Federal, State & Local Governments NEWSLETTER

July 2014

This is the semiannual newsletter of the office of Federal, State and Local Governments (FSLG) of the Internal Revenue Service (IRS). Our mission is to ensure compliance by Federal, state, and local governmental entities with Federal employment and other tax laws through educational and compliance review activities.

For more information, visit our web site at www.irs.gov/govts. For account-related assistance, contact Customer Account Services at 1-877-829-5500. To locate an FSLG Specialist in your area, see the directory at the end of this newsletter.

The explanations and examples in this publication reflect the interpretation by the IRS of tax laws, regulations, and court decisions. The articles are intended for general guidance only, and are not intended to provide a specific legal determination with respect to a particular set of circumstances. You may contact the IRS for additional information. You may also want to consult a tax advisor to address your situation.

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UPDATE ON THE AFFORDABLE CARE ACT

There have been a number of recent developments in the world of the Affordable Care Act (ACA). In this article, we want to highlight a few of the major changes that may affect government entities. We will cover the release of final regulations, and delayed effective dates, of the Employer Shared Responsibility Provisions and Information Reporting of Health Coverage. Along with releasing final regulations, the Treasury Department and the IRS also announced that the effective date of these provisions would be extended an additional year, to 2015. We will also address the due date to report and pay the Patient Centered Outcomes Research Institute Fee on the second quarter Form 720, Quarterly Federal Excise Tax Return.

Employer Shared Responsibility Provision

Under the ACA's employer shared responsibility provisions, effective for calendar year 2015, you may have to make a payment if you do not offer coverage to your full-time employees (and their dependents) or if you offer coverage that does not provide minimum value or that is not affordable to your full-time employees, and one or more full-time employees gets a premium tax credit. The employer shared responsibility provisions only apply to applicable large employers, generally meaning an employer that employed an average of at least 50 full-time employees (or 50 full-time equivalent employees, in the case of an employer with part-time employees) during the previous year. On February 12, 2014, the final regulations for IRC Section 4980H, Shared Responsibility for Employers Regarding Health Coverage, were published in the Federal Register as Treasury Decision (TD) 9655. In addition, the IRS issued a series of frequently asked questions, available on the IRS ACA web page. The answers provided with these frequently asked questions provide information on the basics of the employer shared responsibility provisions, transition relief, the 2015 effective date, and other noteworthy items.

Information Reporting Provisions

Final regulations were also issued for two information reporting provisions of the ACA, IRC Sections 6055 and 6056. Final regulations for IRC Section 6055, Information Reporting of Minimum Essential Coverage, were published in the Federal Register on March 10, 2014, as TD 9660. Additionally, the final regulations for IRC Section 6056, Information Reporting by Applicable Large Employers on Health Insurance Coverage Offered Under Employer Sponsored Plans, were published in the Federal Register on March 10, 2014, as TD 9661. The regulations provide guidance for complying with the information reporting provisions to those responsible for reporting under the respective provisions.

Effective Date for Information Reporting Provisions

The final regulations provide that the information reporting provisions will apply to calendar years beginning after December 31, 2014. However, if you have a reporting responsibility under either or both provisions, you are encouraged to voluntarily report for 2014 to test your reporting systems and plan designs. This may contribute to a smoother transition to full implementation for 2015.

PCORI

The Affordable Care Act provides for the establishment of a private, nonprofit corporation, the Patient-Centered Outcomes Research Institute (PCORI). The Institute was created to assist patients, clinicians, purchasers and policy makers in making informed health decisions by advancing the quality and relevance of evidence concerning the manner in which diseases, disorders, and other health conditions can effectively and appropriately be prevented, diagnosed, treated, monitored and managed. The Institute is funded in part by a fee, imposed under Code sections 4375 and 4376, that is paid by issuers of specified health insurance policies and sponsors of applicable self-insured health plans.

The fee applies to policy or plan years ending after September 30, 2012, and before October 1, 2019. The fee is equal to $1 multiplied by the average number of lives covered under the policy or plan year ending after September 30, 2012, and before October 1, 2013. For policy and plan years ending after September 30, 2013, and before October 1, 2014, the fee is equal to $2 multiplied by the average number of lives covered under the policy or plan year. Finally, for policy and plan years ending after September 30, 2014, and before October 1, 2019, the fee will be adjusted based on national health expenditures.

Issuers and plan sponsors report and pay the fee annually on the second quarter Form 720, Quarterly Federal Excise Tax Return. This return is due on July 31 of the calendar year following the last day of the policy or plan year. Thus, if you sponsored a self-insured health plan with a plan year ending on September 30, 2013, your Form 720 would be due July 31, 2014, to report and pay the fee for that plan year.

If you think you may be responsible for the PCORI fee, please visit the PCORI webpage at www.irs.gov.

Other Provisions

This article was designed to highlight a few key provisions of the ACA that may affect government employers. Please visit the ACA website at www.irs.gov to learn more about other provisions that may affect government employers.

