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Payroll Guide

Highlights

IRS Offers Employers a "Fresh Start" on Classifying Workers The IRS has launched a new voluntary compliance program that will allow many employers to resolve past worker classification issues at a low cost if they voluntarily agree to reclassify their workers as employees.

IRS Explains When Employer-Provided Cell Phones May Qualify as a Tax-Free Fringe Benefit The IRS guidance makes its easier for an employer-provided cell phone, or a personally-owed cell phone used for business, to qualify as a tax-free fringe benefit.

IRS Issues Draft Version of 2011 Unemployment Tax Return The draft version of Form 940 has separate lines to compute the FUTA tax on wages paid before July 1, 2011 and after June 30, 2011.

RIA Estimates Inflation Adjustments for Several Key Tax Figures in 2012 We have prepared estimates for several key tax figures in 2012, including qualified transportation fringe benefits, the adoption exclusion, and long-term care insurance premiums.

Unemployment Tax Relief Part of President's "Plan for Economic Growth and Deficit Reduction" Under the plan, states with outstanding federal loans wouldn't have to pay interest on those loans for two years. In addition, employers in these states wouldn't have to pay federal unemployment tax at a higher rate than other employers.

Federal and State Agencies Sharing Information on Employers Information-sharing between state and federal agencies could subject businesses to multiple fines.

IRS Revises Form Used to Determine Worker's Federal Employment Tax Status The IRS has issued a new version of Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding.*

DOL Working with States to Reduce Unemployment Benefit Errors Several states have made over a billion dollars in unemployment benefit payment errors over the last three years.

IRS Seeks Public Input on Affordable Health Care Rule that Would Help Employers Avoid Penalties Beginning in 2014, employers with 50 or more full-time employees may be subject to penalties if they fail to provide affordable health care coverage.

IRS Updates Specs for Filing Information Returns Electronically The new specifications must be used in the preparation of information returns for the 2011 tax year, and for information returns for tax years prior to 2011 that are filed beginning *Jan. 1, 2012.*

Case Roundup The federal courts have recently issued rulings on: (1) worker classification; (2) personal liability for unpaid employment taxes; and (3) employer responsibility for providing a COBRA election notice.

State Highlights A number of states have reported new laws and developments.

IRS Offers Employers a ' 'Fresh Start' ' on Classifying Workers

The IRS has launched a new program that it says will allow many employers to resolve past worker classification issues under the tax law at a low cost if they voluntarily agree to reclassify their workers as employees [IR 2011-95, 09/21/2011; Ann 2011-64, 2011-41 IRB].

The new program is called the "Voluntary Classification Settlement Program" (VCSP). It is part of the IRS "Fresh Start" initiative. The VCSP will allow eligible taxpayers to voluntarily reclassify their workers for federal employment tax purposes and obtain relief similar to that obtained in the current Classification Settlement Program (see Payroll Guide at ¶ 2315). Participants who voluntarily reclassify their workers as employees in future tax periods will have limited federal employment tax liability for the past nonemployee tax periods. To participate in the program, the taxpayer must meet certain eligibility requirements, apply to participate in the VCSP, and enter into a closing agreement with the IRS. Unlike the Classification Settlement Program, a taxpayer doesn't have to be under audit to participate in the VCSP.

Eligibility requirements. Taxpayers who want to voluntarily change the prospective classification of their workers may apply for the VCSP. The program is open to businesses, tax-exempt organizations, and government entities. It can be used by taxpayers who are currently treating their workers (or a class or group of workers) as independent contractors or other nonemployees, and who want to prospectively treat the workers as employees. To be eligible, a taxpayer must have consistently treated the workers as nonemployees, and must have filed all required 1099 forms for the workers for the previous three years. The taxpayer cannot currently be under audit by the IRS. Furthermore, the taxpayer cannot currently be under audit with respect to the classification of the workers by the Department of Labor (DOL) or a state government agency. A taxpayer who was previously audited by the IRS, or the DOL, with respect to the classification of the workers, will only be eligible to participate in the program if the taxpayer has complied with the results of that audit.

Program terms. A taxpayer who participates in the VCSP must agree to prospectively treat the class of workers as employees for future tax periods. In exchange, the taxpayer will pay 10% of the employment tax liability that may have been due on compensation paid to the workers for the most recent tax year, determined under the reduced tax rates in Code Sec. 3509. The taxpayer will not be liable for any interest and penalties on the liability and will not be subject to an employment tax audit with respect to the worker classification for prior years. Additionally, a taxpayer participating in the VCSP must agree to extend the period of limitations on assessment of employment taxes from three to six years for the first, second, and third calendar years beginning after the date on which the taxpayer has agreed under the VCSP closing agreement to begin treating the workers as employees.

Application and closing agreement. Eligible taxpayers who wish to participate in the VCSP must submit an application for participation in the program on Form 8952, *Application for Voluntary Classification Settlement Program (VCSP),* at least 60 days before they want to begin treating the workers as employees. Along with the application, the taxpayer should provide the name of a contact person or an authorized representative on Form 2848, *Power of Attorney and Declaration of Representative.* The IRS will contact the taxpayer or authorized representative to complete the process once it has reviewed the application and verified the taxpayer's eligibility. The IRS retains discretion on whether to accept a taxpayer's application for the VCSP. Taxpayers whose application has been accepted will enter into a closing agreement with the IRS to finalize the terms of the VCSP and will simultaneously make full and complete payment of any amount due under the closing agreement.

There are frequently asked questions (FAQs) on the VCSP on the IRS website.

IRS Explains When Employer-Provided Cell Phones May Qualify as a Tax-Free Fringe Benefit

The IRS has issued guidance on the tax treatment of employer-provided cell phones [IR 2011-93, 09/14/2011; Notice 2011-72, 2011-38 IRB 407].

