

Concurrent Session: *Travel Track*

The Travel Reimbursement Shake, Rattle and Roll

Speakers:

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| A | B | C | D | F |
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| 294497 | 294498 | 294499 | 294500 | 294501 |



**CAUTION
TAX AUDIT
AHEAD**

Shake, Rattle, and Roll...

This year's Staffing Idol Tax Audit

- 12 to 16 ??? companies under audit for payroll tax/deductions issues.
- Why? Time for a history lesson...

Healthcare Staffing Industry History

- During the last 15+ years, travel reimbursement practices have centered primarily on providing employee/travelers with a per diem payment for lodging and meals, “travel pay” for transportation reimbursement, and various other reimbursements for items such as licenses, continuing education fees etc.
- The temporary (contingent) staffing industry is unique in that the compensation practices of employers/agencies are straitjacketed within a bill rate negotiated with the client.
- To date, there are no Tax Court cases addressing a healthcare staffing agency per diem policy. The industry’s only guidance are interpretations of the Code, Regulations, similar revenue cases and *informal* guidance like Revenue Rulings -FSA 002985 in 1998



Revenue Rulings reflect the position of the IRS

- Rev. Rul. 2006-56 announced that expense allowance arrangements routinely paying excessive allowances, or having no mechanism to determine the deductible/ excludable portion of the payment, will be treated as nonaccountable plans, paying wages.
- However, the news release accompanying Rev. Rul. 2006-56 stated that the IRS will instructing agents *not to apply this revenue ruling to years prior to 2007*, "in the absence of intentional noncompliance." (See I.R. 2006-175.)
- In September 2012, the IRS released Revenue Ruling 2012-25 addressing the practice of Wage Recharacterization. It specifically highlights an example of a reimbursement policy of a hypothetical healthcare staffing agency employing travelers working away from home. It is not a *prospective* ruling like RR 2006-56



Revenue Ruling 2012-25 issued September 2012

- 3 examples of wage recharacterization
 - 1) Tool allowances for cable installers (common in the construction industry)
 - 2) Healthcare Staffing Agency using per diems to reduce taxable wages
 - 3) Construction firm paying non-taxable wages regardless of expense or travel status
- Positive example- *prospective* adjustment.
Cleaning Services Company
Non-qualifying workers receive no gross-up or taxed per diems. Only lower normal wages.



Wage Recharacterization: the ultimate 'no-no'



Revenue Ruling 2012-25

A retroactive ruling?

- Burleson v. Commissioner (T.C. Memo 1994-364 – *prior cases 1993-625, 1994-130*)
 - IRS attempted to redefine definition of local transportation expenses (commuting)
 - Issued retroactive Revenue Ruling
 - Reopened proceedings on the same taxpayer (logger/woodcutter) after new Ruling issued
- Rev Rul 2012-25 surfaces in the heat of the battle – a repositioning for another stab?

Potential Penalties (see chart)

SUMMARY OF POTENTIAL FEDERAL TAXES, PENALTIES, AND INTEREST IMPOSED BY UNDERPAYING EMPLOYER'S COMPENSATION INCOME

| Description of Tax or Penalty | Tax or Penalty Amount |
|---|---|
| A. Reporting and Withholding Penalties | |
| A. Employer liability for underwithheld income taxes (Code § 6652) | Generally 27% and 20% for supplemental wages over \$100, but has changed from 20% to 38 % ¹ |
| B. Employer liability for underwithheld employee FICA taxes (Code §§ 3101 and 3103(a)) ² | 7.65% of unreported income (4.0% as of 10/1/2011, 6.2% up to FASER base \$104,200 in 2006, \$97,500 in 2007, \$102,000 in 2008 \$109,800 in 2009-2011 and \$114,000 in 2012); and 1.45% on excess |
| C. Employer liability for employee FICA taxes (Code § 3111) | 7.65% of unreported income, up to FASER base (\$14,200 in 2006, \$12,900 in 2007, \$143,000 in 2008, \$136,400 in 2009-2011 and \$138,000 in 2012); and 1.45% on excess |
| D. Employer liability for FUTA taxes (Code §§ 3301 and 3306(a)) | 6.2% of unreported income up to \$7,000 of total income (state 50.1 offset applies) |
| E. Penalty for failure to timely deposit withholding and | 10% of unreported employee FICA taxes (amount in C. and D.) |

