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Employers May Have to Amend Form 941 to Get Full COBRA Premium Assistance Tax Credit

Forms 941 (*Employer's Quarterly Federal Tax Return*) for fourth quarter 2009 will be subject to amendment if any employees enjoy COBRA premium assistance for that quarter but don't pay their share of the COBRA premium until 2010, according to IRS Chief Counsel. These and other issues regarding COBRA premium assistance, correct reporting of additional FUTA liability for Michigan employees, and changes to IRS's online withholding calculator were discussed at the December 10 monthly conference call between the IRS and payroll industry representatives. If there are employment tax issues you would like to have addressed in future calls, send them to Scott Mezistrano, CPP, APA's Senior Manager of Government Relations, at smezistrano@americanpayroll.org.

Amended Forms 941?

A participant on the call described the situation where an employee becomes eligible for COBRA coverage and premium assistance due to an involuntary termination in December 2009 but doesn't elect coverage and pay his or her share of the premium until after the 941 for fourth quarter 2009 (generally due February 1, 2010) has been filed. May the employer claim credit for its share of the COBRA premium on the 941 for first quarter 2010? No, according to Mary Gorman, Assistant Division Counsel for the Small Business/Self-Employed (SB/SE) Division in IRS's Office of Chief Counsel. Rather, the employer would have to amend its 941 for fourth quarter 2009, explained John Tuzynski, IRS's Chief of Employment Tax Operations.

An employer may claim its credit on the 941 for the quarter in which the employee enjoyed the assistance or any later quarter in the same calendar year. In addition, the employer may not claim the credit until the employee has paid his or her share of the premium. These rules are explained in IRS's *COBRA Questions and Answers: Form Preparation* at www.irs.gov/newsroom/article/0,,id=205373,00.html.

APA asks IRS to reconsider its position

Employers could become very burdened with having to prepare Forms 941-X for fourth quarter 2009, and IRS would end up burdened with the processing of all of those amended returns, pointed out Mezistrano. While we understand how the answer flows logically from the guidance previously provided, we asked the IRS to reconsider its position. IRS officials reaffirmed their position, but said they would discuss the issue and report back to the group at the February 4 conference call. (Currently, a call is not scheduled during January; an answer on February 4 will precede employers' deadlines for amending the 941 for fourth quarter

2009 and preparing the 941 for first quarter 2010.)

Given the amount of time employers have to issue COBRA eligibility notification to terminated employees and the amount of time those employees have to make their elections, it is possible that a terminated employee could elect coverage and pay premiums as late as April 2010 for periods going back to December 2009, said Russ Weinheimer, Office of Division Counsel/Associate Chief Counsel (Tax Exempt/Government Entities Division).

COBRA premium assistance will end soon

Under the American Recovery and Reinvestment Act of 2009, employees who lose their healthcare coverage between September 1, 2008, and December 31, 2009, due to an involuntary termination during that same period are entitled to purchase their first nine months of COBRA continuation coverage at 35% of the premium they otherwise would have paid. The employer pays the other 65% and is reimbursed by taking a credit on Form 941.

The IRS reminded participants on the call that employees who are covered by health insurance through the end of December and who lose coverage on January 1, 2010, or later are not eligible for COBRA premium assistance. There are bills in Congress to extend the window of eligibility, but there will be no change unless one of the bills is enacted into law.

941 credit vs. carryover

Another participant raised the possibility that the COBRA tax credit she will claim on the 941 for fourth quarter 2009 will result in an "overpayment" return, and she asked if she would be required to request a refund or if she could carry that balance forward, to be recorded as a "payment" on the 941 for first quarter 2010. Either approach is allowed, said IRS officials, who explained that, at least currently, the prohibition applies only to claiming the credit in a subsequent year.

Recording 'credit reduction' FUTA liability

Employers with employees who are covered by Michigan state unemployment insurance will have an extra federal unemployment tax liability for 2009, as Michigan is a FUTA credit reduction state (see *PAYROLL CURRENTLY*, Issue Nos. 16 and 23, Vol. 17). The IRS reminded call participants that this extra amount should be recorded as a liability for the fourth quarter on line 16d of Form 940, *Employer's Annual Federal Unemployment (FUTA) Tax Return*. This will allow line 17 (Total tax liability for the year) to match line 12 (Total FUTA tax after adjustments). The extra amount generally must be deposited by February 1, 2010 (employers with a balance due on line 14 of \$500 or less may pay

the amount with the return).

IRS Withholding Calculator more accurate than Form W-4

Employees with more than one job and those with a working spouse will want to make use of IRS's online Withholding Calculator when it is updated for 2010, said Shelley Dockstader, Senior Tax Analyst in IRS's SB/SE Division. These are two common categories of taxpayers who may find themselves "underwithheld" compared with their true tax liability due to the Making Work Pay Credit, and the APA has pressed the IRS and the Department of the Treasury to improve the W-4 and the withholding tables to address this better.