Background. Code Sec. 132 allows an employee to exclude from gross income the business use of an employer-provided cell phone as a working condition fringe benefit. Code Sec. 132(d) defines "working condition fringe" as any property or services provided to an employee to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction under Code Sec. 162 or Code Sec. 167. Reg § 1.132-5(a)(1)(ii) states that if, under Code Sec. 274 or any other IRC section, certain substantiation requirements must be met in order for a deduction under Code Sec. 162 or Code Sec. 167 to

be allowable, then those substantiation requirements apply when determining whether a property or service is excludable as a working condition fringe.

Prior to Jan. 1, 2010, cell phones were listed property under Code Sec. 280F(d)(4) and strict substantiation requirements had to be satisfied for business cell phone usage to qualify for the Code Sec. 132 exclusion. Moreover, any personal use of an employer-provided cell phone was a taxable fringe benefit. Legislation in 2010 eliminated the strict substantiation requirements by removing cell phones from the definition of listed property, retroactively effective to *tax years beginning after Dec. 31, 2009.*

New guidance. The new guidance says that, effective for *tax years beginning after Dec. 31, 2009,* the value of the business use of an employer-provided cell phone is excludable from an employee's income as a working condition fringe to the extent that, if employees paid for the use of the cell phone themselves, the payment would be allowable as a deduction under Code Sec. 162. If an employer provides an employee with a cell phone primarily for noncompensatory business reasons, the IRS will treat the employee's use of the cell phone for reasons related to the employer's trade or business as a working condition fringe benefit, the value of which is excludable from the employee's income. In addition, solely for purposes of determining whether the working condition fringe benefit provision in Code Sec. 132(d) applies, the substantiation requirements that the employee would have to meet in order for a deduction under Code Sec. 162 to be allowable are deemed to be satisfied (i.e., employees will not have to provide records to support their business use of the cell phone). The IRS will also treat the value of any personal use of a cell phone provided by the employer primarily for noncompensatory business purposes as excludable from the employee's income as a de minimis fringe benefit.

An employer is considered to have provided an employee with a cell phone primarily for noncompensatory business purposes if there are substantial reasons related to the employer's business, other than providing compensation to the employee, for providing the employee with a cell phone. For example, the employer's need to contact the employee at all times for work-related emergencies, the employer's requirement that the employee be available to speak with clients at times when the employee is away from the office, and the employee's need to speak with clients located in other time zones at times outside of the employee's normal work day, are possible substantial noncompensatory business reasons. A cell phone is not provided primarily for noncompensatory business purposes if it is provided to promote the morale or goodwill of an employee, or to attract a prospective employee. It may also not be used as a means of furnishing additional compensation to an employee.

Use of personal cell phones. The IRS has also issued a memo to its examiners that provides a similar administrative approach with respect to arrangements common to small businesses that provide cash allowances and reimbursements for work-related use of personally-owned cell phones. Under this approach, employers that require employees, primarily for noncompensatory business reasons, to use their personal cell phones for business purposes may treat reimbursements of the employees' expenses for reasonable cell phone coverage as nontaxable. This treatment does not apply to reimbursements of unusual or excessive expenses or to reimbursements made as a substitute for a portion of the employee's regular wages. The IRS provided the following examples to its examiners of reimbursement arrangements that may need to be examined more closely because they may not be reasonably related to the needs of the employer's business: (1) reimbursement for international or satellite cell phone coverage to a service technician whose business clients and other business contacts are all in the local geographic area where the technician works; or (2) a pattern of reimbursements that deviates significantly from a normal course of cell phone use in the employer's business (e.g., an employee received reimbursements for cell phone use of $100 per quarter in quarters 1 through 3, but received a reimbursement of $500 in quarter 4) [IRS Interim Guidance on Reimbursement of Employee Personal Cell Phone Usage in Light of Notice 2011-72, 9/14/11].

None of the above guidance applies to cell phone reimbursements that are not primarily business-related, as such arrangements are generally taxable.

IRS Issues Draft Version of 2011 Unemployment Tax Return

The IRS has issued a draft version of 2011 Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return.* The draft version of the form takes into account the elimination of the 0.2% federal unemployment tax (FUTA) surtax, effective *beginning with wages paid on July 1, 2011.* The surtax was part of the 6.2% gross unemployment tax rate that employers paid on the first $7,000 of wages paid annually to

each employee (6% permanent tax rate, 0.2% temporary surtax). The FUTA tax rate, before consideration of state unemployment tax credits, is 6.0%, *effective with wages paid beginning July 1, 2011.* Most employers are allowed to claim 5.4% in state unemployment tax credits (known as the "normal credit") against the FUTA tax rate if they timely pay their state unemployment taxes, making the net FUTA rate 0.6% beginning with wages paid on July 1 (0.8% on wages paid from January 1 to June 30, 2011).

The draft version of Form 940 has separate lines to compute the FUTA tax on wages paid before July 1, 2011 (lines 7b and 7c), and after June 30, 2011 (lines 7d and 7e). Employers should be separately tracking the FUTA wages paid before July 1, 2011, and after June 30, 2011.

Form 940, Schedule A. The IRS did not issue a draft version of 2011 Form 940, Schedule A, *Multi-State Employer and Credit Reduction Information.* Employers who paid wages in any state that is subject to a credit reduction must complete this schedule.

