically file their returns, I suggest that the instructions reflect how it should be done for e-filing.

A. It is acceptable to put a statement in black ink at the top. However, the Federal Emergency Management Agency (FEMA) notifies the IRS on all affected counties in a federally declared disaster area. This information is entered into the IRS computer system therefore identifying the taxpayers located in those affected areas.

Q. During Hurricane Ike many taxpayers lost their food in refrigerators and freezers due to long periods with no electricity. Insurance companies were giving policyholders a flat amount for food loss without having to itemize or file a claim. Could they possibly have a gain if they received more than their original cost of the food?

A. No. IRC §1033(h)(1)(A)(i) states that no gain shall be recognized by reason of the receipt of any insurance proceeds for personal property which was part of such contents and which was not scheduled property for purposes of such insurance.

Q. In FS-2006-7, January 2006 Reconstructing Your Records, you state that you can use your current property tax statement for land vs. building ratios. What is the IRS position on using those property tax values as the FMV before the casualty?

A. The law allows either an appraisal from a competent appraiser [Reg. 1.165-7(a)(2)(i)] or the cost of repairs method [Reg. 1.165-7(a)(2)(ii)]. However, the IRS will review each return on a case-by-case basis based on all the facts and circumstances.

Q. A taxpayer had a beachfront rental property that was totally destroyed during Hurricane Ike in 2008. He has decided that he will not rebuild at all. The land value is only $100 now per the County Tax Assessor. He received insurance proceeds in 2009 and he does have a gain. He had been reporting the income and expenses on Schedule E and had suspended losses. Therefore, does the taxpayer report the gain in 2008 or 2009? Does he consider the property to be disposed of and take the suspended losses? If so, are these losses reported on the 2008 or 2009 return?

A. The gain on the casualty must be reported in the year the insurance proceeds are received, so the taxpayer would report the gain in 2009. Notice 90-21 both addresses this issue and has an example. Under IRC §469(g), losses are allowed without limitation if the taxpayer disposes of the entire interest in the activity to an unrelated person in a fully taxable transaction. In general, this rule does not apply unless all the assets used in the activity (including land) are disposed of. Because the taxpayer has not disposed of the land, he can only take passive activity losses up to passive income in 2008. The suspended losses unallowed would then carryover to 2009.

Since the IRS uses the facts and circumstances approach, using an FAQ approach may give the tax preparers greater assistance in preparation of the returns. IRS has indicated that they will consider updating the FAQs on the website.

F. Electronic Furnishing of Form 1098-T, Tuition Statement

Recommendations

IRPAC recommends that Form 1098-T would be most effectively and securely delivered electronically based on students' negative consent. It has been demonstrated that electronic communication is the most effective means of communicating with college students, the recipients of Form 1098-T. For most students, the absence of affirmative consent to electronic delivery is not an indication that they prefer hard copy forms, but rather an indication that students are unaccustomed to the default to a hard copy environment and do not respond well to requests for affirmative consent. Absent a change in regulations to change the consent requirements, and as a positive first step, the Ad Hoc Subgroup will draft Q&A guidance for Chief Counsel review, covering alternative methods for obtaining affirmative consents from recipients for posting on IRS.gov.

Discussion

Treasury Regulation 1.6050S-2 provides that a person required by IRC §6050S(d) to furnish a written Form 1098-T, Tuition Statement, (furnisher) to the individual to whom it is required to be furnished (recipient), may furnish the statement in an electronic format in lieu of a paper format. The recipient must have affirmatively consented to receive the statement in an electronic format.

Educational institutions conduct most, if not all, administrative functions and correspondence with students electronically. Application for admission, registration for classes, posting of grades, billing and payments, student refunds, transcript requests, financial aid applications and awards, student loan promissory notes, and entrance and exit loan counseling are all transacted electronically. Access to university systems providing these functions and services are commonly made available to students via institutional portals or websites.

Students are accustomed to and expect this electronic environment for delivery of services and business transactions. Other than for the receipt of tax forms, they have no need to provide updated physical mailing addresses to their educational institutions and students no longer consider it important to provide accurate or current postal addresses to universities. In addition, students tend to be transient with frequent address changes.

The regulations require institutions to provide hard copies of Forms 1098-T unless the students affirmatively consent to receive the information electronically. Educational institutions have found that most students do not respond to requests to furnish Form 1098-T electronically. Institutions are then forced to issue paper forms via the Postal Service. Problems with paper forms include the return of a significant number of forms as undeliverable because of incorrect addresses, the significant cost to print and mail the forms, and the inclusion of sensitive information such as student Social Security Numbers on the forms, which are often delivered to an address other than that of the intended recipient.

The regulations include broad consent language focusing on the goal of ensuring receipt of Form 1098-T, providing that the consent may be made electronically in any manner that reasonably demonstrates that the recipient can access the statement in the electronic format in which it will be furnished. Articulation of acceptable alternative methods for obtaining affirmative consent in FAQs will assist furnishers of the statement in establishing a reasonable basis for implementing processes to which students will be responsive. This would alleviate many of the problems involved with delivery of hard copies, result in more timely delivery, and in general better meet student expectations and needs.

IRS Office of Chief Counsel will review FAQs drafted by members of the IRPAC Ad Hoc Subgroup to provide guidance that will be available on IRS.gov. This guidance may give educational institutions a reasonable basis for collecting affirmative consent as part of other administrative functions (for example, when paying tuition or accessing grades). Again, this is a good first step, but more authoritative guidance would be helpful to address this situation.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

Modernization

Subgroup Report

ELIZABETH DOLD
LISA GERMANO
EMILY LINDSAY
TIMOTHY M. MCCUTCHEON
SUZANNE M. SULLIVAN
PHILIP KIRCHNER, SUBGROUP CHAIR

A. Taxpayer Identification Number Masking on Payee 1099s

Recommendation

IRS should issue guidance immediately permitting payers to issue payee statements showing only the last four digits of a payee's Taxpayer Identification Number (TIN).

Discussion

Over the past two years, IRPAC presented proposals to the IRS regarding the masking of TINs on Forms 1099. As stated in its 2008 public report, IRPAC supports the research by the IRS in allowing TIN masking on forms that are delivered from the payer to the payee.

