

# TAX TALK

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• Jessica R. Lubar, *Chair* •

G. Evans Hubbard, *Editor*

Brian L. Oliner, *Assistant Editor*

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## FROM THE CHAIR

By Jessica R. Lubar

This has been a busy year for the Section so far, in terms of activities and issues. We had a great turn out at this fall's Tax Networking Night in Ellicott City. It was wonderful to see so many new and familiar faces turn out on such a rainy night. This fall the Section also co-sponsored a joint networking and educational event with the Family and Juvenile Law Section. We are looking forward to the next joint event with the Business Law Section in March and the annual Shulbank dinner in May. These Section events not only provide an opportunity to talk to fellow tax practitioners but also provide an educational opportunity for members.

The results of the Member Survey have been useful in making sure that we are addressing issues of concern to Section members. Member input is particularly important now, in light of the increased role that the Council will play in the provision of CLE.

The provision of CLE has been a source of much discussion among both Council and Section members in light of the demise of MICPEL. The Tax Section Council has always con-

sidered the provision of CLE to be part of its mission in providing services to Section members. In the past, the Council worked with MICPEL to offer CLE, including the Advanced Tax Institute. While we anticipate continuing the Section's commitment to CLE, the number of programs that will be offered annually and their format are still being determined. Our first webinar will be offered in April on Roth Conversion issues. Information on the program will be available shortly. As we work on establishing a new procedure for providing CLE, the Council welcomes volunteers who are interested in assisting in the process.

Please feel free to continue to send your suggestions and requests to me. My contact information is listed below:

Office Phone: 410-244-7736

E-mail: [jlubar@venable.com](mailto:jlubar@venable.com)

*Jessica R. Lubar*  
Chair

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MSBA Tax Section Presents

# *Annual Irving Shulbank Memorial Dinner and Program*

*~Wednesday, May 13, 2010~*



Come out and enjoy an evening with your fellow tax professionals. Award presentations will be made to the winner of the J. Ronald Shiff Memorial Pro Bono Award and the Tax Excellence Award.

Stay tuned to the Tax Section website, <http://msba.org/sec-comm/sections/taxation/> for additional details, to make reservations, and to purchase tickets.

Please consider helping to keep our ticket prices down! If your firm is interested in being a sponsor for \$250.00 to help underwrite the cost of this event, please contact Keith Blair, at [kblair@ubalt.edu](mailto:kblair@ubalt.edu), Chair of the Tax Section Member Service Committee.



## **TAX TALK © 2010 MSBA TAX SECTION**

Editor, G. Evans Hubbard  
3818 Beech Avenue  
Baltimore, Maryland 21211-2222  
Tel: 410-260-7982  
Fax: 410-947-2968  
[ghubbard@comp.state.md.us](mailto:ghubbard@comp.state.md.us)

Assistant Editor, Brain L. Oliner  
Assistant Attorney General  
Principal Counsel to the Comptroller  
Office of the Attorney General  
80 Calvert Street, Room 303  
Annapolis, MD 21404  
Tel: 410-260-7808  
Fax: 410-974-5895  
[boliner@comp.state.md.us](mailto:boliner@comp.state.md.us)

Comments, contributions, and suggestions are greatly appreciated. Please direct them to the Editor.

Items contained in Tax Talk reflect the views of the individuals who prepared them and do not necessarily reflect the opinions of the MSBA Tax Section.

# TAX SECTION HAPPENINGS

*Recent Events Sponsored By Your Tax Section*



## • **Fall Joint Section Meeting with the Family and Juvenile Law Section**

ON OCTOBER 14, 2009, the Maryland State Bar Association's Taxation and Family & Juvenile Law Sections hosted a joint educational meeting and networking event at the historic Elkridge Furnace Inn in Elkridge, Maryland. 40-50 attendees enjoyed hot and cold hors d'oeuvres and their choice of beverage, followed by a lively panel discussion on "Tax & Family Law Issues In Divorce and Other Marital Situations," or "Tax Law for Family Lawyers / Family Law for Tax Lawyers". Panelists from the Tax Section were David De Jong of Stein, Sperling, Bennett, De Jong, Driscoll & Greenfeig, PC, speaking on "Fifteen NOT SO Simple Issues in Divorce Taxation," and Lisa Shallue of Miles & Stockbridge, P.C., addressing the "Division of Retirement Assets in Divorce." Family & Juvenile Law Section speakers Hadrian Hatfield of Shulman Rogers Gandal Pordy & Ecker, P.A, and Vince Wills of Dragga, Hannon, Hessler & Wills, LLP, added a family law perspective to the divorce tax issues and fielded audience questions with aplomb. Many thanks to our high caliber speakers, to our organizers - Mary Sanders and Dodie Fait of the Family Law Section and Saul Abrams, Leo Canseco, and David Polashuk of the Tax Section Special Programs Committee, and to Pat Elza at the Elkridge Furnace Inn. An interesting and informative evening was had by all.