PROTECTIVE CLAIMS

If you believe you have overpaid your employment taxes, you have a limited amount of time in which to file a claim for a credit or refund. You can claim a credit or refund by filing the "X" form that corresponds to the return being corrected. The "X" forms (e.g., Form 941-X, "Adjusted Employer's QUARTERLY Federal Tax Return or Claim for Refund" and Form 944-X, Adjusted Employer's ANNUAL Federal Tax Return or Claim for Refund) are used to claim refunds, make adjustments, and request abatements of employment taxes. A separate claim must be made for each return for each tax period in which there was an error. Visit the IRS website and enter the keywords "*Correcting Employment Taxes"* for links to the X forms, and to Revenue Ruling 2009-39, which provides examples showing how the claim for refund process operates.

Generally, you must file a claim for a credit or refund within 3 years from the date you filed your original return or 2 years from the date you paid the tax, whichever is later. A special rule applies to returns reporting social security and Medicare taxes or Federal income tax withholding. Returns for a calendar year are considered filed on April 15 of the succeeding year if filed before that date. For example, if you filed your 2012 fourth quarter Form 941 on January 25, 2013, the IRS treats the return as if it were filed on April 15, 2013. To file a timely claim, you must file Form 941-X by April 15, 2016. If you do not file a claim within this period, you may no longer be entitled to a credit or a refund. If the due date to file a return or a claim for a credit or refund is a Saturday, Sunday, or legal holiday, it is considered filed on time if it is filed on the next business day.

If your right to a refund is contingent on future events and may not be determinable until after the time period for filing a claim for refund expires, you can file a **protective claim** for a refund on the appropriate "X" form. Protective claims are often based on current litigation or expected changes in the tax law, other legislation, or regulations. A protective claim preserves your right to claim a refund when the contingency is resolved. A protective claim does not have to state a particular dollar amount. It is suggested that you write $1 if the *exact* amounts are not known. If the amounts are known, you can record the known amounts or $1. To be valid, a protective claim must:

- Be in writing and be signed,
- Include your name, address, taxpayer identification number, and other contact information,
- Identify and describe the contingencies affecting the claim, and
- Identify the specific tax periods for which a refund is sought.

In this situation, you should clearly alert the IRS that you are filing a "Protective Claim" and describe the contingency or anticipated tax law change that is causing the claim to be made. To do this, it is strongly recommended that you write "Protective Claim" on the top of the first page of the "X" form in addition to including it in the description. If the claim is not clearly marked as "protective" any amounts reflected may be incorrectly processed, causing unnecessary problems with your account.

Generally, the IRS will delay action on the protective claim until the contingency is resolved. Once the contingency is resolved, the IRS will request perfected information (e.g., perfected claim amounts) from you. This perfected information will be used to process the claim as appropriate (i.e., allowed in full, allowed in part or disallowed in full).

An employer can protect employee rights to recover overcollected social security and Medicare taxes by repaying or reimbursing overcollected amounts. Alternatively, an employer may obtain the employee's consent to the filing of the refund claim. An employer need not repay or reimburse its employees, or obtain the employees' consents for the filing of a refund claim prior to filing the claim, in order for the claim to be valid. However, the employer must repay or reimburse its employees or obtain the employees' consents before the IRS can grant the claim.

File your claim by mailing it to the address shown in the instructions for the "X" form.

You may contact an FSLG Specialist if you have questions about this procedure. A directory appears at the end of this newsletter.

SUPREME COURT RULES ON SEVERANCE PAY

In a March 25, 2014, decision (*United States v. Quality Stores*, 134 S.Ct. 1395), the United States Supreme Court held that severance payments made to involuntarily terminated employees were wages subject to social security and Medicare (FICA) taxes.

As a result of the decision, the Service will disallow all claims for refund of FICA taxes on severance pay.

In our July 2013 issue, we discussed the tax treatment of severance payments made by government entities to terminated employees. In the article, we noted that under Internal Revenue Code (IRC) section 61, severance pay is included in the gross income of the recipient, and normal income tax withholding rules apply. In addition, the Service's position has been that severance pay is generally wages for purposes of FICA taxes. This position is based on the IRC, revenue rulings, and court decisions. Our article reviewed conflicting court decisions on this subject, and indicated that protective claims that had been filed based on legal developments would continue to be disallowed pending the outcome of the case before the Supreme Court.

Revenue Ruling 90-72 provides a limited administrative exception for certain payments that supplement state unemployment compensation, sometimes referred to as SUB-pay. The revenue ruling provides for an exception for a stream of payments coordinated with the receipt of unemployment compensation. It specifically points out that a lump-sum payment would not qualify for the exception.

The Supreme Court decision did not address the provisions of Revenue Ruling 90-72. Therefore, payments that meet the requirements stated in that ruling continue to be excluded from wages for FICA purposes.
If you have questions about severance pay, you may contact an FSLG Specialist. A directory is provided at the end of this newsletter.