In IRPAC's April 2009 meeting, members of the Office of Privacy, Information Protection, and Data Security (PIPDS) presented information that guidance (most likely in the form of a Revenue Procedure) should be forthcoming that would permit payers to mask TINs on payee statements. The Modernization Subgroup strongly supported the release of that guidance and offered assistance in the review prior to public release.

IRPAC met with PIPDS during the June 2009 meeting and learned that instead of guidance being issued imminently, PIPDS had submitted a priority guidance proposal for 2009-2010 requesting a Revenue Procedure containing a penalty waiver for payers who mask TINs on certain information returns (specifically, Forms 1099). The timing of any guidance, even, in fact, the eventual issuance of guidance, is now unknown. IRPAC respectfully requests that IRS consider IRPAC's additional input as this pressing issue remains unresolved. In particular:

1. The timing of guidance is critical to implementation. In order to mask TINs on Forms 1099 issued for tax year 2009, the industry would need immediate guidance. If guidance were issued in the form of a Notice, Announcement, or as instructions to the 1099 series, perhaps it could be issued more quickly.
2. The proposed penalty waiver applies only to Forms 1099. The 1099 series generally includes additional information returns that are not numbered “1099” (i.e., the 1098 and 5498 forms). We request that all forms in the 1099 series be included in the final guidance.
3. A penalty waiver is an indirect, temporary mechanism for permitting optional TIN masking. IRPAC requests issuance of more direct and affirmative guidance, which would explicitly permit payers to choose to mask TINs on the 1099 series of information returns.

After several years of carrying forward IRPAC’s recommendation to allow optional TIN masking on payee statements, it is time for IRS to act swiftly and decisively in issuing guidance on this important subject.

In response to OMB Memorandum (07-16), Safeguarding Against and Responding to the Breach of Personally Identifiable Information, IRS has developed a plan to eliminate and reduce the unnecessary use of Social Security Numbers (SSNs). PIPDS has consistently supported IRPAC’s TIN masking recommendation and the safeguarding of SSNs.

B. Form 5500, Annual Return/Report of Employee Benefit Plan, Enhancements

Recommendations

To facilitate the IRS' processing and tracking of certain Form 5500 filings, IRPAC recommends the following changes:

1. Form 8955-SSA Filing through e-Channel**:** Use the e-Channel program rather than Filing Information Returns Electronically (FIRE) to process the new Form 8955-SSA because
    a. The format (XML) is consistent with the Department of Labor (DOL) program allowing a more common experience to the filer,
    b. E-Channel XML interface will be integrated into existing software programs that support Form 5500, which will allow Third Party Administrators (TPAs) to e-file directly from the 5500 application, resulting in a greater number of e-filed Form 8955-SSA forms and a reduced likelihood that they will be included as attachments to 5500 filings, and
    c. E-Channel can provide immediate feedback by using available validation routines and acknowledgement processes, and f) use of the FIRE system, with its outdated technology, provides an unnecessary risk for the IRS and does not optimize the filer's experience.
2. Form 5500 Registration Statement: Provide an optional, simple paper and electronic registration statement for retirement plan sponsors who are not required to file a Form 5500 or Form 5500-EZ.
3. Late Form 5500-EZ Filers: Expand the Employee Plans Compliance Resolution System (EPCRS) to accept voluntary correction of late Form 5500-EZ filings, as set forth in Appendix C.

Discussion

Form 8955-SSA Filing through e-Channel

Currently, Schedule SSA for Form 5500, Annual Registration Statement Identifying Participants with Deferred Vested Benefits, is filed as a part of the Form 5500 filing that is transmitted to the Department of Labor (DOL) through their ERISA Filing Acceptance System (EFAST) program. However, beginning with filings for the 2009 plan year certain portions of the current filings, including the Schedule SSA, will not be filed electronically with the DOL. Instead, the IRS, as the agency responsible for collecting data for the Schedule SSA, must determine other processes for plan administrators to submit the required information.

In January, the IRPAC Modernization Subgroup met with the Tax Exempt and Government Entities (TEGE) operating division for an update on the IRS plan to support this form. At that briefing, the subgroup learned that the current plan was to implement an enhancement to the current FIRE system to allow for the filing of Form 8955-SSA. The Subgroup expressed two primary concerns:

1. The FIRE system is a dated technology platform and should not be used to support new programs.
2. Filing third party administrators have no knowledge of the FIRE system and its cumbersome nature will create unnecessary burden.

In April, the IRPAC Modernization Subgroup met with the Electronic Tax Administration (ETA) on the e-Channel initiative. The concept of the e-Channel initiative is to use the modernized e-file electronic "mailbox" to receive filings and provide acknowledgements. The underlying filing would still be formatted in the legacy format and would continue to be processed by the same systems. This program would allow

filers to automate the process for sending/receiving information by supporting an automated program-to-program communication model.

In June, the IRPAC Modernization Subgroup again met with TEGE to receive a status update on the new form. The subgroup learned that the form was given an official IRS number (Form 8955-SSA) and that plans were proceeding to implement via the FIRE system. However, no development had begun. The subgroup informed TEGE of the conversation with ETA and expressed the desire for IRS to explore the option of using the e-Channel program to support Form 8955-SSA.

Form 5500 Registration Statement

Most retirement plans must file an annual report with either the DOL or the IRS. If the retirement plan covers employees other than the owner of the plan sponsor, it must file a Form 5500 with the DOL. If the plan covers only owners of the plan sponsor and has assets greater than $250,000 it must file a Form 5500-EZ with the IRS. If the plan covers only owners of the plan sponsor and has assets not greater than $250,000 there is no requirement to file a Form 5500 or a Form 5500-EZ.

The $250,000 filing threshold was recently increased from $100,000. As a result, many ”owner-only” plans are no longer required to file Form 5500-EZ.

A retirement plan may alternate from year-to-year among the three filing statuses (5500, 5500-EZ, and no filing). For example, a plan that covers only owners with assets not greater than $250,000 will need to file a Form 5500 when a non-owner employee begins participation in the plan. Similarly, a plan that covers only owners with assets not greater than $250,000 will need to file a Form 5500 when assets exceed $250,000.

