INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE PUBLIC MEETING

OCTOBER 24, 2007
1111 CONSTITUTION AVENUE NW
WASHINGTON, DC

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

2007 PUBLIC MEETING BRIEFING BOOK

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INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

GENERAL REPORT

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OCTOBER 24, 2007

GENERAL REPORT
OF THE
INFORMATION REPORTING PROGRAM
ADVISORY COMMITTEE

The Information Reporting Program Advisory Committee (IRPAC) was established in 1991. This was in response to a recommendation contained in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989 that the Internal Revenue Service (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."

Congress believed that in order to fully implement and enforce the mandates of information reporting in a fair and equitable manner, members of the taxpayer community, practitioners and the government must have ongoing dialogue. It is only in this manner that we can be assured that the interests of all parties are fairly served.

Perhaps never before has there been such urgency and tension not only between the government and the taxpayer community but also within each group. At the 2006 Public Meeting, then Deputy Commissioner Mark Matthews said to me, "Be prepared! Compliance, and therefore, information reporting has everyone's attention as the means to close the Tax Gap. IRPAC is uniquely situated to advise all parties to insure that changes are implemented equitably and efficiently."

IRPAC barely had a chance to have its January organizational meeting when the Administration's Fiscal Year 2008 Revenue Proposals were released in February 2007. In a situation which is virtually unprecedented in recent memory, the proposals contain seven *significant* information reporting proposals. These proposals are designed to expand information reporting, improve compliance by businesses, strengthen tax administration and expand various tax failure penalties. In short, they are aimed at raising revenue by improving voluntary compliance. These proposals, if enacted, will significantly increase information reporting responsibilities for a wide variety of taxpayers, as well as for the IRS.

In order for IRPAC to tackle the challenge, it was clear from the beginning that in addition to the significant issues which needed to be covered in each of the four primary IRS divisions – Large & Mid-Size Business, Small Business/Self-Employed, Wage and Investment and Tax Exempt and Government Entities – IRPAC members would have to squeeze in an additional subgroup to address the broad reach of the budget proposals. As such, you will see a report this year from the Strategic Subgroup for Legislative Proposals. Moreover, the Committee felt the need to address in some manner the rising problem of identity theft. To this end, a second subgroup was formed – the TIN Masking Subgroup – to investigate whether identity theft can be reduced. I thank and commend the members of these two subgroups who worked "in their spare time" (meaning early morning and lunch hours) during the regularly scheduled meetings as well as between formal meetings through conference calls to prepare the reports you see and hear today.

Prior to the public meeting on October 24, 2007, the IRPAC met four times in Washington, DC. In addition to the issues mentioned above, there were several other matters discussed, reviewed and resolved. Several recommendations were formulated. Details of these items may be found later in this report.

Early in 2007, The IRPAC Chair and Vice-Chair met with members of the Senate Finance Committee staff to discuss issues related to the information reporting proposals set forth in the Administration's budget. The main theme espoused by IRPAC both then and now is that any new legislation must carefully balance the benefits to be gained from additional reporting with the burdens on the reporting community. At a minimum, there needs to be clear guidance in the form of regulations and issuance of any new or modified tax forms well ahead of any effective date. Virtually every change will require significant systems modifications and personnel training.

On two occasions (once in person), IRPAC met with Michael Desmond, Tax Legislative Counsel, Office of Tax Policy, U.S. Treasury Department to discuss concerns related to a rush to enact new reporting proposals. On two other occasions, members of the Government Accountability Office met with IRPAC. In each instance, they were specifically concerned with understanding the burdens and mechanics of different aspects of any new legislation. Again, significant emphasis was placed on proper guidance and lead time before any new or expanded reporting is implemented. Without this time, the

information produced will not be of much use to anyone. In addition, if penalties are assessed for inaccurate reporting, compliant taxpayers would be penalized for something which is beyond their control. As such, penalty abatement or waiver during a transition period would be vital.

IRPAC has now been under the direction of the Office of the National Public Liaison (NPL) within the IRS for seven years. The administrative support provided by NPL is vital to the continued functioning of IRPAC. All of the IRPAC members wish to recognize the excellent service and support received from NPL. Our special thanks go to Candice Cromling, Director of NPL, Cynthia Vanderpool, Branch Chief and Designated Federal Officer, and Caryl Grant, IRPAC Program Manager, and their respective staffs for the tremendous jobs they have done for us on IRPAC.

We also want to thank all of the IRS liaison personnel to the different subcommittees. Without their help and guidance in setting agendas and finding the right people for us to meet with, we could not have made the progress we have made.

Finally, I want to thank each and every one of my Committee members. They have generously taken time from their jobs, practices, lives and families to help improve the tax system. Their eagerness, enthusiasm, openness and willingness to work made the effort not only successful but also enjoyable. Thank you for your dedication and hard work.

But, the work has only just begun. I conclude this report by reiterating and reinforcing the words of Deputy Commissioner Mark Matthews with which I started this report: "Be prepared! Compliance, and therefore information reporting, has everyone's attention as the means to close the Tax Gap. IRPAC is uniquely situated to advise all parties to insure that changes are implemented equitably and efficiently." The 2008 IRPAC group has an opportunity to make a real difference. Good Luck!

Respectfully submitted,
/s/ *Paul Heller*
Paul Heller, 2007 IRPAC Chair

Information Reporting Program Advisory Committee

Strategic Subgroup for Legislative Proposals

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OCTOBER 24, 2007

Information Reporting Program Advisory Committee
Strategic Subgroup for Legislative Proposals

I. INTRODUCTION

It has never been more apparent that Information Reporting is a powerful tool that improves compliance and can help reduce the Tax Gap. The Administration's Fiscal Year 2008 Revenue Proposals, released in February 2007, contain seven significant information reporting proposals designed to raise revenue by improving voluntary compliance. These proposals, if enacted, will significantly increase information reporting responsibilities for a wide variety of taxpayers, as well as for the Service. The expanded Information Reporting proposals are:

1. Require basis reporting on security sales
2. Require information reporting on merchant payment card reimbursements
3. Require a certified Taxpayer Identification Number from contractors
4. Require information reporting on payments to corporations
5. Expand broker information reporting
6. Require increased information reporting for certain government payments for property and services; and
7. Increase information return penalties.

The level of complexity associated with each proposal varies. Some proposals such as increased information return penalties are relatively straightforward and easy to implement. On the other hand, some of the proposals such as Basis Reporting on Security Sales involve creating entirely new information reporting regimes which will involve extensive guidance from

Treasury and the IRS, and a close partnership between government and industry to assure an effective implementation and a smooth transition.

In response to the anticipated need for guidance and cooperation, IRPAC formed a Strategic Subgroup (the Strategic Subgroup for Legislative Proposals) to study these proposals. The Subgroup is comprised of members from each of the four IRPAC subcommittees (LMSB, SBSE, W & I, and TEGE), thus assuring representation from a broad spectrum of stakeholders.

In April 2007, IRPAC met with Michael Desmond (Tax Legislative Counsel, Office of Tax Policy, U.S. Treasury Department). Mr. Desmond was kind enough to share his perspective on what the Information Reporting proposals contained and how vital these initiatives are to the Administration's goal of increasing voluntary compliance to narrow the Tax Gap. In turn, IRPAC had an opportunity to present its concerns regarding the importance of developing a comprehensive strategy for implementing these initiatives. IRPAC looks forward to more of these discussions and hopes to have ongoing working sessions with the appropriate staff at Treasury and the IRS as detailed guidance is developed.

IRPAC began addressing the proposals in 2007, as described herein.

II. ISSUES AND RECOMMENDATIONS

A. Basis Reporting on Securities Sales

Background

Brokers and other financial institutions are currently required to report proceeds from sales of securities on Form 1099-B. The Administration's Fiscal

Year 2008 Revenue Proposals include a provision to expand information reporting requirements when securities are sold. Under the proposal, brokers and other financial institutions would be required to report the adjusted basis of securities sold, as well as holding period and gain or loss on the sale (collectively referred to as basis reporting).

Basis reporting represents a significant departure from current industry practices for securities firms and other institutions that currently report sales of securities on Form 1099-B. These firms will have to make considerable modifications to their computer systems and business practices in order to furnish accurate and timely basis reporting information. The IRS will have to alter or issue new 1099s to accommodate basis reporting information and its computerized matching systems will require modifications in order to utilize basis reporting information in a manner consistent with sound tax administration.

Recommendation

IRPAC recommends that Treasury and the IRS develop a comprehensive strategy for implementing basis reporting in concert with various stakeholders, including the securities and mutual fund industries, as well as return preparers. This strategy should include the following components:

- Due to the lead time needed to modify systems and business practices, basis reporting should be required only after a reasonable amount of time has lapsed after Treasury and the IRS issue guidance by way of Treasury regulations, IRS forms, or other authoritative pronouncements.

- Leaders from Treasury and the IRS should continue substantive meetings with the Senate Finance Committee and industry representatives to coordinate legislation, regulatory guidance and the development of IRS forms to accommodate basis reporting.
- Treasury should allow a reasonable transition period during which penalties would not be imposed on brokers and other financial institutions that make good faith efforts to transform their business practices and systems to comply with new basis reporting requirements.
- Treasury and the IRS should consider the comments made by various trade organizations, such as the Securities Industry and Financial Markets Association (SIFMA), the Investment Company Institute (ICI), the American Bankers Association (ABA) and other key industry organizations. These trade organizations are well-positioned to provide sound technical and practical advice since their members (securities brokers, mutual fund companies, et. al.) will be responsible for generating and reporting the majority of basis information returns under the proposed regime.

Discussion

The basis reporting proposal presents a variety of significant challenges to the IRS, to the firms that will generate basis information returns and to taxpayers and their preparers who must use the new basis information when preparing tax returns. Although many brokerage firms, mutual fund companies and other financial institutions provide basis information for securities sold, the information is currently provided as a courtesy for informational purposes only, and on a

best-efforts basis. Computing and reporting the adjusted basis of securities sold according to all concepts and possible adjustments under the Internal Revenue Code (the "Code") is precedent setting and a significant departure from current practice.

During 2007, IRPAC interviewed several representatives responsible for basis reporting at large and small financial institutions and reviewed comments made by SIFMA, ICI, ABA, the American Institute of Certified Public Accountants, the American Bar Association, and the U.S. Government Accountability Office. Based on the information provided by these organizations and financial institutions, the major impediments to accurate and timely basis information reporting fall into the following five categories:

- <u>Basis Calculation Methods</u> – Taxpayers are permitted to use various methods to compute their basis (e.g., average cost, specific identification and first-in first-out (FIFO)). If taxpayers are allowed to dictate the basis computation method a reporting institution is to apply, financial institutions will have to build or modify their existing systems to capture and store the basis calculation method chosen by each taxpayer. In addition, the average cost method for mutual fund shares presents an especially challenging issue. Unlike the FIFO or specific identification method, average cost is calculated using the basis of all shares in an account (even shares acquired prior to the effective date of the proposed legislation). Since financial institutions have never been required to maintain basis information for shares acquired prior to the effective date of

the proposed legislation, they may not possess information sufficient to compute basis under the average cost method. Special consideration must be given to account for the retroactive aspect of computations under the average cost method.

- Transfers of Securities – Securities are often transferred from one financial institution to another. Transfers between financial institutions occur for a variety of reasons, such as when a taxpayer decides to move his or her account to a new firm, or when firms merge or change service providers. Securities can also be transferred between taxpayers and financial institutions. When transfers of this nature occur, the organization responsible for reporting the sale may not possess sufficient transactional data. Although the legislative proposals do account for the need to transfer adjusted basis information when securities are transferred among financial institutions and taxpayers, the development effort to accommodate the transfer of information in an automated and efficient manner will be significant. Financial institutions will not only have to modify their own record-keeping systems, but the industry utilities that serve these organizations must also modify their systems. In addition, these modifications must be coordinated among industry participants so that each firm can transfer and receive information in a similar manner. It is critical that the development and modification of these transfer systems be pursued in a coordinated manner and in concert with a well-developed legislative and regulatory basis information reporting strategy.

- Scope of Securities Subject to Basis Reporting – The type of securities subject to basis reporting will determine the size of the development effort needed to comply with a new basis reporting requirement. Brokers and other financial institutions are currently required to report the sale of a security on Form 1099-B to the extent the security sale is subject to Code Section 6045 or the corresponding Treasury regulations. If basis reporting is required for securities not currently subject to Section 6045 reporting, industry participants will need more time to modify their information reporting systems and business practices to comply. In addition, computing adjusted basis information for certain securities that are defined in Section 6045 may not be practical. For example, although proceeds from sales of partnership interests are reportable on a Form 1099-B, it is not practical for financial institutions to compute and report the adjusted basis of partnership interests. Basis in a partnership interest is adjusted to reflect the partner's pro rata share of income, expense and distributions. Financial institutions only record the purchase of a partnership interest and distributions. Adjusted basis information is already provided by the partnerships directly to IRS and each partner on Form K-1, which is due by March 15 and is often furnished long after the January 31 deadline for 1099 reporting.
- Information Not Available or Received Late – Certain information that affects adjusted basis of securities sold is often not available until after 1099s are issued. Basis adjustments due to wash sales, certain "load

charges" under Section 852(f), and post year-end reclassifications of corporate distributions are examples of information that is often not available at the point in time when 1099s are created. In addition, determination of adjusted basis often depends on events and conditions that are extrinsic to a taxpayer's account at the reporting financial institution. For example, a taxpayer's choice of accounting method to amortize bond premium may not be known to the reporting financial institution. In some cases, activities by the taxpayer that occur away from the financial institution could impact adjusted basis, such as the purchase of a substantially identical security at another institution within 30 days of a sale at the reporting institution. In this case, the wash sale rules are triggered and the loss on the sale must be capitalized into the basis of the securities acquired (Code Section 1091). In these instances, the reporting financial institutions are unable to observe the information needed to compute basis. Special consideration needs to be given to information that is not available, arrives late, or that is unobservable.

- <u>Matching Information Returns (1099s) to Taxpayer Reported Gains and Losses (1040 Schedule D)</u> – Basis reporting will enable the IRS to expand its computerized matching system to identify situations where individuals are underreporting their capital gains and losses. In light of the substantial impediments to reporting adjusted basis pursuant to all principles and provisions under the Code, there is a reasonable likelihood that excessive mismatches will occur. To the extent that a mismatch is legitimate, an

IRS inquiry into the matter could create an unnecessary burden on the taxpayers and the IRS officials responsible for administering the matching program. Consideration needs to be given to the application of the matching program and design of tax forms (particularly Form 1040 Schedule D) to avoid unnecessary communications between IRS and taxpayers due to invalid mismatches.

These impediments are significant. Considering the breadth of issues that confront stakeholders, it is not surprising that the effective date of the new basis reporting regime is of paramount concern. When should basis reporting become mandatory? Can basis reporting requirements be phased in over time? Should basis reporting only apply to securities acquired after a certain date? What should that date be? Congress and Treasury should respond to these questions and define the effective date of the basis reporting regime in light of the significant lead time that industry participants will need to modify their systems and business practices.

On May 25, 2007 the Senate Finance Committee released a Discussion Draft concerning basis reporting. IRPAC provided comments on the Discussion Draft on July 11, 2007 (see attached Letter from IRPAC).

Benefit to Payers

Payers will have sufficient lead time to modify their computer systems and business practices to comply with the requirement to report adjusted basis of securities sold.

Benefit to IRS

The IRS will receive accurate and useful basis information from brokers and other financial institutions.

Benefit to Taxpayers

Taxpayers will receive accurate basis information from brokers and other financial institutions, which should ease their compliance burden and encourage voluntary compliance.

IRS Action(s)

Treasury is considering IRPAC's suggestions.

B. Merchant Payment Card Reimbursement Reporting

Background

The Fiscal Year 2008 Budget includes a proposal to require the Secretary of the Treasury to promulgate regulations to expand information reporting requirements by mandating payment card processors to report gross annual reimbursements to merchants.

Recommendation

IRS should address industry concerns about how such a reporting requirement would be met, whether the benefits of this requirement outweigh the costs, and whether the IRS has the capability to use the information in the manner it has identified.

Discussion

The Administration proposal would require "payment card processors to report gross annual reimbursements to merchants." There is a potential for

overlap with existing information reporting requirements depending on how the proposal defines "merchant." Duplicate reporting of a single transaction would produce inefficiencies and data reporting discrepancies, while the value of the information to the IRS would be diminished. Backup withholding on merchant transactions would be particularly problematic, and it should not apply. Backup withholding claims would disrupt the complex relationships in a multi-party payments system, particularly when the parties to a transaction have rights that can be asserted after the transaction is complete. Merchants do not use tax reporting information (such as TINs and tax addresses) to process payments, and the information that typically flows through the payment system is limited and has a short retention period. Finally, gift cards and cash-back transactions would present unique reporting difficulties.

The IRS has publicly stated that the information requested in the IRS proposals will not be used for information matching purposes. The IRS intends to use this merchant information to better target the agency's audit resources by using the data to determine whether merchants have understated cash receipts. This would require extensive research by the IRS on the patterns of credit card use by type of transaction, size, and location of merchant. Because of cash-back transactions, charge-backs, merchant discounts, fees, and accounting rules, gross merchant reimbursements will not necessarily provide accurate information about a merchant's tax situation.

Benefit to Payers

By addressing these industry concerns, the payment card industry would hope to have sufficient time to adapt its systems to comply with a requirement to report reimbursements to merchants without having to redesign entire transaction processing systems at a significant cost.

Benefit to IRS

Before requiring the industry to incur significant costs, it would be helpful to the IRS to determine whether the costs outweigh the benefits and whether the IRS has the capability to use this information for the purposes it has identified.