Under Title XII of the Social Security Act, states with financial difficulties can borrow funds from the federal government to pay unemployment benefits. If a state defaults on its repayment of the loan, the amount of state unemployment tax credits that employers in the state may claim on Form 940 is reduced. This effectually increases the employer's FUTA tax rate by 0.3% annually, beginning with the second consecutive January 1 in which the loan isn't repaid. As of Sept. 15, 2011, 27 states and the Virgin Islands have borrowed money from the federal government to help keep their unemployment insurance (UI) trust funds solvent. Many of these states have had outstanding loans with the federal government for two consecutive years. If these loans are not repaid by *Nov. 10, 2011,* employers in these states will not be eligible to claim 5.4% in state unemployment tax credits against the FUTA tax rate. The IRS will finalize 2011 Schedule A sometime after Nov. 10, 2011.

2011 Form 940 must be filed by *Jan. 31, 2012.*

observation: Included in President Obama's "Plan for Economic Growth and Deficit Reduction" is a proposal to reinstate the FUTA surtax, retroactively effective to July 1, 2011 (see Article 20.11).

RIA Estimates Inflation Adjustments for Several Key Tax Figures in 2012

A number of key tax figures are adjusted each year for inflation based on the average Consumer Price Index (CPI) for the 12-month period ending the previous August 31. The August 2011 CPI has been issued by the U.S. Department of Labor. Using the CPI for August 2011 (and the preceding 11 months), *RIA* is estimating the following amounts for these tax figures in the 2012 tax year:

Qualified transportation fringe benefits. For 2012, an employee will be able to exclude up to $240 a month for qualified parking expenses (up from $230 in 2010), and up to $125 a month for the combined value of transit passes and transportation in a commuter highway vehicle (down from $230 a month in 2010). Temporary legislation made the exclusion for the combined value of transit passes and transportation in a commuter highway vehicle equal to the exclusion for qualified parking expenses, but that legislation is no longer in effect in 2012. See Payroll Guide at ¶ 3585 *et seq.* for further information on the above limitations.

Adoption exclusion. Employer-provided adoption assistance may be excluded from an eligible employee's income for purposes of FIT and FITW if the benefits are provided as part of a qualified adoption assistance program (see Payroll Guide at ¶ 3542). It is estimated that the adoption exclusion per child (whether or not he or she has special needs) will be limited to $12,650 in 2012 (down from $13,360 in 2011). Temporary legislation that increased the adoption exclusion by $1,000 in 2011 is no longer in effect in 2012. The adoption exclusion will begin to phase out for taxpayers with adjusted gross income (AGI) of over $189,710, and will be fully eliminated when AGI reaches $229,710. These figures were $185,210 and $225,210, respectively, in the 2011 tax year.

Long-term care premiums. Amounts paid for insurance that covers qualified long-term care services are treated as medical expenses up to specified dollar limits that vary with the age of the taxpayer as of the close of the tax year. For a taxpayer age 40 or younger, the 2012 limit will be $350 (up from $340 in 2011); older than 40 but not more than 50, $660 (up from $640 in 2011); older than 50 but not more than 60, $1,310 (up from $1,270 in 2011); older than 60 but not more than 70, $3,500 (up from $3,390 in 2011); and older than 70, $4,370 (up from $4,240 in 2011).

Payments received under qualified long-term care insurance. Amounts received under a qualified long-term care insurance contract are generally excludable from income as amounts received for personal injuries and sickness, subject to a per diem limitation, which will be $310 in 2012 (up from $300 in

2011). For further information on long-term care insurance, see Payroll Guide at ¶ 3417.

Archer MSAs. For Archer MSA purposes, in 2012, a "high deductible health plan" will be a health plan that: (1) in the case of self-only coverage, the annual deductible is at least $2,100 and not more than $3,150 (at least $2,050 and not more than $3,050 in 2011); in the case of family coverage, the annual deductible is at least $4,200 and not more than $6,300 (at least $4,100 and not more than $6,150 in 2011); and (2) the annual out-of-pocket expenses required to be paid (other than for premiums) for covered benefits don't exceed $4,200 for self-only coverage ($4,100 in 2011), and $7,650 for family coverage (up from $7,500 in 2011). For further information on Archer MSAs, see Payroll Guide at ¶ 3406.

Health savings accounts. Inflation-adjusted figures for tax-favored health savings accounts (HSAs) are now announced after the release of the March CPI. For the 2011 and 2012 figures, see Payroll Guide at ¶ 3408.

Foreign earned income exclusion. Individuals who have a tax home in a foreign country, and who satisfy either a bona fide foreign residence test or a foreign physical presence test, may elect to exclude a certain amount of their foreign earned income from gross income in a tax year. The foreign earned income exclusion amount will increase to $95,100 in 2012 (up from $92,900 in 2011). See Payroll Guide at ¶ 21,110 for further information on the foreign earned income exclusion.

Property exempt from levy. The value of property exempt from levy under Code Sec. 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) may not exceed $8,570 for levies in 2012 (up from $8,370 in 2011). The value of property exempt from levy under Code Sec. 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) may not exceed $4,290 for levies issued in 2012 (up from $4,180 in 2011). For further information on tax levies, see Payroll Guide at ¶ 17,274.

The IRS has until Dec. 15, 2011, to officially announce changes to the above tax figures for 2012.

Unemployment Tax Relief Part of President's "Plan for Economic Growth and Deficit Reduction"

President Obama has submitted his 80-page blueprint for job growth and long-term deficit reduction to Congress. The plan, which is called the "Plan for Economic Growth and Deficit Reduction," includes several payroll-tax-oriented job stimulus provisions (see Payroll Guide Newsletter at ¶ 19.1), and some tax relief for employers in states that have outstanding federal unemployment insurance (UI) loans. The plan, however, would reinstate the federal unemployment tax (FUTA) surtax [Office of Management and Budget, *The President's Plan for Economic Growth and Deficit Reduction,* September 2011].

