



ITG News

Keeping First Nations Informed



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Message From The Director



Many of you have probably read about the growth in abusive schemes that began two decades ago with what we now call "tax shelters". While the IRS was successful in addressing those initial schemes, we are now experiencing a new generation of individuals promoting opportunities to avoid taxes through structured transactions that "sound too good to be true" and often are.

Unfortunately, Indian tribal governments are not immune from these promoters. In fact, tribal governments have recently helped the IRS identify several promoters that are attempting to use tribal sovereignty and some of the special tax benefits that tribes enjoy, to enrich a select group of individuals they represent. These promoters may offer the tribe a limited benefit that is marketed as being at no cost or risk to the tribe. In some cases the promoters of these schemes may be invisible to tribal leadership, since they hide behind shell corporations and/or attempt to conduct transactions directly with tribal employees.

The simple fact is that these schemes do bring risk to the tribe. Even where there may be no direct financial risk, the risk to the tribe's reputation is significant and the risk to any tribal employee who becomes involved in such a scheme can be substantial.

The office of Indian Tribal Governments has initiated a program to work with tribes to address this area and ensure that these abusive schemes do not gain a foothold in Indian Country. Our Abuse Detection and Prevention Team (ADAPT) is already developing actions to identify abusive schemes being promoted to tribes, and is working with tribes to address them. Our goal is to protect the interests of all governments through mutual actions that will eliminate these schemes. Our web site will contain information on identified schemes, as well as a method to report any concerns to the ADAPT group. We look forward to partnering with tribes and other interested parties in this effort.

Christie Jacobs

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To add your name or e-mail address to our mailing list, please contact us via e-mail at Sandra.K.Leggett@irs.gov, or call Sandra Leggett at (909) 388-8115



Tip Reporting Agreements – Minimizing Financial Risk

Many tribes have enterprises that employ individuals who receive tip income. These tribal enterprises range from food service establishments to some of the largest casinos in the world. Handling large sums of cash presents many risks, and tribes go to great lengths to minimize any risk of loss.

Unfortunately some tribes have not taken steps to minimize risk that can be present from unreported tip income. Employees who do not fully report their tips to their employer can create a future tax liability for both themselves and their employer. If unreported tip income is discovered as a result of an IRS examination, both the employee and employer could face significant assessments of tax, penalties, and interest. These assessments can be particularly troublesome for the employer, who generally has not anticipated the liability.

In order to reduce the potential for unreported tip income, the IRS has developed a Tip Compliance Program. This program combines employee education with a written agreement that calculates tip rates by occupations and work shifts. Employees are openly encouraged to participate in the program. As part of the agreement, the IRS guarantees that it will not examine tip income reporting by those employees as long as they report tips at or above the established rates. Two variations of these agreements are available – the Tip Rate Determination Agreement (TRDA), and the Gaming Industry Tip Compliance Agreement (GITCA). Interested employers have their choice between the two.

The elimination of risk was recently realized by one tribal casino that had entered into an agreement. The amount of tip income being reported by their employees rose by over 400% subsequent to the agreement. By entering into the agreement, the casino eliminated a potential unforeseen liability of \$1.5 million dollars per year. While they paid FICA tax on the additional tips being reported, that liability could be predicted and planned. This enabled them to adequately forecast their revenues and expenses, with a significant reduction to future risk of further tax assessments. Similar benefits exist for employees. One benefit is that they will not be examined on tip income. They also receive a full and accurate reporting of their income, which can be a benefit for programs that are based on income levels. This includes pensions, 401(k) plans, and loans.

If your tribe has employees who report tips, and you have not joined our Tip Compliance Program, we encourage you to contact your Indian Tribal Governments Specialist.

???Questions???

Contact your ITG Specialist, or our toll-free call site at 877-829-5500



Update on the Development of an IRS/Tribal Consultation Policy

We continue to move forward in the process to develop an IRS/Tribal Consultation Policy, having completed 12 regional listening meetings with tribal representatives during 2003. A summary of the input received at those meetings was posted to the ITG web site at www.irs.gov/tribes in January, with a link to submit any further comments. Once the period for submitting further input has passed, we will undertake an initial draft that will be further shared for comment. It is our hope to have a final draft policy for review by late 2004.

We welcome your input, so that we can create the best possible policy. Visit our web site at www.irs.gov/tribes to review the input to date and offer us your thoughts before April 30th.

Tribal Enterprise Structure Issues

We have recently encountered several situations where tribes have formed business structures that may unnecessarily subject their earnings to federal income tax. While federally recognized Indian tribes are not subject to federal income tax, if they form a state-chartered corporation that is not specifically exempted from income tax under the Internal Revenue Code (such as IRC 501(c)(3) entities), the entity must file a Form 1120 and pay federal income tax on any net earnings.

