

TAX TALK TODAY®

SPECIALTY TAXES: ESTATE AND GIFT AND EMPLOYMENT TAXES

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Brought to you by the IRS and produced by L&M Production Design Group, based in Alexandria, VA, Tax Talk Today® is a free, live, monthly interactive Webcast aimed at educating tax professionals on the most contemporary and complex tax issues. Now in its seventh year with over 500,000 viewings, the award-winning series airs monthly at www.TaxTalkToday.tv and programs are archived on the site for one year after each episode. For additional information or to inquire about sponsorship opportunities, please contact Paul Lamonia at (703) 642-6505 or Lamonia@LMpdg.com or visit www.TaxTalkToday.tv.

(Music.)

PHYLLIS GRIMES: This is “Tax Talk Today,” the tax show for the tax pro. Today’s special 100-minute program is “Specialty Taxes: Estate and Gift and Employment Taxes.” Hello, I am Phyllis Grimes and welcome to “Tax Talk Today,” a series of programs brought to you by the Internal Revenue Service. Although we announced that this would be the last “Tax Talk Today” show, because of the multiple provisions of the American Recovery and Reinvestment Act of 2009 that affect America’s business community, the IRS is looking at hosting two additional “Tax Talk Today” shows this fiscal year. Check the “Tax Talk Today” Web site for information on any future programming. We’ll be contacting all of our registered viewers as new information becomes available.

The “Tax Talk Today” series provides you, the tax professional, with the opportunity to interact directly with representatives of the IRS and practicing professionals on current tax issues. The “Tax Talk Today” series is an easy way to earn continuing education credits. For today’s 100-minute program, you will earn two CPE credits. You can purchase CE credits through the “Tax Talk Today” store. You will need the course number, which is given at the end of the program, so don’t forget to jot it down.

Also, we want your questions throughout today’s program, so please e-mail your questions to questions@taxtalktoday.tv. Any questions not answered on the program today will be posted to the “Tax Talk Today” Web site under “resources.” If you have not already done so, visit the resource section of our Web site. We have posted an outline for today’s program, as well as additional, valuable information. Now, let’s get on to today’s program, “Specialty Taxes: Estate and Gift and Employment Taxes.”

On today’s program, we will focus on several employment tax and estate and gift tax topics that may impact a large number of taxpayers. IRS experts and industry professionals will explain the law, steps the IRS is taking to help improve awareness and compliance and some new developments in the area of these specialty taxes. Now, let’s join our first panel, on estate and gift taxes. Today’s moderator is Les Witmer. Les brings to “Tax Talk Today,” 23 years of experience with the IRS, and is currently a communications consultant in Atlanta.

Joining Les is James F. Hogan, senior technician reviewer, estate and gift tax, passthroughs and special industries, office of chief counsel, Internal Revenue Service, Lisa M. Piehl, policy manager, estate and gift tax, small business and self-employed division, Internal Revenue Service, Daniel T. Moore, CPA, senior accountant and chief financial officer, Moore Agency Incorporated, based in Salem, Ohio, and Kathy Harrison-Suits, and enrolled agent and vice president of Summit Capital Advisors, based in Tacoma, Washington. The complete bios for our guests are on the “Tax Talk Today” Web site. Les?

LES WITMER: Thanks, Phyllis. As Phyllis mentioned, we're going to have a special extended program for you today, and dealing with both estate and gift and also employment taxes. In this first segment, we're going to deal with estate and gift taxes. Just a note: If you have any questions on that topic, please get them to us during this first segment, because after the news and the news break, we'll be dealing only with employment taxes. The laws for estate and gift taxes are, some consider, some of the most complicated of all the Internal Revenue Code. Lisa, are they really that complicated?

LISA PIEHL: The rules and regulations have areas that are extremely complicated, there's no doubt about that, but the estate and gift tax, itself, is not that complicated, in the sense that, if a person dies and they meet the following thresholds, they're required to file an estate tax return, and if a person gives a gift during life that meets the following thresholds, they're required to file a gift tax return. It's the nuances of the requirements that we'll get into in this program, I'm sure, that are where the complexities lie.

MR. WITMER: Okay. Kathy, from the practitioner's standpoint, is this something that applies to most practitioners, or have the practitioners specialized in this area?

KATHY HARRISON-SUITS: I think most practitioners are specializing in this area if it's an area that they want to do. The average practitioner probably doesn't have a lot of clients that meet at least the current threshold of \$3.5 million. So it is a very specialized area for a lot of practitioners.

MR. WITMER: Dan, but just to the general practitioner, this still, especially maybe in gift, might come up from time to time?

DANIEL MOORE: Sure. Those practitioners that are generalists in the field are definitely meeting those clients that may have a gift tax requirement – filing requirement. This could result out of a down-payment that a parent gives to their child for their first-time home purchase. We're seeing a lot of that this year with the first-time homebuyer credit. Or it could be a parent who's transferring their home to their children because of state Medicaid reasons.

MR. WITMER: Okay. Jim, paying attention to current news and politics, this is an issue that has some questions about the future.

JAMES HOGAN: Well, that's true, Les. The estate tax, as it is set up now, is set to expire after this year and then come back in 2011 at rates that were much higher than it presently is. Now, for the life of me, I can't predict, but I can't believe that Congress will let the estate tax, as it is, just fall off the side of the Earth and then come back in 2011. (Laughter.) So I would suspect by the end of this year, we will see legislation that will resolve our concerns about this, but it's an important thing to pay attention to.

MR. WITMER: So we need to pay attention to what's going to happen. Well, let's take a look, then. Let's start with estate and gift. Lisa, what are the filing requirements for estate and gift? What are these thresholds you were talking about?

MS. PIEHL: Well, the filing thresholds for an estate tax return, as Kathy said, is 3.5 million (dollars) currently, and for a gift tax return, it's \$13,000. Any gift to any individual above \$13,000 requires a return. In terms of what is includible on an estate tax return, you would look to the – basically, it's a balance sheet of a person's life. The gross estate includes all the real property in which the decedent had an interest, including real property outside of the United States.

The 706, as I said, is a balance sheet of the individual's life. It has all of their assets, liabilities and credits. The assets include lifetime transfers after December 31st, 1976, so any gift tax returns that were given after December 31st, 1976 would be included. So, too, would be the real property, stocks and bonds, cash, insurance, joint property, personal property, assets in trust, matters of appointment and annuities. Liabilities include administrative expenses, fees, mortgage and liens, losses, and then you get deductions for both marital and charitable.

MR. WITMER: Okay. Jim, when is the Form 706 – when's it due? When must it be filed?

MR. HOGAN: Generally, it's due nine months after the date of death of an individual, but there are – you can get an extension if you file the Form 4768, and the extension is for six months out. So that gives you a total of 15 months before you have to file the return. And I'm told by the practitioners I speak to that almost all estates file for the extension. I guess, Kathy, you could maybe address that a little bit, because you're out in the field, you know, trying to gather this information.

MS. HARRISON-SUITS: Absolutely. There are a number of issues that almost always require that we ask for that extension. For one thing, a lot of times, we don't know that the client's died until nine months later. (Laughter.) We find out during tax season. So that creates that need to have extra time to do that. Getting all of the information that's needed is a cumbersome process. There are a lot of documents involved in this, and it takes time.

The other issue is, usually the executor or the personal representative is typically a family member. They're going through the stages of grief and the last thing they want to do is go through the deceased's personal effects to come up with the inventory that's needed. So it does require – typically require an extension.

MR. WITMER: Okay. Maybe you could talk a little bit about trying to get that information together; how do you start, as a practitioner, and maybe from a personal – do you start with a checklist, or how do you gather that information?

MS. HARRISON-SUITS: Actually, I typically start with a checklist. We're going to look at having them list out their brokerage accounts, their real property, the cash on-hand, the personal effects – all of these kinds of things. But we're also going to do a little bit of double-checking. We're going to look at the last couple of tax returns to make sure that they've included all the bank accounts and all the brokerage firms and those types of things. But typically, we'll start with a checklist.

MR. WITMER: This is a cumbersome process for anyone who's had to deal with settling an estate. It does take time. From the IRS point of view, what is considered a complete return? What must be gathered?

MS. PIEHL: Well, what we'd like to see is everything, but that's not always practical. What we need to make a determination is a certified copy of the will, certified copy of the death certificate. If there was life insurance, we'd need Form 712, Life Insurance Statement. If someone elects alternate evaluation, then we would need evidence of the sale or distribution during the alternate evaluation period. And the key to remember with alternate evaluation is, if you elect alternate evaluation, you're still required to provide the date of death values on all the assets to determine if you actually are eligible for that election.

If there's a transfer by a trust, a copy of the trust instrument is required. As I said before, trusts are includible in the gross estate. There seems to be some misunderstandings with the community – mostly with the taxpayers – that if it's in a trust, you don't have to file an estate tax return. Although it relieves you of probate, it does not relieve you of your filing obligation. Powers of appointment instruments, appraisals on any real estate that was included. And we'd love to see appraisals on any non-public enterprises, like closely held corporations and partnerships. But if you don't have an appraisal, what we do require is the financial data.