¹ This is called a "secondary liability" tax, because these income taxes are primarily the employer's liability, but if they are not paid over to the Treasury, the employer is liable for what was not paid (and cannot collect any tax payment if made from the employee). Importantly, the employer's liability is typically calculated at the applicable "supplemental withholding" rate. However, the employer's payment exposure to underwithheld federal income taxes can be reduced, if it can be proven that the employer was in a "good faith" situation, either based on the employer's own records, or based on the Form W-2 on file. See Internal Revenue Manual ("IRM") 4.23.8.8, "Computing Income Tax Withholding." The only other way that the "secondary liability" tax can be abated is for the employer to prove that the employee actually paid income taxes on the income reported on Form W-2. Code § 6672(c). According to IRM 4.23.8.4.1, this proof of "tax payment by employee" must be based on the filing with the IRS by the employer of Form 941.

² Request for Relief From Payment of Income Tax Withholding, with attached Form 1041, "Statement of Payments Received," in which the employee attests, under penalty of perjury, that he or she reported the income on Form 1041, and paid the taxes on file. A Form 1041 must be signed by and filed for each employee involved in the statement request. The statement provisions of Code § 6672(c) do not affect any applicable penalties.

³ Although Reg. § 31.3402(g)(4)(D) states that the supplemental withholding rate is 38%, the rate was increased to 20% for payments made after 1/1/05, but was decreased to 27.5% for payments made after August 8, 2001, and to 27% by 2007-2009. Section 101(a)(1) of the Economic Stimulus and Tax Relief Reauthorization Act of 2001, Pub. L. No. 107-171, as it was further decreased to 20% in 2003, effective for payments made after July 1, 2003. See section 106(a) of the Jobs and Growth Tax Relief Reauthorization Act of 2003, Pub. L. No. 108-27, and Publication 157 (as revised on July 1, 2003). The supplemental withholding rate is currently 27% with respect to supplemental wages for the aggregate for the year) not exceeding \$1 million. Treas. Reg. § 31.3402(g)(4)(D). Effective January 1, 2005, American Job Creation Act ("A.J.C.A."), § 104, increased the supplemental wage withholding rate from the flat 20% rate for single filers (27% in 2006) to the progressive rate in effect (19% in 2005), after the employer's supplemental wages in the aggregate exceed \$1 million. This change effectively increased any employer's tax exposure for excessive compensation made, since the IRS will hold employers liable for the supplemental wages where benefits have been reported) from reporting the withholding.

⁴ This is also a "secondary liability" tax, because the taxes are primarily the employer's liability. If the employer is held liable within the employer's statute of limitations period for the employer's share of the FICA tax, which is more than the employer's share of the FICA tax, the employer's obligation to the employee for the underpayment is a "net" tax settlement between the employer and the employee. Reg. § 31.3205-1(b)(1) (as prior to 2009, Reg. § 31.3205-1(b)(1)). See F.R.A. 2007-2906, items 131 (explaining the employer's ability to assign from employees any FICA taxes paid during the limitations period when the employer was still liable for the employee share of FICA taxes). If the employer reported the income on Form 1099 and the worker paid FICA taxes on the income, the worker can get a refund of those FICA taxes (if corrected Form W-2 and 1099 are issued). If the statute of limitations has closed for the employer, the employer's liability for underwithheld employee FICA can be offset by the worker's FICA tax overpayment. Code § 6301.