In addition, we have encountered situations where tribes have formed subchapter S corporations, where the tribe is a shareholder. While the Service may acknowledge this status and process the resultant Form 1120-S that is filed, the simple fact is that tribes cannot be shareholders in subchapter S corporations. Once these situations are discovered, the entity must be converted to a C corporation, and the resultant Form 1120 will subject the tribe to federal income tax on any net earnings.

If you have either of these situations present within your tribal enterprises, and you wish to restructure them to mitigate the potential tax problem, you should contact your ITG Specialist so that we can take prompt action to effect corrections and limit any potential interest and penalties. In addition, the sooner that a problem is identified, the sooner that you can change the structure of the entity to avoid the future federal tax consequences.

Tribal Employment Tax Guide Now Available

Publication 4268, our on-line Employment Tax Guide for Tribal Governments, is now available at our web site at www.irs.gov/tribes.



CUSTOMER SERVICE

Indian Tribal Governments (ITG) consists of specially trained staff located throughout the country. Our specialists can address issues that are unique to Indian Tribal Governments. In addition to contacting your specialist directly another source of assistance can be found at our customer service phone number, **1-877-829-5500**. Customer Account Services (CAS) toll free assistance is available 8:00 am through 6:30 pm EST, Monday through Friday.

When calling our toll free number make sure to identify yourself as an entity of an Indian Tribal Government. Our customer service representatives can refer you to an ITG Specialist, and provide help with questions regarding:

- Employment tax, which include FUTA, and forms 940,941 & 945
- Wagering Excise Taxes
- Status of application for exemption
- Technical questions regarding Exempt Organizations
- Employer Sponsored retirement plans
- Issuers of tax exempt bonds and other government entities

- How to order Forms/Publications for Indian Tribal Governments. For faster service, if you know the publication number, you can call our distribution center directly at **1-800-829-3676**, and select option #2. To ensure the accuracy of your order, leave a message and include the following information, your full name, the item number, quantity desired, phone number and mailing address.

- For assistance with specific individual income tax related inquiries, or questions related to the preparation of W-2's/1099's, or to order forms, you may call the following toll-free numbers:
 - o Individual tax return questions **1-800-829-1040**
 - o Status of refunds **1-800-829-1954**
 - o Information Reporting Program Customer Service Section (CSS) can answer questions regarding W-2's and 1099's by dialing toll-free **1-866-455-7438**. The CSS can be contacted via email at mcirp@irs.gov. Hours of operation for CSS are Monday through Friday from 8:30 a.m. to 4:30 p.m. Eastern time.

In addition to the information listed above, our website www.irs.gov/tribes contains links to publications as well as other helpful information.

If you have any questions, please give your Indian Tribal Governments' Specialist a call.

Gil Akers	(530) 722-1263	James Rivers	(619) 230-8165 ext. 120
Vincent Garcia	(909) 388-8106	Mitchell Underwood	(909) 388-8385
Scott Karafin	(619) 230-8165 ext. 130	Emily Williamson	(619) 230-8165 ext. 126
Julie North	(916) 974-5578	John Saltmarsh Mgr.	(909) 388-8162



Accountable vs. Non-accountable Plans

Are your employees paying too much in taxes as a result of using a non-accountable plan?

Stipends: A stipend is defined as a fixed sum of money paid periodically for services or to defray expenses. The fact that remuneration is termed a “fee” or “stipend” rather than salary or wages is immaterial. Wages are **generally** subject to employment taxes and should be reported on Form W-2.

IRS Publication 15, Circular E, Employer’s Tax Guide, defines employee business expense reimbursements. A reimbursement or allowance arrangement is a system by which you substantiate and pay the advances, reimbursements, and charges for your employees’ business expenses. How you report a reimbursement or allowance amount depends on whether you have an **accountable or a non-accountable plan**. If a single payment includes both wages and an expense reimbursement, you must specify the amount of the reimbursement.

These rules apply to all ordinary and necessary employee business expenses that would otherwise qualify for a deduction by the employee.

Accountable plan: For this to be an accountable plan, your reimbursement or allowance arrangement must require your employees to meet all three of the following rules.

- 1) They must have paid or incurred deductible expenses while performing services as your employees.
- 2) They must adequately account to you for these expenses within a reasonable period of time.
- 3) They must return any amounts in excess of expenses within a reasonable period of time.