Conversely, a plan that formerly was required to file a Form 5500/5500-EZ may have a change in status where the plan sponsor is no longer required to file either form. These varied requirements may cause confusion and uncertainty among plan sponsors and their advisors, and may trigger unnecessary correspondence from IRS and/or DOL inquiring why the plan sponsor has not filed a Form 5500/5500-EZ.

We recommend that the IRS institute a simple, voluntary registration statement that would be filed for a plan year when a Form 5500/5500-EZ is not required to be filed. This statement would serve three purposes:

1. Prevent notices from IRS/DOL when a Form 5500/5500-EZ was filed in a prior year.
2. Be considered a "return" for purposes of starting the statute of limitations.
3. Eliminate failure to file penalties for Form 5500/5500-EZ when the plan sponsor mistakenly believes that no filing was necessary.

The registration statement should contain minimal information (such as plan and sponsor name, Employer ID Number, and plan number) and should be filed using a paper postcard or electronically via Form 5500 preparation software on an "application-to-application" basis using XML. Form 5500 preparation software vendors should be able to provide this e-filing capability at little or no additional cost, as a similar "application-to-application" capability is currently provided for filing Form 5500. Filing of the registration statement would be completely voluntary, as IRS does not have the statutory authority to require it.

The benefits to the IRS of this registration statement includes the elimination of postage and other costs involved in issuing Notices requesting an explanation as to why

a filing is not made. In addition, the registration statement will prevent plans not required to file a Form 5500/5500-EZ from becoming ”invisible” to the IRS and possibly widening the tax gap. The three effects of filing the registration statement cited above may be enough incentive for plan sponsors to file voluntarily.

The benefit to taxpayers includes the elimination of the need to respond to Notices from the IRS/DOL when filings were formerly required. In addition, the three effects of filing the registration statement may provide peace of mind to plan sponsors and their advisors and eliminate certain penalties when the plan sponsor/advisor mistakenly believes that no filing was necessary.

Late Form 5500-EZ Filers

A plan sponsor who fails to file Form 5500-EZ or Form 5500 for plans without employees (as described in 29 CFR § 2510.3-3(b) and (c)) is subject to strict penalties under the Internal Revenue Code. Specifically, the plan administrator may be assessed a penalty of $25 per day (up to $15,000) for late filing the Form 5500-EZ each year, unless a reasonable cause exception applies under Code § 6652(e). Importantly, unlike other Form 5500 filers, these filers cannot participate in the DOL's Delinquent Filer Voluntary Compliance Program because such plans are not subject to Title I of ERISA.

Therefore, to facilitate voluntary compliance with the annual return requirement, IRPAC recommends that a new Appendix F be added to Revenue Procedure 2008-50, Employee Plans Compliance Resolution System, to provide for a streamlined Voluntary Compliance Program application for late Form 5500-EZ filers. This program would provide for filing of the missed returns, along with a filing fee of $200 for each annual Form 5500-EZ return, not to exceed $750 for a single, multi-year late filer application.

See Appendix C for recommended changes to EPCRS. This program should extend to plan sponsors that become aware of the failure to timely file prior to, or within 90 days of, notification by the DOL or IRS of the failure.

The benefits to the IRS of adding a late 5500-EZ filer program to EPCRS will be increased 5500-EZ filings and a reduction in IRS assessments (and related waiver processing) and costs associated with such a program.

The benefits to taxpayers would include additional certainty in the correction process, and under an established program – EPCRS – that they are familiar with that provides predictable results. Moreover, this approach is consistent with the approach taken by DOL for ERISA-covered plans, and provides fees that are more in line with these small plans.

Form 8955-SSA filing through e-Channel: The Modernization Group learned through informal conversations with ETA that ETA had discussed the use of e-Channel for Form 8955-SSA with TEGE. IRS has not made a final decision about the filing method to be used for the Form 8955-SSA.

Form 5500 Registration Statement: TEGE has indicated that they would be receptive to the Form 5500 Registration Statement.

Late Form 5500-EZ Filers: A similar recommendation was made by IRPAC in its 2007 report. We urge IRS to implement a delinquent filer program for late Form 5500-EZ filers.

C. Information Reporting through the ETA e-Channel Program

Recommendation

IRS should provide necessary funding to implement information reporting using the ETA e-Channel program.

Discussion

In IRPAC's 2008 annual report, the Modernization Subgroup presented a recommendation to enhance the FIRE system used to process information returns. One of the primary recommendations of that report was to allow for an application-to-application model whereby systems that transmit data to the IRS would be able to connect directly without requiring manual uploads.

In IRPAC's April 2009 meeting, ETA presented information on an e-Channel initiative. ETA indicated that the program was currently being considered, and was hopeful that funding would be provided to continue the initiative.

The e-Channel initiative as described provided a method whereby the underlying information transmitted would maintain its existing format with an updated electronic "envelope" based on the IRS Modernized e-file (MeF) platform. This envelope would follow currently accepted data transmission standards that are widely used throughout the public and private sector; it would also constitute an application-to-application program. This envelope is consistent with the current MeF programs and uses the same interfaces.

No change is required in the underlying legacy systems. E-Channel merely provides an XML wrapper around the flat file required by the legacy system. The current front-end servers simply need to be reconfigured to accept XML rather than https file upload.

IRPAC strongly supports this project and encourages the IRS to fund the initiative. The program has the following benefits:

1. This program will encourage software developers to support electronic filing rather than paper options.
    a. Supports unattended transmission: By providing the e-Channel program, IRS will allow software developers the ability to transmit with a single step. This will lower the barrier for information reporting filers and will produce more electronically filed reports.
    b. Provides acknowledgement: The e-Channel program as described will offer an acknowledgement at the point of filing. By offering this option, errors can be resolved quickly before IRS accepts the filing. This will produce more accurate filings and will reduce back-end error resolution and the need to communicate after the filing.
    c. Uses industry standard format for the envelope.
2. Increase in number of information returns filed electronically as most software vendors currently support XML filing.
3. Provides consistency with IRS MeF platform.
4. Retains the value of existing systems by not modifying underlying information structure. The effort required to update IRS systems to support MeF is daunting. The e-Channel initiative provides the ability to migrate the systems as time allows while still providing the benefits listed above.