Benefit to Taxpayers

If the payment card industry is forced to redesign transaction processing systems at a significant cost, it is likely that the cost would be passed on to merchants and eventually to consumers. Addressing industry concerns may help to lessen this burden.

C. Requiring Tax Identification Numbers (TIN) From Contractors

Background

Under current law, trades or businesses must report on IRS Form 1099-MISC any payment of $600 or more made to a non-corporate, non-employee service provider. The tax identification number (TIN) of the service recipient is currently not required to be verified. In addition, income tax withholding is not permitted on such payments which may necessitate the filing of estimated tax payments by such contractors and/or the contractor's inability to make final tax payment installments by tax filing date. In the interest of reducing the estimated

tax filing burden and improving tax collection, the Administration and Treasury have proposed the following:

- Requiring a contractor receiving payments from a business of $600 or more to provide a Form W-9 certifying the recipient contractor's TIN.
- Requiring the payer business to verify the TIN with the IRS, presumably through the IRS TIN matching program.
- Requiring the payer business to withhold a flat rate percentage of the gross payments as income tax withholding if the contractor fails to provide a valid TIN.
- Providing an option to contractors receiving $600 or more in payments from a business to require the payer business to withhold a flat percentage rate of their gross payments with the percentage rate being 15%, 25%, 30% or 35%, whichever is selected by the contractor.

It is estimated that the TIN/Withholding proposal would, between 2008 and 2017, generate an $749 million in additional tax revenue. The proposal would be effective for payments made to contractors on or after January 1, 2008. [1]

IRPAC reviewed the TIN / Withholding proposal, and offers the following recommendations.

Recommendation

The following recommendations are premised on the Budget proposal as presented including the identified effective date. It is anticipated that additional review and study will be undertaken by IRPAC in 2008. IRPAC recommends:

- That the proposed effective date of January 1, 2008 be postponed to a date that follows by at least 18 months the date of issuance by Treasury of detailed regulations and guidance. Sufficient lead-time is necessary to allow affected businesses to develop reliable TIN verification procedures and withholding and reporting systems.
- That the proposed effective date of January 1, 2008 be additionally postponed to a date that follows by at least 6-9 months the issuance by the IRS of the reporting requirements relative to the reporting specifications to be applied, the form to be used, etc. (If the reporting issue and protocol will be incorporated into the regulations referenced above the 18 months is sufficient for both.).
- That the IRS take into account and address in its regulations the issues raised in the discussion below.
- That the dollar threshold for applying the TIN/Withholding requirement be raised to perhaps $2,000 or $5,000 in the interest of minimizing the potentially large burden this new requirement would place on payer businesses.
- That further study of the potentially large burden this will place on payer businesses be taken into account before a TIN/ Withholding requirement is imposed to improve tax compliance.
- That any reporting or withholding penalties not be applied until after the issuance of final regulations with respect to this proposal.

Discussion

In reviewing the TIN/ Withholding proposal, the IRPAC had several concerns and concluded that several considerations and circumstances need to be taken into account either prior to or during the development of any guidance or regulations relative to the TIN/ Withholding issue. These include but are not limited to the following:

- The format for reporting, e.g. whether IRS Form 1009-MISC will be utilized to report payment and withholding or some other form;
- The timeframe for reporting, e.g. January 31st or February 28th of the following year, the payer businesses' tax filing date, the payer businesses' tax filing date plus extensions? How will differences in payer and contractor fiscal years be accommodated?
- How payer business reporting and contractor recipient reporting is to be reconciled when variances occur: what steps need to be taken and by which party? What will be the reporting correction protocol?
- Will electronic reporting to contractors be permitted and if so, under what conditions; the same "consent" provisions as are applied to other electronic reporting?
- What or how will reporting and withholding take place if the TIN provided is invalid? What number should be used and for what purpose or value is withholding if only a faulty TIN is available? Will some code designating the number as invalid be provided?

- How to handle service emergencies where validation of a TIN is not possible and postponing the service delivery by the prospective contractor is not feasible or in the interest of the business or its customers?
- What withholding rate percentage will apply when a valid TIN is not provided? Would the rate be the same as one of the optional rates for voluntary withholding or will some other rate apply?
- To what extent, if any, will the backup withholding rules as described in Code section 3406 apply?
- To what extent, if any, will the standard penalties for failure to provide a valid TIN apply?
- To what extent, if any, will the withholding and reporting provisions be applied to foreign based service providers with no domestic business location? Would the provisions of Code section 1441 apply? Would Form 1042-S reporting apply?
- Currently a vast number of businesses may only have payroll based withholding systems in place and the withholding protocol called for in the proposal would have to be layered on top or interwoven into systems and procedures already in place. In addition, many businesses may have no familiarity or involvement with the IRS TIN matching program. This needs to be considered in applying the effective date.
- Contractual engagement of vendors often is not centralized within a business but rather scattered across internal or external divisions. New procedures for obtaining TIN information and new internal controls would

have to be developed and implemented by affected businesses. This could impede the contracting process and substantially add to the time necessary to execute a contract as departments and divisions would have to either separately develop TIN matching procedures and withholding capabilities or pass a proposed contract through a central department for clearance. Time will be needed to develop the necessary contracting policies and procedures.

- Businesses would have to develop completely new withholding and reporting systems and allocate new resources to accommodate situations where a TIN is not validated or as also proposed, where a contractor voluntarily requests withholding. This will take time.
- To what extent, if any, should a payer reverse voluntary tax withholding requested by a service provider who determines, later in their tax year that taxable income will be much below previous estimates (or that they expect to incur a taxable loss)?

Benefit to Payers

There is little benefit for the businesses that would be required to comply with the new TIN/ Withholding requirement as the requirement will impose additional tax, reporting and withholding burdens and requirements on such businesses that do not exist currently.

Benefit to IRS

The benefit to the IRS would largely center on the improvement in tax compliance and the generation of additional tax revenue. As cited in the *General*

Explanations of the Administration's Fiscal Year 2008 Revenue Proposals an increase of approximately $279 million dollars would be raised by 2017 if the TIN/ Withholding proposal became effective in 2008. Treasury also indicates that it is its belief that the burden of filing estimated taxes and paying self-employment income, if applicable, would be reduced by the availability of voluntary withholding by payer businesses and that by offering the withholding option contractors would be able to more easily and effectively assure that their tax liability can be satisfied.

Benefit to Taxpayers

The benefit to taxpayers is indirect: better tax compliance (and thus higher revenue collected) likely would benefit taxpayers since personal income tax and other tax increases could be avoided if this proposal goes into effect. This proposal could also improve the sense of fairness and shared burden and tax obligation among all taxpayers and lead to a more compliant attitude.

D. Require Information Reporting on Payments to Corporations

Background

Currently, Form 1099-MISC is required to be filed for payments made to noncorporate service providers. Congress is now recommending that these filing requirements be expanded to payments made to corporations for services provided.

Recommendation

IRPAC recommends that the Form 1099-MISC filing requirements not be expanded to corporate service providers.

Discussion

- If the Form 1099-MISC filing requirements were expanded to apply to corporations, there would be significant additional burdens to taxpayers who are paying numerous corporations for services. The additional costs and recordkeeping requirements would impose large time and monetary burdens on both payers and recipients. There will also be many problems with taxpayers not distinguishing, or not being able to distinguish between payments for services and payments for products, which will mean a multitude of additional 1099's issued unnecessarily.
- Tax preparers for corporate recipients of these 1099s may encounter difficulty in reconciling the 1099 amounts with what the taxpayer has recorded as gross receipts. If the 1099's received are greater than the taxpayer recorded amounts, the preparer would have to find out which ones have not been recorded as they may not have been deposited. If the 1099's are less than the recorded amounts, the tax preparer would still have to verify that all reported 1099's are part of the gross receipts.
- Fiscal year corporate recipients receiving calendar year Form 1099's would be especially challenged to reconcile to their fiscal year reported amounts.
- The IRS also would have great difficulty in reconciling these 1099 amounts to what these corporate taxpayers are reporting as gross receipts. Due to this difficulty, the information reported on these forms

would provide little value to the Service, while imposing a large burden on taxpayers.

Benefit to Payers

The payers would not have the additional burdens as listed above.

Benefit to IRS

The Service would benefit by not having to match significant numbers of 1099s which would add little or no value.

Benefit to Taxpayers

Taxpayers and tax preparers would avoid significant expense and time burdens.

[1] Reference pages 67 and 68 of the ***General Explanations of the Administration's Fiscal Year 2008 Revenue Proposals***; issued February, 2007.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE (IRPAC)

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July 11, 2007

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Re: Proposal to Require Adjusted Basis Information Reporting

Dear Mr. Sullivan and Mr. Davis:

The Information Reporting Program Advisory Committee (IRPAC)[1] appreciates the opportunity to comment on the bipartisan staff discussion draft (the "Discussion Draft") released by the Senate Finance Committee on May 25 to expand gross proceeds reporting by brokers and other financial services providers and require reporting of adjusted basis to the Internal Revenue Service (IRS) and taxpayers. Our committee exists to improve information reporting between payers, taxpayers and the IRS and is broadly composed of Enrolled Agents, CPA's, attorneys, consultants and other stakeholders in information reporting.

The members of IRPAC recognize that adjusted basis information reporting will significantly improve the administration of taxpayers' capital gain and loss reporting on sales of securities. The expanded information reporting will also improve taxpayers' voluntary compliance and help narrow the tax gap. The potential benefits of adjusted basis information reporting are significant and vital for all stakeholders.

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[1] IRPAC was established in 1991 in response to an administrative recommendation in the final Conference Report of the Omnibus Budget Reconciliation Act of 1989. Since its inception, IRPAC has worked closely with the IRS to provide recommendations on a wide range of issues intended to improve the information reporting program and achieve fairness to taxpayers. IRPAC members are drawn from and represent a broad sample of the payer community, including major professional and trade associations, colleges and universities, and state taxing agencies.

For these reasons, IRPAC is committed to working with appropriate officials in Treasury and the IRS to make certain that adjusted basis reporting is successful and provides the maximum benefit to the Federal tax administration system.

Adjusted basis information reporting (as proposed in the Discussion Draft) represents a significant departure from current industry and tax administration practices, and will require a concerted and coordinated effort by members of the various impacted groups, such as the securities and mutual fund industries, issuers of corporate stocks and bonds, income tax preparers, IRS, software developers, etc.

In order for this new information reporting program to be successful and achieve its goals, we recommend the following factors be considered: (1) brokers and other financial institutions must be able to calculate and report accurate basis information in accordance with new standards and forms issued by Treasury and the IRS; (2) taxpayers and their advisors must be adequately educated as to the new information reporting program; and (3) IRS must be able to match the new basis information to taxpayers' returns in a manner that is consistent with sound tax administration.

A comprehensive strategy for the implementation that addresses these factors will be needed. Over the past year, several industry groups (e.g., Securities Industry and Financial Markets Association, Investment Company Institute, and American Bar Association) have provided extensive and detailed comments on the adjusted basis information reporting proposals that have been set forth. Their comments illustrate the myriad of implementation issues these industries and their clients will encounter under this new information reporting regime. We urge you to consider their comments and recognize that adjusted basis information reporting will only be successful if a comprehensive strategy is formed well in advance of implementation.

The Discussion Draft provides that the statute will be effective for securities acquired after the date "which is 18 months after the date of enactment." Considering the scope of the proposal and the need for regulatory guidance, we recommend that you consider triggering the effective date from the date that final guidance is issued (either in the form of Treasury regulations or other administrative pronouncements), rather than from the date of enactment. This change will give brokers and other financial institutions adequate time to modify their business practices, and to make the changes to their computer systems that are necessary to gather information to compute adjusted basis and accurately report it on information returns and payee statements. In addition, the formulation of the effective date could give rise to a mid-year effective date. A mid-year effective date should be avoided to minimize confusion when implementing these new reporting requirements. We therefore recommend that the effective date be modified so that the statute becomes effective for securities acquired after December 31 of the calendar year that includes the date that is 18 months after the issuance of final Treasury regulations (or other appropriate authoritative pronouncements).

In addition, we urge Senate Finance Committee to continue substantive meetings with leaders from Treasury and Internal Revenue Service who will be involved in the eventual implementation. Coordination of legislation, regulatory guidance, IRS forms development and taxpayer education will ensure successful implementation of adjusted basis information reporting. If either forms or regulations will not be ready in sufficient time to implement the new legislation 18 months after date of enactment, it is possible that a later date would be more appropriate. We encourage flexibility in this matter.

Finally, the President's 2008 Budget proposals include increased information reporting penalties. We support increased penalties, but would recommend that the Committee consider adopting by statute or through grant of regulatory authority to Treasury, a transition period for the administration of penalties with respect to adjusted basis reporting. Under this approach, which was also used in connection with the implementation of new withholding and reporting tax systems for nonresident aliens[2], the IRS would take into account the extent to which a broker or other financial services provider made a good faith effort during an identified transition period to transform its business practices and systems to comply with the statute and regulations. This acknowledges the likely processing difficulties in coming into compliance with the new reporting regime, while providing the IRS with flexibility to consider good faith efforts as part of their enforcement practices.

IRPAC appreciates the opportunity to comment on the Discussion Draft, and looks forward to working with Treasury and the IRS to ensure that adjusted basis information reporting is introduced in a manner that is fair to all stakeholders. If you have any questions or need additional information regarding IRPAC's comments regarding the proposal to require adjusted basis information reporting, please contact me at (212) 753-4336.

Sincerely,

Paul Heller
2007 IRPAC Chair

cc: Kevin M. Brown, Acting Commissioner, Internal Revenue Service

Michael J. Desmond, Tax Legislative Counsel, Office of Tax Policy, U.S. Treasury Department

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[2] See Notice 98-16, 1998-1 CB 847, (March 27, 1998)

Information Reporting Program Advisory Committee

Large & Mid-Size Business Subgroup Report

Erica Dinner
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October 24, 2007

Information Reporting Program Advisory Committee
Large & Mid-Size Business Subgroup

I. INTRODUCTION

The Large & Mid-Size Business Subgroup (the LMSB Subgroup) consists of tax professionals from large banks, brokers, insurance companies and accounting firms. During 2007, the LMSB Subgroup met multiple times with members of the IRS LMSB Operating Division and Chief Counsel's office to discuss tax withholding and reporting matters of concern to large payers.

Many of the issues raised by the LMSB Subgroup may take years to resolve due to the need for IRS budget support or changes to Treasury regulations. This Report addresses issues that have been resolved in 2007 or that the LMSB Subgroup is actively pursuing into 2008.

II. ISSUES

A. Data Security Concerns

Discussion

The LMSB Subgroup continued to focus on Electronic Tax Administration (ETA) within the IRS by carrying forward items from the 2005 and 2006 IRPAC Public Reports. These recommendations could enhance data security as the IRS currently transmits large amounts of taxpayer data to financial institutions by U.S. mail and facsimiles. The LMSB Subgroup emphasized to the IRS that taxpayer records - some on magnetic tape and some in letters - are regularly lost in the mail and the IRS does not have a mechanism for tracking mail containing this sensitive information. This reality raises major data security concerns. As the National Taxpayer Advocate mentioned in her 2006 Annual Report to Congress, “[t]he privacy of tax return

information is fundamental to tax administration." (Volume 1 page 500). The IRS can mitigate data security exposures by following earlier IRPAC recommendations to move toward electronic data transmission.

During 2007, we met with Bert DuMars, the Director of Electronic Tax Administration (ETA), to discuss the carry over items from the 2005 and 2006 reports and to be briefed on ETA projects related to information reporting. We also met later in 2007 with David Williams, the successor to Mr. DuMars as Director of Electronic Tax Administration, and with Frank Montero, the Senior Manager for IRS Electronic Tax Administration (responsible for the enhancements to the FIRE system that were deployed January 3, 2007).

The IRS identified the following developments for the year:

1. In 2007 ETA addressed IRPAC's request to expand access to the Transcript Delivery System for the Reporting Agent Project.
2. The IRS Enterprise Computing Center at Martinsburg (ECC) will transmit B Notices and Penalty Notices on CD-ROM. [The IRS did complete some of this effort by transmitting CD-ROMs in September 2007 for the 2005 year Penalty Notices.]
3. The IRS is working on a pilot program to provide C Notices electronically and anticipates that this program will go into effect in 2007.
4. The IRPAC-endorsed Information Reporting Clearing House Project is dormant.

Recommendations

IRPAC is encouraged by the programs undertaken by the IRS Electronic Tax Administration. We asked for enhancements in 2007 and earlier years and we anticipate delivery in 2007 of at least two enhancements that will assist with taxpayer data security and will support information return preparers in more efficiently complying with their filing requirements. In calendar year 2007, we expect access to the on-line transcript delivery system will be expanded to payers and withholding agents that were previously prohibited from accessing the system. This will eliminate transcripts provided by facsimile transmission. Also in late 2007 the Martinsburg ECC is expected to send B Notices and 972CG Penalty Notices via CD-ROMs. [As noted above, the IRS did use CD-ROMs to transmit year 2005 Penalty Notices in September 2007.] While the CD-ROM delivery medium is advancement from cartridges and paper, we recommend that the notices be made available for electronic retrieval from the FIRE system by authorized payers. Until the IRS moves to secure electronic delivery of the transcripts and the B Notices and Penalty Notices, unencrypted taxpayer data will continue to float through the facsimile and the mail systems with the potential for misuse if the Notices are lost or stolen prior to being delivered to payers.

The IRS has not addressed the 2005 IRPAC issue requesting electronic C Notices. As with the 2007 enhancements described above, unencrypted taxpayer data will continue to float through the mail system until

the IRS moves to an electronic delivery method for C Notices. The pilot program for B Notices on CD-ROM will not include C Notices.