State certification of payment of state death taxes, if you are in a state – if your decedent was domiciled in a state that had estate death taxes. Copies of any Form 709 gift tax returns that were filed after December 31st, 1976. If there's any foreign death tax, then we would need a copy of the Form 706CE to provide – it's a certification of the payment of the foreign death tax. If there's a non-resident citizen, copies of inventories and other documents filed in a foreign probate court, and in cases for non-resident, non-citizen, documents relating to possible expatriation. So those are the base items that we would really like to see when you're filing an estate tax return.

MR. WITMER: Okay. What can be excluded, or are there deductions that can be taken, Kathy?

MS. HARRISON-SUITS: Absolutely. Lisa alluded to this a little bit earlier. The fees for the administration of the estate – the probate fees, the attorney fees, the accountant fees. And then we look at other deductions – mortgage issues, indebtedness, claims against the estate. And then the two largest ones are the marital deduction and then the charitable gift deductions. And one thing that we need to let people know about on that charitable gift deduction: It's not an issue of, you go in and you pack up all the clothes and the personal effects of the member or the decedent and you take it to Goodwill or Salvation Army. That's not a charitable gift under the estate tax. The charitable gift comes into play through either the trust or the will. And it has to be to a qualified charity – typically a 501(c)(3).

MR. WITMER: Is this an area that you see quite often with some problems, Jim?

MR. HOGAN: I think there – the areas that you see where – in the deductions and the estate tax most often are the marital deduction, where the money passes from the decedent to a

spouse. It's either the outright deduction because property is left outright to a spouse, or it's in the form of a trust – a QTIP trust is the most common marital trust; it's a trust that provides the spouse with a beneficial interest for her life, and then at her death, it's includible in her estate. There are certain aspects of that on the return that have to be signified and the trust has to qualify for the deduction to actually be deductible from the estate. But those are the issues, and I think they're the two major items.

The charitable deduction has to come from the estate to the charity. Normally, that happens in two different ways. The first way is an outright gift, for instance to a university or church – some 501(c)(3) organization. The second planning item that people use is what's called a split-interest trust, a charitable trust. Maybe an individual set up a trust that will give his spouse or somebody else in his family either an annuity interest or a unitrust interest, as that's defined in the code, for, maybe, their life and the remainder to charity.

That's deductible as long as it's in the form prescribed in the code and regulations under, basically, section 664, not to get too technical. But it has to be either an annuity interest or unitrust interest to a qualified charity, and then generally, it passes to – oh, excuse me, a qualified interest to either a spouse or somebody, usually somebody in the family, and then it passes to the charity at that person's death.

MR. WITMER: Okay. The value of the asset – when does that take place? In other words, I think an example would be, say, of stocks. With the economy the way it is today, the stock value might have dropped drastically. When do you value the asset when doing the estate return?

MS. PIEHL: It's the value at the date of death, or during the alternate evaluation period, if it's elected. So it's the fair market-value of the stock at the date of death. If not only the stocks, but the other assets in the estate, go down sufficient to allow the election for alternate evaluation, or you sell the stocks, it's the date you sell them within that six-month period for alternate evaluation, or six months after date of death – whichever is the lower value.

MR. WITMER: Okay, all right.

MS. PIEHL: Whichever was the lower value, except if there was a sale – then you use the sales date.

MR. WITMER: We mentioned earlier extension to file – if there is a tax due, can there be an extension to pay, or are you looking for the money right then and there?

MS. PIEHL: Well, we'd always like the money right away, but we do understand that there are liquidity issues. So there are – there is available to the taxpayer an extension to pay. It's based on a request that is discretionary, on our part, but we will allow it if there's sufficient information in the request to allow us to make an informed decision on the reasonableness. It permits an extension of time to pay the tax shown on the return for a reasonable period, up to 12 months. Normally, the extension is granted for what the reviewer determines to be a reasonable period of time, but it can be requested more than once. As I'm sure you know, the estate tax law

– there is – you know, a time when you thought you would be able to sell the property, you couldn't, so you asked for an additional extension and, based on the facts, it may be granted.

MS. HARRISON-SUITS: And particularly in this economy – the housing crisis and sales are just extremely difficult to affect at this point.

MR. WITMER: Okay. Let's shift gears and go to the gift tax, then. I think you hit a little bit on some of the requirements, but go over them again. What are the filing requirements for filing a gift return?

MS. PIEHL: Well, your filing requirements for a gift tax return is that you've made a gift, that it's a gift in excess of the annual exclusion amount, which is currently \$13,000, that it is – well, basically those are – that you've made a, you know, present interest – gift of a present interest in excess of \$13,000, or a gift of a future interest that is in excess of \$1. And you file the return as complete as possible before the – you know, before the expiration date of time to file, which is April 15th, 2000 – or the year.

MR. HOGAN: April 15th of the year following the gift.

MR. WITMER: Okay. Can an extension be granted for this?

MR. HOGAN: Yes, there's two ways an extension can be granted for this. First of all, if you actually extend your own personal return on the Form 4868, you automatically extended the time for filing your 709. However, if for some reason, you don't want to file that extension on your personal return, but you want to extend the gift tax return, you can file Form 8892, and that will extend the time to file the gift tax return. Now, Kathy, tell me, I suspect that not really many people file a Form 8892. If you don't have enough information to file your own personal income tax return, you're probably not altogether on the gift tax return. And that works well, I think, for both.

MS. HARRISON-SUITS: It does. And you're absolutely right; if you can't get your personal return done, then you're not going to get the gift tax return and vice versa, so –

MR. WITMER: And Dan, I would expect that this is an area that hits more of the general practitioners out there, especially not just in filling out returns, but also in the whole area of financial planning or tax planning?

MR. MOORE: Certainly, as practitioners, we have to advise our clients that they may need to file that gift tax return and have them queued up to know that there are issues that may happen within their lifetime that may cause that. Maybe today, they don't plan on giving money, but in the future, they may plan to do that.

MR. WITMER: Okay, we've got a couple questions that have come in. "If I, after the fact, learn that a client made prior gifts for which a gift tax return was not filed, should late gift tax returns be filed even when there is no gift tax due and minimal possibility of an estate tax return required to be filed upon the client's death?"

MS. PIEHL: I would say yes, absolutely. It's important to file your returns. If you've made a gift and you're required to file, you need to file. You never know what could happen in the future. You may win the lotto and end up filing an estate tax return even when you didn't think you were going to. It also starts the statute of limitations running on the gift tax return. Once you file and provide adequate disclosure on the gift, then there's a three-year statute of limitations period. And once that's run, then there's more certainty. So it's something that we strongly encourage. You're required to file a return, even if there's no tax. It's important to do so.

MR. WITMER: And there's another situation: Say someone had a pretty good portfolio, probably before the recent economic downturn – (laughter).

MS. PIEHL: Just probably.

MR. WITMER: And they would, for planning purposes, decide to, upon their death, give a gift to their children, subject to estate tax. And say, when that person died, again, it went to the children, maybe the same assets were taxed again. Some people would think that's two bites out of the same apple, and consequently, some shrewd individuals were taking the situation where they're going to give it right to the grandchild. But the IRS and tax law hit upon that, didn't they?

MR. HOGAN: Yes it is a tax law, you're right. It's not just the IRS. (Chuckles). People blame us for a lot, but there is an item out there called the generation-skipping tax. If you look on Form 709, the gift tax, it says "gifts and generation-skipping transfers." On the Form 706, "it's gifts and generation-skipping transfers," like that. And the way the tax works is, it's a transfer from an individual that's subject to estate or gift taxes that goes to a generation member that is two generations below the transferor.

Now, that sounds, maybe, very technical but to make it very simple, let's say a grandfather transfers \$1,000,000 to his grandchild. That has skipped over the intermediate generation, so there'll be no tax at the intermediate generation. The generation-skipping tax picks up that, in a sense, revenue loss from skipping over the generation.

Now also, let me – well, there's a couple things to point out. First of all, the tax is at the highest estate tax rate, currently 45 percent, and there are exceptions. If you've made a gift to a grandchild that was, say, below the \$13,000 amount, that would not be subject to the generation-skipping tax. If you are a grandfather and you paid a tuition bill to a college, university, for your grandchild, that would not be subject to the generation-skipping tax.

In addition, under the code as it currently exists, you have a \$3.5 million GST exemption that you can allocate to various gifts and trusts that will, in a sense, exempt you from that particular tax. That's more of a planning item that people should sit down with their estate planner and work that out. Now, there's four ways that the generation-skipping tax can touch you.

One is, let's say you make that gift during life. In my previous example, you gave a million dollars to your grandchild; that would be, in a sense, a direct skip, so that would be reported on the Form 709 – that's on schedule C – and there's a place there to allocate, as well, if you need to. Generally, a direct skip gets an automatic allocation, but you ought to just be aware of what's actually happened.

Second, you might make that same transaction at death. You leave in your will, "I leave to my grandchild a million dollars." That's also subject to the generation-skipping tax at the highest rate. It's schedule R on the 706. Then, well, lets back up. Most people don't leave money outright to grandchildren or family members; they do it through a trust. I mean, there's very few people who want their grandchildren want their grandkids walking around with a million dollars – (laughter) – they feel they might go out and maybe buy a Ferrari or something like that. So instead, they set that up in trust.