## • **Spring Joint Section Meeting with the Business Law Section**

ON THURSDAY, MARCH 11, 2010, the Maryland State Bar Association's Business Law and Taxation Sections held a Joint Section Meeting and Panel Presentation on tax and other issues for Maryland business trusts. The evening included an hour of cross-section networking and an hour of panel discussion. The event was held at the Ellicott Mills Brewing Company on Main Street in Ellicott City, Maryland. Attendance was overwhelming, with over 100 guests participating. Our panel included Jessica R. Lubar, Esq., Venable, LLP, Jeffrey A. Markowitz, Esq., Miles & Stockbridge, P.C., and Michael A. Leber, Venable, LLP. In addition to a thorough and intriguing presentation, the panel and audience engaged in a robust question and answer session, exploring the advantages, implications, and planning opportunities presented by this relatively new business/transaction structuring device. Materials from the event are available on the Tax Section website.

# THE IRS' NEW EMPLOYMENT TAX INITIATIVE: WHAT DOES IT MEAN FOR BUSINESS?

By Jessica R. Lubar

Recent developments have highlighted employment taxes as an area that requires attention. The IRS will begin a three-year research project on employment tax compliance issues (the "NRP"); legislation is pending in the House and the Senate; and the Administration's 2011 budget proposes changes to the worker classification rules. While pending legislation is not a new development for employment taxes, the focus and attention that employment taxes are getting are noteworthy. This is particularly evident in the report issued by the United States Government Accountability Office in August of 2009 titled, "Employee Misclassification: Improved Coordination, Outreach, and Targeting Could Better Ensure Detection and Prevention."

On an immediate basis, employers are most affected by the IRS's NRP. The NRP will involve employment tax audits of at least 6000 employers over the term of the project, with a focus on small businesses. Even if an employer is not selected for inclusion in the NRP, the NRP represents a renewed focus on employment taxes in the IRS. In addition, the IRS will continue to conduct its regular employment tax audits, which typically involve 60,000 audits annually.

If the IRS determines that any adjustments are warranted as a result of an employment tax audit, the affect on the employer could be significant. The employer could end up liable for past withholding, FICA, and federal unemployment taxes, as well as interest and penalties on those amounts. The rate at which income tax withholding and the employee's share of FICA would be calculated could be dependent on the circumstances surrounding the adjustment.<sup>1</sup>

## IRS National Research Program

### **Overview**

The IRS NRP is scheduled to begin in late Feb. or early March 2010 and will be the first employment tax project conducted by the IRS since 1984. The purpose of the project is to collect data that will allow the IRS to understand the compliance characteristics of employment tax filers. The IRS intends to use the information gathered in the NRP to target non-complying taxpayers for audits in the future. However, for the NRP, employers will be chosen randomly for examinations. The NRP will include employers from all industries in order to be comprehensive, including large corporations, S corporations, partnerships, tax-exempt organizations and government entities. According to John Tuzynski, chief of employ-

ment tax operations in the Small Business/Self-Employed Division, the scope of review will be greater in these examinations than normal.<sup>2</sup>

### **Areas of Focus**

Examiners will be required to look at the following issues in every case: (1) worker classification; (2) fringe benefits; (3) executive and officer compensation; (4) backup withholding; and (5) taxpayer identification number issues.

### Worker Classification

The proper classification of a service provider as either an employee or an independent contractor is a frequent area of contention between the IRS and employers. A worker is considered an employee if the employer exercises the requisite amount of control over the employee under common-law principles. Over the years, the courts and the IRS have articulated certain factors that are considered in making that determination. The IRS organized the factors that are considered into three categories: (1) Behavioral Control – whether the business has a right to direct and control how the worker does the task for which the worker is hired; (2) Financial Control – whether the business has a right to control the business aspects of the worker's job; and (3) Type of Relationship.