We further recommend development and a continued aggressive position by ETA in the development of the Information Reporting Clearing House. As stated in the 2005 IRPAC Report, we recommend that delivery of information returns to the Clearing House will eventually comply with the electronic delivery requirements and eliminate the need for payers to mail 1099/1098s to payees. With more than one billion information returns each year, this development would represent a major enhancement of data security. We acknowledge that the IRS considers the Clearing House matter dormant.

Benefits to Payers

Providing enhanced electronic delivery and electronic access to tax information will support the payers' interests in data security and will reduce payers' costs, improve taxpayer compliance and enhance processing efficiency.

Benefits to IRS

Providing payers with enhanced electronic delivery and electronic access to tax information will support the IRS interests in data security and will reduce IRS costs in preparation of paper transcripts and recreation of lost paper lists such as C Notices and B Notices.

Benefits to Taxpayers

Taxpayer privacy and information security are greatly improved by better protection for transmitted taxpayer data. This is a point supported by the

National Taxpayer Advocate in her 2006 Annual Report to Congress.

B. Clean Renewable Energy Bonds and Gulf Tax Credit Bonds

Background

Securities brokerage firms and other nominees are required to report amounts of $10 or more that are deemed paid on Clean Renewable Energy Bonds (CREBs) and Gulf Tax Credit Bonds (Gulf Bonds) on Form 1099-INT. The amounts are treated as paid on credit allowance dates (March 15, June 15, September 15, December 15, and the last day on which the bond is outstanding). The reporting is mandated pursuant to IRC Section 6049(d)(8), and the Secretary is authorized to prescribe regulations necessary or appropriate to facilitate this reporting.

To compute the amount that must be reported on Form 1099-INT, nominees need to know if a bond is a CREB or a Gulf Bond. Since CREBs and Gulf Bonds may be indistinguishable from other bonds with similar terms and features, nominees will have to examine information provided by issuers (such as prospectuses and other offering material) to determine if a bond is a CREB or a Gulf Bond. In practice, this manual process of identifying CREBs and Gulf Bonds is impractical and is not feasible since a list of CREB/Gulf Bond issuers is not available to the public.

Thus, securities brokerage firms and other nominees responsible for Form 1099 reporting often do not have sufficient information from issuers of CREBs and Gulf Bonds to prepare Form 1099-INT.

Recommendation

The IRS should facilitate the flow of information from issuers of CREBs and Gulf Bonds to nominees. IRPAC recommends the following:

1. The IRS should require that CREB and Gulf Bond issuers provide their Committee of Uniform Security Identification Procedures' numbers (CUSIP) to the IRS.
2. The IRS should publish a list of CUSIPs for CREBs and Gulf Bonds on the IRS web site for public use.

Discussion

Nominees need to identify CREBs and Gulf Bonds in order to accurately include the amount deemed paid on Form 1099-INT. Until the Form 8038 is changed, it is difficult to identify information specific to tax credit bonds such as CREBs, Qualified Zone Academy Bonds (QZAB), and Gulf Bonds. In the subgroup's opinion, the information the IRS receives from issuers of CREBs and Gulf Bonds should be passed along to nominees so they can identify CREBs and Gulf Bonds, and prepare and file accurate Forms 1099-INT.

The IRS and the Treasury Department have regulatory authority under the specific delegation in Section 6049(d)(8). That authority should be exercised to create a feasible information reporting system. If the IRS published the list of CUSIPs, nominees would have sufficient information to prepare accurate Forms 1099-INT.

Benefit to Payers

The list of CUSIPs will allow for the identification of CREBs and Gulf

Bonds, and thereby enable nominees to provide accurate reporting to the IRS and taxpayers.

Benefit to IRS

The IRS would receive accurate and complete information returns on a timely basis.

Benefit to Taxpayers

Taxpayers would receive accurate information which is needed for their tax returns.

IRS Action(s)

Until recent discussions with IRPAC, the IRS was unaware of the difficulties in reporting Forms 1099 for CREBs; therefore, there is no comprehensive information available for use in Form 1099 reporting on those securities. In the Notice published in March soliciting applications for the second round (based on 12/22/2006 legislation), the IRS asked the issuers for a voluntary disclosure authorization to release the name of the bond issuer and the amount of the allocation of authority to issue bonds. The authorization did not include disclosure of information concerning bonds' CUSIP numbers to be issued. The allocation information will be publicly available.

The IRS has been advised that it cannot release bond information such as CUSIP numbers and issuer names without consent of the issuer. Accordingly, the IRS is considering asking issuers to voluntarily authorize a release of bond information such as CUSIP numbers when filing the Form 8038. Addition of such a disclosure release to a form that is required to be filed

with the IRS has not been discussed with IRS Counsel. Another Form 8038 specifically for tax credit bonds is under consideration.

C. Taxation and Reporting of Excess Inclusion Income

Background

Notice 2006-97, issued November 13, 2006 provides interim guidance for the tax treatment of excess inclusion income (EII) of a real estate investment trust (REIT) that is either a taxable mortgage pool (TMP) or has a qualified REIT subsidiary that is a TMP.

Notice 2006-97 describes the tax reporting and withholding obligations of REITs, pass-through entities, regulated investment companies (RICs) and other brokers and nominees that hold REITs or RICs that have EII.

Certain tax information reporting and withholding provisions of Notice 2006-97 are either not workable, or are unduly burdensome and outweigh any benefit to tax system administration. For example, with respect to the tax reporting and withholding obligations of nominees:

a. The Notice requires that nominees inform beneficial owners that are not disqualified organizations of the amount and character of their EII. However, the Notice does not set forth any guidelines or requirements as to how or when the information must be reported.

b. The Notice requires that nominees pay the tax imposed by Section 860E(e)(6) on excess inclusion income of beneficial owners that are disqualified organizations. There is no feasible way for nominees to identify whether an account is owned by a disqualified organization. Since nominees were never

required to identify whether an account is a disqualified organization, their systems do not contain the special coding to identify a disqualified organization.

c. The Notice requires that nominees apply withholding tax provisions to the EII portion of payments made to foreign persons without regard to any treaty exemption or reduction in tax rates. In order for such a withholding system to function, nominees need to know how much of a REIT's or RIC's dividends are EII. Furthermore, this information must be provided contemporaneously with the dividend payment. In order for contemporaneous notification to occur, the chain of financial intermediaries responsible for processing dividends for REITs and RICs must modify their computer systems to receive and transmit information regarding EII. Notice 2006-97 is effective upon issuance, and does not provide the necessary lead time for industry participants to modify their systems.

Each of the requirements is associated with operational and logistical burdens. Industry participants need a reasonable period of time to design and implement changes to their computer systems and business practices in order to comply with the terms of this Notice.

Recommendation

IRPAC recommends the following:

(a) The IRS should provide a reasonable amount of time (a transition period) for industry participants to modify their computer systems and business practices to comply with the terms of Notice 2006-97.

(b) The IRS should not impose penalties on industry participants that make good faith efforts to comply with the terms of this Notice during the transition

period.

IRPAC also urges the IRS to consider the comments made by the Investment Company Institute (ICI) and the National Association of Real Estate Investment Trusts (NAREIT) in their letters of December 29, 2006 and January 30, 2007, respectively.

NAREIT offers an attractive solution for administering the tax on EII from REITs. They suggest treating a REIT similar to a Real Estate Mortgage Investment Conduit (REMIC) for purposes of calculating and allocating excess inclusion income. Under their proposal, equity interests in a REIT would be comprised of two components: a regular interest and a non-economic residual interest. Their proposal further states that all EII of the REIT would be allocated to the non-economic residual interest.

NAREIT's proposal is appealing from a tax information reporting standpoint because it concentrates EII in the REIT's non-economic residual interests. Ownership of the non-economic residual interests could be limited based on suitability or other standards, and thus limit the number of taxpayers subject to EII.

Discussion

The tax information reporting and withholding requirements in Notice 2006-97 create significant burdens for issuers of REITs, RICs, pass-through entities and brokers and other nominees. These burdens outweigh the purported benefits to the tax administration system.

The IRS should delay implementation and enforcement of Notice 2006-

97 for a reasonable period of time after a practical information reporting regime is developed.

The IRS should consider alternative solutions presented by NAREIT in their letter of January 30, 2007 to the IRS.

Benefit to Payers

Payers will have time to design and implement tax reporting and withholding systems and business practices. Once efficient tax reporting and withholding systems are in place, nominees will be able to generate accurate tax-reporting, and withhold the correct amount of tax.

Benefit to IRS

IRS will receive accurate tax information reporting, and the correct amount of tax will be collected via withholding.

Benefit to Taxpayers

Taxpayers will receive accurate tax information for preparation of their tax returns.

IRS Action(s)

IRS Chief Counsel is considering these recommendations.

D. Reporting Mortgage Insurance Premiums on Form 1098 in 2007

Background

The Tax Relief and Health Care Act of 2006 added section 163(h)(3)(E) to the Internal Revenue Code of 1986. This provision allows individual

taxpayers to deduct mortgage insurance premiums in certain limited circumstances, for mortgage insurance contracts issued during 2007 and for premiums allocatable to 2007 only. Section 6050H(h) requires information reporting on Form 1098 for mortgage insurance premiums received from an individual.

Recommendation

The IRS should provide guidance on this one-year reporting requirement so that mortgage servicers will be able to comply without undue burden; the IRS should also provide penalty relief for reasonable, good faith compliance.

Discussion

Industry practice is for mortgage servicers to collect and load escrow funds on an aggregate basis. There is no way to track mortgage insurance separately until the servicer makes a payment to the mortgage insurer. We requested clarification that the phrase "premiums paid or accrued" includes the payment from the servicer to the insurer. With this clarification, mortgage servicers could report the amount paid to the insurers without trying to track when the actual payment is received from the borrower. However, it would also result in a deductible amount being reported to a borrower on the basis of the accrued mortgage insurance payment, even if the borrower is delinquent.

Benefit to Lenders

Lenders would be able to comply with this one-year, 2007 only, reporting requirement in a consistent manner that is reasonable and will utilize information available currently, without necessitating significant system

changes. Guidance would provide greater certainty to lenders, and penalty relief would protect lenders in the event that the amount reported on Form 1098 is not exactly equal to the amount deductible under §163.

Benefit to IRS

The IRS would benefit from greater certainty in arriving at the determination of reportable mortgage insurance premiums, as well as improved compliance by lenders.

Benefit to Taxpayers

Taxpayers will be required to determine the appropriate deductible amount of mortgage insurance premiums, regardless of the methodology used by lenders. There are limitations that only the taxpayer would be able to apply. Therefore, the taxpayer should be indifferent to any guidance given to lenders, as long as there is sufficient information available to taxpayers to be able to determine the deductible amount.

IRS Action(s)

IRS Chief Counsel will provide Forms and Publications with legal guidance as necessary to conform the Forms and Publications with this “one-year” change in the law.

E. Form 1042-S Instructions - Reporting of Return of Capital

Background

Treas. Reg. §§ 1.1441-3(b) and (c) require withholding and reporting on gross payments of interest and/or corporate distributions, regardless of whether the payments constitute a return of capital. The Form 1042-S

instructions do not include an income code for return of capital (ROC). Some withholding agents report ROC under Code 50, the "other income" code, but because ROC is not income, this code is not appropriate. Other withholding agents do not report ROC on Form 1042-S.

Recommendation

The Form 1042-S instructions could be revised to add a new income code specifically for ROC. Another option would be to revise Form 1042-S to include a box for nondividend distributions, similar to the Form 1099-DIV, Box 3, nondividend distributions.

Benefit to Payers

Providing an income code for ROC would remove the lack of clarity that currently exists for payers regarding how to report ROC on the Form 1042-S.

Benefit to IRS

By providing a code specifically for ROC, the IRS can ensure that reporting of ROC is completed consistently and accurately by taxpayers.

Benefit to Taxpayers

Providing a separate code for ROC would permit taxpayers to obtain a clearer understanding of the types of income reflected on Form 1042-S.

IRS Action(s)

With the release of the Form 1042-S instructions for 2007, the IRS included a separate income code for ROC. Income code number 37 is the appropriate income code for all reporting of ROC and taxpayers should no longer use code 50 for such reporting.

F. Form W-8 (BEN, ECI, IMY, EXP) and Corresponding Instructions - Country Abbreviations

Background

The Forms W-8 do not provide adequate space for the complete country name on the applicable lines. Many taxpayers have difficulty typing or hand writing the country name in the space provided and the Forms W-8 and corresponding instructions do not permit the use of abbreviated country names in lieu of the full country name. Revenue Agents are invalidating Forms W-8 when clear, commonly recognized and accepted country code abbreviations are being used on the forms.

Recommendation

The IRS should permit taxpayers to use the same country codes specified for use on Form 1042-S (boxes 16 and 18).

Benefit to Payers

Permitting the use of abbreviated country names would insure payers are provided with accurate and legible country information. This would help to avoid confusion and misinformation.

Benefit to IRS

The use of commonly accepted country codes on Form W-8BEN would insure the IRS could obtain accurate information with respect to the correct country and it would avoid problems that arise when the IRS has difficulty reading the information on the form.

Benefit to Taxpayers

Permitting the use of commonly accepted abbreviated country names would insure taxpayers are able to provide accurate and legible country information. This would prevent withholding agents from resoliciting forms when the Form W8 is otherwise valid.

IRS Action(s)

On June 14, 2007, the IRS posted on its website a draft of the revised Form W8BEN and a draft of the revised Form W-8BEN instructions. The proposed effective date for the Form W-8BEN is January 1, 2008. The draft form has removed the phrase "do not abbreviate" from the country section and therefore, country abbreviations may be used on Lines 4, 5 and 9(a). Furthermore, additional space is provided on Line 9(a) to provide the country name under which the tax treaty benefit is being claimed. Although the IRS has not released revised drafts of the other forms in the Form W-8 series, the IRS has indicated the do-not-abbreviate language will be removed from those forms when they are revised. Further, the IRS has indicated that until the other forms in the Form W-8 series are revised, the Examination Division will be advised that use of country name abbreviations will not invalidate the form.

G. Form W-8BEN Instructions - Reverse Hybrid Entities as Beneficial Owners

Background

Line 10 of Form W-8BEN is required to be completed when the beneficial owner chooses to make a treaty claim and an additional representation is

needed to make a valid tax treaty claim. The representation is in addition to those made on Lines 9(a) through 9(e).

The current instructions to Form W-8BEN are unclear with respect to whether a reverse hybrid entity should complete Line 10 when it chooses to make a tax treaty claim. In general, most income tax treaties do not treat fiscally transparent entities as residents under the tax treaty and therefore, such entities are generally not eligible to make a valid claim for benefits under the treaty. However, other income tax treaties do treat fiscally transparent entities as residents and therefore, do permit such entities to make valid claims for benefits under the tax treaty.

Recommendation

The instructions to Form W-8BEN should be revised to address whether a reverse hybrid entity should complete Line 10 when it is a beneficial owner that chooses to make a treaty claim and therefore, must complete an additional representation.

Benefit to Payers / Taxpayers

Revising the instructions to Form W-8BEN to make clear whether and when reverse hybrid entities should complete Line 10 will help to ensure consistency and accuracy on Form W-8BEN.

Benefit to IRS

Revised instructions to Form W-8BEN will make clear whether and when reverse hybrid entities should complete Line 10, and therefore, will help to insure the IRS is obtaining accurate and complete information from taxpayers.

In addition, it will avoid inconsistencies that currently exist depending upon whether a reverse hybrid entity is eligible for treaty benefits as a fiscally transparent entity.

IRS Action(s)

The draft Instructions to Form W-8BEN released June 12, 2007 do not clarify this issue, but the IRS has indicated that the next version of the Form W-8BEN instruction will clarify when a reverse hybrid will need to complete Line 10.

H. Form 1042 Instructions - Reporting Subsequently Determined Underreporting

Background

Treas. Reg. § 1.1441-3(c)(2)(i)(C) provides that a corporation may elect not to withhold on a distribution if, based on a reasonable estimate, the distribution is not paid out of earnings and profits. Treas. Reg. § 1.1441-3(c)(2)(ii)(B)(2) provides that if, at the end of the year of distribution, it is determined that the corporation underwithheld and the underwitholding is paid on or before the due date for filing Form 1042, no penalties for failure to withhold and deposit will be imposed.

Notwithstanding the foregoing regulations, the instructions to Form 1042 provide that withholding agents should report their tax liability on Lines 1 through 60. However, the instructions do not provide a mechanism for withholding agents to report subsequently determined underreporting. Thus, if the current instructions are followed and the underwithholding is reported on a

timely filed Form 1042, a late deposit penalty notice will be automatically generated.

Recommendation

The instructions to Form 1042 could provide that underwithholding may be reported on Line 63(b) (adjustments), which would prevent the automatic issuance of failure to deposit penalty notices from the IRS.

Benefit to Withholding Agents

Revising the instructions to Form 1042 will clarify to withholding agents how to properly report amounts determined to be underwithheld and would save taxpayers the time and expense of preparing reasonable cause explanations to have penalties abated.

Benefit to IRS

Revised instructions to Form 1042 would prevent the automatic issuance of penalty notices due to permitted underwithholding that is not accurately reflected on Form 1042. This would prevent the IRS from having to address this issue with withholding agents on a case-by-case basis to fix the problem and correct inaccurate accounts, a process that is often time consuming and labor intensive for IRS personnel.

Benefit to Taxpayers

Revised instructions to Form 1042 would allow withholding agents to accurately report underreporting on the form in a manner consistent with the regulations. In addition, withholding agents would avoid the time consuming and costly consequences of receiving inappropriate penalty notices when, in

fact, the taxpayer is compliant with IRS regulations.