| Tax or Penalty | Tax or Penalty Amount |
|--|--|
| Code § 7519) This apply where taxes were not income is not reported, or 0. | plus 10% of all income tax withholding and employee FICA taxes that were withheld but not deposited. |
| employment taxes required to in 10 days of notice and | 25% of total taxes under A., B., C. and D. above (penalty is 1/3 per month of underreporting, up to 25%; penalty can be avoided by simply paying within 10 days of notice and demand) |
| guard of rules or statement of tax (Code liability increased in the files. Code § 6672.) | 20% of underpayment of employment taxes (or 25% of the taxes, in cases of civil fraud). Code § 6646(a) provides that the penalty may not be imposed with respect to the portion of an underpayment if the taxpayer acted in good faith and there was reasonable cause for the underpayment |
| timely Form W-2. ⁴ | \$100 per W-2, up to maximum of \$1,500,000 for all such failures in the aggregate for the year (\$30 per W-2, with \$250,000 annual cap if corrected within 30 days of January 31, or \$60 per W-2 with \$500,000 annual cap if corrected on or before Aug. 1) or, in case of intentional disregard, greater of 10% of underreported amount or \$250 per W-2 (with no annual cap). (Lower annual caps apply to small employers with gross receipts under \$5M.) |
| Code § 6721) ⁵ | \$100 per W-2, up to maximum of \$1,500,000 for all such failures in the aggregate for the year (\$30 per W-2, with \$250,000 annual cap if corrected within 30 days of January 31, or \$60 per W-2 with \$500,000 annual cap if corrected on or before Aug. 1) or, in case of intentional disregard, greater of 10% of underreported amount or \$250 per W-2 (with no annual cap). (Lower annual caps apply to small employers with gross receipts under \$5M.) |
| employee (Code § 6722) ⁶ | \$100 per W-2, up to maximum of \$1,500,000 for all such failures in the aggregate for the year (\$30 per W-2, with \$250,000 annual cap if corrected within 30 days of January 31, or \$60 per W-2 with \$500,000 annual cap if corrected on or before Aug. 1) or, in case of intentional disregard, greater of 10% of underreported amount or \$250 per W-2 (with no annual cap). (Lower annual caps apply to small employers with gross receipts under \$5M.) |

apply under Code §§ 6651(a)(1) and (a)(2) for failure to file a return and failure to file penalties apply to the maximum extent can total as much as 45% of the taxes due, 30 AFR, 2007-41ER, 97-2 USTC ¶ 50,740 (Cl. Fed. Cl. Sept. 26, 1997) (corrected federal employment taxes).

By this penalty does not apply. If the IRS alleges that the forms were gag corrected, "delays" were never paid to the IRS or the computation reported was not correct, assessed. Until 2008, the IRS has not applied both the (1) and (2) penalties, Form W-2 information is the same. In recognition of this duplication, the IR (i.e., the Code § 6721 penalty) per return or payee statement would be assessed, applicable. See IRM 1201.7.1.5.2. However, starting in 2008, the IRS has been steady, and has announced that it is revising the IR Manual to instruct agents 409A Settlement Program assess both penalties, see.)

ly increased, effective for returns filed after 2010 (i.e., starting with L 111-240, enacted in October 2010. Prior to the change, for all penalties under 6721 were \$50 per W-2, up to maximum of \$250,000 for all years (\$15 per W-2, with \$75,000 annual cap if corrected within 30 days of 3,000 annual cap if corrected on or before Aug. 1) or, in case of intentional ored amount or \$100 per W-2 (with no annual cap).

initially increased by P.L. 111-240. Prior to the change, for all taxpayers, per W-2, up to a maximum of \$100,000 for all such failures in the aggregate for a, greater of 10% of underreported amount or \$100 per W-2 (with no annual cap).

| Tax or Penalty Amount |
|---|
| \$50 per W-2 |
| 8% in the first two quarters of 2007 (or 10% in the case of large corporate underpayments) varies by quarter based on 3 percentage points (or 5 percentage points for large corporate underpayments) over the federal short-term interest rate. ¹¹ |
| 35% (or corporate tax rate) |
| Zero cost, under Robinson, but 35% (if Robinson is reversed by any subsequent legislation). |
| 35% (or corporate tax rate) |
| 35% (or corporate tax rate) |

H. and generally is not applied.

on under Code § 6205, however, when those taxes than the statute of limitations period for the taxable the IRS. See Rev. Rul. 75-464, 1975-2 C.B. 474 (after 2008). Effective in 2009, under revised final "a mark," (even apparently if the employer won the st-free adjustment is not available.