IRS is currently in the process of evaluating their strategy for electronic filing. This evaluation is being conducted because IRS will not meet its goal of 80% electronic

transactions by 2010. IRPAC believes that this project could significantly increase the number of electronic transactions.

D. E-Services Enhancements

Recommendations

IRPAC recommends that IRS enhance their e-Services product to support the information reporting industry, and has identified a number of e-Services enhancements aimed at improving information reporting in one or more of the following areas:

1. Enhancements to the current e-Services system.
2. Expansion of taxpayers who can access current e-Services.

Discussion

IRPAC is interested in expansion of e-Services that impact information reporting. On July 21, the Modernization Subgroup met with ETA to gather information on ETA's strategic plan. At that meeting, ETA indicated that there is an ongoing study regarding advancing e-file, and a current study focused on e-Services. As ETA is in the process of evaluating requests with the specific focus on those that add value to the business, IRS requested that IRPAC provide suggestions for enhanced e-Services for ETA's consideration. In response, IRPAC developed a list of ETA e-Services Enhancement Recommendations.[30]

IRPAC understands that IRS ETA staff is currently evaluating requests submitted by industry. IRPAC encourages IRS to include the information reporting community to further their goal of the transition to electronic tax administration. IRPAC welcomes the

[30] See IRPAC response to ETA e-Services request (September, 2009): http://www.irs.gov/pub/irs-utl/irpac_eservices_enhancements.pdf.

opportunity to work with ETA on potential e-Services enhancements that impact information reporting.

E. Form 3921, Exercise of a Qualified Incentive Stock Option Under §442(b) and Form 3922, Transfer of Stock Acquired Through an Employee Stock Purchase Plan Under §423(c)

Recommendations

IRPAC has the following comments on the draft Forms 3921 and 3922 in order to more fully comply with IRC §6039 and proposed Treasury Regulations §1.6039-1.

1. Yearly Forms: The forms need to have a "year" date rather than a revision date. These forms are annual forms as opposed to continuous use forms.
2. Consistent Terms: The copy designations and headings should match the language on the Form, and the terminology throughout the instructions and the form should also be consistent. For example, on Form 3922, the copy designation for Copy B references "For Recipient" rather than "Transferor" as used on the form. The term "payer" is also not appropriate. Moreover, the term "Transferor" on Form 3921 and 3922 to refer to different parties may be confusing. Inconsistencies on both forms should be addressed.
3. Due Date: The due date on the forms is more favorable than indicated on the proposed regulations. Also, it may be helpful to permit electronic delivery for the recipient and corporate copy, and provide guidance on an appropriate substitute form.
4. First Transfer: Form 3922 is limited to the first transfer of the stock; therefore, in the instructions for transferor, IRS should replace "transfer or transfers" with "first transfer" and in Box 7 instructions, replace "was transferred" with "was first

transferred." Also, the addition of Line 8 does not appear to be a required disclosure under the proposed regulations. If retained, there needs to be more explanation on when to use the actual exercise price or the deemed exercise price, as both numbers would generally be available at the time the return is filed.

5. Spacing: Form 3921 could benefit from moving Lines 5 and 6 up 1 row. That would allow more text for the name and address box below; the extra line above is not necessary. Form 3922 could benefit from moving the Line under 5 and 6 up 1 row. Also, move the line under Line 7 up 1 row. This change will maintain spacing for computer printing on the form.
6. Other: Please confirm that "keep for your records" is consistently designated where appropriate. IRPAC recommends the more detailed reference to Publication 525, Taxable and Nontaxable Income, on Form 3922 be extended to the instructions for Form 3921. Also for Form 3921, instructions for Box 4 can delete (FMV) as it appears it is not used thereafter. For Form 3922, it does not appear necessary to include "to Transferor" and "by Transferor" in Boxes 1 and 2, which if removed would be consistent with Form 3921.

Discussion

In the January 2009 meeting of IRPAC, the IRS offered a number of topics and Forms for the full committee to consider for comment. Forms 3921 and 3922 were accepted by the Modernization Subgroup. The Subgroup appreciates the opportunity to work with the Service.

F. Form 945-X, Annual Return of Withheld Federal Income Tax and Instructions

Recommendations

IRPAC members have concerns about the length of the instructions and the lack of definitions for certain key terms. The instructions should be short, concise in explanation, and contain examples and charts where helpful. The length of the instructions and the sometimes repetitive information is not as helpful to the user in identifying when and why this form should be used. Our suggestions will help minimize incomplete or incorrect filings.

Discussion

IRPAC provided specific comments about both the form and its instructions (Appendix D). The form is brief, visually intuitive, and in plain English; but it needs some clarification and emphasis in certain areas. The Subgroup provided its specific suggestions. The Subgroup would like to see more concise and less repetitive information in order to decrease the length of the instructions.

A key component of the Subgroup's comments includes definitions. The Subgroup members are concerned that users may interpret a key term in the context of another IRS Form which may not be relevant to the Form 945 –X. Terms such as "administrative error" and "discovery" are used for many purposes in other IRS forms and instructions. The Subgroup asks that these terms be standardized, not just for the Form 945-X, but also as other Forms are developed or modified. For instance, regarding use of the term "discovery," the Subgroup recommends the term be replaced with "ascertained" which is less confusing. It is a term that we recommend IRS examine in its overall use in instructions, forms and guidance.

The Subgroup also suggests that more examples be offered – or a grid – about how to handle corrections that cannot be made using Form 945-X. The Subgroup is concerned that the instructions can be read to imply that the user should not be troubled about under-withholding; Subgroup members believe that this may not be an appropriate message if it is done intentionally or because proper procedures were not in place to know withholding was required. The Subgroup also requests that it be emphasized that the payer should correct the withholding on a prospective basis.

Subgroup members are concerned about the need to highlight the use of this form exclusively for administrative error – that this form is used only for administrative error should be duly noted more clearly and more prominently earlier in the instructions and on the form itself. Our comments request clarification and further definition of what constitutes administrative error and what to do when an error is not covered under this definition.