Relief for employers in states with outstanding federal UI loans. As of Sept. 15, 2011, 27 states and the Virgin Islands have borrowed money from the federal government to help keep their unemployment insurance (UI) trust funds solvent. They will be required to pay interest on these loans unless legislation is enacted to suspend the interest payments. Many states pass the interest payments on to employers. The Obama plan would not require states to make interest payments on UI loans for two years.

Employers in states with outstanding federal UI loans for two consecutive years pay federal unemployment tax at a higher tax rate than other employers. Under the Obama plan, employers in these states would not pay a higher UI rate for two years.

Reinstatement of the FUTA surtax. The 0.2% FUTA surtax expired on July 1, 2011. The surtax was part of the 6.2% gross unemployment tax rate that employers paid on the first $7,000 of wages paid annually to each employee (6% permanent tax rate, 0.2% temporary surtax). The FUTA tax rate, before consideration of state unemployment tax credits, is 6.0%, *effective with wages paid beginning July 1, 2011.* Most employers are allowed to claim 5.4% in state unemployment tax credits against the FUTA tax rate if they timely pay their state unemployment taxes, making the net FUTA rate 0.6% beginning with wages paid on July 1 (0.8% on wages paid from January 1 to June 30, 2011).

The Obama plan would permanently reinstate the FUTA surtax, retroactive to July 1, 2011, to help reduce the federal deficit.

Federal and State Agencies Sharing Information on Employers

The IRS and the U.S. Department of Labor (DOL) have signed a memorandum of understanding (MOU) to fight employee misclassification (i.e., employee vs. independent contractor). In addition, labor commissioners and other agency leaders in Connecticut, Maryland, Massachusetts, Minnesota, Missouri, Utah, and Washington have signed MOUs with the DOL's

Wage and Hour Division (WHD), and, in some cases, other DOL agencies, to fight employee misclassification. The WHD has also entered into MOUs with the state labor agencies in Hawaii, Illinois, and Montana, as well as with New York State's attorney general. The DOL says that the MOUs will enable it to "share information and coordinate law enforcement with the IRS and participating states in order to level the playing field for law-abiding employers and ensure that employees receive the protections to which they are entitled under federal and state law" [WHD News Release, *Labor secretary, IRS commissioner sign memorandum of understanding to improve agencies' coordination on employee misclassification compliance and education,* 9/19/11].

"This agreement takes the partnership between the IRS and Department of Labor to a new level," said IRS Commissioner Doug Shulman. "In this new phase of our relationship, we will work together more efficiently to address worker misclassification issues, and better serve the needs of small businesses and employees."

The DOL has noted in published reports that information-sharing between state and federal agencies could subject businesses to multiple fines. In the past, a company might pay a single fine to a state agency for not making proper unemployment insurance payments. Under the new agreements, a state can share the information with the DOL, which can seek fines and penalties for federal wage violations too. The violations would also be reported to the IRS, which could go after the company for unpaid taxes.

IRS Revises Form Used to Determine Worker's Federal Employment Tax Status

The IRS has posted an August 2011 version of Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding,* on its website. The form was last revised in December 2009. Some changes have been made to the form.

Background. An employer or a worker may file Form SS-8 with the IRS to request a determination of the worker's status (i.e., employee vs. independent contractor) for federal employment tax and income tax withholding purposes. The form has five parts. The filer is asked to provide information in the following areas: (1) Part I-General Information; (2) Part II-Behavioral Control (facts that show whether the business has a right to direct and control how the worker does the task for which the worker was hired); (3) Part III-Financial Control (facts that show whether the business has a right to control the business aspects of the worker's job); (4) Part IV-Relationship of the Worker and Firm (facts that show the type of relationship between the parties); and (5) Part V-For Service Providers or Salespersons (this part is completed if the worker provided a service directly to customers or if the worker is a salesperson).

Form changes. The form now requests additional contact information from the employer and the worker. For example, employers are now asked to provide their fax number, e-mail address, and website. Workers are now asked to provide their fax number and e-mail address.

A new line has been added to Part I-General Information that asks for certain information if the worker received pay from more than one entity because of an event such as a sale, merger, acquisition, or reorganization of the firm for whom the services are performed. The requested information includes the name and taxpayer identification number of the firm's previous owner, the type of change (i.e., sale, merger, acquisition, reorganization, or other), and the date of the change.

Question 2 in Part III-Financial Control now asks whether the worker leases equipment, space, or a facility. A new question in this section asks whether the worker establishes "the level of payment for the services provided or the products sold."

Question 9 in Part IV-Relationship of the Worker and Firm now asks the following question: "How does the firm represent the worker to its customers (for example, employee, partner, representative, or contractor), and under whose business name does the worker perform these services?"

The form instructions note that Form SS-8 should be mailed to the IRS. The IRS does not accept faxed, photocopied, or electronic versions of the form.

DOL Working with States to Reduce Unemployment Benefit Errors

The U.S. Department of Labor (DOL) has posted statistics on its website that detail improper unemployment benefit payments by states over a three-year period from July 1, 2008 to June 30, 2011. While improvements have been made in reducing "improper payments," 13 states still have "improper payment" rates exceeding 14%. Louisiana has the highest error rate (43.63%), with Indiana (43.56%) and New Mexico (27.01%) in second and third place, respectively. Kentucky posted the lowest error rate (4.39%), followed by Vermont (4.55%), and Connecti-

cut and Massachusetts (5.06%). An "improper payment" is defined as "any payment that was made to an ineligible recipient, duplicate payments, and payments that are for the incorrect amount–both overpayments and underpayments, including inappropriate denials of payment or service."