Q&A ON TAX TREATMENT OF DIFFICULTY OF CARE PAYMENTS

On January 3, 2014, the IRS issued Notice 2014-7, addressing the income tax treatment of certain payments to an individual care provider under a state Home and Community-Based Services Waiver (Medicaid waiver) program. The notice provides that the IRS will treat "qualified Medicaid waiver payments" as difficulty of care payments excludable from gross income under § 131 of the Internal Revenue Code. For purposes of the notice, qualified Medicaid waiver payments are payments by a state, a political subdivision of a state, or a certified Medicaid provider under a Medicaid waiver program to an individual care provider for nonmedical support services provided under a plan of care to an individual (whether related or unrelated) living in the individual care provider's home.

The notice applies for income tax purposes only. The notice does not address when qualified Medicaid waiver payments are subject to Federal Insurance Contributions Act (FICA) tax (i.e., social security and Medicare taxes).

In March, the Service released a set of seven questions and answers on issues related to the notice and the filing of a return.

The IRS may release an additional set of questions and answers on other issues, including the application of FICA to qualified Medicaid waiver payments excludable from income under the notice. Please visit the FSLG website periodically to check for additional information on this topic.

FINAL REGULATIONS ON DESIGNATION OF PERSON TO PERFORM ACTS OF AN EMPLOYER

Governmental entities who share employees with other employers should be aware of recently released Treasury Decision 9662, providing final regulations under section 3504, Designation of Payor to Perform Acts Required of an Employer. These regulations were published in the Federal Register on April 1, 2014. The regulations are effective for wages or compensation paid in quarters beginning on or after March 31, 2014.

The regulations address a longstanding collection issue for the Service by providing authority to impose employment tax liability against a third-person (payor) that pays wages or compensation to individuals performing services for an employer (client) pursuant to a service agreement.

The determination of the parties' employment tax obligations in a three-party arrangement is a resource-intensive analysis of complex facts and circumstances. The Service intends that the regulations assist both taxpayers and the Service in determining the parties' employment tax obligations when a payor enters into a service agreement with a client and represents to its client that it will pay the employment taxes with respect to wages or compensation it pays to employees for services performed by the employees for the client.

Under the regulations, if a payor pays wages or compensation to individuals performing services for a client pursuant to a service agreement between the payor and the client, the payor may be designated to perform acts of an employer, including assuming liability for the employer's employment taxes, with respect to the wages or compensation paid by the payor to those individuals. If a payor is designated under the regulations, the payor and employer are subject to all provisions of law applicable to the employer. Although the Service will only collect the employer's employment taxes once, the Service may collect an employer's employment taxes from either the payor or the employer.

The regulations define a service agreement as an agreement pursuant to which the payor (1) asserts it is the employer (or "co-employer") of the individuals performing services for the client; (2) pays wages or compensation to the individuals for services the individual(s) performs for the client; and (3) assumes responsibility to collect, report, and pay, or assumes liability for, any employment taxes with respect to the wages or compensation paid by the payor to the individuals performing services for the client.

The payor may implicitly or explicitly assert that it is the employer (or co-employer) of the individuals performing services for the client, including by agreeing to (a) recruit and hire employees of the client or assign employees as permanent or temporary members of the client's workforce, (b) hire the client employees as its own and then provide them back to the client, or (c) file employment tax returns using the payor's employer identification number.

The regulations provide that a payor will not be designated to perform acts of an employer if the payor (1) files employment tax returns using the client's employer identification number (i.e., the payor is a payroll service provider or reporting agent), (2) is a common paymaster, (3) is the employer of the individuals (either the common law employer or a section 3401(d)(1) employer), or (4) is treated as an employer under section 3121(a)(2)(A) (relating to payments made for sickness or accident disability).

The example below illustrates the general application of the regulations.

Example: Corporation P enters into an agreement with Employer, effective January 1, 2015. Under the agreement, Corporation P hires the Employer's employees as its own employees and provides them back to Employer to perform services for Employer. Corporation P also assumes responsibility to make payment of the individuals' wages and for the collection, reporting, and payment of applicable taxes. For all pay periods in 2015, Employer provides Corporation P with an amount equal to the gross payroll (that is, wage and tax amounts) of the individuals, and Corporation P pays wages (less the applicable withholding) to the individuals performing services for Employer. Corporation P also reports the wage and tax amounts on Form 941, Employer's QUARTERLY Federal Tax Return, filed for each quarter of 2015 under Corporation P's employer identification number. Corporation P is not a common paymaster, the employer of the individuals (including an employer within the meaning of section 3401(d)(1)), or treated as the employer of the individual under section 3121(a)(2)(A). Corporation P is designated to perform the acts of an employer with respect to all of the wages Corporation P paid to the individuals performing services for Employer for all quarters of 2015. Employer and Corporation P are each subject to all provisions of law (including penalties) applicable in respect of employers for all quarters of 2015 with respect to such wages.