IRS Action(s)

Currently the instructions to Form 1042 provide that Line 63(b) may only be used by RICs and REITs for adjustments to withholding on dividends. However, Form 1042 instructions for 2007 will clarify that the adjustments line, *i.e.* Line 63(b), may be used when it is subsequently found that a reasonable estimate of tax due on a corporate distribution was inaccurate, and the estimate resulted in underwithholding.

I. Reporting of Undistributed Earnings to a Foreign Partner on Form 1042

Background

Treas. Reg. § 1.1442-5(b)(2) provides that partnerships that have not made an actual distribution of income to a foreign partner are required to withhold tax on the foreign partner's distributive share on the earlier of (a) the mailing date of the K-1 or (b) the due date for filing the K-1. However, the instructions to Form 1042 do not clearly indicate which year withholding should be reported - i.e.*,* the year in which the undistributed income is earned, which automatically triggers a failure to deposit penalty notice, or the same year in which the withholding takes place.

Consequently, some taxpayers report the withholding in the year in which the undistributed income was earned, which automatically triggers a failure to deposit penalty notice. Other taxpayers report the withholding in the same year in which the withholding took place.

Recommendation

The instructions to Form 1042 should be revised to make it clear to taxpayers that they should report withholding in the year the withholding was done.

Discussion

Although revising the instructions to Form 1042 may avoid the issuance of failure to deposit penalty notices to taxpayers, there may be a mismatch between the information on a partner's Schedule K-1 and the Form 1042 for a given tax year. Moreover, if the partnership issues a Schedule K-1 for the income for the year the income was earned and the deposit is made in the subsequent calendar year, it is unclear whether this is reported on the Form 1042 and Form 1042-S of the year the income was earned or the year the deposit was made.

Benefit to Payers / Taxpayer

Withholding agents will obtain clarity around how to properly report withholding on undistributed partnership earnings. In addition, taxpayer will avoid the time consuming and costly consequences of receiving inappropriate penalty notices when, in fact, the taxpayer is compliant with IRS regulations.

Benefit to IRS

As a result of revised instructions, the IRS will receive consistent and accurate reporting of undistributed partnership earnings instead of having to determine how a particular taxpayer treated this item for reporting purposes. In addition, the revised instructions will prevent the automatic issuance of

penalty notices. Consequently, the IRS will not have to remedy the issue on a taxpayer-by-taxpayer basis to correct inaccurate accounts, a process that is often time consuming and labor intensive for IRS personnel.

IRS Action(s)

The IRS has advised that Form 1042 instructions for 2007 will clarify that withholding agents should report the withholding on undistributed partnership earnings in the *same* year in which the withholding takes place. This will result in a mismatch between the information reported on the partner's Schedule K-1 and the information reported on Form 1042. However, it will avoid the automatic generation of failure to deposit penalty notices.

J. Substitute Form W-8 Statement Above Signature Line

Background

Guidance for substitute Forms W-8 is contained in the Instructions for the Requester of Forms W-8BEN, W-8ECI, W-8EXP, and W-8IMY. The instructions to these forms require that the taxpayer include a statement immediately above the single signature line. For example, on Form W-8BEN, the instructions require the following:

> Additionally, the following statement must be presented in the same manner as in the preceding sentence and must appear immediately above the single signature line: "The Internal Revenue Service does not require your consent to any provision of this document other than the certifications required to establish your status as a non-U.S. person and, if applicable, obtain a reduced rate of withholding."

This language appears to be too broad because the statement applies to all substitute Forms W-8.

Recommendation

The language in the instructions to Forms W-8BEN, W-8ECI, W-8EXP, and W-81MY should be modified to provide that the statement is only required when a substitute Form W-8 contains a single signature line that is used to indicate consent to provisions other than the certifications in the official Form W-8.

Discussion

Requesters are similarly required to place this statement above the signature line when creating a substitute Form W-9. However, for purposes of Form W-9 the statement is only required when the single signature line relates to the other provisions of the document. In contrast, the statement is required on all substitute Forms W-8, even those that do not contain other provisions.

Benefit to Payers

Payers would benefit from clarity and by having consistency between Forms W-8 and W-9 instructions.

Benefit to IRS

IRS would benefit from having consistent instructions addressing the use of substitute forms.

Benefit to Taxpayers

This proposal supports simplification and efficiency.

IRS Action(s)

The IRS has agreed to address this issue in the Instructions to the Requester of the Form W-8BEN by requiring the statement only when a substitute Form W-8 contains a single signature line that is used to indicate consent to provisions other than the certifications in the official Form W-8.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

TIN MASKING SUBGROUP REPORT

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OCTOBER 24, 2007

Information Reporting Program Advisory Subgroup
TIN Masking Subgroup

I. INTRODUCTION

In an effort to combat the rising problem of Identity Theft, the ultimate recommendation is to have the recipient's taxpayer identification number (TIN), masked on all information returns that are sent to the payee. (i.e. Forms 1099 and W-2). The full TIN would still appear on the government copy of the forms. This would be a proactive measure towards aiding privacy and thwarting identity theft efforts. IRPAC believes this proposal will satisfy all purposes of information reporting with no harm and will greatly benefit the taxpayers by reducing the likelihood of identity theft.

II. ISSUES AND RECOMMENDATIONS

Background

At the April 2007 IRPAC meeting, the TIN Masking Subgroup met with Barbra Symonds, Director, Office of Privacy and Information Protection, to discuss the concept of TIN masking on payee information returns. We discussed the issues identified by the Subgroup (listed below) at this meeting. Ms. Symonds confirmed that the IRS is also concerned with privacy and identity theft issues and that the initiative of TIN masking is worth exploring. The Service is currently looking into removing employee TINs from all internal documents, a project which conveniently coincides with this subgroup's objectives. Additionally, Ms. Symonds suggested to the subgroup that we explore a wide range of possible solutions. She suggested we contact Chief Counsel to see whether tax statutes or regulations would need to be changed to allow for TINs to be masked.

At the June 2007 IRPAC meeting, Zaida Candelario, Lead Analyst, Privacy and UNAX, Office of Privacy gave a presentation to IRPAC about what is currently being done within the Service to address identity theft and privacy issues. She stated that the Office of Management and Budget is asking agencies to conduct an SSN study as a first step. These studies would produce an inventory list of all forms, documents, and letters generated from within the Service that include an SSN. This study was mentioned in a subgroup meeting, also conducted at the June IRPAC meeting, in which both Barbra Symonds and Nancy Rose, Office of Chief Counsel, attended. Ms. Rose mentioned a few important items at this meeting:

1. Many states are already enacting prohibitions against the use of SSNs on documents.
    a. Most privacy concerns are directed toward individuals rather than businesses.
    b. Internal Revenue Code section 6109 requires the use of an identifying number on Form 1099 information returns. The SSN is deemed to be that identifying number for individuals.
    c. Internal Revenue Code section 6051(a) (2) states that a Form W-2 requires the inclusion of an SSN. This statutory provision could be a significant hurdle to overcome for recipient copies of Form W-2.
    d. Forms 1099 and other information returns may be easier to change, although any change to using an identifying number would require

Treasury or Congress to change or expand the definition of the identifying number.

e. An incomplete SSN on the tax statement could create uncertainty for the payee.

Recommendation

The Subgroup recommends the IRS continue to study the concept of masking TINs on information returns.

Discussion

The following additional items were also discussed by the Subgroup prior to meeting with IRS personnel:

a. If the TIN is masked on the statements received by recipients, how will recipients know if the payer entered their TIN into the payers' systems accurately? Possible Form 1040 issues – some tax filers may put xxx-xx-1234 on their tax returns, as an example.
b. Need to determine costs to the payer to do this (i.e. internal programming changes, vendor application changes, etc.)
c. Is this something the IRS wants to consider?
    i. Can the IRS mandate TIN masking?
    ii. Would this be optional with the decision made by each payer?
d. Would B Notice and Penalty Processing be impacted?

i. The IRS would continue to receive the entire TIN from payer files and would continue to include the entire TIN in files sent back to payers (Notices CP2100 and 972CG).

ii. Payers would still be required to complete proper B Notice solicitations. However, due to the nature of the solicitation, the payer's mailing would have to continue to include full TIN. Is this a impediment to what we are trying to accomplish?

e. For those who file their Form 1040 return on paper (as well as their state tax return), a copy of any Form W-2 is required to be sent with the return. If the TIN is masked, what impact will that have from an IRS/State processing perspective?

f. The Subgroup discussed the concept of using a 'check digit' in conjunction with the last 4 digits of the SSN.

g. The Subgroup must learn what measures or projects, if any, are currently underway by the IRS and Treasury and who is responsible.

Benefit to Payers

Masking TINs on information returns sent to taxpayers will support the payers' interests in data security

Benefit to IRS

Masking TINs on information returns sent to taxpayers will support the IRS interests in data security, identity theft and privacy.

Benefit to Taxpayers

Taxpayer privacy and information security are greatly improved by better protection for mailed taxpayer data.

IRS Action(s)

Nancy Rose, Chief Counsel has assured IRPAC that the IRS and Treasury are considering and discussing this issue and continue to keep abreast of proposed legislation.

Barbra Symonds, Director Office of Privacy and Information Protection stated that the IRS scheduled an internal identify theft summit this fall and recommended IRPAC to follow up with her once that takes place. Ms. Symonds agreed with the subgroup that prior to sending out a proposed notice for comment, it would be best to seek feedback from other payers. She also made it clear that tax fraud was not the primary reason for identity theft. The leading cause of identify theft is to obtain fraudulent passports and is accomplished by mail theft or dumpster diving. Clearly, information returns mailed to recipients are an easy target for mail theft because they contain all the necessary information about a person: legal name, address, SSN and the mailing envelope reads "Important Tax Information Enclosed" so it is easy to identify.

Additionally, Ms. Symonds stated that the Federal Trade Commission (FTC) is the government's ID Theft Clearinghouse.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

TAX EXEMPT AND GOVERNMENT ENTITIES SUBGROUP REPORT

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OCTOBER 24, 2007

Information Reporting Program Advisory Committee
Tax Exempt & Government Entities Subgroup

I. INTRODUCTION

The Tax Exempt & Government Entities Subgroup (TE/GE Subgroup) addresses the needs of three very distinct customer segments: Employee Plans, Exempt Organizations, and Government Entities. The customers range from small local community organizations and municipalities to major universities, huge pension funds, state governments, Indian tribal governments and participants of complex tax exempt bond transactions.

During 2007 the TE/GE Subgroup consulted with Mark O'Donnell and Roger Kuehnle of the Employee Plans group area on the information reporting challenges the Pension Protection Act of 2006 brought to pension plans. We discussed the Internal Revenue Service Form 5500-EZ with Joyce Kahn and Schedule SSA with Ann Junkins of the Service as well as others from the Social Security Administration. Lastly, we worked with Michael Seto, Ron Schultz and Theresa Pattera and others from the Exempt Organization group to discuss various topics that impact the exempt organizations and government entities. These topics included clarification of certain provisions of recent tax legislation; changes and other implications to the Form 990, Return of Organization Exempt from Income Tax; and filing requirements regarding foreign corporations, including the Form 8621, Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund and Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation.

The TE/GE Subgroup would like to extend our sincere gratitude to all the individuals with whom we worked this past year. Their openness and support allowed us to truly work as a collaborative team.

II. ISSUES AND RECOMMENDATIONS

Exempt Organizations

A. Legislation that Impacts the Form 990-T and the Form 990

Background

The IRS has responded in an official manner on a timely basis to requests made by the TE/GE subgroup regarding recent legislation that impacts the filing requirements for exempt organizations and governmental entities.

- **Public Disclosure of Form 990-T, Exempt Organization Business Income Tax Return:**

With the enactment of the Pension Protection Act of 2006 (PPA), Congress imposed a new requirement on all organizations exempt from federal income tax under IRC Section 501(a) and described in IRC Section 501(c)(3) to make available for public inspection a copy of any annual return filed under IRC Section 6011 relating to tax imposed under IRC Section 511. Thus, these exempt organizations must disclose to the public their tax returns, the Form 990-T.

The question arose, however, whether state colleges and universities are subject to this new law. Although the income derived by state universities is excluded under IRC Section 115 rather than IRC Section 501(a), they file the Form 990-T as required under IRC Section 511 and perform similar to private schools that are subject to this new law.

- **Prohibited Transactions:**

With the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), Congress designated certain transactions as prohibited tax shelter transactions, and imposed excise taxes on exempt organizations and, possibly, their managers, when they

participate in these transactions. Subsequently, the IRS revised the form 990 to require the exempt organization to indicate whether it was a party to such a transaction during the year.[1] Accordingly, the exempt organization community sought more guidance on the definition of a prohibited tax shelter transaction.

Recommendations and Discussion:

- **Form 990-T, Exempt Organization Business Income Tax Return:**

The TE/GE subgroup recommended that the IRS provide some guidance to the higher education community as to whether state institutions are subject to the new disclosure rule regarding their Forms 990-T.

The IRS issued this year Notice 2007-45 that provides, among other things, guidance with respect to this disclosure rule. Those state universities that file the Form 990-T but have not been recognized as exempt under IRC Section 501(a) are excluded from this disclosure requirement. However, those state institutions that exclude income under IRC Section 115 and have received recognition as exempt under IRC Section 501(a) are required to disclose this tax form.

- **Form 990, Return of Organization Exempt from Income Tax:**

The TE/GE subgroup recommended that the IRS provide guidance to exempt organizations when they are considered to have participated in a prohibited transaction.

The IRS issued this year Notice 2007-18 that provides, among other things, guidance with respect to the term “party to a prohibited transaction.” An exempt organization is a party to such a transaction if (1) it facilitates the transaction by reason of its exemption, indifferent or tax-favored status, or (2) the transaction is identified as a prohibited tax shelter transaction. This notice also gives examples.

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[1] Form 990, Return of Organization Exempt from Income Tax, Part VI, Other Information, Question 89(e).

Benefits to IRS and Taxpayer:

This guidance should serve to promote better compliance from the exempt organizations and governmental entities with respect to their disclosure and filing requirements.

B. The Redesigned Form 990, Return of Organization Exempt from Income Tax:

Background

In reaction to statements from Congress[2] and as part of an internal initiative to revise the form 990, the IRS has significantly redesigned its Form 990 by requiring additional information. Highlights of the redesigned draft can be found at www.irs.gov/pub/irs-TE/GE/highlightsform990redesign. The IRS anticipates this redesigned form to be available for filing for the 2008 tax year (returns filed in 2009).

In cooperation with public interest groups, this subgroup put forth verbal recommendations on the redesigned form in general as well as submitted written recommendations on the Schedule A, Supplemental Information for Organizations Exempt Under Section 501(c)(3), Schedule H, Hospitals, and Schedule K, Supplemental Information on Tax-Exempt Bonds.

Recommendations

Due to the voluminous information requested with the redesigned form, the objectives are to provide comments that provide for thresholds and certain transitions as a means to capture the essential information without unduly burdening the taxpayer. Also, it is in the best interest of all parties if the form requests critical information in the correct format.

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[2] On May 29, 2007, the Senate Finance Committee sent a detailed letter to the Secretary of the Department of Treasury requesting major revisions to the Form 990 as a means to gather more information and foster greater transparency than previously reported.

- **Recommendations in general are the following:**

  a. Define the term review in Part III, line 10, that requests whether the organization's governing body reviewed this form prior to filing. Review may include delegated authority as well as direct involvement;

  b. Define the term substantial in Part VII, line 8b, that requests whether the organization conducted a substantial part of its exempt activities through a partnership, LLC or corporation. The IRC provisions relating to exempt organizations define substantial anywhere from 2% to 85%;

  c. Reduce the number of years required to report endowment funds in Schedule D, Part XII as it relates to Part VII, line 6, for the past four years to include only the current and prior year. The prior year returns include this information, thus, this modification will avoid restating the same information;

  d. Define the term donor in Schedule F, line 5a, that asks whether any grantee is related to any person with an interest in the organization, including a donor. Note that charitable organizations receive numerous small donations from individuals and businesses without considering them as having an interest in the organization;

  e. Increase the threshold with respect to organizations that may file the Form 990-EZ.

- **Recommendation on Schedule A regarding supplemental information for charities, is the following:**

  a. The TE/GE subgroup recommends that the IRS include in the instructions a provision that allows charitable organizations that file as public charities under

Part II to compute the test on either the cash or accrual basis.[3] Note that the current Form 990 (not the redesigned draft) requires charitable organizations to compute this test on a cash basis only. This redesigned Form 990 makes no reference to this cash basis requirement and it is assumed that the charitable organization may compute this test using either method; however, specific reference in the instructions will highlight this change for those filers.

b. Previously, the accrual basis charitable organization was required to convert contributions from individual donors to a cash basis in order to complete this test, requiring a high administrative burden that is not justified by precedential authority, compelling reasons, or best business practices. The rationale was simply to assist small charitable organizations that keep their accounting records on the cash basis. Accordingly, this recommendation should assist and accommodate the large as well as the small charitable organization.

c. As evidence of the large taxpayers who rely on this test to maintain their public charity status, this subgroup submitted to the IRS a file that included at least 20 large charitable organizations that file the Schedule A using this test. The term large corporation is defined as an organization that uses the accrual basis accounting method with revenues ranging from $25 million to $3.5 billion.

- **Recommendations on Schedule H regarding hospitals include the following:**

  a. Consider making available to the hospitals the instructions, definitions and worksheets prior to the 2008 year. The information that hospitals are required

[3] This test refers to charitable organizations that maintain their public charity status under IRC Section 170(b)(1)(A)(iv)and (vi).

to report includes the entire year and without appropriate guidance, the information reported may be inaccurate and incomplete. Alternatively, consider a postponement in reporting this schedule until the information is available.

b. Include Medicare payments as part of community benefit in Part 1 on the grounds that these payments function similar to Medicaid payments. To the extent that they differ, consider a discount factor to apply accordingly.

c. Include the cost of patient care bad debt as part of community benefit to the extent that it covers low-income patients and can be tracked as a separate cost to the organization. Consider a discount factor, if appropriate.