And if the trust has individuals who are beneficiaries in an intermediate generation – for example, I set up a trust to my son for life, remainder to my grandchildren. Then any distributions that come out of that trust to a grandchild – or I guess they would both have to have the present interest – anything that came out to grandchild would be what's called a taxable distribution. Now in that case, the distributee – the grandchild in this case – would be responsible to pay the tax. The trustee files what's called a 706GSD-for-distribution, he sends a copy to the IRS and sends a copy to the distributee – it's a little bit like the 1099 program – so it can be matched up. And there is a responsibility on the part of the distributee, the grandchild, to pay the tax.

If, in our first example, when we said income to son for life, remainder to grandchild, at son's death, there is what's called a taxable termination, because the only interest left is the interest of the grandchild. That's, again, a taxable termination. The difference there is the trustee of the trust is responsible to pay the tax. He files with the IRS a form 706GST-for-termination, and pays the tax with it, and then the rest of the money is distributed to the grandchild. So, in a nutshell –

MR. WITMER: A nutshell?

(Laughter.)

MR. HOGAN: – four different ways you could pay the GST tax, or it can affect you.

MR. WITMER: That's a very good explanation. Must it be to a relative in order for this to apply?

MR. HOGAN: No, it doesn't really have to be to a relative. You can make a generation-skip if you transfer assets to someone that's more than 37.5 years in age difference. I say normally, that goes from older to younger, but I guess it could go the other way. (Chuckles.) In the instance though, where – the one question I got from the field one time, this individual had made a transfer for the benefit of a housekeeper.

But the housekeeper, she was very old, she was in her 80s, and she really wanted to help these people out, and she had no idea about – nor did her accountant have any idea about – the possibilities of the GST. And she didn't think, well, these people weren't related to me, she wasn't thinking of any sort of transfer tax problems. So she made that transfer without understanding what was going to happen in terms of the GST. So that's an example of how that could possibly come into play.

MR. WITMER: Okay, I've got some other questions in. "Many estates include small, closely held businesses and family farms and may have insufficient liquid assets to pay estate taxes and may have to liquidate to pay estate taxes. Does the service keep any records on liquidations and are there alternatives to liquidation?"

MS. PIEHL: Well, we do not keep – the service does not maintain records on taxpayers, for that. But we do have alternatives, so they do not have to liquidate the family farm or closely held business. The two that come to mind most readily are 2032CAP-A, which is specially used valuation. And basically what that allows is it allows the estate to elect to value a certain farm or closely held business real property at its farm or business use rather than the fair market value. So that's one protection that they would have.

Also, under Internal Revenue Code section 6166, there's an election to pay part of the estate tax in installments, so you can extend payments up to 15 years. And if they can't make their annual installment payment, and there's good reason, that can be extended under IRC section 6161, as well, where even if you don't have a family farm or a business, but you don't have liquidity, there are alternatives that allow an extension for a reasonable cost.

MR. WITMER: Okay. "If the deceased had a joint bank account, do you show half on the estate tax return or a different manner?"

MS. HARRISON-SUITS: You're going to show the full 100 percent on the estate return; it's as simple as that.

MS. PIEHL: The one caveat I would like to add to that: If it's reported on schedule E, which is a joint tenancy, if the surviving joint tenant can prove that they contributed a certain percentage of those assets, then they can reduce that amount. If it's not a joint tenancy account, then it's always 100 percent includible, but the joint tenancy rules do allow for proof of contribution.

MR. WITMER: "If my client creates a trust in 2009 which gives his children a discretionary right to income of \$13,000, is a gift tax return required to be filed?"

MR. HOGAN: Well I would say, yes, because it's just a discretionary right. It has to be – they have to have the right, I guess – you have to define discretionary. Do they have that right to take that money? Maybe that's a present interest, but if they don't have the right, then it's a future interest.

MS. PIEHL: That's correct, I would agree with you. It has to be a present interest to gain the \$13,000 annual exclusion. If it's a future interest, even a chance of any future interest, you do not get the annual exclusion and you have to file.

MR. HOGAN: And one thing to add here: You can make as many gifts as you like of the \$13,000 amount to various individuals. It's not just \$13,000; it's 13 (thousand dollars) to as many people as are out there that you can give to.

MR. WITMER: We're on a roll and we've got some more that have come in. "Does the trust document which we should attach to the 706 estate tax return need to be certified?"

MS. PIEHL: It does not need to be certified. Usually, a statement from the attorney who drafted it is a correct copy and is sufficient, but if you don't have a certified copy of any of the documents, if you provide a copy and provide information why you can't provide a certified copy, that's sufficient.

MR. WITMER: If an executor – I think, Kathy, you might have hit on this, but let's reinforce it since we got it in. "If an executor or personal representative decides to donate the decedent's car to a charity, is the estate entitled to a charitable deduction on the estate tax return?"

MS. HARRISON-SUITS: They are not, and that's similar to what you were talking earlier. It has to be in the will or the trust document that it goes to the charity for it to be a charitable deduction on the 706.

MS. PIEHL: I can think of one other time where it's not in the will or trust, and that would be if it's an insurance policy and they're the beneficiary. It's only because I've been fooled on that before – (laughter) – and made the mistake of not thinking that all the way through. But if there's a direction within the asset itself to pay to a charity, then that, too, can gain a charitable – but other than that, if the executrix, executor, trustee, trustor, decides of their own volition to give a gift, it's nice, but it's not a charitable deduction.

MR. WITMER: Okay, let's take a little bit of time to talk about the IRS estate and gift program – how you're organized. I think many of the practitioners, with modernization, have changed some things around and centralized. Tell us a little bit about how estate and gift is organized now, and where filing takes place, and I think that would be of interest.

MS. PIEHL: Great. We used to file in different service centers; now all of the filings for estate and gift, whether domestic or international, are filed with our Cincinnati campus. So all estate and gift tax forms are filed with – the 706, the 709, all of the international – are filed with the Cincinnati campus. We used to be organized by districts or areas, so where you lived would be where you were organized under.

We have now centralized estate and gift into what's called the specialty programs; with excise and employment tax, we report to the specialty director. We have a chief. There is multiple territory managers – right now, currently, we have four territory managers, and all of the

estate tax attorneys, paraprofessionals, report to the territory managers who then report up through the chain. Audits are based on our national workload. We no longer work out of specific areas.

So the result is, if your decedent died in Florida, you may be in Washington, but the return may be handled with you in Washington out of our Washington office, or it could be handled anywhere in the country. It is not necessarily where the decedent was domiciled. So that's a change from past practices; now we do more of a national approach to our state tax. And that's basically, in a nutshell, how we've reorganized.

MS. HARRISON-SUITS: And Lisa is correct: With the national workload, it can very frequently happen that the estate is being handled in Washington, but perhaps our IRS counterpart is in New York. I know when this first came about people were really concerned that, oh I'm not going to be able to handle this, you know, I need somebody close by. But the truth of the matter is, with telephone conferences, being able to fax information back and forth using regular correspondence, it really has not seemed to put an undue burden on the practitioner at this point.

MR. WITMER: Okay, with that, what is the workload like? What are some of the issues that you are faced with today, I guess especially in the area of audit?

MS. PIEHL: If you can imagine the types of different assets an individual can hold and expand that – we look at real property both inside and outside the United States. We look at closely held businesses, partnerships, limited liability corporations. We often look at a charity or a marital deduction to assure that the charity qualifies, as you so eloquently pointed out, and that the marital deduction – it's key if the spouse is a non-U.S. citizen, we make sure there is a qualified domestic trust, otherwise they don't get the full benefit of the marital deduction.

We have valuation issues. There is – personal property is an interesting area of valuation. You can have jewelry, pieces of fine art, car collections – there's just so many different items and individual can own, and based on that, we see just so many different things and rely on support services including the art panel and engineering services.

MR. WITMER: And Kathy, I guess, one of the issues you face is people just not filing the return and then coming to you later, or you finding out about it.

MS. HARRISON-SUITS: Exactly. That has been a challenge, probably, forever. I mean people, first of all, don't want to deal with the death, they don't want to deal with the issues that come up and in some cases, it's just so complicated they don't know where to start. There may be real property in multiple states, multiple countries, they don't know how to get the information, and it is a real challenge to get those documents and to get that information in.

MR. MOORE: As Lisa indicated, there is this whole laundry list of items that you have to gather, and you are also dealing with your client's children maybe aren't living in the local area – so you're corresponding with them, they're living around the country – to try to gather that information. So in addition to the grieving period, we're also trying to gain and gather that

information. That does become quite – we have our own workload when it comes to gathering that information. (Chuckles).

MS. PIEHL: Do you find, often, that because of a lack of experience with the gift tax laws that you have, even when you're preparing an estate tax return, there may have been non-filed gift tax returns that you then have to explain that that required a return and then trying to bring them back into compliance?

MS. HARRISON-SUITS: Absolutely. That happens almost with every estate that comes through, that there have been gifts made over the years. Part of the reason is that a lot of people don't understand what constitutes a gift. They think it's writing a check. Well, that's one aspect of it. But it could be stocks, it could be bonds, it could be mutual funds, it could be the car, it could be the house. It could be any number of things, and they're just not aware that that constitutes a gift.