There is also a general concern among members that there is no guidance as to what to do if there is an incorrect under-withholding. The Modernization Subgroup suggests providing information on ways to correct or avoid penalties.

Since Form 945-X affects the retirement plans community, the Subgroup also recommends that its use and development be announced under the Retirement Plans Community section of IRS.gov as well as in the general forms website and highlighted in the Employee Plans Newsletter.

The instructions are unduly long and repetitive, which makes the prospect of reading them daunting. Appendix D offers specific suggestions made to IRS. A chart

with definitions will aid in the user more clearly identifying what is needed to complete the new form with greater confidence and accuracy.

Definitions in one place would be helpful for the terms that are used freely such as administrative error; adjustment or adjustment process; claim or claim process; federal income tax or backup withholding. The following are the areas for improvement:

1. Explain terms are used interchangeably.
2. Define how both these terms may be used for backup withholding or withholding using Form 1099.
3. Explain the uses for each types of federal income tax withholding (retirement, gaming, backup) in a brief way to ensure when the instructions provide specific information, that the user can identify when one would apply and understand why.
4. Provide examples within the definitional section (e.g., Correct or Corrections as noted under What's New, fifth paragraph).

Finally, Form 945-X is used to correct both federal income taxes and backup withholding, but the instructions consistently refer only to federal income taxes. The Modernization Subgroup suggest that the Service either repeat federal income taxes/backup withholding each time or prominently inform the reader that both are intended when only one is mentioned.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

Tax Gap

Subgroup Report

MARSHA BLUMENTHAL
CHARLES CHRISTIAN
ANDREW B. LYON
LILLIAN F. MILLS
GEORGE A. PLESKO
JOHN K. SCHOLZ
GEORGE K. YIN
ERIC J. TODER, SUBGROUP CHAIR

The purpose of the IRPAC Tax Gap Subgroup is to help the IRS improve its estimates of the tax gap. This is the report for 2009, which is the third year in the panel's three-year term.

In pursuing its mission, the panel conducted two meetings with IRS staff from the Office of Research, Analysis, and Statistics (RAS) this year – a telephone conference call on November 10, 2008, and a conference call January 15, 2009.

In addition to the conference calls, one of the panel's members, Marsha Blumenthal, participated in a panel discussion entitled "Is There a Gap in the Tax Gap Estimates?" at the IRS Research Conference on July 8, 2009. In her comments, Prof. Blumenthal summarized the findings from this panel's 2008 report.

Most of the panel's deliberations during this year were centered on reviewing and providing constructive comments on potential estimation methodologies for the estate non-filing tax gap and individual income tax underreporting gap. Prior to each conference call, IRS provided panel members with white papers detailing the potential estimation methodologies so that members would have sufficient time to review and formulate questions. During the conference calls, the IRS researcher responsible for preparing the white paper presented the methodology to the panel. In addition to providing a number of verbal comments during the conference call, panel members provided extensive written comments on the individual income tax underreporting gap methodology.

Recommendations

A. Estate Tax Non-filing Gap Estimation

The November conference call was devoted to discussing a document prepared by staff from RAS, “Estate Tax Filing Noncompliance.” This document updated the methodology used by the IRS to generate the current estimate of the estate tax non-filer gap. The methodology relies on an external panel survey of older households and the wealth held by that segment of the population. IRS uses this data to estimate wealth adjusted mortality curves in order to estimate the number of estates with a filing requirement. Comparing these predictions to the actual number of filers in the Statistics of Income (SOI) data provides an estimated number of non-filers and the sum of the estimated taxes due for each predicted non-filer gives a prediction of the non-filing tax gap.

Based on that telephone call and subsequent conversations, the Tax Gap Subgroup recommended the following actions concerning the estate tax non-filing gap estimation methodology:

1. IRS should account for estates that file, but do not have a filing requirement.
2. IRS should account for married couples where both spouses die in the study period because those households may have different filing patterns.
3. In estimating the estate tax non-filing gap, it is necessary to estimate household wealth and allocate wealth among spouses. The estimates of allocation of wealth within married couples should be informed by knowledge of residency in a community property state.
4. The following recommendations concern the use of the Health and Retirement Study (HRS) to estimate wealth across various demographics;

a. IRS should consider benchmarking the HRS wealth distribution to the Survey of Consumer Finances (SCF) to account for the truncated right hand tail of the wealth distribution observed in the HRS.
b. IRS should determine whether the HRS sample captures people over the target age that are living in households over the target age (e.g., elderly parents living with their adult children).
c. IRS should consider using multiple years of HRS data to smooth the wealth estimates.
d. IRS should compare the wealth values reported to HRS to estate values reported for tax purposes.

5. IRS should consider the performing the following sensitivity analysis. Instead of estimating mortality by level of wealth (bin) across demographic groupings (cell), the IRS should investigate applying the mortality model directly to the individuals in the HRS study over the filing threshold. IRS should allow the binning of wealth to vary by cell. The $675,000 filing threshold should be lower for those individuals who have already used some of their unified credit for gift taxes; IRS should investigate what effect this fact may have on the estimates. IRS should estimate confidence intervals for both the number of non-filers and the dollar value of noncompliance.
6. IRS should discuss the link between tax planning and estate tax filing behavior. How does tax planning differ by age, marital status, etc.? Can one identify tax planning by looking at the trajectory of wealth over time? Does the HRS capture

information on common tax planning techniques (e.g., Family Limited Partnerships (FLPs), closely held businesses, and valuation discounts)?

7. Filing compliance is likely different (higher) for high value estates than low value estates. Therefore, IRS should account for increases in the filing threshold when projecting estimates from one year to another.