Due to the factual nature of any worker classification determination and the consequences of being wrong, Congress provided relief from employment tax liability for certain employers who misclassified workers as independent contractors using the common-law facts and circumstances standards. The relief was enacted as Section 530 of the 1978 Revenue Code (as amended) and is known as "Section 530 Relief." In order to be entitled to Section 530 Relief, a taxpayer must meet three requirements:

1. The Substantive Consistency Requirement: The taxpayer has not treated the individual as an employee for any period and has not treated any other individual holding a substantially similar position as an employee (for purposes of employment tax) for any period.
2. The Reporting Consistency Requirement: All federal returns (including information returns) that are required to be filed by the taxpayer with respect to the

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worker for such periods are filed on a basis consistent with the taxpayer's treatment of the individual as an independent contractor.

3. The Reasonable Basis Requirement: The taxpayer had a reasonable basis for not treating the worker as an employee. A reasonable basis only exists if it is supported by judicial precedent, IRS rulings, a past IRS audit, or a long-standing practice of a significant segment of the relevant industry.

The consequences of misclassifying a worker as an independent contractor are significant to an employer regardless of whether the misclassification was deliberate or inadvertent. Therefore, it is critical that any business review its relationships with its service providers to determine how they should be classified. If the proper classification is not clear, an employer may ask the IRS to determine the proper classification by filing a request for a worker classification determination on Form SS-8. A Form SS-8 may be filed by either a service provider or a service recipient, however, historically service recipients have not filed many requests for a classification determination. Practitioners differ on whether employers should make such a request.

In all events, any business that is receiving services should at the very least ensure that individuals that it treats as independent contractors would satisfy the requirements for Section 530 Relief so as to avoid the consequences of misclassification.

### Fringe Benefits

The fringe benefit area is frequently overlooked by employers. It often comes as a surprise to employers (and employees) that certain of the "perks" they provide should be included in an employee's income as taxable compensation, even if no cash is paid. Perks provided by employers may be either taxable or tax-free fringe benefits. If an employer incorrectly treats a fringe benefit as tax-free, it is treated as if the employer did not report the full amount of compensation paid.

In past initiatives, the IRS has identified the personal free use of a car or apartment, personal components of business travel, holiday gifts, payment for relocation travel and expenses and employee education expenses, as commonly unreported fringe benefits. Employee reimbursements may also be considered taxable fringe benefits. Reimbursed expenses, even employment-related expenses, must be made in accordance with a written reimbursement plan or otherwise qualify as a tax-free fringe benefit to be excluded from an employee's income. For employment related reimbursements to be tax-free under a written reimbursement plan, the plan must require employees to adequately account for the expenses and to pay back any excess payments received (i.e., an accountable plan). The IRS has noted that the following reimbursements sometimes fall through the cracks: expense reimbursements outside corporate policies, spouse travel expenses,

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[www.msba.org/sec\\_comm/sections/taxation](http://www.msba.org/sec_comm/sections/taxation)

**H**ave you visited the Tax Section website lately? If you are looking for something to do, check the main page for information on upcoming events, or visit the Study Groups page for schedules for each of the Tax Section Study Groups. If you are looking for a job, visit our new Employment Opportunities page (and if you have a position to offer, we will post it for you!). If you are looking for a government contact, the 2008 Maryland Tax Practitioner's Handbook is now online. And we have added additional resource materials such as the combined reporting regulations, handouts from IRS meetings, even a video! Use the tabs at the top and right of the screen to access even more information.



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tax gross-ups, non-accountable expense allowances, and club memberships.

In contrast to most employers' perception of fringe benefits, the value of any benefit or "perk" provided to an employee needs to be included in compensation unless an exception applies. Common exceptions to income inclusion are the working condition fringe benefit and the de minimis fringe benefit.

It is important for employers and employees to take a close look at any fringe benefits that are provided.<sup>3</sup> Even if the value of the fringe benefit that is provided is relatively small on an individual basis, if the benefit is provided to many employees, interest and penalties for failing to report it as taxable could be significant.

### **Officer Compensation**

The application of the third area of focus of the NRP – executive and officer compensation – depends on the type of taxpayer being examined. However, the crux of the issue is whether compensation that is being paid by the employer is reasonable.

For a C corporation, the IRS is concerned that the amount that is being paid to an employee who is also a shareholder is too high, effectively permitting the "excess" amount to escape double taxation. For an S corporation, the IRS has the opposite concern. If an S corporation is paying an employee who is also a shareholder less than a reasonable amount as salary, the amount that is distributed to the shareholder avoids the imposition of employment taxes. Finally, tax-exempt organizations must also contend with the excess benefit transaction rules under Section 4958 and the significant penalties that may be imposed.

### **Other Issues**

Among other issues, examiners conducting NRP reviews also will be looking at whether an employer is filing required tax returns and whether the employer is complying with the backup withholding rules on payments to independent contractors, if necessary. Examiners will be looking for Forms 1099 that do not have taxpayer identification numbers on them. Any Form 1099 that is submitted by an employer without a taxpayer identification number should have had backup withholding done on the payment.