MR. WITMER: Dan, you mentioned different states; how do the states mirror the federal estate and gift tax situation?

MR. MOORE: Jim, they just don't. (Laughter.) That's the best answer I can give you on that one, and I know Kathy has a situation in Washington state where she is working with multiple states.

MS. HARRISON-SUITS: They have real property in Washington, Oregon and California. All three of them have different sets of rules, guidelines, and it may wind up that we do the federal estate return in perhaps a California estate, and maybe a Washington, but not an Oregon. There's just multiple combinations because of the way the states handle the estate tax.

MR. WITMER: What about from the federal side? Do you still have the exchange program, and does that also include the estate and gift?

MS. PIEHL: Yes, the federal-state exchange program is still in existence and we do work with them. We use that as one of our ways to identify non-filers, as well, because the IRS is committed to reducing the tax gap by vigorously pursuing those individuals do not file returns as they are required to by law. So that's why we always encourage practitioners when they do find that a return should have been filed to voluntarily bring their taxpayers into compliance.

MR. WITMER: You mentioned that some of the areas that might get kind of complicated, especially valuation and everything else. At the end of an audit you either have the agreement or not. What about the taxpayers' rights or the executors' rights in that case? Regular appeals the same as would be the situation in other areas of IRS?

MS. PIEHL: Absolutely, there's a timing issue, though, because the estate tax does not have an extendable statute of limitations. If there's insufficient time to issue what we call a 30-day letter – which allows them to then file a protest, and then we send it to appeals – if there's insufficient time for that, we issue what's called a 90-day letter, which gives them the right to file the petition with the court, with the tax court, and then they pursue it that way.

They usually still get appeals rights, but they have to file the petition first. It's in our interest and in the taxpayers' interest. We always do our best to allow them the first alternative. We do our best to meet the deadlines and we try to work with the taxpayers' representatives and the taxpayers, too, to meet all timelines that we've agreed upon.

MR. WITMER: You provide a lot of information and if any of our viewers are looking for other information, where are some of the ways or some of the things that you do – outreach or other things – that the IRS does to keep people up to date on this?

MS. PIEHL: We do, do outreach, but one of my favorite places to get information is IRS.gov. Even though I have internal sources, I still go to IRS.gov on a regular basis. There's a keyword search – for example, the Whistleblower program is a new program within the IRS dealing with claims for information for non-filers and other, you know, under-reporters, fraud.

I would go to IRS.gov, put in the keyword “whistleblower,” and it would provide me the information where I could file the form, you know, what the rules are. So that's a key source for us. We, as an operation – estate and gift tax does do outreach. We work with local bar communities, attorney bars, and CPA enrolled agents and we try to do outreach. Jim, do you –

MR. HOGAN: Well, also, I would look at the instructions for both the 709 and the 706. They are very informative. They have examples about almost everything on a line-by-line item. They're, in essence, kind of a little nutshell as to how the estate tax works – what's includable, what's not includable, what's deductible, what's not deductible. And it can walk you through and probably resolve a lot of your issues before you file a return.

MR. WITMER: And I would imagine many of the organizations do their own type of seminars and –

MS. HARRISON-SUITS: Exactly. I know many of the state enrolled agent societies in the CPA organizations provide their own CPE on estates and trust. There are a number of the typical CPE firms – Western CPE and NCPE come to mind – that offer classes in estates and gift taxes.

MR. WITMER: A lot of good information and a lot of good places to go and good information today. We thank you for doing that, especially Lisa and Jim, as you won't be with us after the break. Kathy and Dan, sit tight, and we'll come back –

MR. HOGAN: Thank you for having us.

MS. PIEHL: Yeah, it was a pleasure.

MR. WITMER: – and do employment taxes. But before we get to that segment, let's go back to Phyllis for the headline news.

(Music.)

MS. GRIMES: Here are the top stories from the IRS: IRS nationwide tax forums. Registration for the nationwide tax forums is under way. Come and meet IRS leaders and your fellow professionals at this year's tax forums. The three-day event begins this year on July 7th in Las Vegas, Nevada, at the Mandalay Bay Hotel and Casino. Other cities include San Diego, Orlando, New York, Dallas and Atlanta. IRS is registered with the National Association of State Boards of Accountancy, or NASBA, and participants may earn up to 18 continuing professional education credits.

This year, the tax forum curriculum content is substantially improved with several technically advanced seminars. In addition, several longer and interactive workshops will be featured. Workshops include "The Redesigned Form 990," "1040NR," and "Using e-Services Products for Account Resolution." There will also be a non-credit workshop for individuals who consider becoming enrolled agents. On-site will be an e-IRS room, where participants can register for the e-services suite of Web-based products that allow them to conduct business with IRS electronically; a case-resolution room, to obtain assistance with an unresolved tax case; and an exhibit hall featuring some of the latest financial products. We have posted the link on our resource page to obtain more information.

Ponzi schemes: Thousands of taxpayers have been victimized by dozens of fraudulent investment schemes. These too-good-to-be-true investment ruses have often taken the form of so-called Ponzi schemes. The perpetrator of the fraud promises returns and sometimes even provides official-looking statements showing interest, dividends or capital gains, some or all of which is fictitious. To help provide clarity in this very complicated and tangled matter, and to assist taxpayers, the IRS has issued guidance articulating the tax rules that apply, and providing "safe harbor" procedures for taxpayers who've sustained losses in certain investment arrangements discovered to be criminally fraudulent.

The first is Revenue Ruling 2009-09, which clarifies the income tax law governing the treatment of losses in such schemes. The second is Revenue Procedure 2009-20, that provides a "safe harbor" method of computing and reporting the losses. We have posted both items to the resource page.

ARRA and Net Operating Losses: A new provision enacted as part of the American Recovery and Reinvestment Act of 2009, or ARRA, enables small businesses with a net operating loss or NOL, in 2008, to elect to offset this loss against income earned at up to five prior years. Typically, an NOL can be carried back for only two years. Small businesses with deductions exceeding their income in 2008 can use a new net operating loss tax provision to get a refund of taxes paid in prior years.

The IRS released Revenue Procedure 2009-26, simplifying the procedures for making the special carryback election originally described in Revenue Procedure 2009-19, released on March 16th. Instructions for two key forms have been updated – Forms 1045 and 1139 – that small businesses can use to make use of the special carryback provision for tax year 2008. These forms are used to accelerate the payment of refunds. More information can be found on irs.gov using search word A-R-R-A. We have also posted links to our resource page.

Now let's begin our conversation on employment taxes. Joining our panelists are Mary Gorman, assistant division counsel, pre-filing, small business self-employed division, Internal Revenue Service, and Joseph Tiberio, program manager, employment tax policy, small business self-employment division, Internal Revenue Service. Les?

MR. WITMER: Thanks, Phyllis. And welcome, Mary and Joe. As we mentioned, during this segment, we're going to be talking about employment taxes. So again, if you have any questions on employment taxes, we'll be taking questions only on that topic during this segment. You know, with the recent economic downturn, it has affected many people. They've lost their homes, their jobs and their health coverage, and recent tax legislation has provided some relief in this area. It's called the COBRA subsidy, so I guess a good place to start, Mary, is what exactly is it?

MARY GORMAN: Well, as Phyllis said, ARRA is the American Recovery and Reinvestment Act of 2009. It's also called the stimulus act. And it created a subsidized COBRA premium. COBRA was enacted in 1985 and COBRA actually means the Consolidated Omnibus Budget Reconciliation Act, and most people just call it COBRA –

MR. WITMER: We just call it COBRA.

(Laughter.)

MARY GORMAN: And usually what they mean when they talk about COBRA is the continuation coverage program that's part of COBRA, which means that if you have a group health plan with your employer and you're laid off, you have the option, under COBRA, to continue to pay for that group health plan coverage and stay a member of that group health plan, as does your spouse and your dependents.

But with regular COBRA, the COBRA that was enacted in 1985, you have to pay 100 percent of your share of that group health plan, plus an administrative cost, which could be up to 2 percent. So you'd be paying 102 percent of your group health coverage when you had just gotten laid off. So what ARRA did was they made that cheaper.

What happens now, if you are an assistance-eligible individual under the act, you can pay just 35 percent of your monthly premium. The other 65 percent is paid by your employer, and then the federal government will reimburse your former employer through a credit on the Form 941 Employment Tax Return.

And to be an assistance-eligible individual, you had to be involuntarily terminated between September 1st of 2008 and December 31st of 2009, you had to be eligible for COBRA during that period, and you had to have been able to elect COBRA, and it can also, as I said, include a spouse or a dependent.

MR. WITMER: Now, this just impacts the COBRA subsidy – the one that you just explained – just impacts people who involuntarily lose their job, not someone who voluntarily leaves.

MS. GORMAN: Well, people who voluntarily leave, they can still get COBRA; they just can't get cheap COBRA.

MR. WITMER: Okay. All right, Joe, what're the requirements for the employer? Is there a reporting requirement here?

JOSEPH TIBERIO: Well, Les, there is a requirement – there are several requirements – for the employers to participate in this. There is no information reporting – you talk about reporting of the COBRA premium subsidy. So when I think about information reporting, 1099-miscellaneous, or W-2, or something like that, neither of those are required for a COBRA premium subsidy. Keep in mind, it's not income to the individual who received the benefit. So, again, we don't require any information reporting on behalf of the employer for the employee.