B. Individual Income Tax Underreporting Gap Estimation

The purpose of the January 2009 teleconference was to discuss a proposed new methodology for estimating the individual income tax underreporting gap. Prior to the conference call, the IRS provided a copy of a white paper applying this methodology for Tax Year 2004 entitled "Tax Year 2004 Individual Income Tax Underreporting Gap: Description of Methodology and Line Item Estimates." This white paper described four major changes in the underreporting gap estimation methodology from what was used to produce the official estimates for TY2001. The white paper also suggested an approach to estimate the individual underreporting gap for tax years where National Research Program (NRP) reporting compliance data do not exist. The four changes are: (1) line-item estimates of undetected misreported income using the technique of detection controlled estimation (DCE),[31] (2) implementation of a tax calculator to compute total income tax (and self-employment tax) liability for TY 2001 and TY 2004 using both reported and corrected income and offset amounts, (3) use of SOI's Complete Report File (CRF) to provide a data bridge to estimate tax underreporting in the absence of NRP data, and (4) imputation of TY 2001 DCE-based estimates of misreported income specifically to TY 2004. Following the meeting, members of the

[31] Erard, Brian and Jonathan Feinstein, *Adjustment of Income Tax Underreporting Using Detection Controlled Estimation*. Final report under contract order number TIRNO-05D-00050 0001, November 15, 2007.

panel provided written comments on the white paper to the Chairman who then forwarded the comments to the IRS.

The Tax Gap Subgroup expressed concerns with the “black box” nature of the DCE methodology used to estimate the amount of income that is undetected by IRS examiners during the audit. Although the goal of the white paper was to describe a proposed methodology for estimating the underreporting gap, the DCE methodology is a key component and deserves more explanation than was given in the white paper. This is especially important since the new DCE methodology developed under contract to the IRS includes large changes in the corrections for undetected income for several line items. The panel was concerned about understanding the reasons for large DCE corrections for some line items where there is information reporting and where the correction was significantly larger than in prior estimates.

The Tax Gap Subgroup recommends that the IRS conduct additional research on the DCE methodology and provide more detail on the DCE methodology and the underlying equations in subsequent tax gap reports. We believe that this additional research is needed to increase the transparency and credibility of using the DCE methodology to measure the tax gap and will provide useful insights on areas for improved data collection in future random audit studies conducted by the IRS' National Research Program Office.

The Subgroup also recommends that IRS provide estimates of the extent to which changes in methodology affect changes in the estimated tax gap. Ideally, IRS should be able to provide estimates that separate out the sources of changes in the tax gap into changes in methodology, changes in tax law, changes in the underlying income

distribution, and changes in voluntary compliance. Finally, the panel provided IRS with some technical comments on the imputation methodology.

Appendix

Appendix A: Outline of IRPAC's Comments on IRM for U.S. Withholding Agent Examinations

1) Withholding Tax Issues as a Tier I Issue

On Monday, December 8, 2008, IRS Commissioner Doug Shulman announced at the George Washington University International Tax Symposium that the IRS has designated "withholding tax issues" as a Tier I issue. The elevation of withholding tax issues as a Tier I item requires IRS examiners to examine withholding matters during every examination, and to coordinate the audit and their findings with the issue owner executive and issue management team.

IRPAC Comment: The mandatory audit requirement resulting from the Tier I status of withholding tax issues places an undue burden on the IRS and on taxpayers. For many companies, a full-scope withholding tax audit is unnecessary. IRPAC suggests that the Internal Revenue Manual ("IRM") provide that the audit manager has discretion in each case to consider certain predetermined factors (*i.e.*, type of business, industry, internal controls, etc.) with respect to each taxpayer, and, if appropriate, perform a spot check to determine if a full-scope withholding tax audit is required.

2) Comparison of Forms 5471 and 5472 to Forms 1042 and 1042-S

Section 4.10.21.9.6 of the IRM requires IRS examination agents to request copies of Form 5471, *Information Return of United States Persons with Respect to Certain Foreign Corporations*, and Form 5472, *Information Return of a 25% Foreign-Owned Corporation*, to identify payments made to related foreign entities. The examiner is then supposed to match these payments to those reported by the taxpayer on Forms 1042 and 1042-S.

IRPAC Comment: Forms 5471 and 5472 generally are prepared on an accrual basis, whereas fixed or determinable, annual, or periodical payments are reported on a cash disbursements basis. The IRM should note these differences in accounting, and indicate in the Manual that the amounts reported on the Forms 5471 and 5472 may not reconcile with the amounts shown on Forms 1042 and 1042-S.

3) Payments for Personal Services - Contemporaneous Documentation

Generally, personal services are sourced at the location where the services are performed. The burden of proof of non-U.S. source is on the withholding agent. Section 4.10.21.9.4 of the IRM provides the following factors that the IRS examiner should consider in determining where the personal services were performed: contemporaneous records, travel expenses, vendor contracts, and interviews with the approver of the expense or contract.

IRPAC Comment: It should be noted in IRM Section 4.10.21.9.4 that the list of factors to consider is a nonexclusive list, and that the withholding agent can apply a reasonably prudent business person standard to determine where the services were performed. Such factors may include review of contracts, notations on invoices by service provider and/or person who approved the invoice for payment, subsequent confirmations of service performance sent via email or facsimile, among other things.

We also recommend the following portion of subparagraph 2 be deleted " . . . however, keep in mind that they may not be the most reliable source to determine the source of the expense. It is usually in the vendor's best interest to source all income as foreign to minimize the tax withholding." We believe this statement is misleading and could unduly influence an IRS examiner to automatically dismiss the veracity of the service provider's comments. The IRS examiner should consider all available evidence such as any notations on the invoice provided by the vendor along with other related items (e.g., expenses, etc.)

4) Validation Process of Forms W-8

Section 4.10.21.8.4.3 sets forth the steps an examiner should take to determine the validity of Forms W-8.

IRPAC Comment: We recommend the above section be modified to clarify that each section is severable. Specifically, it should state that (1) a Form W-8BEN with an invalid tax treaty claim is still valid to document the beneficial owner's status as foreign (assuming Part I of the form is properly completed) and (2) a Form W-8IMY that is otherwise valid except that one or more of the documentation from the underlying owners is invalid, may still be relied upon by the withholding agent by determining the beneficial owner's status in accordance with the presumption rules contained in Treas. Reg. § 1.1441-5(d)(3).