- **Recommendations on the Schedule K are the following:**

a. Include a question on record retention practices in an effort to assess the integrity of managing bonds.

b. Include a question that asks whether the issuer has filed the Form 8038-T, Arbitrage Rebate, Reduction and Penalty in Lieu of Arbitrage Rebate, as required by the IRC, and, if not, whether it met an exception.

c. Consolidate the private use questions into one general question that asks whether each bond complies with these restrictions appropriately. The current questions can mislead a bond holder or credit agency into thinking that a bond has lost its exemption when, in fact, it has not since these questions fail, taken together, to address compliance as a whole.

d. Reduce the information requested in Parts I and II to changes that have occurred with respect to outstanding bonds rather than re-stating much of the information provided in the prior year returns.

Benefits to IRS, the Taxpayer and the General Public

This guidance should serve to promote better compliance and transparency from the nonprofit community with respect to how it operates and benefits the general public.

IRS Action(s):

The IRS will further evaluate these recommendations for the upcoming year.

C. Filing Requirements Regarding Foreign Corporations:

Background

With the recent attractiveness of foreign investments to investment brokers and management firms, many nonprofit organizations with modest to large endowments find as a matter of consequence that they are subject to foreign filing requirements which can be burdensome and overwhelming, resulting in attaching an excessive number of forms to their annual income tax returns. This increased burden has lead exempt organizations to question whether, due to their exempt nature, these forms apply to them and, if so, exactly how to file the forms completely and accurately.

- **Form 8621 - Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund:**

  a. This form subjects to taxation a U.S. person who invests in passive foreign investment companies (PFICs), i.e. foreign corporations which generate primarily passive income.[4] The rationale is to prevent a perceived abuse whereby a U.S. person could defer taxes on the foreign fund's earnings and

[4] Internal Revenue Code Sections 1291 – 1297

obtain capital gains treatment when the gains were realized by redeeming the stock.

b. The form includes three taxation regimes under the PFIC provisions: (1) the excess distribution regime that imposes an interest charge on excess distributions from PFICs; (2) the qualified electing fund (QEF) regime, if the U.S. investor so elects, that follows the rules similar to those for controlled foreign corporations; and (3) a third regime that allows the holders of marketable stock in a PFIC to make a Mark-to-Market election on an annual basis.[5]

c. Exempt organizations, however, are generally excluded from taxation on dividends paid by corporations, including foreign corporations, and on gains derived from sales of capital assets, including stock.[6] The notable exception is when the investment property is debt-leveraged, in which case, the dividend paid is subject to unrelated business income tax (UBIT) under the debt-financed rules.[7] Accordingly, based on these UBIT provisions, investments in PFICs which are not debt-financed do not trigger taxation under any of these regimes and, thus, by logic, should be excluded from filing this form.

d. The instructions, however, do not address this threshold issue, and, in fact, as written, leave the nonprofit organization in doubt as to whether it must file the form.

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[5] O'Donnell, 923 T.M., *Passive Foreign Investment Companies – Sections 1291-1297*.
[6] IRC Sections 512(b)(1) and 512(b)(5). The term corporation refers to a corporation recognized under subchapter C of the IRC.
[7] IRC Section 514.

- **Form 926 - Return by a U.S. Transferor of Property to a Foreign Corporation:**

  a. IRC Section 6038B, Notice of Certain Transfers to Foreign Persons, provides that "each U.S. person who transfers property to a foreign corporation in an exchange described in section 332, 351, 354, 355, 356, or 361, … shall furnish to the Secretary, at such time and in such manner as the Secretary shall by regulations prescribe, such information with respect to such exchange or distribution as the Secretary may require in such regulations".[8]

  b. These IRC provisions do not necessarily apply to exempt organizations. For instance, when an exempt organization establishes taxable subsidiaries, the tax consequences are not analyzed under the non-recognition provision of IRC Section 351.[9] In fact, the instructions to Part III confirm this position. Under this part, question 10, the taxpayer is required to describe the type of non-recognition transaction it conducted, and the instructions list only the IRC provisions mentioned above without any reference to the UBIT rules.

  c. The Treasury regulations and instructions do not give clear guidance on this threshold issue, leaving the nonprofit organization in doubt as to whether it must file the form and, if so, how to complete Part III.

Recommendation

Form 8621 - Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund:

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[8] IRC Section 6038B(a)(1)(A).
[9] LTRs 9016072 (Jan. 24, 1990); 9308047 (Dec. 4, 1992).

The TE/GE subgroup recommends that the IRS clarify whether and, if so, under what circumstances, exempt organizations are required to file this form.

The instructions reference exempt organizations by tax regimes, but do not make it clear as to whether and when this form, taken as a whole, should be filed. For instance, under the first tax regime, it states that the tax and interest rules of IRC Section 1291 apply only if the dividend from the PFIC is taxable to the exempt organization under Subchapter F, Exempt Organizations.[10] Whereas with the election regime, the instructions provide that the exempt organizations that are not taxable under Section 1291, may not make the election.[11] Accordingly, although technically correct, these detailed instructions without any overall guidance have given some exempt organizations the impression that they may have a filing responsibility with respect to this form. Yet, clearly, based on the form's rationale and the UBIT provisions, this filing requirement seems unnecessary.

- **Form 926 - Return by a U.S. Transferor of Property to a Foreign Corporation:**

The TE/GE subgroup recommends that the IRS clarify whether exempt organizations are required to file this form and, if so, how to complete Part III.

The Treasury regulations and the form instructions reference exempt organizations when discussing exceptions to filing this form, implying that but for this circumstance, they must file accordingly. The Treasury Regulations 1.6038B-1(b)(2)(A)(2) and (B)(2) and form instructions exclude exempt organizations from filing

[10] This language is derived from Treas. Reg. 1291(e).
[11] This language is derived from Treas. Reg. 1295(d)(6).

this form when transferring stock or securities under Section 367(a) when the exempt entity is the transferor and the income is not UBTI.

Although these regulations and instructions give the impression that exempt organizations may have a filing responsibility with respect to this form, based on a strict interpretation of the statute, this filing requirement does not appear to apply.

Benefit to IRS

Clarification regarding these threshold filings should serve to promote better compliance with exempt organizations as to their filing requirements and, if excluded from filing, will further contribute to its paper reduction initiative.

Benefit to the Taxpayer

Such guidance should help exempt organizations to file accurate and complete tax returns and, if excluded from filing, will reduce their administrative burdens.

IRS Action(s)

The IRS will further evaluate these recommendations for the upcoming year.

Employee Plans

A. REPORTING ISSUES RELATED TO THE PENSION PROTECTION ACT (PPA)

Background

On August 17, 2006, President Bush signed the Pension Protection Act of 2006 (PPA) into law. The Act contains many significant provisions relative to qualified plans, 403(b) accounts, government sponsored 457 plans, IRA accounts and certain tax-exempt entities. While the primary focus of the Act was on improving the funding viability of defined benefit plans, many provisions in the Act bring about changes for

defined contribution plans, such as 401(k) plans, and for Individual Retirement Accounts (IRAs).

The focus of this report will be the expansion of certain rollover and distribution opportunities with regard to employer sponsored plans and IRAs that were brought about by PPA. The reporting issues associated with these transactions have been identified and discussed by the TE/GE Subgroup and are outlined below. A total of six different distribution/rollover situations are being addressed in this report along with the issue of reporting distributions of "erroneous automatic contributions" made pursuant to an automatic enrollment program. [Note, for purposes of this discussion, the term "qualified plan" will refer to plans under section 401(a), 403(a), 403(b) and government 457 plans, as applicable. In addition, all references to the Form 1099-R Instructions refer to the 2007 version of these instructions.]

Recommendations

- **Reporting Issues With Regard to Certain Rollovers:**

The following distribution/rollover reporting issues should be added to or clarified in the Form 1099-R instructions as indicated below:

a. **Distributions from designated Roth accounts to participants:**

Distributions from non-qualified designated Roth accounts are reported with Code B in box 7 of Form 1099-R. For distributions that are *not* being directly rolled over, the Instructions do not address whether the 20% withholding applies to the earnings portion of the distribution. Confirmation of this withholding requirement is requested. A discussion of the 20% withholding and reporting requirement should be added to the instructions for:

"*Designated Roth account distributions"* and "*Designated Roth account*" discussions respectively on page R-7; and to the section entitled "*Eligible rollover distribution: 20% withholding*" on page R-8 and the discussion of the direct rollover requirements on page R-3.

b. Direct rollovers from designated Roth accounts to Roth IRAs or other eligible plans by participants:

Presumably this transaction would be coded as BG in box 7 of Form 1099-R since this code combination is apparently allowed but there is no confirmation of this code combination usage in the Form 1099-R instructions. Such guidance is needed to insure proper and consistent reporting among employer payers. Such guidance should be inserted on page R-3 of the Instructions under "*Reporting a direct rollover*" or under "*Designated Roth Accounts*" or both. Either a new sentence could be added at the bottom of the first paragraph in either (or both) sections or a separate new paragraph discussing the reporting scheme could be added. An additional sentence could also be added to the discussion of code G on page R-12.

Alternatively and in consideration of Item (e) below, a new code could be assigned to direct rollovers of designated Roth account distributions. Doing so appears necessary to avoid having to use a three-digit code in box 7 to indicate direct rollovers from designated Roth accounts to Roth IRAs by non-spouse beneficiaries as it was confirmed by the IRS Forms and Publications division that a three-digit code combination is not possible. Accordingly, Code H should be considered for this purpose. Code H is a retired distribution code

that was previously used to designate a direct rollover from a qualified plan to an IRA. Code H was eventually retired when it was no longer necessary to distinguish whether the rollover recipient was an IRA or another qualified plan. Payer systems may still carry code H on an inactive basis in their IT systems such that it might not be as much of a hardship to reactivate it as it would be to program for a new distribution code altogether.

c. Direct and indirect rollovers to Roth IRAs, effective beginning 2008:

In the case of a direct or indirect rollover of a non-Roth distribution from an employer sponsored plan to a Roth IRA, the taxable portion of the distribution would be taxable to the participant in the year the distribution occurs. The direct or indirect rollover to a Roth IRA should not in any way affect the otherwise taxable status of the distribution. Reporting recommendations in this regard are as follows:

1. Reporting *direct rollovers* to Roth IRAs:

   The gross distribution amount should be reported in box 1 on Form 1099-R and the taxable amount should be reported in box 2a; as opposed to entering zero as is normally the case when a code G is used. Code G would be placed in box 7 to indicate that the distribution was directly rolled over to a Roth IRA. The unique reporting combination of a taxable amount appearing in box 2a and a code G in box 7 would indicate that the distribution was taxable in the year received and rolled over to a Roth IRA. The Roth IRA Custodian would report the amount received as a rollover in box 2 of Form 5498 and the participant would

treat the amount as basis in the Roth IRA. In addition, the participant would report the rollover on a Form 8606, which should be revised for this purpose.

2. Reporting *indirect rollovers* to Roth IRAs:

   The distribution would be reported in the same manner as other eligible rollover distributions that are not directly rolled over by plan participants; e.g. a code 1, a 7 or a 4 would be entered in box 7; instead of a code G. In addition, 20% of the taxable portion of the distribution would be withheld and reported in box 4 of Form 1099-R just as it is now for other eligible rollover distributions not directly rolled over. If the participant later decides to roll over the distribution to a Roth IRA, the Roth IRA custodian would report the amount received as a rollover contribution in box 2 of Form 5498 and the amount would subsequently be treated by the participant as basis in the Roth IRA. The participant would also need to report the rollover on a Form 8606, which should be revised for this purpose as noted above.

It is also recommended that the Form 1099-R instructions include explicit guidance as to the reporting of direct rollovers to Roth IRAs by plan sponsors and the reporting of indirect rollovers to Roth IRAs by Roth IRA custodians in the appropriate places in the Form 1099-R Instructions.

d. Direct rollovers of distributions to Inherited IRAs by non-spouse beneficiaries:

While it is assumed that rollovers of non-Roth distributions to Inherited IRAs are to be reported using the combination of codes G and 4, the Form 1099-R instructions do not currently address these reporting requirements. It is recommended that the reporting requirements be specifically addressed: on page R-3 under "*Reporting a direct rollover,*" preferably as a new separate paragraph under that subsection; on page R-6 under "*Beneficiaries*"; and on page R-12 in the discussion of code G.

e. Direct rollovers from designated Roth accounts to Inherited Roth IRAs by non-spouse beneficiaries:

In the opinion of the TE/GE Subgroup, there is nothing in the applicable section of PPA that would preclude application of the non-spouse rollover option to designated Roth account distributions. Therefore, it is recommended that the reporting of such direct rollover transactions be explicitly addressed in the Form 1099-R Instructions. To this end, since a three-digit code, such as BG4, is not programmatically possible for the IRS, it is recommended that a combination of a new Code H and 4 be used in box 7. (See Item (b) above for the code H discussion). It is also recommended that the issue of rollovers of designated Roth accounts to Roth IRAs be addressed in the Form 1099-R instructions in the form of a new paragraph in the subsection entitled "*Designated Roth accounts*" on page R-3 and in the subsection entitled "*Designated Roth account*" on page R-7.

f. **Direct rollovers of eligible rollover distributions to Inherited Roth IRAs by non-spouse beneficiaries:**

It is recommended that direct rollovers of non-Roth amounts by non-spouse beneficiaries to Roth IRAs be reported in the same manner as such rollovers by participants, as described above in Item (c), except that the combination of codes G4 would be used in box 7. Under current law, an indirect rollover to an IRA (or Roth IRA) by a non-spouse beneficiary is not permitted.

- **Distributions of Erroneous Automatic Contributions Within 90 Days:**

Recommendations

The Form 1099-R instructions should include the following reporting guidance. The erroneous automatic contribution amount being returned plus attributable earnings would be reported as fully taxable in box 2a of Form 1099-R (to the extent the contribution amount is not a Designated Roth contribution). In box 7, a numeric combination of 2 and 8 could be used to designate that the distribution is a return of an erroneous automatic contribution that is taxable in the year distributed and that it is not subject to the 10% premature penalty. In addition, any amounts returned within six months of the close of the plan year that are in excess due to the failure of the actual deferral percentage (ADP) or actual contribution percentage (ACP) test, could also be reported in this manner. The sections entitled "*Corrective Distributions*" appearing on pages R-4 and R-5 would need to be revised to reflect this special treatment as would the section on "*Failing the ADP or ACP Test After a Total Distribution*" on page R-5. It is also recommended that a new paragraph be drafted to describe erroneous automatic contributions and that it be inserted after the section entitled "*Excess deferrals.*" The

sections entitled "*Excess Contributions*" and "*Excess Aggregate Contributions*" on page R-5 would also need to be revised to reflect the special treatment for the return of excess contributions and excess aggregate contributions within six months after the close of the plan year.

Guidance was also sought on how investment losses on erroneous automatic contributions should be handled; e.g. would the plan or employer plan sponsor be responsible for making the employee whole for investment losses or would such losses not have to be made up? It is recommended that the plan not be forced to make up investment losses as to require same would have an inequitable impact on the plan accounts of the other plan participants and further it could put the employer plan sponsor in the position of having to make non-deductible contributions to the plan. It is further recommended, if the employer plan sponsor is required to make up the loss through payroll, that this amount be reported as additional compensation (wages, salaries, tips) on Form W-2.

Discussion

Clarification as to whether distributions of erroneous automatic contributions would be reported on Form 1099-R or on Form W-2 was sought from the IRS. It was recommended by the TE/GE Subgroup that reporting of these distributions be performed on Form 1099-R in order to assure consistency with the reporting requirements applicable to comparable "excess" deferrals and contributions and because of the presence of earnings. It would be a potential hardship for plan administrators and confusing for affected participants to have the wage adjustment reported on Form W-2 but the earnings attributable to the returned deferrals reported on

Form 1099-R. In addition, since the returned deferrals plus earnings are taxable in the year distributed, this would cause particular confusion for participants to the extent the return takes place in the year following the year in which the compensation being returned was earned and otherwise taxable; i.e., the return in the subsequent year, if reported on Form W-2 would serve to misrepresent the actual compensation earned and deferred in that subsequent year.

Benefit to Payers

The TE/GE Subgroup believes that for all the items addressed above, the benefit to payers is the existence of needed guidance which will enable accurate and consistent reporting compliance and relieve the burden of reporting uncertainty.

Benefit to IRS

The TE/GE Subgroup believes that the provision, or expansion and clarification of reporting guidance for these PPA items would greatly enhance operational and reporting compliance and, as a result, would generate timely, consistent and accurate reporting among sponsoring employers and IRA custodians alike. Such enabled compliance could help insure the proper reporting and collection of the appropriate tax revenue.

Benefit to Taxpayers

The TE/GE Subgroup believes that plan sponsors and affected employees want to comply with their reporting obligations and pay the proper taxes due, as applicable. If there were clear, concise and consistent guidance available on how to accurately report these rollover and distribution transactions and how to treat them from a tax perspective, the subgroup strongly believes that both plan sponsors and affected

employees would be in a better position to comply with their respective reporting and any associated tax payment obligations.