However, there is a reporting on the 941 itself. The Form 941 has been revised for 2009 and '10 to accommodate reporting by the employer of the credit, to claim the credit, and potentially claim a refund or an offset against future liabilities. Now, line 12a—the new line 12a on 941 – would be the amount of the premium subsidy provided by the employer. So that's the 65 percent that Mary was referring to. And that would be multiplied by however many employees you had covered.

So, for example, in a given quarter, you could report all that you'd paid on behalf of those individuals on line 12a. Line 12b is used to reflect the number of workers that had been terminated, and, specifically, the number of assistance-eligible individuals that were covered with a premium subsidy. And that's regardless of family coverage.

So, for example, let's say there were 10 employees that had been involuntarily terminated. They are assistance-eligible—they qualify as assistance-eligible individuals in the first quarter of 2009. Regardless of how many payments you've made for that individual, or how many other dependents are covered for that individual in a family plan, you would just count the 10 on line 12b.

MR. WITMER: Are practitioners aware of this? This is fairly new. Are there issues here that are affecting practitioners?

MR. MOORE: You know, with any of these late tax changes we have to commend the IRS and the fact that not only do they have to get all the correspondence out, but they also have to change the forms. So for the first quarter filing, they did have to re-do the 941 to reflect the COBRA changes on line 12. And we didn't have problems. Most of our employers were aware of the change in coverage through their healthcare provider and were able to get this information out to us quickly in time so that we could process the 941. We were also able to continue to file it electronically and so we really did not see a change in the system because of that.

MR. WITMER: Okay, we've gotten a few questions in from our viewers on this: "My client does not have the funds available to make the 65 percent subsidy payments and also pay their federal tax deposit on time. What can they do?" I can certainly see this happening with the way the economy is.

MR. TIBERIO: Absolutely, yeah. And in fact, the premium subsidy credit is available on the return when they file their quarterly tax return. However, they are able to offset their deposits during that quarter. So say, for example, in this current—the second quarter of 2009 – if you've made payments to cover a premium subsidy and you can anticipate the value of that, you would be able to reduce your regular deposits by that same amount. It's almost like, in effect, you would get credit for the payments paid, versus the federal tax deposits made.

MR. WITMER: "I filed my clients' employment tax returns. Can I still file electronically and claim the COBRA credit?"

MS. GORMAN: Just as was mentioned, we did reprogram the e-filing and that is available and appears to be working.

MR. WITMER: Okay. Joe, you mentioned that this does not count as income for the individual. Depending on the individual's income level, just the gross income, does that have any impact on this?

MR. TIBERIO: It does. There's a recapture provision, which is in place for individuals. Again, it's not considered income for purposes of what they report. However, they are subject to recapture some of the premium subsidy that they've received if their AGI is over \$125,000 for individuals, or over \$250,000 for married, filing jointly. At full recapture, it takes place at \$145,000.

MS. GORMAN: Or 290 (thousand dollars).

MR. TIBERIO: Or \$290,000 for joint return. And there is a phase-out in between –

MS. GORMAN: There is a phase-out. I mean, if you were making \$125,000 and now you make \$125,100, you're not going to have to pay back 100 percent of the COBRA subsidies that were paid on your behalf by your former employer. It's going to phase-in as the percentage of the amount that's over \$125,000, to the difference between \$125,000 and \$145,000, which would be the \$20,000.

MS. HARRISON-SUITS: Joe, if I could ask you a question. As a practitioner, since there's no information reporting, how, as a practitioner, are we going to know what the amount is to put into this worksheet to do the recapture?

MR. TIBERIO: Well, you're not. (Laughter.) Not by any form that the employer is going to provide to you or that the IRS is going to provide to you. What I think practitioners will need to do, and you'll need to do as you prepare for filing the individual income-tax return for 2009, is if you have a client, you may want to ask, if not all your clients, or perhaps just certain

clients, as part of your interview process, ask if they did receive a COBRA-premium subsidy, and if so, you'll have their AGI as you prepare the return.

Now, again, whether you use that for those that you know have been terminated from a position, or you're with someone that maybe you know they've reported unemployment compensation on their 1040, there may be certain things that will kind of tip you off to ask the question. Or you could just ask it as a matter of course.

MS. HARRISON-SUITS: And is there a way for the employee to find out that amount, that number that has been subsidized?

MS. GORMAN: Well, they are going to have to find out. As Joe said, there's not going to be any annual reporting that tells them that number. But every month, they're sending their check – their 35 percent of their check. They know who they're sending it to and what address they're using, and that would be the person to contact, to ask them how much had been paid on their behalf as the 65-percent subsidy premium.

MS. HARRISON-SUITS: Thank you.

MR. WITMER: What happens to an individual who's eligible for the COBRA subsidy, or taking the COBRA subsidy? What happens to that individual if they then gain employment, and another employer?

MS. GORMAN: Well, the statute requires an employee to inform a former employer that they're now covered by another group health plan. Or, that they're covered by Medicare. And, if they don't do that – because there's no way the former employer would know that this had happened – they're subject to a penalty for 110 percent of the 65 percent that was paid on their behalf. And this is the new Internal Revenue Code Section 67 CAP-C. And it will be 110 percent of what was paid.

MR. WITMER: Joe, you mentioned that there's no reporting, but what kind of documentation should the employer keep on this?

MR. TIBERIO: Well, your 941 is going to contain this credit information. It's a refundable credit. It really has the standard of any type of deduction or credit that an individual or a business would claim on their return. So the need to maintain documentation that would support – in the event of an audit or in the event of any kind of request – for support to show that they actually did incur this expense and that they're entitled to the credit. So that documentation, at a minimum, would include information about the 35 percent received from their former workers, or the assistance-eligible individuals.

So, again, a record of the date that that amount was received, the amount that actually was received, and who it was received from. I think they would also want to keep a copy of any information as far as actually paying the expense to an insurance company. That could be an invoice, it could be cancelled checks. Again, just to support that they actually did incur the

expense on behalf of that individual and in the case of a self-insured plan, which there are a number of those out there.

They would need to be able to show that the individual in question is still being covered by the plan. As far as proof of termination, the former employer would need to keep a record of the employees that are being claimed a credit for, as to when they were terminated, the date, their other personal information – also, a record of Social Security numbers. Basically, in the event that we were to ask about the validity of this credit, the need to support that they are entitled to the amount claimed on their 941.

MR. WITMER: Where can any of our viewers get more information on COBRA?

MS. GORMAN: Well, www.irs.gov. And on the landing page, you'll see right as you get to irs.gov, there is an "AARA" button that you can push that will link you to all the information on AARA, of which COBRA is a piece. You can also keyword-search COBRA.

MR. TIBERIO: Also, the Department of Labor. Their Web site has a wealth of information on the COBRA premium subsidy because they're very involved in administering these programs.

MR. MOORE: As practitioners, we're receiving a lot of calls from our clients on AARA and we're checking irs.gov constantly and you have been updating the site on a daily basis, as more information's available.

MS. GORMAN: There are several, I mean, 25 or so maybe more, FAQs for just COBRA and the COBRA premium subsidy in AARA.

MR. WITMER: We have placed those, the frequently asked questions, there on the "Tax Talk Today" resource page, and also, I think we've linked it to irs.gov. So, anybody looking for that can certainly get that on our resource page. Okay, let's shift gears here and go to an area that we've talked about quite a bit on "Tax Talk Today" programs before, and that is correcting employment returns – the old 941C. Dan, what were the issues with the way that you used to correct employment tax returns?

MR. MOORE: Sure. Listen, the 941C, with all respect to my IRS friends, just didn't work. And I think IRS would agree that it just wasn't – it was a nightmare, and it was actually a process of revising the form that actually came out of the IRS. The 941C was complex and it caused huge taxpayer burden. The 941C – an employer could complete the 941C, follow the instructions to the letter, submit that in to IRS, and IRS still did not have enough information to properly process that return.

This, in turn, resulted in additional correspondence and time delays, and it was a burden not only for the employer, but for the IRS processing those returns as well. The 941C also wasn't a standalone tax return. It had to be filed in conjunction with either a current-quarter 941, in which the 941C had to be attached to the 941 to make the adjustments balance, or it was attached to Form 843, a claim for refund.

Many people – employers – were not filling these forms out on a regular basis, and so they would complete a 941C and mail that into the service center and IRS just simply did not process those returns. One of the large problems with the 941C was the fact that you could lump a year's worth of changes onto one 941C. So if you had an issue that spanned several quarters, you just had to send in one Form 941C. And honestly, the IRS lost track of those adjustments and had issues with posting those errors. So it was a huge systemic problem across IRS.

MS. GORMAN: I know with collection we've had trouble, sometimes, explaining to him – to a taxpayer – exactly what he owed, because all of his adjustments would have showed up in one quarter of his employment tax record, and we have to kind of parse out what – you know, what quarter they really belong to. So now, with the new 941X, as it comes in, we're going to actually adjust the quarter where the correction was made. So you should see the correct tax for that quarter when you pull it up, now, on our transcript.