Appendix B: Supplemental W-4 Instructions for Nonresident Aliens

- Nonresident Aliens must follow special instructions when completing Form W-4. If you are an employee and you receive wages subject to graduated withholding, you will be required to fill out a Form W-4. Also complete Form W-4 for a scholarship or fellowship grant to the extent it represents payment for past, present, or future services. These are services you are required to perform as an employee and as a condition of receiving the scholarship, fellowship or tuition reduction. If you are claiming a tax treaty withholding exemption on this income, do not complete Form W-4. Instead, complete Form 8233, *Exemption from Withholding on Compensation for Independent (and Certain Dependent) Personal Services of a Nonresident Alien Individual*. See Form 8233 for more information at www.irs.gov.

- *Are you a Nonresident Alien? If so, these special instructions apply to you.* Keep in mind that terminology and determinations of residency are very different for tax purposes than for immigration purposes. Resident Aliens can include immigrants and nonimmigrants (e.g., foreign students, H-1B visa holders, others). These special Form W-4 instructions do not apply to resident aliens who should follow the general W-4 instructions. A Nonresident Alien:
  - Is, for the most part, temporarily in the U.S. for short periods of time, and does not meet the "substantial presence test" (www.irs.gov/businesses/small/international/article/0,,id=96352,00.html) in this calendar year, and
  - Is not a U.S. citizen or lawful permanent resident (does not hold a "green card" (hyperlink to http://www.irs.gov/businesses/small/international/article/0,,id=96314,00.html).

Individuals become U.S. resident aliens if they are substantially present in the United States under the 183-day residency formula (the "substantial presence test"). You are (or will become) substantially present if you have at least 31 U.S. days in the current calendar year and your U.S. days over the current calendar year and the two prior calendar years will equal or exceed 183 days using this formula: all of the countable U.S. days in the current calendar year, 1/3 of the countable U.S. days in the prior calendar year and 1/6 of the countable U.S. days in the calendar year before the prior calendar year. However, if you reside in Canada or Mexico and commute to work in the United States, your U.S. days might not be countable. If you are in certain U.S. immigration categories, your U.S. days might not count during certain calendar years.

- Foreign-government related individuals in A and G status are always exempt from counting days. (Dependents in A or G status age 21 or older are not exempt from counting days, however.)
- Students, who are in F and M Student status and J Exchange Visitors in the Student category, do not count their U.S. days for 5 calendar years.

- Teachers and Trainees (who include J Exchange Visitors in any of the J Exchange Visitor categories except Students) and Q Cultural Visitors, do not count U.S. days for 2 out of the 7 current calendar years.

Your U.S. days in F, J, M, or Q status in some of the current 3 calendar years might not be exempt-from-counting U.S. days if you were in the U.S. in a prior visit[s] in F, J, M, or Q status. See IRS Publication 519, *U.S. Tax Guide for Aliens* for more information on how to apply the substantial presence test. See also The Green Card Test and the Substantial Presence Test at www.irs.gov/businesses/small/international/article/0,,id=129390,00.html

Note: If you are a bona fide resident of American Samoa or Puerto Rico for the entire tax year, you generally are taxed the same as a U.S. resident alien. These special instructions do not apply to you; follow the general Form W-4 instructions. For determination as to who are bona fide residents and for information for residents of other U.S. territories or possessions, consult IRS Publication 570, *Tax Guide for Individuals with Income from U.S. Possessions.*

- *What compensation is subject to withholding and requires a W-4?* All wages and any other compensation for services performed by employees in the U.S. are considered to be from sources in the U.S. and are subject to withholding under the graduated income tax withholding tables. Employers need you, a Nonresident Alien, to complete Form W-4 under these special instructions to correctly effect this withholding.

- *Are there any exceptions to this withholding?* Yes, exceptions to withholding are provided for (a) wages paid to employees of foreign employers who earn not more than $3000 annually and are in the U.S. for not more than 90 days, (b) wages paid to certain crew members, (c) transportation related wages paid to Nonresident Aliens who are residents of Canada or Mexico and (d) certain wages paid to Nonresident Aliens who are residents of Puerto Rico, or the U.S. Virgin Islands. See IRS Publication 519 to see if you qualify for these exceptions.

- *Treaty Exceptions***.** If you perform personal services as an employee or as an independent contractor and you can claim an exemption from withholding on that personal service income because of a tax treaty, give Form 8233 to each withholding agent from whom amounts will be received. Even if you submit Form 8233, the withholding agent may have to withhold tax from your income. This is because the factors on which the treaty exemption is based may not be determinable until after the close of the tax year. In these cases, you must file Form 1040NR (or Form 1040NR-EZ if you qualify) to recover any overwithheld tax and to provide the IRS with proof that you are entitled to the treaty exemption. See IRS Form 8233 and related instructions, as well as IRS Publications 519 and 550 for further information on treaty benefits.

- *Am I required to file a U.S. tax return even if I am a Nonresident Alien?* Yes. Nonresident Aliens who receive U.S. sourced compensation are required to file U.S. tax returns on Form 1040NR and pay U.S. taxes on their U.S. sourced compensation. However, if your only U.S. source income is wages, and your total annual wages do not exceed the Personal Exemption Amount, then you are not required to file a U.S. tax return. Employers are required to withhold income taxes from your pay under special rules and in order to do so, employers will ask you to complete IRS Form W-4 under these special instructions. Any withheld amounts are credits against your U.S. tax return when you file.

- *Will my withholding amounts be different from withholding for my U.S. co-workers?* Yes. As a Nonresident Alien, you cannot claim the standard deduction amount when you file your U.S. Form 1040NR. In addition, Nonresident Aliens do not qualify for the Making Work Pay Credit made available in 2009 and 2010 under the American Recovery and Reinvestment Act. The Making Work Pay Credit is a refundable tax credit of up to $400 for working individuals (and $800 for married taxpayers filing joint returns) who are U.S. citizens and tax residents. The benefits of the standard deduction and the Making Work Pay Credit are included in the existing wage withholding tables published in IRS Publication 15 T. Since Nonresident Aliens do not qualify for these benefits, employers are instructed to withhold an additional amount from a Nonresident Alien's wages. For more information, see Notice 2005-76 on page 947 of Internal Revenue Bulletin 2005-46 at www.irs.gov/pub/irs-irbs/irb05-46.pdf. For the specific amounts to be added to wages before application of the wage tables, see IRS Publication 15T. Nonresident Aliens students from India and business apprentices from India are not subject to this procedure.