### **Legislative Proposals**

The primary target of both the pending legislation and the Administration's proposals is Section 530 Relief. Under

the proposals, Section 530 Relief would either be eliminated in its entirety or the taxpayers who would be eligible for relief would be substantially narrowed. The proponents of change perceive Section 530 Relief as a "loophole" instead of a safe harbor.

### **Conclusion**

Employment tax issues are going to be the subject of greater scrutiny by the IRS in the immediate future. Even if an employer is not subject to an examination under the NRP, employment tax is an issue that is likely to arise in future examinations of any business. In addition, while the legislative proposals are only pending at this point, they indicate a focus and perspective on worker classification issues that are likely to result in change to the existing rules.

Businesses should take this opportunity to review their current compliance status and, if necessary, address any issues that arise before a visit from the IRS.

*Jessica Lubar is Of Counsel in Venable's Baltimore Office. She is a member of the firm's Nonprofit Organizations and Tax practice groups, and advises clients on a broad array of tax, estate and business matters at the state, federal and international levels. For information, contact Ms. Lubar at 410-244-7736 or jrlubar@venable.com.*

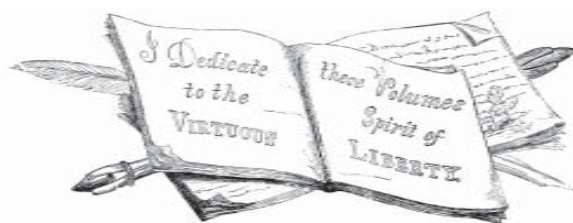
**Author's Note:** *This article is not intended to provide legal advice or opinion and should not be relied on as such. Legal advice can only be provided in response to specific fact situations.*

### **Footnotes:**

<sup>1</sup> See, I.R.C. 3509.

<sup>2</sup> NRP Employment Tax Audit Program To Examine 6,000 U.S. Companies, 182 DTR G-1 (Sept. 23, 2009).

<sup>3</sup> Former Senator Tom Daschle withdrew his nomination as Secretary of the Department of Health and Human Services over a failure to report income, which included the value of the personal use of a car service. He was also assessed interest and penalties on the unreported amounts by the IRS.



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# CALL FOR NOMINATIONS

## *J. Ronald Shiff Memorial Pro Bono Award*

The Maryland State Bar Association's Section of Taxation is seeking nominations for the **2010 J. Ronald Shiff Memorial Pro Bono Award**. The Award is presented annually to an attorney (whether in private practice, government, academia, public service or other area) who has demonstrated a commitment to providing legal services to low-income taxpayers. The Award will be presented to the recipient at the Section of Taxation's **Annual Irving Shulbank Memorial Dinner and Program** to be held on **May 13, 2010**, at the Belvedere Hotel.

If you know an individual who should be considered, please send your nomination by email ([katrina.kamantauskas@holderlaw.com](mailto:katrina.kamantauskas@holderlaw.com)) or fax (410.296.9554) to Katrina C. Kamantauskas-Holder, chair of the Pro Bono Award Committee. You must include a brief statement as to why you feel the nominee is worthy of consideration. Nomination forms are available on the Section's website [www.msba.org/sec\\_comm/sections/taxation/](http://www.msba.org/sec_comm/sections/taxation/). Nominations must be submitted **on or before March 7, 2010**.



## *Tax Excellence Award*

The Maryland State Bar Association's Section of Taxation is seeking nominations for the **2010 Tax Excellence Award**. The Tax Excellence Award is presented annually to an attorney, law school professor, public official or member of the judiciary who exemplifies professional, academic or public service excellence, integrity, compassion and commitment in the areas of practicing, teaching or developing tax law or tax policy. The Award will be presented to the recipient at the Section of Taxation's **Annual Irving Shulbank Memorial Dinner and Program** to be held on **May 13, 2010**, at the Belvedere Hotel.

If you know an individual who should be considered, please send your nomination by email ([katrina.kamantauskas@holderlaw.com](mailto:katrina.kamantauskas@holderlaw.com)) or fax (410.296.9554) to Katrina C. Kamantauskas-Holder, Chair of the Tax Excellence Award Committee. You must include a brief statement as to why you feel the nominee is worthy of consideration. Nomination forms are available on the Section's website [www.msba.org/sec\\_comm/sections/taxation/](http://www.msba.org/sec_comm/sections/taxation/). Nominations must be submitted **on or before March 7, 2010**.