MR. WITMER: Joe, the 941X is just part of the – there are some other forms as well – the X forms, I guess, as you're calling them?

MR. TIBERIO: Yes, there are. For errors discovered after January 1st of 2009 in payroll tax – involved with payroll taxes – the X process, the 941X process, is now available, which replaces, or takes the place of, the 941C or other, similar forms. And there is an X form for payroll returns – not for all of them, but for many of them. For 941, which is the employer's quarterly federal tax return, there's a 941X.

There's also a 943X, which is the employer's annual federal tax return for agricultural employers and employees. Form 944 will also have an X version, and that's the employer's annual federal tax return. The 945 is the annual return of withheld federal income tax. Typically non-wage-type withholding is reported on a 945, and there's an X for that. There's also a CT1X available for the employer's annual real-world retirement tax return. Important to note: There is not an X developed for the Form 940, which is the FUTA – the federal unemployment tax return.

MR. MOORE: To simply amend a 941 FUTA tax return, you would just check the box to amend that tax return.

MR. TIBERIO: Yeah, the 940 was redesigned not that long ago, and we did add a check-box feature to report an amended 940.

MR. WITMER: Now, can these forms be filed electronically?

MR. TIBERIO: Not at this point, no. The X series of forms for payroll taxes are all paper at this point in time.

MR. WITMER: Okay. Is there a deadline for when the 941X has to be filed?

MR. TIBERIO: Well, there's several dates and deadlines that come into play with the amended returns. Probably the overriding date is a three-year statute of limitations. So say, for

example, in the case of a 2009 payroll – all 2009 payroll tax returns, whether they be a 941 or 943, 944, et cetera, have a filing date – or the statute of limitations begins to run on April 15th of the following tax years.

MS. GORMAN: That's when it's deemed to be filed.

MR. TIBERIO: It's deemed to be filed for statute purposes. So even though you've got four quarters in 2009, and they'll be filed throughout the year in April and then, you know, later on throughout the course of 2009, all four of those returns, if they're timely filed, will carry a 4/15/2013 statute date – it's three years from 4/15/2010.

MR. WITMER: Okay.

MR. MOORE: Joe, I think we also want to point out, too, that there's a new 90-day rule. So we have our – the statute's going to expire on April 15th, 2013, and so the new 90-day rule is going to have you back out from that date 90 days to January 15th of 2013. So that determines the way you're going to file. On the prior 941C, you would either file for an adjustment or for a claim.

And on the 941X, you're going to choose whether you're going to be filing an adjustment or a claim. If you are within that 90-day period, if you have an overpayment situation, you aren't going to be allowed to file for an adjustment. You can still get the money back, but you do have to file it as a claim to get a paper check from the IRS. And we still have clients that love to get those paper checks from the IRS.

(Laughter.)

MR. WITMER: I think it will be interesting and also very informative – and this is an important change; maybe we could give some examples or go line-by-line and take a look at the 941X. And just a reminder to our viewers, that we have placed that on the “Tax Talk Today” resource page. So if you don't have a 941X in front of you, or if you haven't seen it, it would be good to go ahead and get that. But Dan, maybe you could give us some information or give us an example, and maybe walk us through some of this new 941X?

MR. MOORE: Certainly, Les. The 941X, which has a new name – it's the Adjusted Employers Quarterly Tax Return or Claim for Refund. The 941X is not a standalone tax return, which can be filed by itself, unlike the 941C which had to be attached to other documents. So the 941X has the same look and feel as the 941, and some practitioners really like that, in that sense. On the top part of the 941X, and I'm following along here on the form, you have your basic information, your employer identification number, the company's name, and the address. And so, you're going to be correcting a tax return for the 941, and so there's a box on there to select 941 or a 941SS, if you're a filer for the 941SS.

I thought today, it'd be best to give an example of maybe an overpayment situation, just so that we can illustrate the two different filing processes on the 941X. So say, for instance, we have an employer on June 29th of 2009, maybe they're getting ready to go on vacation, and in a

hurry they process payroll and get interrupted in the middle of it, and they go back to processing payroll again and don't realize that they have double-posted, or double-entries payroll checks. And have posted a payroll check twice to each of their employees' accounts. The quarter ends, of course, on June 30th, and July rolls around, and the payroll department processes the Form 941 and pays the tax due by the due date.

On August 5th of 2009, bookkeeping is reconciling the checking account and they observe that there is a double set. For each employee there is two checks, the amount is the same, the dates are the same, and they discover at that point that they've got an issue within their payroll. So, at that point they're ready to file a 941X, so they would pull out the form 941X, enter in their basic information, and then they would select which quarter they are filing the correction for. Now because this happened on June 29th 2009, that's the second quarter, so they would select the April-May-June for the second quarter, and then they would enter in the year for 2009 as the year that they were correcting.

There is a new box on the 941X, and that is the date that you discovered the errors. The date that you discovered the errors is the date that you have sufficient knowledge. That's the date you should really fill out your 941X. This isn't something you want to set aside till you get a free moment, but this is the date that you're going to enter to file your 941X. This date also triggers whether or not you want to use an adjustment or a claim for refund.

So we're going to move over to part one in which we're going to select a process, and we're going to only select one process. If you wanted to select that you wanted an adjusted tax return, and what you're going to calculate the credit on the 941X and apply that credit on the current quarter 941, you would use the adjustment process. Now because we discovered our error on August 5th of 2009, that's in the third quarter, we're going to apply our credit for claim to adjustment calculated on the 941X on the current quarter's 941. And you're going to enter that on line 11 of the 941.

The other option is if you would like a refund check mailed out to you, you would then select the claim. So these are important boxes too as we talked about the 90 day rule as to which process you can choose, you really have to – in this situation the statute is not going to expire, but if you are getting close to the statute expiring, you have to be very careful on which box you are going to select. Because you are – if you do file an adjusted tax return and you are filing for a credit on your current quarter 941, you want to get that into the service center as soon as possible so that IRS can process the 941X and apply that credit to your current quarter 941.

MS.GORMAN: In your example, there were duplicate checks, duplicate employment payroll checks, but you didn't actually – did everybody get two checks? Or did they just get one check?

MR. MOORE: No. So in this situation they just got one check, and the other checks were never printed, and through their payroll software would have reversed all those checks and voided those checks.

MS. GORMAN: So the other part is part two, in the 941X, which has to be completed, and that's going to – those are the certifications, because normally when there's an overpaid tax, when you are trying to get the money back, we kind of assume that you've over-withheld from your employees. And those consents in the boxes in part two are how you tell us how you protected your employees' rights to get their over-withheld tax back. Either you gave it back to them or they got it back on their own, or they've consented for you to get your overpayment. But in your facts, there actually was no over-withholding because there was no check.

MR. MOORE: Correct, and that's a really great point. On part two, we still have certifications, we had those on the 941C, and I'm going to really refer to the instructions on a lot of this area because they can be somewhat complex – but the IRS has done a great job at providing, in the instructions, sample certifications and really have outlined that process perfectly. As you'll notice on part two on the certification section you do need to check box three, and box three states that I certified that I have filed or will file form W-2 or form W-2C.

MS. GORMAN: And in your facts, since they actually – your W-2 is probably correct as filed.

MR. MOORE: Correct, because we haven't filed it yet. So we're in the current year, we're going to file that W-2 correctly, because we're going to make the adjustment in August –

MS. GORMAN: Because you know about it before you did it every –

MR. MOORE: So we need to make a certification –

MS. GORMAN: But even so, you still had to check that box –

MR. MOORE: Correct. Yes, you do need to check the box on line three. So we also do have to make a certification, and depending on what kind of process you're choosing from part one, that depends on what line in the certification you're going to choose. So say you choose an adjustment of the employment tax return with a credit on the current quarter 941, you're going to pay attention to the certifications on line four.

In our instance we're actually going to check box 4c, which is the adjustment for federal income tax, social security tax, and Medicare tax that I did not withhold from the employee's wages. In this situation, the employee never got the check, they never got that second check, so we didn't withhold any wages from them. So that's the box we would check if we were choosing an adjustment.

If we were choosing a claim for refund, we would go down to line five, and we would choose line 5d as our claim as to the certification from that. So there's other instances in which you're going to have to read these certifications very closely, and again the instructions – I'll refer back to those as a great example of the type of certifications you'll need to provide.

MS. GORMAN: And you made the point that there's set of certifications if you're asking for an adjustment, and there's another set of certifications if you're asking for a refund.

MR. MOORE: Correct, line four, the certifications are for the adjustment in line five before the credit. That's exactly correct. I'm just going to move on to page two, which contains part three, which is essentially the adjustment worksheet for correcting and determining the calculation of whether you have an overpayment or an underpayment on the 941X.

We really like this section as practitioners we are used to filing 1040X tax returns, which are individual income tax taxpayers and filing a 1040X. And so the lines of the 941 match the lines of the 941X. And so, the adjustment has even been made to include the new lines for Cobra that were adjusted early this year for the 941.

MR. TIBERIO: Yeah that was interesting, January 1st we had the 941X available and then when the law passed in February we had to quickly pull that down to make a revision to reissue it.