The following states had over a billion dollars in improper payments during the three-year period: California ($1.6 billion), Illinois ($1.2 billion), Indiana ($1.7 billion), Pennsylvania ($1.1 billion), and Texas ($1 billion).

The DOL notes that improper unemployment benefit payments are most likely to occur when: (1) recipients continue to claim benefits after returning to work; (2) employers or their third-party administrators do not submit timely or accurate separation information; and (3) claimants fail to register with state employment services agencies, as dictated by state law.

The DOL has been working collaboratively with the states to develop strategies that focus on the prevention of unemployment benefit overpayments. Earlier this year, the DOL encouraged the 10 states with the highest error rates to examine their procedures. Senior DOL officials contacted these states to determine specific steps the states should take to address the error rates, and the DOL provided technical assistance. The DOL says that dramatic progress is being made, with a 23% reduction in improper payments to people who did not register with employment services agencies, including a more than 35% drop in eight states.

Each year, beginning in September 2011, the DOL will identify the states with persistently high improper UI payment rates as "High Priority," and provide targeted and customized technical assistance to improve their performance. The DOL will work closely with these states to identify the impediments, action steps, and technical assistance strategies to improve performance, with a specific focus on prevention. "High Priority" states will be subject to additional monitoring and technical assistance until they achieve an improper payment rate under 10% and sustain that performance for at least six months [DOL website, *Unemployment Insurance (UI) Improper Payments By State*].

IRS Seeks Public Input on Affordable Health Care Rule that Would Help Employers Avoid Penalties

The Treasury Department and the IRS have requested public comments on a proposed affordability safe harbor rule under the shared responsibility provisions in the Patient Protection and Affordable Care Act of 2010 (Affordable Care Act) that would help employers avoid penalties [Notice 2011-73, 2011-40 IRB; IR 2011-92, 09/13/2011].

Background. Starting in 2014, Code Sec. 4980H, as added by the Affordable Care Act, imposes a penalty on employers with 50 or more full-time employees (large employers) that don't provide "affordable" health care coverage to full-time employees. The employer is liable for the penalty if any full-time employee is certified to receive an applicable premium tax credit or cost-sharing reduction and either the employer: (1) fails to offer to its full-time employees (and their dependents) the opportunity to enroll in minimum essential coverage (MEC) under an eligible employer-sponsored plan; or (2) offers its full-time employees (and their dependents) the opportunity to enroll in MEC under an eligible employer-sponsored plan that is either unaffordable or does not provide minimum value.

In August, the IRS said that it was considering a safe harbor for employers in determining whether an employer-sponsored health plan is "affordable." Now, the IRS has issued details on how the safe harbor would work. The proposed "safe harbor" would determine the affordability of an employer's health care coverage by looking at the employee's wages from the employer, and not household income (as is currently used in the Internal Revenue Code). The IRS notes that by "allowing employers to base their affordability calculations on each employee's W-2 wages (which employers know) instead of each employee's household income (which employers generally would not know), the safe harbor would provide a more workable and practical method of measuring the affordability of any employer's coverage for Code Sec. 4980H purposes." The safe harbor would apply only for purposes of determining whether the employer's coverage satisfies the affordability test.

The deadline to submit comments is *Dec. 13, 2011.* Comments may be mailed, e-mailed, or hand-delivered to the IRS.

IRS Updates Specs for Filing Information Returns Electronically

The IRS has updated the specifications for filing Forms 1097, 1098, 1099, 3921, 3922, 5498, 8935, and W-2G electronically. The new specifications must be used in the preparation of information returns for the 2011 tax year, and for information returns for tax

years prior to 2011 that are filed beginning *Jan. 1, 2012* [Rev Proc 2011-40, 2011-37 IRB 235].

The regulations under Code Sec. 6011(e)(2)(A) state that any person, including a corporation, partnership, individual, estate, and trust, who is required to file 250 or more information returns must file such returns electronically. The 250-or-more requirement applies separately for each type of return and separately to each type of corrected return. Even though filers may submit up to 249 information returns on paper, the IRS encourages filers to transmit those information returns electronically.

Transmitters are required to submit Form 4419, *Application for Filing Information Returns Electronically (FIRE),* to request authorization to file information returns with the IRS. A transmitter must submit a separate Form 4419 for each of the following forms: (1) Form 1099-MISC, *Miscellaneous Income;* (2) Form 1042-S, *Foreign Person's U.S. Source Income Subject to Withholding;* and (3) Form 8027, *Employer's Annual Information Return of Tip Income and Allocated Tips.*

The new version of the publication notes that information return penalties have significantly increased (see Payroll Guide at ¶ 4294). The publication now includes specifications for Form 1099-K, *Merchant Card and Third Party Network Payments.* There are a number of programming changes to various forms (see Section 2 of the publication).

Rev Proc 2010-26, 2010-30 IRB 91, has been superseded.

The 2011 W-2 electronic filing specifications are in Social Security Administration Publication EFW2, *Specifications for Filing Forms W-2 Electronically.*

Case Roundup

The federal courts have recently issued rulings on: (1) worker classification; (2) personal liability for unpaid employment taxes; and (3) employer responsibility for providing a COBRA election notice.

Worker classification. The U.S. Tax Court has ruled that a university properly classified an adjunct professor who taught online courses in economics as an employee [*William Schramm v. Commissioner,* T.C. Memo 2011-12, 8/30/11].

The professor argued that he should have been classified as either an independent contractor or a statutory employee. Workers who are classified as employees may only deduct business expenses related to their work on Schedule A, *Itemized Deductions,* of their personal income tax return. They do not receive a deduction on the return to the extent the expenses do not exceed 2% of their adjusted gross income. Independent contractors and statutory employees may deduct these expenses on their personal income tax returns without consideration of the 2% limitation.