The 2010 withholding tables have been adjusted (see **PAYROLL CURRENTLY**, Issue No. 23, Vol. 17), and so has the Two Earners/Multiple Jobs worksheet on the 2010 Form W-4 (see www.americanpayroll.org/members/Forms-Pubs/#tax), but using the online Withholding Calculator will result in a more accurate calculation of how one of these employees should adjust his or her W-4, according to Dockstader. The calculator will be adjusted by the first week of January, she said, and Publication 919, *How Do I Adjust My Tax Withholding?*, will be updated soon after that. The calculator is at www.irs.gov/individuals/article/0,,id=96196,00.html. ■

Retroactive Changes in State and Local Income Taxation Under Military Spouses Residency Relief Act

Employer duties for withholding and reporting state and local income taxes have changed dramatically and retroactively to January 1, 2009, under the Military Spouses Residency Relief Act (Pub. L. No. 111-97, enacted 11-11-09). However, there is no time for employers to implement a change for 2009, and employers need protection from penalties for failure to withhold in 2010 and forward from employees who claim exemption under the Act.

The Act protects a spouse of a military servicemember from taxation by a state or local jurisdiction when the spouse is living and working there only because he or she has moved there with that servicemember based on military service orders. Not only would he or she be exempt from withholding, but his or her earnings would not be reported as taxable wages to that jurisdiction. In addition, that spouse will not have a change in state or local residence or domicile by virtue of such a move.

Protecting employers: recommendations

The American Payroll Association and the National Payroll Reporting Consortium (NPRC) have submitted to the Federation of Tax Administrators (FTA), which represents state tax agencies, a list of 13 recommendations with regard to the states' implementation of this law, and we participated in an FTA conference call to discuss the issue. Among the states represented on that call, there seemed to be broad acceptance of our suggestions, and we're hopeful that the states will act accordingly. Our recommendations included:

- Don't change W-2 reporting for 2009, but let individuals claim tax relief under the Act via their state personal income tax returns.
- Change their state withholding allowance certificates for 2010 to allow an employee to certify exemption from state income tax under the Act and to give employers evidence for why they did not withhold (thereby providing protection from penalty).
- Urge local income tax authorities within their borders to do the same.

- Employers should be expected to process and honor any such claim on a prospective basis only. That is, if, in March, an employee submits a withholding allowance certificate claiming relief under the Act, the employer should not be expected to refund any taxes withheld up to that date, reverse any taxable wages, or transfer any wages or taxes to another jurisdiction.

- The amended withholding allowance certificate should also include a space for the employee to identify his or her state of residence. If the employer has nexus in that state or if the employer voluntarily withholds and reports for that state, this will allow the employer to withhold and deposit that state's income tax and report the wages and taxes to that state according to that state's rules.

- If any state wants the employer to maintain some additional documentation to support an employee's claim of exemption, the withholding allowance certificate should direct the employee to provide that documentation to the employer and make it clear that the exemption cannot be claimed unless that documentation is provided. Examples of additional documentation being considered by the states are the "military spouse" identification card, a paystub belonging to the servicemember, and the Department of Defense form by which a servicemember declares a permanent state of residency.

- If an employee has properly completed the withholding allowance certificate and provided any required documentation, and if the employer has maintained that certificate and documentation (in accordance with that state's records retention requirements), the employer should be held harmless from any liability for the tax or any penalties for failure to withhold tax for, or report wages to, that state, even if the state subsequently determines that the individual was not entitled to relief under the Act.

The complete list of our recommendations is available at www.americanpayroll.org/government/. ■

Healthcare Reform Update: Congress Listens to APA Concerns

W-2 reporting of employer-provided health insurance coverage and limiting the definition of "medical expense" for purposes of reimbursement through a health flexible spending arrangement, originally proposed to take effect next month under the America's Healthy Future Act (AHFA), have been pushed to later years in bills currently under consideration by the U.S. Senate and House of Representatives.

In October, APA spoke with staff members of the Senate Finance Committee and the Joint Committee on Taxation about the January 1, 2010, proposed effective dates for these provisions, as contained in the version of AHFA passed by the Senate Finance Committee (see "Inside Washington" for November). We

explained that by the time any healthcare reform bill is enacted, there would not be enough time for employers to adjust their systems to accommodate these changes.

The bills currently under consideration have later effective dates for these provisions. The Senate has amended its version of the bill to have them take effect in tax year 2011. And the House of Representatives approved the Affordable Health Care for America Act with these provisions taking effect in tax year 2013.

Of course, before any changes can take effect, the House and Senate will have to reconcile their respective versions of reform, and both chambers will have to pass the same legislation so it can be sent to President Obama for his signature. ■