MR. MOORE: So you're going to carry your information from your 941, and make the adjustments in total. I do want to point out in column two, as you file the original tax return or as previously corrected – so if you're going back into a quarter to make a second correction, you would use the previously adjusted numbers.

MS. GORMAN: And previously adjusted means if IRS adjusts it that quarter, you'd be using the number after the IRS adjusted it.

MR. MOORE: Right - just one thing to point out, we're not going to use parenthesis anymore; we want to make sure you use negative numbers on the worksheet. Although the form didn't get any shorter, we did expand it out to three pages, but there is line twenty that is a very important line, and that is the detailed explanation of where you came about for those changes.

MR. TIBERIO: Yeah, I agree that really is a very important part of the form, and the reason it's important is because it really explains to the IRS why you're submitting this form in the first place. In the past with the 941C, oftentimes there was really not a lot of room to make an explanation as to what you were doing, so oftentimes we would see administrative error or rounding, or there was some very short couple of words to explain why the form was being filed.

With the 941X, there is plenty of space to explain the reason for the error, or the reason for the change, for the adjustment, and what I would encourage practitioners to do is to really consider putting in as much information as they can to allow, really an expeditious processing of the return. As the return comes in, as it is being reviewed, and if everything is there that needs to be there, the return will get processed very quickly, and if it's a refund or some kind of a credit, that will be allowed very quickly. If there is not enough information, what will happen is we will actually make contact with the filer or with the company or with the designee and ask for additional information. And that just slows down the process for you and for the IRS.

MS. GORMAN: So like, in your facts, the fact that it would be good for us to know that even though there were duplicate checks, that the duplicate checks were not actually given to the employees, and there was actually no over-withholding.

MR. MOORE: Sure, I always tell my clients, tell me a story here, and this is where we are going to create the story for the IRS of all the facts and circumstances and fully develop the story. Now, what happens when I don't have enough space to write my story here on line 20? What can I do then?

MR. TIBERIO: Well, again, we think there is plenty of space, but in the event that you need to provide more information you can provide other attachments, you can provide whatever information you think we're going to need to process that return right away.

MS. GORMAN: This is a paper return, so one of the advantages –

MS. HARRISON-SUITS: I hear that you don't want us to put "administrative error" in there anymore and stop at that point. (Chuckles.) And you have the facts, it's not usually that you don't know what it was, you can usually explain it pretty well.

MR. WITMER: In your case it wasn't an underpayment, it wasn't anything due – what happens when there is an underpayment and there is tax due?

MR. TIBERIO: Well, the process is similar there's just different options as you're preparing the form, a really important thing to make sure of as you're preparing a 941X is that a payment does need to be made with that return, if at all possible. If a payment is not made, then possibly interest and penalties could certainly accrue on the amount that's due and not paid.

An important factor about the 941X is that there's no voucher, there's no V-form of voucher that goes along with that form. So the practitioner could attach a check, it could be paid via credit card – or even through EFTPS – but if a form comes in with a balance due and no funds attached to it to satisfy that, then again interest and penalties will run.

MR. MOORE: I think too we should point out the interest free adjustment period, of which you have a deadline to file, should you have an underpayment.

MS. GORMAN: It has to be filed at the end of that quarter if you want the benefit of 6205, the interest free adjustment. And that's not new, I mean that's always been –

MR. MOORE: So if you discover the error in the first quarter, you'd need to file the 941X by April 30th in order to get the interest free penalty.

MR. TIBERIO: Which makes the discover date, or the ascertain date, very important. If you discovered or ascertained the error in the first quarter of the year, and then made the correction next year or much further down the road, you're really jeopardizing your interest free provision.

MR. WITMER: Now there is a fourth page –

MS. GORMAN: Oh, yes there is. We couldn't stop with three. (Laughter.) Why have three when you can have four? But the fourth page is actually very useful. It is a decision tree, and it talks about if you have this kind of fact, then what you really want to check is that you're asking for an adjustment, or if you have these set of facts, you're asking for a refund – because we really did combine two forms here. We combined what was the 941C and the 843 and it's now on one form. And you can say you either want to use it as a 941C or you want to use it as an 843. This fourth page tells you what you need, what box you need to check, on part one of the form.

MR. WITMER: Now, Joe mentioned that it matches up line-line to the 941, so in developing the 941X, did it have any impact on the 941?

MR. TIBERIO: It did actually, yes. One of the advantages of the 941 was that there were adjustment lines that were on the old 941 which have now been moved to the 941X. I believe there were four of them –

MS. GORMAN: We took four lines off the face of the 941, which simplified the face of the 941, and it also created room for the COBRA lines that we needed to add. (Chuckles.)

MR. WITMER: So where are we with the X forms? The 941Xs are being filed; any issues, any problems?

MR. TIBERIO: Not at this point, the information we've had – it's only been a few months – but from what we can see, the 941Xs are processing pretty well. We haven't had any significant issues at this point.

MS. GORMAN: Good work by our accounts management people and the service officers. And it seems to be working.

MR. MOORE: And from the practitioner's standpoint, you like it – you like the feel of it. It makes more sense. It's more methodical as far as filling the format. I spoke to those at the American Payroll Association and they are happy with the form as well.

MR. WITMER: Okay. What about the rest of the X forms? Anything – are they all go, or are there any changes still to come?

MR. TIBERIO: They're all a go. I mean, everything's still on schedule for the planned forms that we have. So they'll be available in time, for use and maybe there's some guidance coming I believe.

MS. GORMAN: Yes, we are, we are putting out guidance, it's actually on our guidance plan for this year where we're going to give examples of certain facts that require a 1041X and how you fill out the 941X.

MR. WITMER: Very good and I'm sure that, that will be publicized on the irs.gov?

MS. GORMAN: Yes, and then they'll do outreach, there's a lot of outreach to practitioners and payroll people.

MR. WITMER: Okay, let's shift gears for a minute here and talk – in previous “Tax Talk Today” programs we talked about the national research project and what it was. There's a special NRP program for employment taxes, right, Joe?

MR. TIBERIO: There is, it's actually under development right now. I guess for a little bit of background, for NRP, the IRS has used the National Research Project process to in other areas, in the 1040, the form 1040 area and the 1120S, the corporate, subject for S corporation returns. Now, in what we're designing right now and planning on right now is a similar study using that same process for payroll tax returns.

And the objective of this study, of this project is to collect examination data that will allow the IRS to understand the compliance characteristics of employment tax returns and employment tax to tax-payers. And really kind of identify the levels of compliance and non-compliance and help us really better align our resources in the field in the future.

MS. GORMAN: And we haven't done an employment tax study like this since 1984.

MR. TIBERIO: In 1984 there was a very comprehensive kind of a landmark study, if you will, of payroll taxes. The IRS did a very significant study at that time. Over the past 25 years there have been periodic updates to the information on that study so we have kept current with that information, but we've never used the National Research Project process that we're going to be using now.

MR. WITMER: And any details, how will employers know that they're subject to this?

MR. TIBERIO: Well, an employer will find out that it's been selected for an audit under an NRP for employment tax when they receive their notice. There will be information contained, it won't be, there will be a designation, you know, with the letter that you receive indicating that you've been selected for examination and it's not a routine, you know, payroll tax return – examination – it is an NRP examination. And that will give information, kind of set the scope, if you will, as to what the audit's going to look like. So I think that, hopefully, the preparers will be, you know –

MS. GORMAN: Prepared.

MR. TIBERIO: Prepared and, again, what we're trying to accomplish here is to secure statistically valid information so the returns that are being selected for audit under NRP are actually stat samples, statistically valid samples. So there's not necessarily, you know, an indication that there was something wrong with that return. It'll be part of a stat sample which will enable us to project across that population to some extent.

MS. GORMAN: And still these audits can result in no additional tax.

MR. TIBERIO: Possibly.

MS. GORMAN: Because we've really selected them for other reasons.

MS. HARRISON-SUITS: And that's going to be the thing from my perspective, the client's going to come to me with this letter in a panic, what did I do wrong? Well, they may not have done anything wrong; it is strictly just a statistical sampling at this point.

MR. TIBERIO: I think what I would encourage a practitioner in your situation, when you do have a client that comes to you with that letter in a panic. Assure them that this is part of the National Research Project study that's being done –

MS. GORMAN: And they're very lucky to have been chosen.

(Laughter.)

MS. TIBERIO: Again, it will be a very comprehensive audit, it's not a limited scope, it's going to be very comprehensive. It'll be looking at various issues; it'll be potentially looking at worker classification, if there's maybe some workers that retreated as independent contractors that should be treated as employees. So they'll be open to their range of issues, but again, what I would encourage you to tell your clients, is really to work with the IRS, to of course work with their practitioner to help guide them through the process.

MR. MOORE: And Joe, it's a good point that you brought up worker reclassification, because the 941X does have a complete section on worker reclassification. IRS is sort of sending that message that if you have employees that you've been paying as sub-contractors all this year, you do have an opportunity to self-correct and there is some special relief on the 941X. Three very specific lines on page two of the 941X – (laughter) – that allow for worker reclassification so, people should be aware of that.