B. REPORTING ISSUES NOT RELATED TO THE PENSION PROTECTION ACT (PPA):

Background

This report focuses on the prospective reporting requirements governing miscellaneous transactions that affect Individual Retirement Account (IRA) holders and IRA custodians alike. Two of the issues arose as a result of the passage of two separate laws in 2006; the Tax Increase Prevention and Reconciliation Act of 2005, (TIPRA) and the Tax Relief and Health Care Act of 2006 respectively. The third issue addressed in this report is one that has been addressed in prior years' TE/GE Subgroup Public Reports but unfortunately remains unresolved. The backgrounds for the three issues addressed are as follows. [Note: all references to the Form 1099-R instructions refer to the 2007 version of these Instructions.]

- **Eligibility, treatment and reporting of conversions from traditional IRAs to Roth IRAs and of Direct Rollover Distributions from Employer plans to Roth IRAs.** Section 824 of the Pension Protection Act of 2006 amended Code Section 408A(e) to allow for direct rollovers from qualified plans, §403(b) accounts and §457(b) governmental plans to Roth IRAs effective beginning 2008. Code Section 408A(c)(3) was amended to impose on such rollovers from employer sponsored plans, the same income restrictions applicable to conversions from IRAs to Roth IRAs, e.g. Adjusted Gross Income (AGI) not in excess of $100,000. TIPRA as passed in May of 2006, amended Code Section 408A(c)(3) to

eliminate the income restriction currently contained in Code Section 408A(c)(3), effective beginning 2010, meaning the restriction will no longer apply as of that date. Amounts that are converted from IRAs and/or rolled over from employer sponsored plan from plans to Roth IRAs beginning in 2008 are includable in taxable income in the year distributed to the extent the amount exceeds after tax basis.

- **Reporting of rollovers from IRA accounts to Health Savings Accounts (HSAs), effective beginning 2007.** Effective for years beginning in 2007 and thereafter, an eligible individual with an HSA account can take a one-time distribution from his or her IRA and directly roll it over to an HSA account as a contribution. The standard HSA contribution limits apply. An exception to the once in a lifetime rollover/contribution restriction is available if an eligible individual's coverage status changes from individual to family in which case, the eligible individual would have the opportunity to execute another IRA rollover to an HSA account. Only taxable amounts can be rolled over in this manner.
- **Reporting of corrections of excess SEP and SIMPLE contributions.** Simplified Employee Pension plans (SEP plans) and Salary Reduction Simplified Employee Pension Plans (SARSEP plans) and Savings Incentive Match Plans for Employees Plans (SIMPLE IRA Plans) are plans that are primarily adopted by small businesses, including self-employed individuals, other non-incorporated businesses and small corporations. Except in the case of SARSEP plans that by law cannot be adopted after December 31, 1996, the adoption and employee coverage of these plans has grown tremendously. With growth comes the need

for detailed operational and reporting compliance guidance. While some operational and reporting compliance guidance regarding the correction of excess deferrals and excess contributions can be found for SARSEP IRA plans in the IRS Form 1099-R instructions, no such guidance is included in the Form 1099-R instructions for the correction of excess contributions to SEP IRA accounts or excess contributions or deferrals to SIMPLE IRA accounts.

Recommendations

- **Recommendations for eligibility, treatment and reporting of Conversions from Traditional IRAs to Roth IRAs and of Direct Rollover Distributions from Employer plans to Roth IRAs.** Several discussions took place on this topic, however it will be a carry-over item for 2008 as no guidance has been issued as of this writing.
- **Recommendations for the Reporting of Rollovers from IRA accounts to HSA accounts.** The TE/GE Subgroup recommends that the IRS add a few sentences to the subsection entitled “IRAs Other than Roth IRAs,” which appears on page R-2 under the section of the Form 1099-R instructions entitled “IRA Distributions” in order to specifically address the reporting of one-time distributions from IRA accounts that are directly rolled over to HSA accounts. Likewise it is recommended that no special distribution coding be required for an IRA to HSA rollover transaction; i.e. the transaction is to be reported by IRA custodians as normal (code 7) or premature (code 1), whichever is applicable. Finally, it is recommended that the IRS add a discussion to the Form 1040

instructions for line 15 of the Form that details how a taxpayer is to report an IRA to HSA rollover transaction on his or her Form 1040.

- **Recommendations for the Reporting of Corrections of Excess SEP and SIMPLE Contributions.** The TE/GE Subgroup recommends that the IRS provide explicit guidance in the instructions for Form 1099-R as to how to properly report the distribution of excess contributions, including employee deferrals as applicable, made to SEP and SIMPLE IRA plans. The logical place for such a discussion would first be an addition to the subsection entitled "Excess Deferrals" on pages R-4 and R-5 to address the correction of excess SIMPLE deferrals and next, a new section could be added entitled something to the effect of "Certain Excess Contribution Amounts Made to SEP and SIMPLE Plans" which could be inserted after the section entitled "Certain Excess Amounts Under Section 403(b) Plans" appearing on page R-5.

  With regard to excess deferrals to SIMPLE IRA accounts and excess contributions to SEP and SIMPLE IRA accounts, the TE/GE Subgroup recommends that to the extent it can be demonstrated to the IRA custodian that adjusted reporting was performed by the employer or, alternatively, that the excess contribution amount will be returned to the employer, the excess contribution amount can be distributed with attributable earnings to the employee upon request, assuming the correction is taking place by the employees' tax filing date plus extensions. The principal excess contribution amount would be reported as tax free while the earnings would be reported as taxable to the employee. To this end, in the case of a self employed person, such adjusted

reporting could consist of information that no deduction was being taken for the excess amount contributed. This could also apply to the distribution of excess deferrals made to a SIMPLE IRA plan as self-employed individuals often make both types of contributions to SIMPLE IRA plan before they determine their earned income for the year.

To the extent such adjusted reporting is not to be performed by the employer and/or the excess funds are not to be returned to the employer, the excess contribution amount plus attributable earnings would be distributed to the employee upon request but the total amount would be reported as fully taxable to the employee. The same treatment would apply to the distribution of excess deferrals made to a SIMPLE IRA plan. This recommended reporting scheme approximates the corrective actions for excess SEP and SIMPLE contributions/ deferrals as outlined in Section 6.10 of Revenue Procedure (Rev Proc.) 2006-27 which pertains to the IRS Employee Resolution Compliance Resolution System (EPCRS).

Discussion

- **Eligibility, Treatment and reporting of Conversions from Traditional IRAs to Roth IRAs and of Direct Rollover Distributions from Employer plans to Roth IRAs.** As noted above, beginning in 2010, the income limits for making conversions from Traditional IRAs to Roth IRAs and direct rollovers of eligible distributions from employer plans to Roth IRAs, will be eliminated. In addition to the expanded eligibility for conversions brought about by PPA, TIPRA allows

taxpayers who convert (or roll over) in 2010 to both postpone taxation of the distribution/conversion until 2011 and spread the taxation of the conversion/ distribution over two years. Guidance is needed as to how this new income elimination and the availability of the special income tax spread rule will apply to direct rollover distributions to Roth IRAs from employer sponsored retirement plans.

- Operational questions left unanswered relate to the taxation and reportability of such conversions. Should the amount being rolled over to a Roth IRA be taxed and income tax withheld, if elected, prior to the direct rollover? If so, is the withholding subject to the 10% early withdrawal penalty just as it is in the case of a Traditional IRA conversion to a Roth IRA? If not taxed and income tax not withheld at the time of conversion, will there be separate coding to designate that the Roth account had not been taxed prior to moving the monies into a Roth IRA? Will the custodian need to keep the rolled over amount separate from the other basis in an already existing Roth IRA so as to report any subsequent distribution consisting of the rolled over amount as taxable? These are a few of the outstanding questions on treatment of this new provision.
- **Reporting of Rollovers from IRA accounts to Health Savings Accounts (HSAs).** The Form 1099-R Instructions currently do not contain any reference to or guidance for the reporting of one time rollovers of IRA distributions to HSA accounts, meaning the reporting of these IRA to HSA rollovers will vary from IRA Custodian to IRA Custodian and from IRA account holder to account holder. Many IRA account holders undoubtedly are expecting that IRA Custodians will

report these distributions as tax free on Form 1099-R (line 2a on the form left blank) while many Custodians, absent any guidance to the contrary, may plan to report these distributions as normal or premature, as applicable. Those IRA Custodians who assume that no special distribution/rollover coding on Form 1099-R is required, will undoubtedly be confronted by upset taxpayers who demand special coding in the form of subsequent reporting corrections, to support their own reporting of these transactions as tax-free. This would particularly be the case if guidance also does not appear in the Form 1040 Instructions. Alternatively, some Custodians may assume that special IRA to HSA rollover coding is in order and apply Code G in box 7 of Form 1099-R accordingly.

The recommendation above that no special coding be required for reporting IRA to HSA is indicative of the rationale invoked by the IRS for the reporting of Qualified Charitable Distributions (QCDs); i.e. the determination of eligibility and reporting of the transaction is the exclusive responsibility of the taxpayer. Allocation of reporting responsibility to the taxpayer is also appropriate in the case of IRA to HSA rollovers because an IRA custodian would not have any knowledge of a taxpayer's contribution eligibility or whether such a rollover transaction had already been performed at some other time, etc., and would have no means for independently obtaining or certifying such information. Any requirement to report distributions that are rolled over to HSA accounts with any special distribution code on Form 1099-R could compromise or counteract an IRA custodian's ability and desire to report distributions accurately and with

integrity. Notwithstanding, it is very important that the IRS include reporting guidance in the Form 1040 instructions to which affected taxpayers can refer and to which IRA Custodians can direct their clients who execute IRA to HSA rollovers.

- **Reporting of the Corrections of Excess SEP and SIMPLE Contributions.** IRS Publications 560 and 590 and Rev. Proc. 2006-27, which was subsequently amended, contain some limited information as to the treatment of excess SEP and SIMPLE contributions but such guidance is somewhat inconsistent and these publications would not normally be consulted for reporting guidance. Thus guidance with respect to the correction and reporting of distributions of excess deferrals and excess contributions needs to be substantially improved and expanded in the opinion of the IRPAC TE/GE Subgroup. As is, given the lack of guidance to the contrary, it is standard practice for IRA custodians to distribute excess contribution/deferral amounts from both SEP and SIMPLE IRA plans as non-taxable as in of Code Section 408(d)(4).

Proper reporting is further complicated by the fact that it is stated in IRS Publication 560 that excess SEP and SARSEP contributions are deemed to become employee IRA contributions except that the publication does not also indicate that such treatment would necessitate corrective reporting by the sponsoring employer to reflect the additional taxable compensation paid in the form of the employer SEP contribution treated as the employee's own IRA contribution. In addition, some sponsoring employers believe they can change their minds about making a SEP or SIMPLE IRA contribution and demand that

the IRA custodian return the contribution amounts to the employer on a tax free basis even though such amounts are not in excess of any limitation.

If there were explicit guidance in the Form 1099-R Instructions as to how to report the distribution of excess deferrals and excess contributions to SEP and SIMPLE IRA plans, what information IRA custodians need to obtain from plan sponsors or employees and what operational and reporting steps custodians should take with regard to requests for distributions of excess SEP and SIMPLE IRA deferrals and contributions (or change of mind contributions), custodians would be in a better position to more adequately and accurately report such distributions as taxable or non-taxable, as applicable, and be finally able to apply operational consistency.

Benefit to Payers

The TE/GE Subgroup believes that for all three items being addressed here, the benefit to payers is the existence of needed guidance which will enable improved compliance. Likewise clear and detailed guidance will serve to relieve the prevalent uncertainty as to how to report the transactions addressed and enable consistent reporting among payers.

Benefit to IRS

The TE/GE Subgroup believes that the provision or expansion and clarification of reporting guidance for the prospective rollovers to Roth IRAs once the $100,000 adjusted gross income (AGI) limit has been removed, IRA to HSA rollover transactions and distributions of excess deferrals and excess contributions to SEP and SIMPLE IRA plans would greatly enhance operational and reporting compliance and as a result

substantially reduce potential underreporting of taxable income and thereby increase the collection of appropriate taxes by the IRS.

Benefit to Taxpayers

Just as with payers, it is assumed that the plan sponsors and affected employees want to comply with their reporting obligations and pay the proper taxes due, as applicable. If there were clear, concise and consistent guidance available on how to accurately report rollovers to Roth IRAs once the $100,000 AGI limit has been removed, IRA to HSA rollover transactions and distributions of excess deferrals and excess contributions to SEP and SIMPLE IRA plans and how to treat them from a tax perspective, it is strongly believed that compliance by both plan sponsors and affected employees would substantially improve.

C. Form 5500:

Background

- **Alternatives to Electronic Filing:**

The Form 5500 and its related schedules are used by the Service and the Department of Labor (DOL) to collect information regarding employee benefit plans. In addition, the Form 5500-EZ is used by the IRS to collect certain information from employee benefit plans that are not subject to the Employee Retirement Income Security Act. Beginning in 2009, most Forms 5500 must be filed electronically with the DOL. However, certain portions of the current filings, including Form 5500EZ and Schedule SSA for Form 5500 (Annual Registration Statement Identifying Participants with Deferred Vested Benefits), will not be filed electronically with the DOL. Instead, the IRS, as the agency responsible for collecting data for the Form 5500EZ and Schedule

SSA, must determine other processes for plan administrators to submit the required information.

- **Form 5500-EZ Closing Agreement Program:**

On March 28, 2002, the DOL introduced the Delinquent Filer Voluntary Compliance Program (DFVC) that provides for reduced penalties for late filing of Form 5500. However, filers of Form 5500-EZ or filers of the Form 5500 where there are no common-law employees participating in the Plan cannot use the DFVC program. Under DFVC, a plan pays a set penalty amount of $10 per day (up to a maximum of $1,500 for small plans and a maximum of $4,000 for large plans).

Late filers of Form 5500-EZ or filers of the Form 5500 with no common-law employees must pay a penalty of $25 per day up to $15,000 for the late filing of these returns unless reasonable cause is established. Because the IRS has not published any guidelines as to what may constitute reasonable cause, some late filers may be reluctant to file in situations where the penalties, if not waived, would be severe.

Recommendations

- **Alternatives to Electronic Filing:**

The electronic filing requirement for Schedule SSA should not be burdensome to small filers. An analysis of recent Form 5500 filings would suggest that a few large filers report most of the participant names reported on the Schedule SSA. The analysis indicates that approximately 5% of the filers account for 85% of the participant names reported on Schedule SSA. Electronic filing of the Schedule SSA should be mandated for those filers who are responsible for the reporting the majority of participant names

and a paper filing option should be available to filers who must report a relatively small number of participants.

The TE/GE Subgroup made several recommendations to IRS regarding the paper replacement for Form 5500-EZ and its instructions.

- **Form 5500EZ Closing Agreement Program:**

The IRS should develop a closing agreement program for Form 5500-EZ and Form 5500 for plans with no common-law employees. The program should be patterned on the DOL DFVC program so that the delinquent filer program offered by the IRS would also provide for a reduced daily penalty amount and a significantly reduced maximum penalty amount.

Benefit to Payers, IRS and Taxpayers

- **Alternatives to Electronic Filing:**

The recommendations regarding Schedule SSA will provide IRS with an efficient method to capture Schedule SSA information in a manner that is not overly burdensome to filers. The recommendations regarding the new Form 5500-EZ will make the form easier to use and should result in fewer erroneous entries.

- **Form 5500-EZ Closing Agreement Program:**

A closing agreement program would benefit taxpayers by allowing them to become compliant with their filing obligations at a certain, modest cost. The program would benefit the IRS by increasing taxpayer compliance with filing requirements and providing the IRS with a better understanding of the universe of small owner-only plans. In addition, the closing agreement program may provide additional revenue to the IRS.

IRS Response

- **Alternatives to Electronic Filing:**

As to the recommendations regarding Schedule SSA, the IRS has indicated that it is reviewing its statutory authority to compel electronic filing of Schedule SSA information. The IRS has already implemented the recommendations regarding the new Form 5500-EZ and instructions.

- **Form 5500-EZ Closing Agreement Program:**

The IRS is currently investigating the feasibility of implementing a closing agreement program for Form 5500-EZ/5500.

Information Reporting Program Advisory Committee

Wage and Investment Subgroup Report

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October 24, 2007

I. INTRODUCTION

During the 2006-2007 IRPAC sessions the Wage and Investment Subgroup explored many key issues brought up by representatives of the W&I Operating Division. Several forms and form families, coming up for revision in their review cycle, were reviewed for proposed changes, and recommendations for any further changes.

Additionally, the subgroup surfaced an issue that could be a cost saving measure for the Service. Forms routinely mailed out by IRS Service Centers to taxpayers or practitioners were explored to determine their pertinence and continued need. Many returns are filed on forms generated by tax preparation software, with the mailed-out forms being discarded. Moreover, many of the mailed-out forms themselves simply are not needed for the vast majority of returns. Elimination of these mailings would save the Service operating funds.

Form 944, an annual form for payroll taxes and its impact on small businesses were explored in detail. The requirement to file Form 944 instead of Form 941 has caused unintended consequences discussed below. The history of the proposed regulation and complications that arose were reviewed and evaluated.

Form W-9 (Request for Taxpayer Identification Number and Certification) is used to collect information in order to issue the Form 1099-MISC. The form was discussed by all members of IRPAC with input resulting in clarification of the form and instructions.

The Form 1099 A/Form 1099 C (Acquisition and Abandonment of a Secured Property and Cancellation of Debt) issue was resolved with a minor change to the form directing the receiver to the publication.

II. ISSUES AND RECOMMENDATIONS

A. Form 944 Regulations and Impact

Background

IRS issued temporary and proposed regulations introducing the new Form 944 (Employer's Annual Federal Tax Return) effective January, 2006. The intent of the new form was to reduce burden on specific eligible small employers to just one employment tax return and payment per year. However, the implementation of the new regulations has caused unintended complications and confusion to a portion of the small employer community, payroll service providers, CPAs and the Service itself.