Notice 87-23, 1987-1 C.B. 467. If the employer by an IRS agent, the IRS typically waives this and W-2 as originally filed. ¹² Code Code cited by the OAF Opportunity Zone Act of 2005, (retirement expenses incurred for or on behalf of as wages in the case of an employee. A "specified hangup Act of 1934. See Notice 2005-45, 2005-24

| Tax or Penalty Amount |
|---|
| Indeterminate amount of increase in value of reportable benefit. See, the disputes over our valuation in <i>B&W of North America v. United States</i> , 83 A.F.T.R. 2d ¶ 99-413 (D.C.N.J. 1998) (unpublished opinion) |
| benefit valuation rules" for if for income, purposes. Reg. these special rules for any if error was made in |

CCH) 312, 320 (1987), of F.S.A. 200025002, concluding that Code § is a "ordinary and necessary business expenses under section 162," "imputation" to the employees.

beneficial because they provide values equal to slightly more than first class, the special valuation rules do not apply) provide values of 20 to 30 times (iii). However, per the changes to § 274 referenced in Note 12 above, the due to the corporate deduction disallowance.

Characteristics of Wage Recharacterization Practices



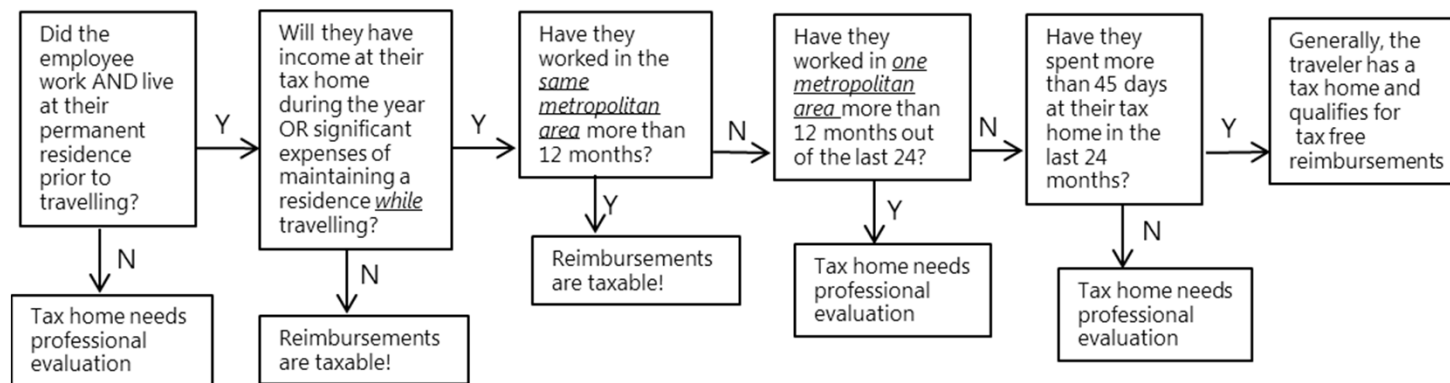
Define: A traveler who is “away from home”

- Do you have a written Tax Home Questionnaire?
- How detailed is it?
- How often is it completed?
- Are questions clear to the traveler?
 - Does it ask “leading” questions?
- Do your recruiters/staff understand the form?
- Distance from asserted tax home used to screen travelers for overnight stays ?
 - No “50 mile rules” please!

Define: A traveler who is “away from home”

- Is there a policy in place if answers show that the worker does not or may not qualify?
- Is completion of new form permitted, when you are aware of inaccurate answers?

TravelTax's Basic Tax Home Flowchart © 2012



visit www.traveltax.com for FAQs on tax homes or call 402.379.7818 for a free consultation

12 Month Rule

- Repetitive assignments in same location – Does tax status change prospectively?
 - Ex 9 months with 4 month extension?
- Break in service – how much time is required?
 - Traveler threshold more stringent than employer
 - 12/24, 18/36 months
 - New facility, same area. How to determine?