Amounts paid under an accountable plan are not wages and are not subject to income tax withholding and payment of social security, Medicare and Federal unemployment (FUTA) taxes. (*Reminder: Announcement 2001-16 indicates which Indian tribes are not subject to FUTA taxes.*)

If the expenses covered by this arrangement are not substantiated or amounts in excess of expenses are not returned within a reasonable period of time, the amount is treated as paid under a non-accountable plan. This amount is subject to income tax withholding and payment of social security, Medicare, and FUTA taxes for the first payroll period following the end of the reasonable period.

A reasonable period of time depends on the facts and circumstances. Generally, it is considered reasonable if your employees receive the advance within 30 days of the time they incur the expense, adequately account for the expenses within 60 days after the expenses were paid or incurred, and they return any amounts in excess of expenses within 120 days after the expense was paid or incurred. Also, it is considered reasonable if you give your employees a periodic statement (at least quarterly) that asks them to either return or adequately account for outstanding amounts and they do so within 120 days.

Continued on the next page



Accountable vs. Non-accountable Plans

Are your employees paying too much in taxes as a result of using a non-accountable plan?

Non-accountable plan: Payments to your employee for travel and other necessary expenses of your business under a non-accountable plan are wages and are treated as supplemental wages and subject to income tax withholding and payment of social security, Medicare, and FUTA taxes. Your payments are treated as paid under a non-accountable plan if:

- 1) Your employee is not required to or does not substantiate timely those expenses to you with receipts or other documentation or
- 2) You advance an amount to your employee for business expenses and your employee is not required to or does not return timely any amount he or she does not use for business expenses.

See section 7 of Publication 15 for more information on supplemental wages.

Per diem or other fixed allowance: You may reimburse your employees by travel days, or miles, or some other fixed allowance. In these cases, your employee is considered to have accounted to you if the payments do not exceed rates established by the Federal Government. The 2002 standard mileage rate for auto expenses is 36.5 cents per mile. The rate for 2003 is 36 cents per mile. The 2004 standard mileage rate for auto expenses is 37.5 cents per mile. The government per diem rates for meals and lodging in the continental United States are listed in Publication 1542, Per Diem Rates. Other than the amount of these expenses, your employees' business expenses must be substantiated (for example, the business purpose of the travel or the number of business miles driven).

If the per diem or allowance paid exceeds the amounts specified, you must report the excess amount as wages. This excess amount is subject to income tax withholding and payment of social security and Medicare taxes. Show the amount equal to the specified amount (i.e., the nontaxable portion) in box 12 of the Form W-2, using code L.

IRS Publication 15-B, Employer's Tax Guide to Fringe Benefits, discusses "Are Fringe Benefits Taxable?" If the recipient of a taxable fringe benefit is your employee, the benefit is subject to employment taxes and must be reported on Form W-2, Wage and Tax Statement. However, you can use special rules to withhold, deposit, and report the employment taxes. Refer to section 4 of Publication 15-B, Rules for Withholding, Depositing and Reporting.



Treatment and Information Reporting of Tribal Council Member Payments Made by Indian Tribal Governments

Revenue Ruling 59-354 explains that monies paid for services performed as tribal council members (e.g. monies paid to attend council meetings) **do not constitute wages** for purposes of **FICA** or **income tax withholding**. Such payments, however, are considered income and are **subject to federal income tax** regardless of whether tax was withheld or a Form W-2 was issued. These monies are reported as income on Form 1040, Line 7. Use **Form W-2** to report income from meeting stipends if the combined amount of the meeting stipends plus Tribal government wages is **\$600 or more** in a calendar year. Please refer to Treasury Regulation 1.6041-2(a)(1) to review the \$600 W-2 reporting rule in further detail. **Do not** report meeting stipends on Form 1099-Miscellaneous. Please note that tribal council members may **voluntarily elect** to have income tax withheld from their meeting stipend payments.

Hopefully, the following examples will help clarify any questions you may have.

Situation 1: A Tribal government pays an individual \$200 in a calendar year for meeting stipends as a tribal council member. The Tribal government does not employ the council member in any other capacity.

Neither FICA tax nor income tax withholding applies to the \$200 payment. Because the council member earns fees that are less than \$600, the Tribal government is not required to issue Form W-2, but the individual must still report the income on their federal income tax return.

Situation 2: A Tribal government pays a tribal council member \$1,100 in the calendar year for meeting stipends. The Tribal government does not employ the council member in any other capacity.

Neither FICA tax nor income tax withholding applies to the \$1,100 paid to the council member for the calendar year. Box 1 of Form W-2 will reflect \$1,100 for meeting stipends. There are no entries in boxes 2, 3, 4, 5, or 6 (or you can enter zeros if you prefer). Enter "Revenue Ruling 59-354" in Box 14 of Form W-2. The employee must report the full \$1,100 as wages on their federal income tax return.