Some commercial tax preparers were unable to complete programming or elected not to pay additional fees for electronic submission of Form 944 causing more paper Form 944s to be filed. Notices of discrepancy were generated further confusing taxpayers who wanted to continue filing and paying their taxes as Form 941 filers using established procedures and more readily available software. Initially, IRS systems were not ready for taxpayers identified as Form 944 filers who electronically filed their first quarterly Form 941, causing taxpayers to be notified that IRS had switched their accounts from Form 944 to Form 941 after the original notification.

Many new employers were identified, erroneously, as Form 944 filers because the base determination period is the second prior calendar year, when the business did not exist. The initial IRS impact estimates predicted that 1 million taxpayers would be eligible to file and pay annually as Form 944 filers each year, with an additional 250,000 taxpayers added each subsequent year. The 2006 extract identified 646,000 taxpayers and the 2007 extract identified an additional 379,000 taxpayers. Although the initial first year impact was lower, the subsequent year is over 50% higher than expected.

As a result of this unintended inclusion a large number of Form 944s filed in 2006 showed much higher tax liabilities than the maximum $1,000 threshold. IRS Chief Counsel has acknowledged that there is some confusion and has estimated that at least 16% (101,000 Form 944 returns) exceeded the $1,000 threshold for 2006 filing.

The IRS deadline for opting out of the 944 filing requirement (April 1 of each year) caused confusion as well. By the time an inexperienced taxpayer understands what the Form 944 notification from IRS really means, the time allowed to switch to a Form 941 filer (prior to the first return filed for the tax year or April 1) may have elapsed.

The maximum threshold for filing an annual return is $1,000; however, the threshold for remitting taxes annually (with return) is $2,500. The different dollar amounts and levels are confusing to taxpayers.

Recommendations

(1) IRS should change the regulation to allow small employers to elect to file Form 944 annually or continue to file Form 941 quarterly, instead of being forced to file Form 944.

(2) IRS should increase the maximum annual tax liability for filing Form 944 to $2,500 to match the maximum for annual deposit frequency.

(3) IRS should consider the filing of a quarterly Form 941 as the indicator that the taxpayer wishes to opt out of the Form 944 filing designation. IRS should send a notification to the taxpayer to confirm the filing change.

(4) IRS should make the election to opt out of the Form 944 filing requirement permanent and not require an annual confirmation by taxpayers.

Discussion

Generally, qualifying employers will pay their tax liability when they file their Form 944 on January 31; however, those employers who exceed the maximum of $2,500 must pay on a monthly or semi-weekly frequency. Many employers are confused between the $1,000 liability maximum for Form 944 filing and the $2,500 tax liability maximum for annual tax payments.

The regulations state that employers are required to file Form 944 if notified in writing from IRS to do so, even when liabilities exceed the threshold of $1,000. This delays the IRS balance process for those employers who really do not fit the intention of the regulation thus creating a potential loophole for

fraudulent activity and possible additional cases contributing to IRS compliance workload or, ultimately, the tax gap. The IRS does not allow Payroll Service Providers to elect out of the Form 944 designation on behalf of the employer even with a fully executed Form 8655 (Reporting Agent Authorization), thus requiring the inexperienced taxpayer to contact IRS directly to make the election to opt out of the filing. This must be done each and every year as the regulations are currently written.

Allowing for a voluntary opt-in approach to Form 944 filing will maintain the intention of burden reduction for those small taxpayers that meet the criteria. It will also allow the employers, who may fall into the criteria unintentionally, to use the existing infrastructure and readily available options in fulfilling their employment tax requirements.

Benefit to Payers

Software vendors or payroll service providers would not have to program or maintain another form and payment process for a small subset of the employer market. By allowing the employer to opt out of the Form 944 program, small CPA firms or other vendors would be able to file the quarterly Form 941 electronically rather than filing the paper Form 944 tax return. Because of the complexity of limits, general confusion over 944 regulations, and tax notices generated, professional preparers would not have the burden of preparing informational documents or discussing the new and old rules for taxpayers.

Benefit to IRS

IRS will continue to reduce the number of tax returns and payments needing processing for small employers who wish to file and pay annually. The IRS will benefit from receiving electronically filed Form 941s, rather than face the burden of processing paper Form 944s. IRS will reduce their annual costs to notify and process requests from taxpayers who have already opted out of the 944 filing and who want to continue filing as Form 941 filers.

Benefit to Taxpayers

Employers who already have financial software packages that produce an electronic Form 941 file or who contract with a service provider that files electronically can continue to enjoy the benefits of automation in meeting their employment tax obligation. New business owners, who may have under-estimated their initial tax liability on Form SS-4, will be able to elect out of the Form 944 program just by filing a Form 941 during their first quarterly filing period.

B. Form W-9

Background

In 2006, a recommendation was made by IRPAC to revise Part II, item # 3 (clarification to definition of a U.S. Person) of Form W-9 (Request for Taxpayer Identification Number and Certification). The Form W-9 continued to be ambiguous enough to cause confusion to those completing the form. The form is used to gather information about payees such as legal name, TIN/EIN number, type of entity, etc. This information is then used by the payer when issuing a

Form 1099 to ensure the name and tax identification number on the Form 1099 is accurate, based on the information the payee provided to the payer on the Form W-9. One area of confusion lies with the definition of a limited liability entity since these entities can be taxed as an individual/sole proprietor, a corporation, an S-corporation or a partnership. Clarification of the form is essential to reflect the correct designation for a Limited Liability entity.

Recommendation

IRPAC made several recommendations to clarify parts of the Form W-9 which have already been agreed to by W&I points of contact. Additionally, the subgroup has recommended the expansion of the classification of limited liability entities. The change in the text for item # 3 in Part II, Certification, to clarify the definition of a U.S. person and the revised text and new heading of the section definition of a U.S. person were both made in 2006. There also were minor changes in format for the SSN and the EIN in Part I that were included in revision plans (for example, typographical matters such as changing lines to dashes so they would fax and photocopy more clearly).

Discussion

IRPAC believes that clarity and precision in completion of the Form W-9 is critical and clarification of any areas of ambiguity or confusion was essential. The W&I Division requested that the form be given great critical attention as it came up for planned revision and the IRPAC LMSB subgroup had also noted the need for greater clarity, for example, in the definition of “disregarded entity.”

Benefit to Payers

Identification of the correct entity for taxing issues and the ability to issue Form 1099-MISC to the correct entities will help ensure greater accuracy and increase compliance of those who are asked to complete and sign the W-9.

Benefit to IRS

Increased compliance and correct use of the Form W-9 will make it more reliable and valuable as an information document.

Benefit to Taxpayers

The ability to correctly fill out the W-9 Form with the correct entity information will ensure accurate reporting and compliance with tax regulations.

IRS Action(s)

W&I agreed that the following major changes to Form W-9 (Rev. September 2007) were warranted in view of the subgroup's recommendations:

- IRS changed the 3rd line of the entity section on the form to expand classification of limited liability entities.
- IRS revised the check boxes format for the SSN and EIN in Part I.
- IRS revised the text for item 3 in Part II, Certification, to clarify the definition of a U.S. person.
- IRS revised the text and added a new heading to the section for the Definition of a U.S. person.
- Under "What is backup withholding?" IRS added tax-exempt interest to the list of items subject to backup withholding per Notice 2006-93.

- Under "Specific Instruction," IRS revised the text for Limited Liability Company section to expand the entity classification portion.
- On page 4, IRS added a section for Identity Theft information because the taxpayer is providing their TIN to a third party.
- IRS will add language to the instructions for Requester of Form W-9; it need not include the language "(defined below)" in the third certification of substitute forms.
- IRS will change the Exempt check box to read "Exempt Payee."

C. Unnecessary Mailings

Background

The Service mails millions of forms and related instructions of many types to taxpayers and tax practitioners in many categories, including Form 941 (some 22 Million in 2006), Form 940 (some 6.6 Million), Form 1040 ES (nearly 6.4 Million for the first three payments for 2007) and Form 1040-ESV (about 9.5 Million in 2006).

Recommendation

The Service already has taken steps to identify taxpayers who do not need all of the forms they are receiving. Preliminary findings for Forms 1040 ES and ESV mailings alone indicate costs could be reduced (mailings could be reduced by 8 Million pieces). The IRS should continue this analysis across all mailed forms and IRPAC should continue to nominate forms, instructions and other mailings which could be explored for possible elimination.

Discussion

Many of these forms go to taxpayers who may use tax preparation software or who use a paid preparer, who in turn uses this software. In many cases, the software generates the appropriate forms and forms mailed by the IRS are discarded. There are also other forms taxpayers receive that they have no use for and discard. There are many cost factors involved in the Service's generating and mailing out of these unused forms and accompanying instructions to taxpayers and paid preparers: printing, postage and IRS handling costs are obvious factors. Non-Service cost factors include environmental impacts such as costs to produce the raw print stock and eventual disposal of the paper wasted.

Benefit to Payers

Practitioners will save considerable time fielding questions from their taxpayer clients who receive mailings from the IRS that are unnecessary and unused. IRS field activities will likely save time responding to similar queries from taxpayers.

Benefit to IRS

Resource savings will be realized from decreased print and publication paper purchase, printing, handling and postage costs, in addition to time saved responding to queries from taxpayers.

Benefit to Taxpayers

Reduction in unnecessary mailings received and time spent learning what to do with them.

D. Form 1099A/Form 1099C

Background

Form 1099A (Acquisition and Abandonment of Secured Property) is often issued by the lender when a home foreclosure takes place and Form 1099C (Cancellation of Debt) is issued by the lender when the debt is canceled. This was a carry over issue from 2006.

Recommendation

Language should be added on Forms 1099A and 1099C directing taxpayers to Publication 523 (Selling Your Home) for specific use of these forms.

Discussion

Real estate sales and home ownership have increased in the U.S. during the past few years due to low interest rates. Now, with increasing interest rates affecting many taxpayers, we are already seeing an increase in home mortgage foreclosures. At the August meeting IRPAC noted that there was no mention of a possible Section 121 exclusion of gain from a home sale either on the back of the copy of the 1099A/1099C received by the taxpayer, or consistently in Publication 544 (Sales and Other Dispositions of Assets.)

Benefit to Taxpayers

The taxpayer will be able to determine from the additional information in Publication 523 if they have Section 121 exclusion when receiving the Forms 1099A/1099C.

INFORMATION REPORTING PROGRAM ADVISORY COMMITTEE

SMALL BUSINESS/SELF-EMPLOYED SUBGROUP REPORT

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OCTOBER 24, 2007

Information Reporting Program Advisory Committee
Small Business Self-Employed Subgroup

I. INTRODUCTION

The Small Business and Self-Employed (SBSE) subgroup includes representatives of the tax preparer, information reporting, tax training and technology communities. Throughout the year, the subgroup met with IRS representatives to discuss a number of issues: development of a Schedule R for Form 941 and changes to Form 2678, changes to the B Notice processing procedures for Barter Exchange companies, and review of certain tax gap Internal Revenue Code (IRC) modifications for their impact on the information reporting community. In addition, the subgroup continued to observe the development of the proposed changes to the definition of broker for Form 1099 reporting purposes.

II. ISSUES

A. Creation/Modification of Schedule R (Form 941), Allocation Schedule for Aggregate Form 941 Filers

Discussion

IRS is creating a Schedule R for Form 941 - Allocation Schedule for Aggregate Form 941 Filers. Schedule R is to be completed each time an agent, approved by the IRS and defined by Section 3504, files an aggregate Form 941. Schedule R is used to allocate the aggregate information (wages, FIT, FICA, AEIC, and any payments) reported on Form 941 to each employer.

This form is in initial draft stages, and is scheduled for release in 2009.

Recommendations

Draft Schedule R (Form 941) has been passed to the full IRPAC for review and comments.

Benefits to Payers

Per Section 3405, agents as well as the employers/payers they represent, are liable for taxes. The Schedule R will appropriately allocate this liability among the employers/payers.

Benefits to IRS

IRS will have information sufficient to appropriately allocate liability amounts to employers/payers represented by agents filing aggregate Forms 941.

B. Revised Form 2678, Employer/Payer Appointment of Agent

Background

Agents as defined in Code Section 3504 are authorized to make deposits or payments of employment and backup withholding taxes. However, Form 2678 does not cover Form 940, Federal Unemployment Taxes. The form has historically been used by corporations to have one entity perform payroll and reporting functions for its related entities. The largest volume of Forms 2678 is now coming from recipients enrolled in homecare programs administered by state and local governments. The state and local governments generally contract with one or more vendors to administer the care programs, and the disabled or elderly service recipients often appoint an IRC 3504 agent to handle payroll and tax reporting using Form 2678. Changes were also made to accommodate these filers.

Recommendation

The SBSE Subgroup recommended changes to language in the form to clarify that the form is to be used for both wages and other compensation and by employers as well as non-employer payers.

Discussion

References were included, for example, to employers as well as payers, rather than exclusively to employers, as well as to compensation other than wages.

A check box was also added to allow the revocation of an existing agreement with an IRC Section 3504 agent.

Benefit to Payers

The form has been simplified, is easier to read, and the instructions are clearer.

Benefit to IRS

IRS is able to better identify agents through improved system programming.

IRS Action(s)

Most of the SBSE subgroup's recommendations were adopted.

C. Tax Gap Legislation

Background

Three tax gap bills that have been passed have come to the attention of the SBSE subgroup as having a potential impact on information reporting. The

SBSE subgroup was asked to make recommendations on any issues that might arise in the implementation of the Code for:

1. modification of collection due process procedures for employment tax collections; and
2. understatement of taxpayer liability by tax return preparers;

Discussion

Questions were raised during discussions on whether new notices should be drafted regarding the modification of the collection due process procedures for employment tax liability, and whether a tax preparer who files a protective claim for refund on behalf of a client can be penalized under the modifications to Code Sections 6694, 7701 and 6662.

Recommendation

The SBSE subgroup makes the following recommendations:

1. Modification of Collection Due Process Procedures for Employment Tax Liability

Under this provision, a levy issued to collect federal employment taxes is exempted from the pre-levy collection due process (CDP) hearing requirement if the taxpayer subject to the levy requested a CDP hearing with respect to unpaid employment taxes arising in the two-year period before the beginning of the taxable period with respect to which the employment tax levy is served.

Considering the extremely broad implications of the implementation of this section of the Code on the taxpayer, the SBSE Subgroup recommends that the notices for this levy not be a modification of the existing notices for levy, but that a separate notice regarding the exception from the pre-levy CDP hearing should

be created and drafted with care. The heading of the notice should clearly indicate that the taxpayer does not have a right to pre-levy CDP. The taxpayer should also be informed about his or her right to a post-levy hearing within a reasonable period of time.

As a procedural matter, the SBSE Subgroup recommends that the notices be sent by certified mail or return receipt requested to ensure that the taxpayer has received the levy notice. The collection process should start only after affirming that the taxpayer has been served the levy notice.

2. Understatement of Taxpayer Liability by Tax Return Preparers

The SBSE Subgroup recommends that the instructions include an explicit explanation of how the protective claims for refunds procedure is interpreted under Sections 6694 and 7701, clarifying that tax preparers who file such claims would not be subject to penalty under the modifications to the provisions.

Benefit to IRS

The protective claims process is an important mechanism for disclosure. A clear understanding by taxpayers that these claims are allowed under the new modifications to the law will increase disclosure and compliance.

Benefit to Taxpayers

The recommendations will minimize the possibility of any unintended, undue hardship to taxpayers.

Clarifying how protective claims are treated under the modifications to Sections 6694, 7701 and 6662 will remove certain concerns of tax preparers regarding the use of these claims.

D. Barter Exchange Backup Withholding and B Notice Requirements For Name-TIN Mismatches

Background

Barter Exchanges are defined as third-party record keepers under The Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) and are grouped together with financial brokerage companies for purposes of Form 1099-B reporting and subsequent B Notice solicitation requirements for name-TIN mismatches. Subject to certain exceptions, Section 3406 requires that B Notice form letters be sent to payees appearing on the CP2100/2100-A. The language in the B Notice specifically states that "the law requires us to backup withhold on interest, dividends, and certain other payments that we make to your account."

Barter Exchanges are unable to comply with the backup withholding requirements of Section 3406 because they are not in possession or control of any cash accounts for their clients. Barter Exchanges only control barter/trade accounts which hold "trade dollars," not cash. Consequently, the backup withholding language of the B Notice makes an assertion that withholding may occur, when it is impossible for Barter Exchanges to backup withhold, as a matter of fact. Barter Exchanges are then subject to 972CG penalties for the name-TIN mismatches.

In order to argue successfully for waiver of the penalty, payers must establish, pursuant to Section 6724, reasonable cause for the failures referenced on the Notice 972CG. In order to establish reasonable cause, payers must explain the manner in which they satisfactorily met the B Notice solicitation

requirements. While Barter Exchanges are able to send the appropriate B Notices, they are unable to effect backup withholding on the accounts of any recipients who fail to respond. Often, this practice results in a denial of the waiver request, even though all other reasonable cause requirements are met. Consequently, Barter Exchanges must then pursue the appeals process for the denial of the penalty waiver, an undue hardship that results simply from the Barter Exchanges' inability to effect backup withholding on non-cash accounts.

Recommendation

There are several methods of alleviating the problem including increased barter industry education, the creation of a revised B Notice that would be specific to barter exchanges, or legislation to exempt barter exchanges from backup withholding for Name-TIN mismatches.

Discussion

First, we recommend that the IRS educate the barter industry on the Form W-9 solicitation and Section 3406 backup withholding requirements through outreach programs that will be effective to reduce 972CG penalties in the future.