The Tax Court found that the taxpayer was properly classified as an employee because: (1) the university had control over the textbooks to be used, the subjects to be covered, and the duration of the course; (2) the university paid the costs to maintain a staff for recruitment, registration, and recordkeeping, and it provided the servers and support required to maintain the online classroom; (3) the professor lacked significant opportunity for profit or loss because the amount of pay he received depended only on the number of classes he taught; (4) there was no evidence that the university would be liable for breach of contract if it chose to terminate the relationship with the professor before the employment contract expired; and (5) the professor's services were clearly an important part of the university's primary business.

Personal liability for unpaid employment taxes. The U.S. Court of Federal Claims has ruled that a husband and wife were each personally liable for the employment taxes and penalties owed by a law firm they owned that had incorrectly classified the husband as an independent contractor [*Western Management v. U.S.,* Ct. Fed. Cl., 108 AFTR 2d ¶ 2011-5261, 9/9/11].

The husband had submitted an affidavit to the Tax Court in which he admitted that he was the "alter ego" of the law firm. The husband and wife had also admitted that the law firm was operated as a "disregarded entity." It had also been determined that the husband had attempted to classify himself as an independent contractor of his own law practice to avoid paying the taxes at issue.

The court agreed with the IRS that disregard of the corporate entity was necessary to prevent an unjustified loss to the government since the law firm had no assets. In addition, the court noted that the husband and wife had also been parties to previous litigation in which the U.S. Tax Court had held that it was appropriate to apply certain personal checks that they had written to the law firm's employment tax liability. Furthermore, certain payments they had made on behalf of the law firm were well beyond the three-year statute of limitations for refund claims.

The court also found the wife to be personally liable for the unpaid employment taxes under the community property laws of Washington state.

Employer responsibility for providing a COBRA election notice. A federal district court has ruled that an employer who was not the plan administrator was not required to provide notice to an involuntarily terminated employee about her right to continued health insurance coverage under COBRA [*Marceau v. State of Idaho, Department of Insurance,* DC ID, Dkt. No. 1:09-CV-00514-N-EJL, 8/5/11].

29 USCS 1166(a)(2) requires an employer to notify the plan administrator about an involuntary termination no later than 30 days after the termination. The plan administrator is required to provide the employee with the COBRA election notice. It was undisputed that the employer was not the plan administrator. Therefore, the employer had no obligation to provide the employee with the election notice. The employer had notified the plan administrator about the employee's termination before the expiration of the 30-day deadline.

Stateline

New laws and developments are reported from the following states:

ALABAMA

Withholding. Withholding tax filers who are unable to meet their filing deadlines as the result of damage caused by Hurricane Irene are urged to contact the Alabama Department of Revenue (ADOR) by e-mail at www.revenue.alabama.gov, "About Us, Contacts," or by telephone at (334) 242-1300 [ADOR Notice, *Alabama Tax Relief Offered to Hurricane Irene Victims,* 9/9/11].

ARIZONA

Unemployment. All employers (except reimbursable employers) will pay a special assessment (SA) in 2011 and 2012 to help the State pay the interest on its federal unemployment insurance loans. In 2011, the SA rate is 0.4% of taxable wages (maximum $28 per employee). The SA payment for the first three quarters of 2011 is due by *Oct. 31, 2011.* The special assessment is paid with the filing of the quarterly unemployment tax return (Form UC-018, *Unemployment Tax and Wage Report,* Part C, Line 7), beginning with the third quarter Form UC-018 due on October 31. Employers may either include the amount of the SA due for the first two quarters of 2011 on their third quarter 2011 return and remit a single payment for all amounts due, or pay the SA for the first two quarters separately via the online Tax and Wage System (TWS), or by check or money order [Arizona DES website, *Special Assessment on Taxable Wages Paid in 2011 and 2012*].

Withholding. The Arizona Department of Revenue (ADOR) is providing tax relief (including withholding tax relief) to taxpayers affected by Hurricane Irene in Connecticut, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Pennsylvania, Puerto Rico, and Vermont. The ADOR will automatically grant a 60-day extension to all affected taxpayers having to file an Arizona return or make a payment during the month of September. The ADOR will grant a 30-day extension to affected taxpayers having to file or make a payment in October. The ADOR will waive penalties and interest if the filing or payment is made during the extension period [ADOR Notice, *Arizona Department of Revenue Grants Relief to Victims of Hurricane Irene,* 9/16/11].

CALIFORNIA

Unemployment. According to the Employment Development Department's (EDD) May 2011 unemployment insurance (UI) fund forecast, unemployment tax rates will continue to be determined under Schedule F+ (Schedule F plus a 15% surcharge) in the 2012 tax year, and employers will see a 0.3% reduction in available state unemployment tax credits on their 2011 federal unemployment tax return because California has had an outstanding federal loan for two consecutive years.

Withholding. The Franchise Tax Board (FTB) has informed its staff that, *effective Aug. 29, 2011,* the new "Withhold at Source System" (WASS) has started processing all non-wage withholding forms and payments. The FTB Withholding Services and Compliance Section administers the nonwage withholding program, which includes resident, nonresident, and backup withholding. The current withholding system no longer provides the flexibility to process withholding forms and payments and will be replaced by WASS [California FTB Public Service Bulletin 11-16, 08/22/2011].

COLORADO

Withholding. The Colorado Department of Revenue (CDOR) has issued frequently asked questions on its tax amnesty program, which runs from *Oct. 1, 2011 through Nov. 15, 2011* [CDOR TaxInfo Blog, *Colorado Tax Amnesty "Jump at the Chance! The Time is now," 09/19/2011;* CDOR, *Tax Amnesty FAQ,* 9/19/11].