MR. WITMER: Okay, all right, we've talked about employment, the NRP and the X forms. We started off with the COBRA and I think as some of that has sunk in, we're getting in some questions. So let's go back, put on our COBRA hats and take a look at some of these. For employers who laid off their employees prior to the passing of ARRA, are they required to locate and notify those terminated employees about the new COBRA subsidy?

MS. GORMAN: If they were laid off after September 1, 2008, yes, they are.

MR. WITMER: So that is the requirement for the employer? What if you aren't terminated but your hours are reduced and your insurance is terminated?

MR. TIBERIO: You would not be eligible for the premium subsidy in that case. The involuntary termination that we talk about is a termination of employment, not a termination of insurance coverage.

MR. WITMER: Can we claim the COBRA subsidy credit for the entire year on our fourth quarter 209 form, 941 filing?

MS. GORMAN: Yes, you can, in fact we didn't talk about that but you can take all of the COBRA. It's got to be in the same calendar year, but if you want to wait until the fourth quarter of 2009 and take all of your COBRA subsidy on the line 12 of your fourth quarter 941, you can. Or you can if you want file a 941X in 2010 and get it all back.

MR. TIBERIO: And then in 2010 you're only option would be to file –

MR. GORMAN: Yes, it would be, but we are saying because we did have questions when we first started with people saying, am I going to file an X every time I get a COBRA premium check in that really belongs to last quarter but I didn't get it into this quarter. And we said, basically you can take it in subsequent quarters. The determining fact is that you've got the check, that you've got 35 percent; you can't take 65 percent until you've actually received the 35 percent from the former employee. But once you have received it, you have the rest of the calendar year to claim that 65 percent and you have to pay the 65 percent.

MR. TIBERIO: In a sense though, if you do that, if a company chooses to wait until the fourth quarter, they're kind of losing some of the benefit of the immediate relief. You know, they won't be reducing their deposit, they really couldn't reduce their deposits now and then just reflect everything on a 941.

MS. GORMAN: Because that assumes, right, that you're making full FTDs, that you're not electing to offset FTDs.

MR. WITMER: Must all employers participate, i.e., is there an employee/payroll size threshold requirement for the employer? Or what if the employer has no medical insurance coverage for anyone?

MS. GORMAN: Well you're not subject to COBRA if you don't have group health coverage. And federal COBRA is 20 or less, 20 or more employees. But there are state, what they call, mini COBRAS which can apply to employers who have less than 20.

MR. TIBERIO: So, for purposes of federal COBRA, the employer would have to have employed, in their normal course of business, 20 or more workers and they would have to have a group, have offered a group health coverage prior to the termination and subsequent to the termination.

MS. GORMAN: And subsequently.

MR. WITMER: What happens if the employer goes out of business?

MS. GORMAN: Then he doesn't have a group health plan.

MR. WITMER: Doesn't have a group health plan anymore.

MS. GORMAN: I say that generally, there could be some states that maybe it doesn't work that way, but generally for federal COBRA, if you're not providing group health plan to your active employees, you don't have to give COBRA continuation to former employees.

MR. WITMER: Should the employer wait until the past employee sends in their 35 percent monthly COBRA payment to make the entry each month on their 941 for the 65 percent?

MR. TIBERIO: I think, just thinking about the question, if the employer does not have to wait to offset their deposit. If they know that they're going to receive a 35-percent payment, they can offset based on –

MS. GORMAN: They can look out over the quarter and see what, you know, and manage their cash flow and their tax deposits based on what they think they're going to have to pay up for COBRA premiums. And IRS will treat the amount on line 12a, if you have offset deposits and you're worried about FTD penalties – they will treat the amount on line 12A as a payment that was made on the first day of the quarter; which is similar to what it's in the 941X. And that way, you will not be getting, you should not be getting FTD penalties for offsetting your deposits.

MR. WITMER: Okay, we've got a couple of questions also that have come in on the 941s so let's take a look at these. If we have identified an under-reporting during the preparation of the first quarter 941 and corrected in on a timely filed first quarter 2009 form 941, is this considered an interest free correction? Is there a penalty still separate from any interest free amount? Does the form 941X still need to be submitted?

MS. GORMAN: Well, I think – you shifted quarters here right? They did, they ascertained the error in the first quarter but they didn't report it to the second quarter? Well, right there they've lost the interest rate adjustments because you have to report, you have to report the adjustment in the same quarter where you ascertain the error and it says that they'd ascertained it in the first quarter.

MR. TIBERIO: Yeah and that specific set of facts right there, if that were changed and you had ascertained the error, say at the first week of the second quarter and then you made the correction, and when you filed your 941, if you had corrected it on the original filing then of course, it wouldn't be an issue. There'd be no interest to and no potential for penalty.

MR. WITMER: For line A, here's one that's getting into the details, for line A of the form 941X it says to multiply the difference by .124 or .062 if you are correcting the employee share only. What if you are making corrections for two employees? The employee and the employer's share can be claimed for one and the employer's share only can be claimed for the other. Do you have to complete two separate form 941Xs?

MS. GORMAN: No, but you do need to use box 20 to explain exactly what you're doing.

MR. MOORE: In box 20 go ahead and include a lot of detail if you're doing that, in outlining the facts and circumstances as to why you're doing that for one employee and not the other.

MS. GORMAN: And why it's 6-2 for one and 12 for the other.

MR. MOORE: Correct.

MR. WITMER: And where does that come in? Is it page two of the 941?

MR. MOORE: The calculation would be on page two and then line 20 is on page three.

MR. WITMER: Okay, let's see if we can get a couple more in here before our time expires. In 2008 we included our prior period over-payments, offsets and underpayments with our semi-weekly EFTPS tax deposits for the current quarter.

These prior period overpayments and underpayments were included with our current quarter form 941 liabilities and Schedule B. At the end of the fourth quarter, 2008, the total form, 941 including form 941C liabilities, Schedule B and EFTPS deposits were equal. Please explain the impact of the form 941 on Schedule B if an overpayment from a form 941X is being applied or credited.

MS. GORMAN: Well the short answer is there's no impact on Schedule B because Schedule B is not a schedule of deposits, it's a schedule of liabilities and we have the same issue with the 941X if you're offsetting or reducing your federal tax deposits to the amount of your COBRA premium this also has no impact on Schedule B because Schedule B is a schedule of your liabilities and the date on which those liabilities arose.

And that's not going to change, what you're adjusting are your deposits, but your liability for the current quarter will remain the same and there shouldn't be any impact on Schedule B, either for the 941X or COBRA. I mean it's the same answer for COBRA, because we get this question a lot on COBRA too.

MR. MOORE: And it's also good to point out where you don't have to submit a revised Schedule B with a 941X because of that –

MS. GORMAN: Right, because your liabilities are still your liabilities for the quarter.

MR. WITMER: What's the best thing for practitioners who are not familiar with the 941X to do? You said there is going to be some examples coming out, what would be the best thing to do – it's to take a look at it and work through the instructions similar to what you did?

MR. MOORE: The instructions have a great list of examples in every scenario. They've tried to really capture all the scenarios and what you may have an over-reported and an under-reported of the situation where you may have a combined over-reported and under-reported issue within the same quarter – and they did a great job of pulling out those examples.

MS. GORMAN: There's also if you go into irs.gov and you put in the search box, you put in, "correcting employment taxes" it will bring you to a point where all of these forms and instructions are linked and you can just, you know, pull them down from there.

MR. WITMER: One of the, I guess one of the things we didn't touch on is in developing the X forms, how much input did you get from the practitioner community? How exactly was it done?

MS. GORMAN: Well, the original request for the 941X came in as an industry issue resolution request from the reporting agents who are the large payroll processors, like ADP and Seriu. And it went from there, it was given to Burden Reduction and Burden Reduction worked on developing the X and which also played into – because when Burden Reduction was redesigning the 941, they were trying to take some of those adjustment lines off the face of the return because when they went out and tried to figure out where most of the errors were happening with the 941 and what could be simplified, those adjustments were the lines. And you know, they couldn't take them off until we had somewhere else to put them which was the X.

MR. MOORE: A draft version of the 941X was also out on irs.gov, in which they asked for response from the practitioner community, what do you like about the form, what should we change, does this read correctly, and try to address these issues before issuing the final version.

MR. TIBERIO: The Office of Taxpayer Burden Reduction, which led the creation of the 941X also is the same office that did the re-design of the 940 which made it a much simpler form, easier to use than the 944 as well. And they did, as you said, they went through a process where they got public comments, they worked with practitioner groups, payroll groups, things like that.

MR. WITMER: Okay, well, looks like we hopefully have a successful form here, one that everybody can benefit from both from the practitioner standpoint and from the service and processing. Thanks for a lot of good information, not only on the 941X but explaining COBRA and also the research program that we talked about. So very interesting discussion and thank you for tuning in and watching this – before we go out today let's go back to Phyllis.

(Music.)

MS. GRIMES:

That brings us to the end of today's program. Remember to stay tuned for information about additional programs in the near future. We'll be contacting all of our registered viewers as new information becomes available. Remember that you will be able to view today's and other "Tax Talk Today" programs by going to archives on our site. And you can download a podcast of the programs from the home page of "Tax Talk Today" by clicking on audio podcasts. Podcasts may also be found under archives. Additionally, written transcripts of our program are available on our site under news.

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(Music.)

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