- Cites to IRS publications for additional information. Publications 15, 515, 519, 550 and 570.

SPECIAL FORM W-4 INSTRUCTIONS FOR NONRESIDENT ALIENS

- *What are the special Form W-4 instructions*? Nonresident Aliens required to complete Form W-4 must follow these instructions:
  Line 3: Check "single" regardless of your actual marital status.
  Line 5: Claim only one withholding allowance unless you are:
  - A resident of Canada, Mexico, or the Republic of Korea (South Korea) who meet tax treaty terms in the relevant United States tax treaties allowing more than one personal allowance,
  - A U.S. National, Note: A U.S. National is an individual who, although not a U.S. citizen, owes his or her allegiance to the United States. U.S. nationals include American Samoans and Northern Mariana Islanders who chose to become U.S. Nationals instead of U.S. citizens.
  - Or, a resident from India who entered as a student or business apprentice who is allowed more than one personal allowance under the United States-India Income Tax Treaty.

Line 6: Write “Nonresident Alien” or “NRA” above the dotted line. Optional – enter any additional amount you want withheld from each paycheck. A Nonresident Alien employee may request additional withholding at his or her option for other purposes.

Line 7: Do not make any entry. You are not allowed to claim exemption from withholding.

- *Scholarships and Fellowship grants paid for services*: Any part of a scholarship or fellowship grant that is a payment for services past, present, or future is subject to graduated withholding as wages, and requires FormW-4 completion under the instructions above.

Appendix C: Form 5500 Enhancements

APPENDIX F, SCHEDULE 10

Late Form 5500-EZ Filers

Plan Name: _____ EIN: _____ Plan #: ____

PART I. YEAR(S) OF FAILURE (check one)

[ ] Late Form 5500-EZ for years: _____ [list late years]

[ ] Late Form 5500 (only for plans without employees as described in 29 CFR § 2510.3-3(b) and (c)) for years: _____ [list late years]

PART II. LATE FILINGS (check one)

[ ] Attach for each year noted in Part I above, the most current Form 5500 Series Annual Return/Report form prepared (including all schedules and attachments) and indicate in the appropriate space on the first page of the Form 5500 the plan year for which the annual return/report is being filed.

[ ] Attach for each year noted in Part I above, the Form 5500 Series Annual Return/Report form prepared for such plan year (including all schedules and attachments).

PART III. CONFIRMATION OF ELECTRONIC SUBMISSION

[ ] Check this box to confirm that a copy of the late filings was transmitted to the Service at the appropriate ERISA Filing Acceptance System (EFAST) address listed in the instructions for the most current Form 5500 Annual Return/Report, or electronically in accordance with the EFAST electronic filing requirements. Mark Box B and attach a statement that the report is being submitted under the EPCRS Program with "**Form 5500, Box B - EPCRS FILING"** prominently displayed at the top of the statement.

Appendix D: Specific Comments to Form 945-X and Instructions

I. Form 945-X

The form is brief, visually intuitive and plain English, but needs some clarification and emphasis.

1. Under the name and address, the flush language should be clear to state that the only errors to be used with this form are administrative. The word “administrative” can be used preceding the word “error” in the first sentence.

2. Since the form tells the preparer to complete both pages of the form in two places, it may be more helpful to delete that reference in the bold text underneath the name and address on the first page and instead leave the second sentence as a centered page item to bring more attention to it in bold. We also suggest that the sentence be altered to read: It is important to understand the definitions for the terms used in this form. It is imperative that you read the instructions before you complete this form to avoid later corrections and communications by IRS personnel and delayed processing.

II. Instructions for Form 945-X

Our comments are structured to follow the instruction format for ease of attribution to the specific instruction. One result the Committee would like to see is more concise and less repetitive information in order to decrease the length of the instructions, where possible.

What’s New?

1. Second Paragraph. We recommend that this paragraph/sentence be deleted from this section as it is better placed as the last sentence of the first paragraph under **Specific Instructions: Part 1: Select ONLY One Process.**
2. Third Paragraph - Since Form 945-X requests the preparer to read the instructions before completing the form, paragraph three should be deleted in its entirety, as its content is communicated either in the form itself or elsewhere throughout the instructions
3. Fourth Paragraph. **Background** paragraph should be removed from this section and only its first sentence placed as the first sentence of the **New Form** paragraph because this content is stated in other parts of the instructions.
4. Fifth Paragraph. This paragraph should be removed from this section and moved to the third paragraph of the section **What is the Purpose of Form 945-X?**.
5. Sixth Paragraph. We recommend that this paragraph be deleted in its entirety as its contents are already contained in the Paperwork Reduction Act Notice and also in the section: **Where Can you Get Help?**
6. Eighth Paragraph. We believe Form 945-X will be a useful form but its use to essentially replace Line 3 of Form 945 should be explained in the first paragraph of the instructions. The 945 should also be made clear this is to be used for an administrative mistake – just like we believe the instructions should make clear what comprises an administrative error.

General Instructions: Understanding Form 945-X

1. What is the Purpose of Form 945-X? The first sentence should be rewritten: *"Use Form 945-X to correct an administrative error on a previously filed Form 945. DO NOT file a new Form 945; file Form 945-X by itself to correct the error. Use Form 945-X to correct the reporting of either federal income taxes withheld from pensions, annuities, IRAs, gambling winnings, etc., or backup withholding from interest, dividends, broker transactions, contractor payments, prizes and awards, etc. The instructions that refer to "federal income taxes" apply equally to the correction of backup withholding administrative errors."*
2. The last sentence of the third paragraph under **Part 2 What Amounts Should You Report in Part 2** should be deleted from that paragraph and placed as the last paragraph of this section.
3. Where to get Help? This paragraph should be deleted as its contents are in the instructions in the **Paperwork Reduction Act** section and also **How Can You Order Forms and Publications from the IRS?** Section.
4. When Should You file Form 945-X? The first line should include "administrative" as preceding the term "error" in the first sentence. This section should refer to a definitions section and be used to provide examples for each type of potential use: gambling, backup and retirement plan distributions.
5. **Due Dates.** The last three sentences should be deleted as redundant in the effort to shorten the length of the instructions.