Situation 3: A Tribal government pays a council member \$200 in a calendar year for meeting stipends. The Tribe also employs the council member in another capacity in which the employee earns wages of \$300 that are subject to FICA tax and income tax withholding.

Neither FICA tax nor income tax withholding applies to the \$200 paid to the employee for services as a tribal council member, but the \$300 payment for wages is subject to FICA tax and income tax withholding. The Tribal Government must report on Form W-2 the \$300 payment for wages and the amounts of tax withheld. The \$200 payment is not required to be reported on Form W-2 because the total of the two payments is less than \$600 for the calendar year. However, the full \$500 must be still reported by the employee on their federal income tax return.



Treatment and Information Reporting of Tribal Council Member Payments Made by Indian Tribal Governments

Situation 4: A Tribal government pays a council member \$200 in a calendar year for meeting stipends. The Tribe also employs the council member in another capacity in which the employee earns wages of \$500 that are subject to FICA tax and income tax withholding.

Neither FICA tax nor income tax withholding applies to the \$200 paid to the employee for services as a tribal council member. The \$500 payment for wages is subject to FICA tax and income tax withholding. Because the total of the two payments is \$600 or more for the calendar year, the Tribal government must report on Form W-2 both the \$200 and the \$500 payments, and the amounts of tax withheld. Box 1 of Form W-2 will reflect \$700 for total wages, Box 3 will reflect \$500 for FICA wages, and Box 5 will reflect \$500 for Medicare wages. The applicable federal income tax withheld will be shown in Box 2, while Boxes 4 and 6 will reflect the FICA and Medicare tax withheld. Enter "Revenue Ruling 59-354" in Box 14 of Form W-2. The full \$700 must be reported by the employee on their federal income tax return.

The Tribal government may choose to file more than one Form W-2 for Situation 4 in order to report the income from meeting stipends and Tribal government wages separately.

Federal Tax Calendar for Second Quarter 2004

April 2004

SUN	MON	TUE	WED	THU	FRI	SAT
				1	2 * Payroll date 3/27-3/30	3
4	5	6	7 * Payroll date 3/31-4/2	8	9 * Payroll date 4/3-4/6	10
11	12 Employees report tips from March	13	14 * Payroll date 4/7-4/9	15 ** Monthly Deposit for March	16 * Payroll date 4/10-4/13	17
18	19	20	21 * Payroll date 4/14-4/16	22	23 * Payroll date 4/17-4/20	24
25	26	27	28 * Payroll date 4/21-4/23	29	30 * Payroll date 4/24-4/27	

May 2004

SUN	MON	TUE	WED	THU	FRI	SAT
						1
2	3	4	5 * Payroll date 4/28-4/30	6	7 * Payroll date 5/1-5/4	8
9	10 Employees report tips from April	11	12 * Payroll date 5/5-5/7	13	14 * Payroll date 5/8-5/11	15
16	17 ** Monthly deposit for April	18	19 * Payroll date 5/12-5/14	20	21 * Payroll date 5/15-5/18	22
23	24	25	26 * Payroll date 5/19-5/21	27	28 * Payroll date 5/22-5/25	29
30	31					

* = Make a Payroll Deposit if you are under the semi-weekly deposit rule. ** = Make a Monthly Deposit if you qualify under that rule.

NOTE: Deposits made through EFTPS are due one day prior to the dates listed.



June 2004

SUN	MON	TUE	WED	THU	FRI	SAT
		1	2	3 * Payroll date 5/26-5/28	4 * Payroll date 5/29-6/1	5
6	7	8	9 * Payroll date 6/2-6/4	10 Employees report tips from May	11 * Payroll date 6/5-6/8	12
13	14	15 ** Monthly deposit for May	16 * Payroll date 6/9-6/11	17	18 * Payroll date 6/12-6/15	19
20	21	22	23 * Payroll date 6/16-6/18	24	25 * Payroll date 6/19-6/22	26
27	28	29	30 * Payroll date 6/23-6/25			

*= Make a Payroll Deposit if you are under the semi-weekly deposit rule.
 **= Make a Monthly Deposit if you qualify under that rule.

NOTE: Deposits made through EFTPS are due one day prior to the dates listed

Return Filing Dates

By April 30th

File Form 941 for the first quarter of 2004. If the tax was deposited in full and on time, file by May 10th.

File Form 730 on applicable wagers accepted during March 2004.

By June 1st

File Form 730 for applicable wagers accepted during April 2004.

By June 30th

File Form 730 for applicable wagers accepted during May 2004. or a Gaming Industry Tip Compliance Agreement, file the annual report required by the agreement.