Second, we request that the language in the current B Notice be amended to provide language that would be more pertinent to the barter industry. This recommendation could be accomplished by adding the words "to the extent feasible" before the words "the law requires us to backup withhold." If modifications to current B notices are not possible, we recommend the creation of a B notice specific to Barter Exchanges that includes the aforementioned language.

Third, we suggest that Section 3406 be amended to exempt Barter Exchanges from the backup withholding requirement, since it is impossible for them to comply with the requirement as they are not in control of any payee cash accounts.

Finally, we recommend updating IRS Publication 1281, Backup Withholding for Missing and Incorrect Name/TINs, if any changes are made to the B Notice solicitation procedures reflecting the issues unique to the barter industry.

Benefit to Payers

The barter industry would be relieved of the undue burden of unnecessary penalties for failure to comply with a requirement that is impossible to comply with on its face.

Benefit to IRS

Internal IRS education on the issue would reduce campus burden. Amending the B Notice to provide a barter specific B Notice would increase compliance in the barter industry, thereby reducing the need for 972CG penalties, waiver requests and appeals. The exemption of backup withholding for barter exchanges would further reduce IRS burden by eliminating a backup withholding requirement that on its face cannot be effected.

In addition, modification of the B Notice to exclude reference to the backup withholding requirement, or to include a reference that backup withholding will be effected to the extent feasible, increases the credibility of the solicitation, which is

currently diminished as the result of reference to an action (backup withholding) payees understand would be impossible to take.

Moreover, it is now industry standard for Barter Exchanges to use the IRS TIN Matching Program at account set up to ensure that the proper name and TIN are obtained. Accordingly, most of the accounts appearing on the CP2100/CP2100-A have long been closed and those account holders are no longer doing business with the Barter Exchange.

Consequently, granting such an exemption or modification would not represent a significant loophole, since Barter Exchanges already require current W-9s from all their clients before proceeding to conduct business.

Benefit to the Taxpayer

Both education of the barter industry and/or amended B Notice language specific to the industry will result in more compliance. The exemption of Barter Exchanges from backup withholding requirements would not increase taxpayer non-compliance, as the barter industry, through use of the IRS TIN Matching Program, already insists on proper Name-TIN matching as a prerequisite of doing business with the taxpayer.

E. Expansion of the Definition of Broker Under Section 6045

Background

The definition of "broker," as defined in IRC Section 6045, is intentionally broad. Despite the definition's breadth, the IRS has determined that auction, consignment or similar transactions facilitated by third parties utilized by sellers and buyers do not come within the purview of this definition. As such, these

transactions are currently not subject to Form 1099-B, or other information reporting requirements.

Nonetheless, evidence indicates that a large number of people utilize traditional or digital auction, consignment or similar types of engagements to buy and sell property. We note that converting unneeded or unused personal property to cash through such transactions creates no income reporting obligation, as personal property sold at a loss is not deductible. In contrast, those persons utilizing auction, consignment or similar methods on a regular or frequent basis may be engaged in the conduct of a trade or business. Because business owners incur a tax liability as a result of profitable transactions, sales are reportable on Schedule C. The same result occurs for those persons engaged in the buying and selling of collectibles through auction, consignment or similar methods, as investment income is reportable on Schedule D.

It is probable that a significant number of these individuals either choose to ignore income reporting requirements or are unaware of their obligations in this regard, thus contributing to the tax gap.

Recommendation

IRPAC recommends that the definition of broker be further clarified or broadened to include within its parameters those third parties assisting, effecting or facilitating on a regular basis sales between buyers and sellers through auctions, consignment, or similar means.

Benefit to IRS

The IRS will benefit directly as it will receive information reporting on transactions effected through auction, consignment, or similar means. IRS research has demonstrated that increased information reporting results in increased taxpayer compliance, thus contributing to the closure of the tax gap.

Benefit to Taxpayers

Through IRS and other education efforts, taxpayers unaware of their income reporting and taxpaying obligations will receive the necessary information to assist them in complying with their obligations. In addition, taxpayers receiving reports of these sales will have a method of maintaining a yearly record of gross receipts, which will assist them not only in correctly completing their tax returns but in also taking the appropriate deductions for expenses incurred in the conduct of their trade or business, or sales of investment-grade collectibles or other property.

Information Reporting Program Advisory Committee
2007 Member Biographies

Chandra Bhansali

Mr. Bhansali has been President and co-founder of AccountantsWorld since 2000, located in Hauppauge, NY. AccountantsWorld offers an array of products and services to accountants including: AccountantsWorld.com—a portal for accountants and with over 100,000 members that is one of the most widely used resources for tax and accounting information, Payroll Relief—an online payroll processing center designed exclusively for accountants to help them offer payroll services to their clients, and Accounting Relief Pro—a web-based accounting system that lets accountants and their clients work collaboratively. . From 1984 to 2002, Mr. Bhansali was President of Micro Vision Software, the developer of the professional tax program, Tax Relief. Mr. Bhansali holds a PhD in Engineering from the State University of New York in Buffalo. Mr. Bhansali has been named one of the 100 Most Influential People in Accounting by Accounting Today for the past 5 years. **(SBSE Subgroup)**

Karen Botvin

Ms. Botvin is a Senior Manager with Vanguard Group, Inc., Investor Tax Services in Malvern, PA. She provides technical consulting and support services related to tax reporting and withholding for Vanguard's retail, institutional and brokerage clients. Ms. Botvin is also responsible for monitoring legislative, regulatory and judicial developments related to federal tax reporting and withholding matters. She is a member of the AICPA, the Pennsylvania Institute of Certified Public Accountants and the American Society of Pension Actuaries. She is a Qualified Pension Administrator and has an MS in Taxation from Widener University in Chester, PA. **(TEGE Subgroup, IRPAC Vice-Chair)**

Holly Carlin

Ms. Carlin has been the owner of Holly A. Carlin, CPA, Inc. in Park City, UT since 1998. Her business includes tax, accounting, financial planning, business consulting, IRS representation and mediation. Ms. Carlin is a member of AICPA, UACPA, NAEA, NSA, NATP and NSTP. She has a CPA License from the state of Utah and is also an enrolled agent. She received a BS in Education from Indiana University, a BS in Accounting from Weber State College, a post graduate certificate in Conflict Resolution from the University of Utah and an MS in Taxation from Washington School of Law. **(W&I Subgroup Chair)**

Marianne Couch

Ms. Couch is a founding member/manager of the COKALA Tax Group. She was formerly the Executive Director for the National Association of Form 1099 Filers Inc. and the Director of Research for Balance Consulting, Inc. in Ann Arbor, MI. She has worked for several years translating complex sections of the U.S. tax code and specializes in addressing tax regulations of international and Form 1099 reportable payments. Ms. Couch conducts annual corporate tax-training seminars instructing tax professionals in complying with IRS regulations. She

received her Juris Doctor, cum laude, from Michigan State University in 1995. **(SBSE Subgroup Chair)**

Erica L. Dinner Ms. Dinner has been with Hartford Life Insurance Company in Simsbury, CT since 1998. She is currently the Director, Tax Information Reporting which does centralized tax reporting for the entire company as well as preparing tax forms of their customers. She is a CPA and has a BS in Accounting from Simmons College, Boston, MA, and has a Masters in Professional Accountancy from Barry University, Miami Shores, FL. **(LMSB Subgroup)**

Charles F. Egender Mr. Egender was the owner of Charles F. Egender, CPA, P.A. from January 1993 until May 2005. His firm specialized in tax preparation, tax advising and business consulting. In May 2005, Mr. Egender merged his firm with Getz Tax Services, LLC in Bel Air, MD, which specializes in the same areas. In 1991 he retired from the Army as a Sergeant Major after 23 years of service. He started preparing tax returns in 1980 and has been electronically filing since 1991. Mr. Egender is a very active member of the Maryland Society of Accountants (MSA), serving on the Education, Legislative, Tax Affairs, Awards, and Nominating Committees. He has chaired the Policy and Procedures Committee and the Tax Affairs Committee. He is currently the Chair of the Seminar Planning Committee. From July 2003 to June 2004 he was president of MSA. He is also a member of the National Society of Accountants. In 2002 and 2004 he was selected as an Exemplary ERO. **(W&I Subgroup)**

Barry C. Faison Mr. Faison is the Chief Financial Officer for the Virginia Retirement System in Richmond, VA. He has had more than 28 years experience in directing a large fiscal staff which includes public pension, investments and benefits accounting. He is responsible for the System's GAAP reporting and the related disclosure requirements of the GASB Standards. Mr. Faison is a CPA and holds a CGFM certification from the Association of Government Accountants. He was the 2004-2005 president of the National Conference of State Social Security Administrators and is currently Chairman of the Audit Committee for the City of Richmond, Virginia. **(TEGE Subgroup Chair)**

Robert J. Foley Mr. Foley is Director of Product Tax at the State Street Bank and Trust Company in Boston, MA. He is a lawyer and has spent ten years supporting tax operations, new business installations and RFPs at State Street. He previously worked at the IRS Office of Chief Counsel and a law firm. He is a member of the Boston Bar Association and its Tax Section and is active on its International Tax Committee. He is also a member of the Securities Industry and Financial Markets Association (SIFMA) Committee on Tax Compliance and Administration. Mr. Foley

holds degrees from Boston University, Suffolk University Law School and Boston University School of Law (LLM in Taxation). **(LMSB Subgroup Chair)**

Paul Heller

Mr. Heller is Director, Bank Tax Withholding & Reporting for Royal Bank Of Canada in New York, NY. He has almost 30 years of corporate tax experience as a Director, Tax Attorney, Financial Director, Vice President, Tax Manager and Tax Analyst. He received his Juris Doctor from Case Western Reserve University School of Law in 1976. He is a member of the NY Chapter of Tax Executives Institute (Board Member, Chairman of LMSB Financial Services Subcommittee, Past President of Chapter); International Fiscal Association; American Bar Association; Ohio Bar Association and Committee of Banking Institutions on Taxation. **(IRPAC Chair)**

Richard Hollingsworth

Mr. Hollingsworth is the Manager of Tax Information Returns and Cost Basis departments for H&R Block Financial Advisors, Inc. located in Detroit, MI. He manages client and government reporting for a broker dealer that is a wholly owned subsidiary of the largest tax preparer in the country. He is a member of the AICPA, the Michigan Association of Certified Public Accountants and the National Association of Form 1099 Filers, Inc. and the Securities Industry Association. Mr. Hollingsworth earned his MBA in finance from Indiana University. **(LMSB Subgroup)**

Nadine K. Hughes

Ms. Hughes is a Vice President of Agency Services of CompuPay, Inc. in Miramar, FL. She has been working in the payroll service provider industry for the past 20 years. Ms. Hughes is a member of the Reporting Agent Forum (RAF) for over 10 years and is a member of the American Payroll Association. She has a BS in Education and has taught study classes for the national certification of payroll professionals (CPP). (**W&I Subgroup)**

Edward J. Jennings

Mr. Jennings is the Corporate Tax Manager at the University of Michigan in Ann Arbor, MI. He serves as a tax consultant on various tax issues, including unrelated business income tax, employment taxes, excise taxes, retirement plans and fringe benefits, bonds, charitable giving, and state and local tax matters. He is a member of the National Association of College and University Business Officers (NACUBO) Tax Council since 2001 and recipient of the 2007 NACUBO Tax Award. He graduated with a B.S. in accounting from St. Joseph's University (Philadelphia, PA) and has a CPA license. He received his JD from Wake Forest School of Law in Winston-Salem, NC. **(TEGE Subgroup)**

Virgil A. Julian Mr. Julian is the owner of the Julian and Company CPA PC in Independence, MO. He is a CPA and has been preparing federal income tax returns for over 62 years since 1942, the first year Americans had to file voluntary income tax returns. In addition to being in practice he has been in the following businesses: Air Charter Service; Motion Picture Exhibitor, (15 theatres); started, built and sold a cable television company, a redevelopment company, many specialty stores, specialty goods, glassware, coffee, restaurants, ice cream parlors, and others. He presently has a flower and gift shop. Mr. Julian is a life Member of the American Institute of Certified Public Accountants (AICPA) and a member of the Missouri Society of Certified Public Accountants (MS/CPA) and the Missouri Association of Tax Practitioners (MATP). He is a Rotarian and a Mason. **(SBSE Subgroup)**

Samuel W. Kerch Mr. Kerch is a CPA and Controller/Senior Tax Research Analyst with Symmetry Software in Scottsdale, AZ. He directs all corporate accounting and payroll, financial reporting and preparation of withholding and income tax returns. In addition he does payroll tax law research for software program development and customer support. Mr. Kerch is a member of the American Payroll Association and the Association of Certified Fraud Examiners. He has a Master of Accounting and Financial Management from Keller Graduate School of Management… **(SBSE Subgroup)**

Katherine S. Kinnicutt Ms. Kinnicutt is the Manager of the IRA and Qualified Plan Technical Operations and Compliance area of the Retirement Plan Services Department of Raymond James & Associates in St. Petersburg, FL. She provides research and analysis for retirement savings products (defined contributions plans, Traditional, Roth, SEP and SIMPLE IRAs, and 403(b) plans and accounts) that Raymond James offers to employers and individuals; monitors, develops and revises operational procedures, including tax reporting procedures, and IRA documents as needed for compliance purposes; counsels Financial Advisors with regard to retirement issues and oversees the prototype plan operation at Raymond James. She has more than 25 years experience in the retirement field in various capacities including her current manager position, as a retirement technical assistant to Senior Vice President of Retirement Plan Services, an actuarial assistant and as an assistant to a plan administrator. Ms. Kinnicutt earned a Certified Employee Benefits Specialist (CEBS) designation from the International Foundation of Certified Employees Benefits and the Warton School in 1993 and a BA degree, cum laude, from Vassar College. **(TEGE Subgroup)**

Jon Lakritz

Mr. Lakritz is a Vice President with JPM Chase Bank in New York, NY. He has responsibility for the firm's tax information reporting and withholding for a wide variety of transactions and clients. He is a certified public accountant, and is a member of the AICPA and the New York State Society of CPAs. He currently serves on the Tax Compliance and Administration Committee of the Securities Industry and Financial Markets Association (SIFMA). Mr. Lakritz holds a BS in Accounting from the State University of New York, and an MS in Taxation from Pace University. **(LMSB Subgroup)**

Timothy McCutcheon

Mr. McCutcheon is the President of Fort William LLC in Milwaukee, WI. Fort William LLC is a provider of software tools for the employee benefits professional. The firm offers government forms software as well as retirement/welfare plan document software. He is a member of the American Society of Pension Professionals and Actuaries (ASPPA), and the Wisconsin Bar. Mr. McCutcheon has a JD from the University of Wisconsin Law School and an MBA from Northwestern University. **(TEGE Subgroup)**

Maria Murphy

Ms. Murphy is the Director, Washington National Tax Services at PricewaterhouseCoopers LLP in Washington, DC. She works on domestic and international tax matters specializing in information reporting. Ms. Murphy is an adjunct professor at Howard University School of Business. She is a member of the American Bar Association, AICPA and the National Association of Black Accountants. Ms. Murphy received her Juris Doctorate from Widener University School of Law and a Masters of Laws in Taxation from Georgetown University Law Center. **(LMSB Subgroup)**

Suzanne Sullivan

Ms. Sullivan is a Senior Vice-President and Senior Financial Manager at the Bank of America in Providence, RI. She advises businesses enterprise-wide on any information reporting and withholding issues. She is also a business partner to the Personnel Department providing advice on payroll, executive compensation and other tax-related compensation issues. She is a member of the Rhode Island Bar Association, and the Bank of America representative to The Clearing House and to the Securities Industry Financial Markets Association. Ms. Sullivan received her B.A. from Amherst College and her JD from Harvard Law School. **(LMSB Subgroup)**

Regina D. Tarpley

Ms. Tarpley has been an Enrolled Agent for the past three years. She and her partner have owned and operated T&M Tax Service, Inc. dba Jackson Hewitt Tax Service for the past ten years. For tax year 2005,

their four offices did over 5,000 returns including individual, business and corporate tax returns. Prior to 1997, she was an administrative manager for eighteen years doing payroll, human resources and customer service. Ms. Tarpley earned a Master of Business Administration in 1994. She is a member of the National Association of Enrolled Agents, the National Association of Tax Practitioners, the National Society of Tax Professionals and other professional organizations. **(SBSE Subgroup)**

Faye Touchet

Ms. Touchet is and Enrolled Agent and the Principal of Faye Touchet, EA in Lafayette, LA. Her professional tax practice offers services which include tax preparation, maintaining and/or consulting on accounting systems and representation before the Internal Revenue Service. She is a member and past president of the National Association of Enrolled Agents and a member and past president of the Louisiana Society of Enrolled Agents. Ms. Touchet is part of a speaker cadre for the IRS Small Business Workshops. **(W&I Subgroup)**

Ron Whitney

Mr. Whitney is CEO of the Barter Network Inc. in Chadds Ford, PA. He was the founder of the Philadelphia region's largest barter exchange with over 1,100 participating businesses. He is responsible for negotiating complex barter transactions with participating businesses. Mr. Whitney is a member of the National Association of Trade Exchanges, the International Reciprocal Trade Association, the Chadds For Business Association, and the Chester County, New Castle County and Southern Chester County Chambers of Commerce. He received his JD from the Widener University School of Law. **(SBSE Subgroup)**

Ralph Zerbonia

Mr. Zerbonia is a Tax Principal at UHY Advisors, Inc. in Southfield, MI. He works with all tax returns, researches tax problems, does tax planning with clients, tax accrual review of certified financial statements and has worked with IRS on all tax matters. He is a member of the AICPA and the Michigan Association of Certified Public Accountants. He received a Master of Science in Taxation from Walsh College. **(W&I Subgroup)**