CONNECTICUT

Withholding. The Connecticut Department of Revenue Services has issued a policy statement providing guidance as to what constitutes undue hardship for purposes of obtaining a waiver from mandatory electronic filing and payment requirements [Connecticut Policy Statement 2011(3), 09/15/2011].

DISTRICT OF COLUMBIA

Withholding. Effective for tax years beginning after *Dec. 31, 2011,* an employee is entitled to additional

withholding exemptions "with respect to payment of wages equal to a number determined by dividing by $1,370 his or her estimated itemized deductions." Also, effective for tax years beginning after *Dec. 31, 2011,* if a resident payee receives an early distribution from a retirement plan or account pursuant to federal Code Sec. 3405, and the payment is subject to mandatory federal withholding, then D.C. tax must be withheld by the payor at the highest D.C. income tax rate in effect at the time of the distribution [L. 2011, Act 19-98 (Law 19-21)].

GEORGIA

Withholding. The Georgia Department of Revenue has adopted regulations, effective for taxable years beginning on or after *Jan. 1, 2011,* on the taxability of deferred income and stock options received by nonresidents. A Georgia nonresident regularly engaged in employment, trade, business, or activity for financial gain or profit in a prior year within Georgia will be subject to Georgia tax on deferred income, or income received from the exercise of stock options, if the deferred income, or income from the exercise of stock options, exceeds the lesser of 5% of all the income received by the nonresident during the taxable year, or $5,000. An employer must withhold Georgia income tax on all deferred compensation and stock options that are required to be included in Georgia taxable income [Georgia Rule 560-7-4-.05].

HAWAII

Unemployment. A spokesperson for the Hawaii Department of Labor and Industrial Relations (DLIR) has told *RIA* that Hawaii's Title XII federal unemployment loans have been repaid. As a result, Hawaii will not have to pay interest on these loans. The spokesperson said that Hawaii does not expect to obtain additional federal loans in 2011. In addition, Hawaii does not expect the employment and training assessment to be in effect in 2012, unless there are changes in legislation or trust fund projections, or Hawaii takes out more Title XII loans before the end of 2011.

Withholding. The Hawaii Department of Taxation will consider requests by Hurricane Irene victims for extensions to file and pay taxes, and waivers of penalties and interest, on a case-by-case basis [Hawaii Dept. of Taxation Announcement 2011-23, 09/13/2011].

IDAHO

Withholding. The Idaho State Tax Commission (STC) is extending tax filing and payment deadlines (including withholding tax deadlines) until *October 31* for taxpayers affected by Hurricane Irene in Connecticut, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Puerto Rico, and Vermont. To qualify for the extension, a taxpayer must write "Hurricane Irene" in red ink at the top of the tax return. Taxpayers should call the STC at (800) 972-7660 if they receive penalties or are charged interest for filing returns or paying taxes late [STC Notice, *Tax Deadlines Extended for Hurricane Irene Victims,* 9/12/11].

KANSAS

Unemployment. The October 2011 quarterly wage report (QWR) form will be the last paper form that is mailed to employers. Beginning with fourth quarter wage reports, employers must mail their QWRs each quarter without first receiving a mailing from the Kansas Department of Labor [Kansas Connection: Employer Newsletter, 2nd Quarter 2011].

The Kansas Department of Labor (DOL) has announced that the 90-day grace period for paying quarterly unemployment taxes will no longer be offered after the third quarter payment. This means that, *beginning in 2012,* employers will be charged interest if their quarterly tax payment is not received by the normal due date [Kansas Connection: Employer Newsletter, 2nd Quarter 2011].

KENTUCKY

Unemployment. Governor Beshear has announced that Kentucky has paid the $28 million in interest that was due to the federal government by September 30 on federal unemployment insurance (UI) loans. Approximately, $9.8 million of the money used to pay the interest payment came from a State penalties and interest account. The rest, about $18.4 million, will be borrowed from elsewhere within the State government [*RIA* conversation with Kentucky Office of Employment and Training spokesperson].

MICHIGAN

Withholding. The tax rate reduction that was scheduled to take place on Oct. 1, 2011 was repealed by L. 2011, Public Act 38. The tax rate is now scheduled to remain at 4.35% through 2012. The withholding tables in Payroll Guide at ¶ 25,406 remain in effect [Michigan Department of Treasury Notice, *Withholding Rate and Income Tax Rate,* 9/16/11].

MINNESOTA

Withholding. Beginning in October, the Minnesota Department of Revenue (DOR) will start to transition businesses that currently use the eFile Minnesota system to a new online system called "Minnesota e-Services." The DOR will be offering a live demonstration of the new system on *October 12* [*DOR Revenue Connection #4,* 9/20/11; DOR Notice, *New and Improved e-Services!,* 8/12/11].

NEW JERSEY

Unemployment/Disability. Payments in kind for personal services, in lieu of or in addition to monetary wages, are, with certain exceptions, taxable wages for unemployment tax and disability benefit purposes. The dollar equivalents for certain payments during calendar year 2012 are as follows: $203.90 for weekly full room and board (previously, $199.20), $87.40 for weekly lodging (previously, $85.40), and $23.30 for three meals per day (previously, $22.80). Individual meals should be valued as follows if employees have less than three meals per day: breakfast $7.00 (previously, $6.80), lunch $7.00 (previously, $6.80), and dinner $9.30 (previously, $9.10) [NJ Dep't of Labor & Workforce Development website].

NEW MEXICO

Unemployment. The New Mexico Supreme Court must decide whether Governor Martinez properly vetoed legislation that called for a $128 million tax increase to ensure the future solvency of the unemployment trust fund. According to published reports, Martinez didn't believe that unemployment tax rates should be increased during a period of economic downturn. If the New Mexico Supreme Court overturns Martinez's veto, it is possible that the tax increase could be implemented in January 2012.