12 Month Rule Cont.

- No formal guidance issued
- Chief Counsel Memorandums
 - *Advice to audit staff etc.*
- Summary of informal guidance documents
 - 30 days disregarded
 - 7 months “significant”
 - 12 months “definitely significant”

Why No Formal Guidance?

- Tax home is the regular or primary place of business (where one earns their income)
- Every situation is unique
 - Based on facts and circumstances
 - Intentions of the taxpayer
- “How Long?” is dependent on the situation



Excessive Reimbursements

- Paying more than local per diem rate
- Paying housing per diems when housing is provided, facilitated or paid in kind
- Per Diems way more than wages



Transportation Allowances without Substantiation

- There is no per diem daily amount for transportation
- Paid by business mile
- Substantiation required



Employee Contracts

- In audits of travelers, employee contracts are required as proof of reimbursements
- Are your employee contracts drawing attention?
 - Gives employee choice of wages vs. tax free
 - Acknowledges a previous employee choice
- Transportation allowances at assignment site without reporting

Paying Per diems on the same basis as wages

- Like hours worked, miles driven, etc.
- Practice allowed only for certain industries.
- Penalties for missed shifts often treat per diems as hourly wages
 - Sliding scale preferred
- Potential for *wage recharacterization* assessment – IRS and Labor Boards
 - (Gagnon v. United Technisource)

Employee Contracts Cont.

- Over the top praise for “Tax Advantage”
 - “ *We are pleased to offer you our award winning Tax Advantage program*”
 - Marketing Tax Advantage as a way to increase pay



Per Diem and Meal Audits

50% Disallowance Issues

- Revenue Procedures governing per diem method of reimbursement require allocation of payment to lodging and meals (60/40%) when per diem payment is less than published rate (Rev. Proc. 2011-47 §6.05(4)(b))
- Meals are 50% deductible to payer
 - No “lodging only” per diems allowed
 - Unless lodging paid in kind
- Rev. Rul. 2008-23 acknowledged that the 50% disallowance *can* be shifted to another party (including a government or tax-exempt entity), but unreasonably requires “immediate notification,” and conscious assignment of expense.
 - *see Transport Labor Contract/Leasing*.

Navigating the Ruling

- How concerned should we be?
- Effect on travelers
 - Restatement of W2's?
 - Audits to accumulate evidence?



Revenue Ruling 2012-25

Not as authoritative as Code/Regs

- Congress writes the Tax Code
- Treasury writes regulations to apply Code
- IRS enforces Code and Regulations
- Revenue Rulings reflect IRS understanding of the Code/Reg. provisions and their application
- Courts defer to Rev Rulings on inconsistent basis
 - Judge consistency with Code/Regs

Revenue Ruling 2012-25

Inconsistent Treatment of Regulations

- Relies on more authoritative Treasury Regulations
- Uses §1.62-2(j) Examples
 - 9 examples of reimbursement polices/plans
- Only applies example 1 and 3
 - Example 2 highlighting airline industry more closely resembles HSI plans. Acceptable within parameters.

Solutions

- Dual Plans
 - Always maintain base wage
 - For those that do not qualify, per diems treated as separately stated taxable wages
 - OT on base
- Entity Isolation
 - Per diem operation along side travel division



Other Issues



Whistleblower Audits

- In December 2006, legislation increased the awards to informants who report perceived “tax abuses” by other taxpayers
 - increased from 10% to 15% with caps to 15% to 30% of collection.
- Some firms have been created simply to advise whistleblowers on filing effective reports with the IRS.
- Significant numbers of recent audits are traceable to whistleblowers.

State Payroll Tax Audits

- If IRS requires corrected W2's, state payroll audits will likely follow – with more lengthy statute of limitations that vary by state.
- Whistleblowers exist at state level, too.
- Audits triggered by non-reporting of workers passing through states have increased.

Proposed Legislation Targeting Temporary Workers

- States have separate thresholds for
 - Taxability of wages and earnings
 - Withholding
- Proposed legislation would limit states from taxing transient worker earning de minimis income unless certain wage thresholds are met

QUESTIONS?

- For more Information, please contact:

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