NEW YORK

Withholding. The Department of Taxation and Finance (DTF) is offering tax relief to Tropical Storm Lee victims in the counties of Broome, Chemung, Chenango, Delaware, Otsego, Schenectady, and Tioga. Employers will not be subject to penalties on withholding tax remittances made on Form NYS-1, *Return of Tax Withheld,* that would normally be due between Sept. 7, 2011 and Sept. 21, 2011, if the remittance was made by *Sept. 22, 2011.* With respect to withholding tax or Metropolitan Commuter Transportation Mobility Tax (MCTMT) remittances required to be made by employers through the PrompTax system during the period between Sept. 7, 2011 and Sept. 21, 2011, penalty relief will apply as long as the remittance was made by *Sept. 22, 2011* [New York Special Tax Department Notice N-11-10, 09/01/2011].

OREGON

Payroll Taxes. Oregon will be using a new electronic filing system called the "Oregon Payroll Reporting System" in 2012. The Oregon Tax Employer Reporting (OTTER) system will be moved to a web-based application, and the Secure Employer Tax Reporting (SETRON) system will be replaced. In preparation for these changes, the Oregon Employment Department (OED) is asking employers to validate their contact information and the contact information for their preparers when filing their third quarter 2011 report. Also, employers using an outside service must file a new power of attorney form (Form 150-800-005, *Tax Information Authorization and Power of Attorney for Representation*) no later than *Sept. 30, 2011* [OED website, *New Electronic Filing System Coming in 2012!*].

Wage and Hour. Oregon's minimum wage rate will increase from $8.50 per hour to $8.80 per hour on *Jan. 1, 2012* [Oregon Bureau of Labor and Industries Press Release, 9/15/11].

Withholding. Effective beginning with the 2011 calendar year, businesses with 250 or more Forms 1099 of any one type (e.g., Form 1099-MISC or Form 1099-R) are required to file the form electronically. The Oregon electronic filing specifications are now available. The Oregon specifications generally follow the federal Form 1099 electronic filing specifications. All Oregon employers, including those submitting 1099 information electronically, are required to submit Form WR, *Oregon Withholding Annual Reconciliation Report,* with the total state withholding figures reported to the IRS on Forms W-2/1099. The Oregon Department of Revenue also notes that employers should not use EFT to remit payments for payroll withholding tax billings. Such payments can easily be misapplied through the EFTC/EFTD system, as it is difficult to input the correct assessment information when attempting to transmit the payment [Oregon Payroll Tax News-LISTSERV, September 2011].

PENNSYLVANIA

Withholding. The Pennsylvania Department of Revenue (DOR) is offering tax relief to Hurricane Irene and Tropical Storm Lee victims. Withholding tax deposits due after Aug. 27, but before Sept. 19, 2011, will not be subject to penalty or interest, as long as the deposits were made by *September 19.* If the quarterly reconciliation return (Form PA-W3) is filed late as a result of the disaster and the taxpayer receives a notice from the DOR, the taxpayer should call the number on the notice to discuss possible administrative relief, which will be considered on a case-by-case basis [*Department of Revenue Extends State Tax Deadlines for Taxpayers Impacted by Hurricane Irene; Tropical Storm Lee,* 9/14/11; DOR website, Disaster Recovery, *Will penalty and interest be charged on late employer withholding filings?,* 9/14/11].

Starting in 2012, any Philadelphia employer that remits an average of $10,000 in withholding taxes per month must file the wage tax return and remit withholding taxes electronically. (The threshold is currently $20,000 per month.) The average will be determined using the prior calendar year's filings. Businesses subject to the mandatory electronic payment requirement

will be individually notified by the Philadelphia Department of Revenue (PDOR). Taxpayers who fail to follow the above rules will be subject to penalties. The complete electronic filing manual and registration forms are on the PDOR website [Philadelphia ReveNews, Summer 2011].

PUERTO RICO

Unemployment/Disability. The electronic filing format for Form PRUI-10A, *Quarterly Report of Wages Paid to Each Employee,* has been revised, *effective Oct. 1, 2011,* to allow employers to enter two last names for employees. Employers may use either the new or old format on third and fourth quarter 2011 tax returns. They must use the new format *beginning with the first quarter 2012 return* [Puerto Rico Employment Security Information Memorandum, *Re: Quarterly Report of Wages Paid to Each Employee*].

SOUTH CAROLINA

Unemployment. Recent legislation will lower unemployment tax rates for many employers, retroactive to Jan. 1, 2011. South Carolina businesses were scheduled to receive final notification of their revised unemployment insurance tax rate around *Sept. 23, 2011.* Overpayments from the second quarter will be refunded upon request [South Carolina Department of Employment and Workforce (DEW) News Release, 9/15/11].

The South Carolina Business One Stop (SCBOS) eNotify system allows the South Carolina Department of Employment and Workforce (DEW) to automatically notify a business by e-mail and/or telephone about unemployment benefit claims. The DEW said that this new system will expedite the employer reply process and will hopefully assist in keeping unemployment insurance rates down [DEW website, *Help keep your unemployment insurance rates down*].

WISCONSIN

Withholding. The Wisconsin Department of Revenue is offering Hurricane Irene victims a 30-day extension of time until *October 31* to file withholding tax returns and payments due before October 31. To apply for this extension, affected taxpayers should contact: Registration Unit, Wisconsin Department of Revenue, PO Box 8949, Madison, WI 53708-8949 [Wisconsin News for Tax Practitioners 09/14/2011, 09/14/2011].

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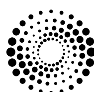

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